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

(87 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9226 / June 22, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13847

In the Matter of MORGAN ASSET MANAGEMENT, INC.; MORGAN KEEGAN & COMPANY, INC.; JAMES C. KELSOE, JR.; and JOSEPH THOMPSON WELLER, CPA, Respondents.	ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION

I.

Respondents Morgan Asset Management, Inc. ("Morgan Asset") and Morgan Keegan & Company, Inc. ("Morgan Keegan") (collectively "Respondents") have submitted a letter, dated June 3, 2011, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from Respondents' settlement of an administrative proceeding commenced by the Commission.

II.

On June 22, 2011, pursuant to Respondents' Offer of Settlement, the Commission issued an Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) And 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.

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Under the Order, the Commission found that: (i) Morgan Asset and Morgan Keegan engaged in conduct which caused the mispricing of fair-valued securities in the portfolios of five registered investment companies ("the Funds") managed by Morgan Asset, a registered investment adviser; (ii) Morgan Keegan, a registered broker-dealer and investment adviser, was the distributor of the Funds' shares and priced each portfolio's securities and calculated its daily net asset value ("NAV") through its Fund Accounting Department; (iii) between at least January 2007 and July 2007, the NAV of each of the Funds was fraudulently inflated as a result of the willful misconduct of the Funds' portfolio manager, an employee of Morgan Asset; and (iv) Morgan Keegan employees assigned values to portfolio securities at the direction of the portfolio manager and otherwise failed to employ the fair valuation policies and procedures adopted by the Funds' Boards of Directors.

In the Order, the Commission, with regard to Morgan Asset and Morgan Keegan, (i) ordered Morgan Asset to cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-7 thereunder, and Section 34(b) of the Investment Company Act of 1940 ("Investment Company Act") and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act; (ii) ordered Morgan Keegan to cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act; (iii) ordered Morgan Asset and Morgan Keegan, jointly and severally, within 10 days of the entry of the Order, to pay disgorgement of $20,500,000, prejudgment interest of $4,500,000 and a civil money penalty in the amount of $75,000,000 to the Commission; (iv) censured Morgan Asset and Morgan Keegan; (v) ordered Morgan Asset and Morgan Keegan to comply with certain undertakings related to the valuation of portfolio securities for which market quotations are not available; and (vi) ordered Morgan Asset and Morgan Keegan to certify in writing to the staff of the Commission that they have complied with the undertakings.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to section 15(b) of the Securities Exchange Act of 1934 or Section 203(e) of the Advisers Act. 17 C.F.R. § 230.602(c)(3). Rule 602(e) provides, however, that the disqualification "... shall not apply ... if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption from registration pursuant to Regulation E be denied. 17 C.F.R. § 230.602(e).

III.

Based upon the representations set forth in Respondents' request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64720 / June 22, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3218 / June 22, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29704 / June 22, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3296 / June 22, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13847

In the Matter of MORGAN ASSET MANAGEMENT, INC.; MORGAN KEEGAN & COMPANY, INC.; JAMES C. KELSOE, JR.; and JOSEPH THOMPSON WELLER, CPA, Respondents.	CORRECTED ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, AND IMPOSING SUSPENSION PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e)(1)(iii) OF THE COMMISSION'S RULES OF PRACTICE

I.

On April 7, 2010, the Commission instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Morgan Asset Management, Inc. ("Morgan Asset"); Morgan Keegan & Company, Inc. ("Morgan Keegan");

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James C. Kelsoe, Jr. ("Kelsoe"); and Joseph Thompson Weller, CPA ("Weller"); pursuant to Section 15(b)(4) of the Exchange Act against Morgan Keegan; pursuant to Section 15(b)(6) of the Exchange Act against Morgan Asset, Kelsoe and Weller; pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Morgan Asset and Morgan Keegan; pursuant to Sections 203(f) and 203(k) of the Advisers Act against Kelsoe and Weller; and pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice against Weller. Respondents Morgan Asset, Morgan Keegan, Kelsoe and Weller (collectively "Respondents") have submitted an Offer of Settlement which the Commission has determined to accept.

II.

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 Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 4C and 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission's Rules of Practice ("Order"), as set forth below.

III.

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

A. RESPONDENTS

1. Morgan Asset, incorporated in Tennessee on April 10, 1986, has been an investment adviser registered with the Commission at all relevant times. Morgan Asset's principal place of business is in Birmingham, Alabama. Morgan Asset is a wholly-owned subsidiary of MK Holding, Inc., which in turn is a wholly-owned subsidiary of Regions Financial Corporation.

2. Morgan Keegan, incorporated in Tennessee on June 27, 1969, has been registered with the Commission as a broker-dealer at all relevant times and as an investment adviser since July 27, 1992. During the relevant time period, Morgan Keegan served as the principal

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

underwriter and sole distributor of shares of the open-end Funds described in paragraph 5, below. Morgan Keegan's principal place of business is in Memphis, Tennessee.

3. Kelsoe, 49 years of age, is a resident of Memphis, Tennessee. During 2007, Kelsoe was the senior portfolio manager for Morgan Asset. Kelsoe is a Chartered Financial Analyst and previously held Series 7 and 65 licenses. Kelsoe was associated with Morgan Keegan at all relevant times, and was a registered representative of the firm from August 1994 through November 2008.

4. Weller, 46 years of age, is a resident of Memphis, Tennessee. Weller has been employed by Morgan Keegan since 1992. During the relevant period, he was Morgan Keegan's Controller and the head of its Fund Accounting Department reported to him. He holds Series 7, 27, and 66 licenses and is a CPA who was previously licensed in the State of Tennessee. That license is currently lapsed. Since at least January 1, 1993, Weller has been associated with the investment adviser arm of Morgan Keegan. Additionally, from at least December 1997 through the present, Weller has been a registered representative associated with the broker-dealer arm of Morgan Keegan.

B. OTHER RELEVANT ENTITIES

5. Helios Select Fund, Inc., formerly known as Morgan Keegan Select Fund, Inc. ("Select Fund"), incorporated in Maryland on October 27, 1998, has been an investment company registered with the Commission since its inception. In 2007, the Select Fund contained three open-end portfolios: the Select High Income portfolio, the Select Intermediate Bond portfolio, and the Select Short Term Bond portfolio.

6. Helios High Income Fund, Inc., formerly known as RMK High Income Fund, Inc., a closed-end fund incorporated in Maryland on April 16, 2003, has been an investment company registered with the Commission since its inception.

7. Helios Multi-Sector High Income Fund, Inc., formerly known as RMK Multi-Sector High Income Fund, Inc., a closed-end fund incorporated in Maryland on November 14, 2005, has been an investment company registered with the Commission since its inception.

8. Helios Strategic Income Fund, Inc., formerly known as RMK Strategic Income Fund, Inc., a closed-end fund incorporated in Maryland on January 16, 2004, has been an investment company registered with the Commission since its inception.

9. Helios Advantage Income Fund, Inc., formerly known as RMK Advantage Income Fund, Inc., a closed-end fund incorporated September 7, 2004, has been an investment company registered with the Commission since its inception.

C. FACTS

Overview

10. Morgan Asset, through Kelsoe, as Portfolio Manager, managed the Helios Select Fund, Inc., the Helios High Income Fund, Inc., the Helios Multi-Sector High Income Fund, Inc., the Helios Strategic Income Fund, Inc., and the Helios Advantage Income Fund, Inc. (collectively, the "Funds") from at least November 2004 through July 29, 2008.

11. Respondent Morgan Keegan, a registered broker-dealer and registered investment adviser, was the principal underwriter and distributor of shares of the open-ended Funds. Each of the Funds' Boards of Directors was responsible for pricing the Funds' securities in accordance with the Funds' valuation policies and procedures ("valuation procedures"). Although the Funds' prospectuses stated that Morgan Asset would price the securities, each Fund's Board of Directors delegated the pricing responsibility to Morgan Keegan. Morgan Keegan priced each Fund's securities and calculated the Fund's daily net asset value[2] ("NAV") through its Fund Accounting Department ("Fund Accounting"). Weller was an officer and treasurer of the Funds. Weller, Morgan Keegan's Controller, along with other Morgan Keegan personnel, staffed a "Valuation Committee" that oversaw Fund Accounting's processes and evaluated the prices assigned to securities. Morgan Keegan and Weller failed to adequately fulfill Morgan Keegan's responsibilities, as delegated to it by the Funds' Boards of Directors, to price the Funds' securities in accordance with their valuation policies and procedures regarding valuation. For example, at various times from January 2007 through July 2007, Fund Accounting accepted unsubstantiated "price adjustments," submitted by Kelsoe, that inaccurately inflated the prices of certain securities, contrary to the Funds' valuation procedures. Fund Accounting failed to document justifications for such pricing adjustments.

12. The Funds' valuation policies and procedures required the comparison of fair values to prices provided by other sources. Pursuant to that requirement, Fund Accounting periodically obtained broker-dealer price confirmations for certain fair valued securities. Unbeknownst to Fund Accounting and the Funds' independent auditor ("Independent Auditor"), the Portfolio Manager, Kelsoe, actively screened and influenced a broker-dealer to change the price confirmations that Fund Accounting and the Independent Auditor obtained from the broker-dealer. Kelsoe also failed to advise Fund Accounting or the Funds' Boards of Directors when he received information indicating that the Funds' prices for certain securities should be reduced.

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[2] The "net asset value" or "NAV" of an investment company is the company's total assets minus its total liabilities. An investment company calculates the NAV of a single share (or the "per share NAV") by dividing its NAV by the number of shares that are outstanding.

13. Each of the Funds held, in varying amounts, securities backed by subprime mortgages, and the market for such securities deteriorated in the first half of 2007. Morgan Keegan utilized practices which were not reasonably designed to determine that the Funds' NAVs were accurate. Morgan Asset, through Kelsoe, engaged in actions that forestalled declines in the NAVs of the Funds that would have occurred as a result of the deteriorating market, absent his intervention.

14. Many of the securities that were held by the Funds and backed by subprime mortgages lacked readily available market quotations and, as a result, were required by the Investment Company Act to be priced by the Funds' Boards of Directors, using "fair value" methods. Under Section 2(a)(41)(B) of the Investment Company Act, the Funds were required to use market values for portfolio securities with readily available market quotations and use fair value for all other portfolio assets, as determined in good faith by the board of directors. The fair value of securities for which market quotations are not readily available is the price the Funds would reasonably expect to receive on a current sale of the securities.[3]

15. The Funds adopted valuation procedures for pricing the Funds' portfolio securities and assigned the task of following those procedures to Morgan Keegan. The Funds' valuation procedures for fair-valued securities mandated that such securities should be valued in "good faith" by the Valuation Committee, considering a series of general and specific factors including, among others, "fundamental analytical data relating to the investment," "an evaluation of the forces which influence the market in which the securities are purchased or sold" and "events affecting the security." The procedures required the Valuation Committee to maintain a written report "documenting the manner in which the fair value of a security was determined and the accuracy of the valuation made based on the next reliable public price quotation for that security." The procedures also required that values assigned to securities be periodically validated through, among other means, broker-dealer price confirmations. Fund Accounting also used broker-dealer price confirmations to set current values. The procedures specified that prices obtained from a broker-dealer could only be overridden when there was "a reasonable basis to believe that the price provided [did] not accurately reflect the fair value of the portfolio security." Whenever a price was overridden, the procedures mandated the basis for overriding the price to be "documented and provided to the Valuation Committee for its review."

16. In filings with the Commission, the Funds stated that the fair value of securities would be determined by Morgan Asset's Valuation Committee using procedures adopted by the Funds' board of directors. In fact, the responsibility was delegated to Morgan Keegan, which primarily staffed the Valuation Committee. Morgan Keegan and the Valuation Committee did not

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3 See AICPA Audit and Accounting Guide - Investment Companies (Sect. 2.35-2.39), which incorporates Accounting Series Release No. 118 ("ASR 118"). The Commission has provided interpretative guidance related to financial reporting in the Accounting Series Releases, which is included in the Codification of Financial Reporting Policies. Thus, conformity with the ASR 118 is required by Commission rules and complies with Generally Accepted Accounting Principles ("GAAP"). See also Articles 1-01(a) and 6.03 of Regulation S-X.

reasonably satisfy their responsibilities under the Funds' procedures in several ways. Among other things: (i) the Valuation Committee left pricing decisions to lower level employees in Fund Accounting who did not have the training or qualifications to make fair value pricing determinations; (ii) Fund Accounting personnel relied on Kelsoe's "price adjustments" to determine the prices assigned to portfolio assets, without obtaining a reasonable basis for or documentation supporting the price adjustments or applying the factors set forth in the procedures; (iii) Fund Accounting personnel gave Kelsoe discretion beyond the parameters of the valuation procedures in validating the prices of portfolio securities by allowing him to determine which dealer price confirmations to use and which to ignore, without obtaining documentation to support his adjustments; and (iv) the Valuation Committee and Fund Accounting did not ensure that the fair value prices assigned to many of the portfolio securities were periodically re-evaluated, allowing them to be carried at stale values for months at a time.

17. Morgan Asset adopted its own procedures to determine the actual fair value to assign to portfolio securities and to "validate" those values "periodically." Among other things, those procedures provided that "[q]uarterly reports listing all securities held by the Funds that were fair valued during the quarter under review, along with explanatory notes for the fair values assigned to the securities, shall be presented to the Board for its review." Morgan Asset failed to fully implement this provision of its pricing policy.

18. At various times between January 2007 and July 2007, Kelsoe had his assistant send "price adjustments" to Fund Accounting. The adjustments were communications by Kelsoe to Fund Accounting concerning the values of specific portfolio securities. In many instances, these adjustments were arbitrary and did not reflect fair value. The price adjustments were routinely entered upon receipt by the staff accountant into a spreadsheet used to calculate the NAVs of the Funds.

19. Fund Accounting did not generally request, and Kelsoe did not generally supply, supporting documentation for his price adjustments. Fund Accounting and the Funds did not record which securities had been assigned values by Kelsoe.

20. As part of the Funds' valuation procedures, Fund Accounting sometimes requested third party broker-dealer price confirmations as a means to validate the values it had assigned to the Funds' fair valued securities. The Funds' Independent Auditor used similar requests for third party broker-dealer price confirmations as part of its annual year-end audits of the Funds. Fund Accounting or the Independent Auditor would periodically send such requests to broker-dealers asking them to provide price confirmations for various portfolio securities.

21. During the period from January through July 2007, when month-end dealer price confirmations were received by Fund Accounting, an employee of Fund Accounting performed a review to estimate whether they contained any securities prices that varied from current portfolio values by more than five percent. If so, then Kelsoe determined whether the current values should be maintained or a new value—which may or may not have been the price given by the broker-dealer—should be assigned to the security. Thus, Fund Accounting generally allowed Kelsoe to

determine whether broker-dealer price confirmations were used or ignored. In some instances, when price confirmations were received that were substantially lower than current portfolio values, Fund Accounting personnel, acting at the direction of Kelsoe, lowered values of bonds over a period of days, in a series of pre-planned reductions to values at or closer to, but still above, the price confirmations. As a result, during the interim days, Fund Accounting did not price those bonds at their current fair value.

22. During the period from January through July 2007, Fund Accounting failed to record which bond values were not adjusted in response to dealer price confirmations at Kelsoe's direction.

23. The head of Fund Accounting reported to Weller, and Weller was a member of the Valuation Committee. He knew, or was reckless in not knowing, of the deficiencies in the implementation of the valuation procedures set forth above, and failed to remedy them or otherwise make sure fair-valued securities were accurately priced and the Funds' NAVs were accurately calculated. During the period from January through July 2007, Weller was aware that: (i) the Valuation Committee did not adequately supervise Fund Accounting's application of the valuation factors; (ii) Kelsoe was supplying fair value price adjustments for specific securities to Fund Accounting but the members of the Valuation Committee did not generally know which securities Kelsoe supplied fair values for or what those fair values were, and did not generally receive supporting documentation for those values; and (iii) the only other pricing test regularly applied by the Valuation Committee was a "look back" test, which compared the sales price of any security sold by a Fund to the valuation of that security used in the NAV calculation for the five business days preceding the sale. The test only covered securities after they were sold; thus, at any given time, the Valuation Committee never knew how many securities' prices could ultimately be validated by it. Weller nevertheless signed the Funds' annual and semi-annual financial reports on Forms N-CSR, filed with the Commission, including certifications pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002.

24. During the period from January 2007 through July 2007, Morgan Keegan, acting through Weller and Fund Accounting, failed to employ reasonable procedures to price the Funds' portfolio securities and, as a result of that failure, did not calculate current NAVs for the Funds. Despite these failures, Morgan Keegan published daily NAVs of the Funds which it could not know were accurate and, as distributor of the open-end portfolios, sold and redeemed shares to investors based on those NAVs.

25. On various dates from January 2007 through July 2007, Morgan Asset, through Kelsoe, screened and influenced the price confirmations obtained from at least one broker-dealer ("the Submitting Firm"). Among other things, the Submitting Firm was induced to provide interim price confirmations that were lower than the values at which the Funds were valuing certain bonds, but higher than the initial confirmations that the Submitting Firm had intended to provide. The interim price confirmations enabled the Funds to avoid marking down the value of securities to reflect current fair value. Kelsoe was aware that use of the interim price confirmations was inconsistent with the valuation procedures and did not reflect fair value, that the Submitting Firm

would be providing lower price confirmations in response to future pricing validation requests, and that the Funds would be required to further mark down the value of the securities to reflect their already diminished value, but that information was not disclosed to Fund Accounting, the Funds' Boards of Directors or the Independent Auditor. In some instances, even after causing the Submitting Firm to increase its price confirmations, Kelsoe subsequently provided price adjustments to Fund Accounting that were higher than even the Submitting Firm's increased price confirmations. These adjustments were not consistent with the Funds' procedures. In other instances, the Submitting Firm was induced to not provide price confirmations to Fund Accounting (or, depending on the period, to the Independent Auditor), where those price confirmations would have been significantly lower than the Funds' current valuations of the relevant bonds. Fund Accounting and the Funds' Boards were not advised that the Submitting Firm had proposed price confirmations which were lower than the current valuations recorded by the Funds, and that the Submitting Firm had refrained from submitting price confirmations to Fund Accounting or had submitted price confirmations at higher prices than it had originally planned.

26. In each of the Funds' annual and semi-annual reports filed with the Commission on Forms N-CSR during the relevant period (including, among others, the Annual Report for the Morgan Keegan Select Fund, Inc. for the year-ended June 30, 2007 filed with the Commission on October 4, 2007), Kelsoe included a signed letter to investors reporting on the Funds' performance "based on net asset value." In fact, the performance reported was materially misstated. Untrue statements of material fact concerning the Funds' performance were made in the Funds' annual and semi-annual reports filed with the Commission on Forms N-CSR. Morgan Asset, through Kelsoe, also provided a quarterly valuation packet reflecting inflated prices for certain securities to the Funds' Boards, failed to disclose to the Funds' Boards information indicating that the Funds' NAVs were inflated and that broker-dealer price confirmations were being screened and caused to be altered, and provided Fund Accounting with unsubstantiated price adjustments. In addition, the prospectuses incorrectly described Morgan Asset as responsible for fair valuation of the Funds' portfolios.

D. VIOLATIONS

27. Investment advisers owe their clients, including investment company clients, a fiduciary duty. *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S.11, 17 (1979); *SEC v. Capital Gains Research Bureau, Inc.* 375 U.S. 180, 195-97 (1963). Misstatements or omissions of fact by an investment adviser, such as those made to the Funds' boards, violate an adviser's fiduciary duty and constitute fraud when they are material. Similarly, the failure to disclose to the Funds' boards that Morgan Asset and Morgan Keegan were not complying with stated valuation procedures constitutes fraud. In addition, the knowing or reckless failure to value securities, for which market quotations are not readily available, consistent with fair value requirements under the Investment Company Act and that materially affects a fund's NAV constitutes fraud. *See, In re Piper Capital Management, Inc.*, Exch. Act. Rel.48409 (August 26, 2003). Section 206(1) of the Advisers Act makes it unlawful for an investment adviser to employ any device, scheme or artifice to defraud any client or prospective client. Section 206(2) makes it unlawful for an investment adviser to engage in any transaction, practice or course of business that operates as a fraud or deceit upon any client or prospective client. As a result of the conduct described above,

Respondent Morgan Asset willfully violated, and Kelsoe willfully aided and abetted and caused violations of, Sections 206(1) and 206(2) of the Advisers Act.

28. Section 206(4) of the Advisers Act prohibits fraudulent, deceptive or manipulative practices or courses of business by an investment adviser. Rule 206(4)-7 requires investment advisers to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation" of the Advisers Act and the rules thereunder by their supervised persons. An adviser's failure "to have adequate compliance policies and procedures in place will constitute a violation of our rules independent of any other securities law violation." *Compliance Programs of Investment Companies and Investment Advisers*, Advisers Act Release No. 2204, 68 F.R. 74714, 74715 (Dec. 24, 2003) ("Compliance Programs Release"). As a result of the conduct described above, Respondent Morgan Asset willfully violated, and Respondent Kelsoe willfully aided and abetted and caused violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

29. Section 34(b) of the Investment Company Act prohibits untrue statements of material fact or omissions to state facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, in any registration statement, report or other document filed pursuant to the Investment Company Act or the keeping of which is required pursuant to Section 31(a) of the Investment Company Act. Any person who makes a material misrepresentation concerning a Fund's performance in the Fund's annual and semi-annual reports filed with the Commission, or in the records required to be maintained by the Fund, or submits inflated prices to be included in the Fund's NAV calculations and the records forming the basis for the Fund's financial statements, violates Section 34(b). As a result of the conduct described above, Respondents Morgan Asset and Kelsoe willfully violated, and Respondent Morgan Keegan willfully aided, abetted, and caused violations of, Section 34(b) of the Investment Company Act.

30. Rule 22c-1 under the Investment Company Act prohibits the sale or redemption of shares in a registered investment company "except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security." For an NAV to be deemed current, Section 2(a)(41) of the Investment Company Act and Rule 2a-4 thereunder require portfolio securities for which market quotations are not readily available to be valued at fair value. As a result of the conduct described above, Respondent Morgan Keegan willfully violated,[4] and Respondents Morgan Asset, Kelsoe and Weller willfully aided and abetted and caused violations of, Rule 22c-1 promulgated under the Investment Company Act.

31. Rule 38a-1 under the Investment Company Act requires that a registered investment company adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund and to provide for oversight of compliance by the fund's investment adviser. Failure of a fund to have adequate compliance

[4] 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)).

policies and procedures in place and/or to implement them will constitute a violation of Rule 38a-1 independent of any other securities law violations. *Compliance Programs Release*. Morgan Keegan and Morgan Asset knowingly and substantially assisted the Funds' failure to implement fair valuation procedures, which resulted in prices that did not reflect current NAVs. Morgan Keegan, Morgan Asset, Kelsoe and Weller thereby willfully aided and abetted and caused the Funds' violations of Rule 38a-1.

UNDERTAKINGS

32. Respondent Morgan Keegan undertakes as follows:

A. Morgan Keegan shall not, for a period of three years from the date of the Order, be involved in, or responsible for, recommending to, or determining on behalf of, a registered investment company's board of directors or trustees or such company's valuation committee, the value of any portfolio security for which market quotations are not readily available.

B. If, after three years but within six years from the date of the Order, Morgan Keegan becomes involved in, or responsible for, determining or recommending determinations to a registered investment company's board of directors or trustees or valuation committee of the value of any portfolio security for which market quotations are not readily available and which are held by or on behalf of such registered investment company, Morgan Keegan shall promptly notify Commission counsel identified below or his successor and within 30 days of beginning such valuation activity, shall hire, at its expense, an Independent Consultant ("Consultant") not unacceptable to the Commission's staff, to review the valuations provided by Morgan Keegan to any registered investment company for the next two quarters following the beginning of such valuation activity, and make an Initial Report with recommendations thereafter on Morgan Keegan's policies, procedures and practices with regard to such valuations. The Initial Report shall describe the review performed and the conclusions reached, and will include any recommendations deemed necessary to make the policies, procedures, and practices adequate and consistent with GAAP and the Investment Company Act. Morgan Keegan shall cooperate fully with the Consultant and shall provide the Consultant with access to its files, books, records, and personnel as reasonably requested for the review. Morgan Keegan shall cause the review to begin no later than 60 days after beginning such valuation activity.

C. At the end of that review, and in no event more than 200 days from after beginning such valuation activity, to require the Consultant to submit the report and recommendations to Morgan Keegan and to William P. Hicks of the Commission's Atlanta Regional Office or his successor.

D. Within 30 days of receipt of the Initial Report, Morgan Keegan shall in writing respond to the Initial Report. In such response, Morgan Keegan shall advise the Consultant and the Commission's staff of the recommendations from the Initial Report that it has determined to accept and the recommendations that it considers to be unduly burdensome. With respect to any recommendation that Morgan Keegan deems unduly burdensome, Morgan Keegan may propose an alternative policy, procedure or system designed to achieve the same objective or purpose.

E. Morgan Keegan shall attempt in good faith to reach agreement with the Consultant within 60 days of the date of the receipt of the Initial Report with respect to any recommendation that Morgan Keegan deems unduly burdensome. If the Consultant and Morgan Keegan are unable to agree on an alternative proposal, Morgan Keegan shall abide by the recommendation of the Consultant.

F. Within 90 days of the date of the receipt of the Initial Report, Morgan Keegan shall, in writing, advise the Consultant and the Commission's staff of the recommendations and proposals that it is adopting.

G. No later than one year after the date of the Consultant's Initial Report, Morgan Keegan shall cause the Consultant to conduct a follow-up review of Morgan Keegan's efforts to implement the recommendations contained in the Initial Report, and Morgan Keegan shall cause the Consultant to submit a Final Report to the Commission's staff. The Final Report shall set forth the details of Morgan Keegan's efforts to implement the recommendations contained in the Initial Report, and shall state whether Morgan Keegan has fully complied with the recommendations in the Initial Report.

H. Morgan Keegan shall cause the Consultant to complete the aforementioned review and submit a written Final Report to Morgan Keegan and to the Commission's staff within 400 days of the date of the Initial Report. The Final Report shall recite the efforts the Consultant undertook to review Morgan Keegan's policies, procedures, and practices; set forth the Consultant's conclusions and recommendations; and describe how Morgan Keegan is implementing those recommendations.

I. Morgan Keegan shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Consultant's Final Report.

J. To ensure the independence of the Consultant, Morgan Keegan: (a) shall not have the authority to terminate the Consultant without the prior written approval of the Commission's staff; (b) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; (c) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other privilege or doctrine to prevent the Consultant from transmitting any information, reports, or documents to the Commission staff; and (d) during the period of engagement and for a period of two years after the engagement, shall not enter into any employment, customer, consultant, attorney-client, auditing, or other professional relationship with the Consultant.

K. Morgan Keegan shall cause the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Morgan Keegan, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Atlanta Regional Office Commission staff, enter into any employment, consultant, attorney-client, fiduciary, auditing or other professional relationship with Morgan Keegan, 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. Notwithstanding the foregoing, the Consultant may serve as a Consultant for Morgan Asset, pursuant to paragraph 34 below.

L. *Certification of Compliance by Respondent.* Morgan Keegan shall certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), 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 William P. Hicks, Associate Regional Director in the Commission's Atlanta Regional Office, or any other member of the Commission's staff identified to receive the report by the staff, 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.

33. Morgan Keegan further undertakes as follows:

Ongoing Cooperation by Morgan Keegan. Morgan Keegan undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order or involving, directly or indirectly, trading in or valuation of, the securities of the funds described in this Order. In connection with such cooperation, Morgan Keegan has undertaken:

To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff, or by the Distribution Agent to be appointed pursuant to the Order, with a custodian declaration as to their authenticity, if requested;

To use its best efforts to cause its employees and former employees to be interviewed by the Commission's staff, at the option of the staff with representatives of other government agencies present, at such times and places as the staff reasonably may direct. Live interviews on 72 hours notice at the Commission's Atlanta office or its headquarters office, or at any U.S or state government office in Memphis Tennessee, and telephone interviews on 48 hours notice, at the option of the staff, shall be deemed to be reasonable.

To use its best efforts to cause its employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

In connection with any interviews of Morgan Keegan employees to be conducted pursuant to this undertaking, requests for such interviews may be provided by the Commission's staff to Morgan Keegan's General Counsel, or such other counsel that may be substituted by Morgan Keegan.

34. Respondent Morgan Asset undertakes as follows:

A. Morgan Asset shall not, for a period of three years from the date of the Order, be involved in, or responsible for, recommending to, or determining on behalf of, a registered investment company's board of directors or trustees or such company's valuation committee, the value of any portfolio security for which market quotations are not readily available.

B. If, after three years but within six years from the date of the Order, Morgan Asset becomes involved in, or responsible for, determining or recommending determinations to a registered investment company's board of directors or trustees or valuation committee of the value of any portfolio security for which market quotations are not readily available and which are held by or on behalf of such registered investment company, Morgan Asset shall promptly notify Commission counsel identified below or his successor and within 30 days of beginning such valuation activity, shall hire, at its expense, an Independent Consultant ("Consultant") not unacceptable to the Commission's staff, to review the valuations provided by Morgan Asset to any registered investment company for the next two quarters following the beginning of such valuation activity, and make an Initial Report with recommendations thereafter on Morgan Asset's policies, procedures and practices with regard to such valuations. The Initial Report shall describe the review performed and the conclusions reached, and will include any recommendations deemed necessary to make the policies, procedures, and practices adequate and consistent with GAAP and the Investment Company Act. Morgan Asset shall cooperate fully with the Consultant and shall provide the Consultant with access to its files, books, records, and personnel as reasonably requested for the review. Morgan Asset shall cause the review to begin no later than 60 days after beginning such valuation activity.

C. At the end of that review, and in no event more that 200 days from after beginning such valuation activity, to require the Consultant to submit the report and recommendations to Morgan Asset and to William P. Hicks of the Commission's Atlanta Regional Office or his successor.

D. Within 30 days of receipt of the Initial Report, Morgan Asset shall in writing respond to the Initial Report. In such response, Morgan Asset shall advise the Consultant and the Commission's staff of the recommendations from the Initial Report that it has determined to accept and the recommendations that it considers to be unduly burdensome. With respect to any recommendation that Morgan Asset deems unduly burdensome, Morgan Asset may propose an alternative policy, procedure or system designed to achieve the same objective or purpose.

E. Morgan Asset shall attempt in good faith to reach agreement with the Consultant within 60 days of the date of the receipt of the Initial Report with respect to any recommendation that Morgan Asset deems unduly burdensome. If the Consultant and Morgan Asset are unable to agree on an alternative proposal, Morgan Asset shall abide by the recommendation of the Consultant.

F. Within 90 days of the date of the receipt of the Initial Report, Morgan Asset shall, in writing, advise the Consultant and the Commission's staff of the recommendations and proposals that it is adopting.

G. No later than one year after the date of the Consultant's Initial Report, Morgan Asset shall cause the Consultant to conduct a follow-up review of Morgan Asset's efforts to implement the recommendations contained in the Initial Report, and Morgan Asset shall cause the Consultant to submit a Final Report to the Commission's staff. The Final Report shall set forth the details of Morgan Asset's efforts to implement the recommendations contained in the Initial Report, and shall state whether Morgan Asset has fully complied with the recommendations in the Initial Report.

H. Morgan Asset shall cause the Consultant to complete the aforementioned review and submit a written Final Report to Morgan Asset and to the Commission's staff within 400 days of the date of the Initial Report. The Final Report shall recite the efforts the Consultant undertook to review Morgan Asset's policies, procedures, and practices; set forth the Consultant's conclusions and recommendations; and describe how Morgan Asset is implementing those recommendations.

I. Morgan Asset shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Consultant's Final Report.

J. To ensure the independence of the Consultant, Morgan Asset: (a) shall not have the authority to terminate the Consultant without the prior written approval of the Commission's staff; (b) shall compensate the Consultant, and persons engaged to assist the Consultant, for services rendered pursuant to this Order at their reasonable and customary rates; (c) shall not be in and shall not have an attorney-client relationship with the Consultant and shall not seek to invoke the attorney-client or any other privilege or doctrine to prevent the Consultant from transmitting any information, reports, or documents to the Commission staff; and (d) during the period of engagement and for a period of two years after the engagement, shall not enter into any employment, customer, consultant, attorney-client, auditing, or other professional relationship with the Consultant.

K. Morgan Asset shall cause the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Morgan Asset, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Atlanta Regional Office

Commission staff, enter into any employment, consultant, attorney-client, fiduciary, auditing or other professional relationship with Morgan Asset, 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. Notwithstanding the foregoing, the Consultant may serve as a Consultant for Morgan Keegan, pursuant to paragraph 32 above.

L. *Certification of Compliance by Respondent.* Morgan Asset shall certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), 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 William P. Hicks, Associate Regional Director in the Commission's Atlanta Regional Office, or any other member of the Commission's staff identified to receive the report by the staff, 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.

35. Morgan Asset further undertakes as follows:

Ongoing Cooperation by Morgan Asset. Morgan Asset undertakes to cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in this Order or involving, directly or indirectly, trading in or valuation of, the securities of the funds described in this Order. In connection with such cooperation, Morgan Asset has undertaken:

To produce, without service of a notice or subpoena, any and all documents and other information reasonably requested by the Commission's staff or by the Distribution Agent to be appointed pursuant to the Order, with a custodian declaration as to their authenticity, if requested;

To use its best efforts to cause its employees and former employees to be interviewed by the Commission's staff, at the option of the staff with representatives of other government agencies present, at such times and places as the staff reasonably may direct. Live interviews on 72 hours notice at the Commission's Atlanta office or its headquarters office, or at any U.S or state government office in Memphis Tennessee, and telephone interviews on 48 hours notice, at the option of the staff, shall be deemed to be reasonable.

To use its best efforts to cause its employees to appear and testify truthfully and completely without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission's staff; and

In connection with any interviews of Morgan Asset employees to be conducted pursuant to this undertaking, requests for such interviews may be provided by the Commission's staff to Morgan Asset's General Counsel, or such other counsel that may be substituted by Morgan Asset.

36. Morgan Keegan and Morgan Asset undertake to, pursuant to and in compliance with this Order and with orders being entered in Joint Administrative Proceedings (File Nos. SC-2010-0016 (Alabama), 2010-AH-021 (Kentucky) and 08011 (South Carolina), and the separate Tennessee matter File No. 12.06-107077J (collectively "the State Proceedings"), and the sanctions described in Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No. 2007011164502, jointly and severally pay the total sum of $200 million, including the disgorgement, interest and penalties to be ordered in this matter.

37. Kelsoe undertakes to, pursuant to and in compliance with this Order and with orders being entered in the State Proceedings, to pay $500,000 in penalties, including the penalties to be ordered in this matter pursuant to paragraph IV. L.

In determining whether to accept the Offer, the Commission has considered the undertakings in paragraphs 33, 35, 36 and 37, above.

IV.

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

Accordingly, pursuant to Sections 4C and 15(b) of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, Sections 9(b) and 9(f) 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 Morgan Keegan and Morgan Asset are censured.

B. Respondent Morgan Keegan shall cease and desist from committing or causing any violations and any future violations of, Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act.

C. Respondent Morgan Asset shall 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)-7 thereunder, and Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act.

D. Respondent Kelsoe shall 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)-7 thereunder, and Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act.

E. Respondent Weller shall cease and desist from committing or causing any violations and any future violations of Rules 22c-1 and 38a-1 promulgated under the Investment Company Act.

F. Respondent Kelsoe be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, 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.

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.

G. Respondent Kelsoe 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.

H. Respondent Weller be, and hereby is suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, for a period of 12 months, effective on the second Monday following the entry of this Order, 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, for a period of 12 months, effective on the second Monday following the entry of this Order.

I. Respondent Weller be, and hereby is, suspended 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 for a period of 12 months, effective on the second Monday following the entry of this Order.

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

After two years from the date of this Order, Respondent Weller 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 Weller'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 Weller, 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 Weller, 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 Weller 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 Weller 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.

The Commission will consider an application by Respondent Weller 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.

K. Respondents Morgan Keegan and Morgan Asset shall jointly and severally pay disgorgement of $20,500,000 and prejudgment interest of $4,500,000 to the Securities and Exchange Commission, and a civil penalty of $75,000,000 to the Securities and Exchange Commission, within ten (10) business days of the entry of this Order.

L. Respondent Kelsoe shall pay a civil penalty of $250,000 to the Securities and Exchange Commission, within ten (10) days of this Order.

M. Respondent Weller shall pay a civil penalty of $50,000 to the Securities and Exchange Commission, within ten (10) days of this Order.

N. All payments pursuant to paragraphs IV. K, L and M, above, shall be made by certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission. The payment shall be delivered or mailed to the Office of Financial Management, Accounts Receivable, Securities and Exchange Commission, 100 F Street, NE, Stop 6042, Washington DC 20549, and shall be accompanied by a letter identifying Respondent as a respondent in these proceedings; setting forth the file number of these proceedings; and specifying that payment is made pursuant to this Order, a copy of which cover letter and money order or check shall be sent to William P. Hicks, Associate Regional Administrator, Securities and Exchange Commission, 3475 Lenox Rd., N.E., Suite 500, Atlanta, GA 30326-1232. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717 and/or SEC Rule of Practice 600.

Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest, and penalties described in Paragraphs IV. K, L and M and any funds paid in connection with related actions pursuant to Paragraph III. 36, above. Regardless of whether any such distribution is made from such Fair Fund, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that any Respondent receiving such offset shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against any of the Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

O. The disgorgement, interest, civil penalties, and any other funds which may be paid to the Fair Fund through or as the result of related actions, shall be aggregated in the Fair Fund, which shall be maintained in an interest-bearing account, and shall be distributed pursuant to a distribution plan (the "Plan") to be administered in accordance with the Commission Rules on Fair Fund and Disgorgement Plans. A Fund Administrator (the "Administrator") shall be appointed by the Commission. The Administrator shall identify the investors in the Funds who suffered losses as a result of the violations determined herein, evaluate investor claims and propose and effectuate a plan to distribute the Fair Fund resulting from this order. The Fair Fund shall be used to compensate injured customers for their loss. Under no circumstances shall any part of the Fair Fund be returned to Morgan Keegan, Morgan Asset, Kelsoe or Weller.

Respondent Morgan Keegan shall pay all reasonable costs and expenses of such distribution within thirty (30) days after receipt of an invoice for such services.

P. Morgan Keegan shall comply with the undertakings specified in Paragraph 32 above.

Q. Morgan Asset shall comply with the undertakings specified in Paragraph 34 above.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9227 / June 22, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64721 / June 22, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3219 / June 22, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29705 / June 22, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13847

In the Matter of MORGAN ASSET MANAGEMENT, INC.; MORGAN KEEGAN & COMPANY, INC.; JAMES C. KELSOE, JR.; and JOSEPH THOMPSON WELLER, CPA, Respondents.	ORDER UNDER SECTION 27(A)(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO MORGAN ASSET MANAGEMENT INC., AND MORGAN KEEGAN & COMPANY, INC. AND THEIR AFFILIATES.

Morgan Asset Management, Inc. ("Morgan Asset") and Morgan Keegan & Co., Inc. ("Morgan Keegan"), and have submitted a letter on behalf of themselves, their affiliates, and other offering participants, dated June 15, 2011, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from their settlement of an administrative proceeding commenced by the Commission.

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On June 22, 2011, pursuant to the Offer of Settlement by Morgan Asset, Morgan Keegan and others, the Commission issued an Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission's Rules of Practice. Under the Order, the Commission found that (i) Morgan Asset violated Sections 206(1), 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-7 thereunder, and Section 34(b) of the Investment Company Act of 1940 ("Investment Company Act") and aided and abetted violations of Rules 22c-1 and 38a-1 promulgated under the Investment Company Act; and (ii) Morgan Keegan violated Rule 22c-1 promulgated under the Investment Company Act and aided and abetted violations of Section 34(b) of the Investment Company Act and Rule 38a-1 promulgated under the Investment Company Act.

The Order, with regard to Morgan Asset and Morgan Keegan, censures Morgan Asset and Morgan Keegan and (1) requires Morgan Asset to 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)-7 thereunder, and Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act; (2) requires Morgan Keegan to cease and desist from committing or causing any violations and any future violations of Section 34(b) of the Investment Company Act and Rules 22c-1 and 38a-1 promulgated under the Investment Company Act; (3) censures Morgan Asset and Morgan Keegan; (4) requires Morgan Asset and Morgan Keegan, jointly and severally, within 10 days of the entry of the Order, to pay disgorgement of $20,500,000, prejudgment interest of $4,500,000 and a civil money penalty in the amount of $75,000,000 to the Commission; (5) requires Morgan Asset and Morgan Keegan to comply with certain undertakings related to the valuation of portfolio securities for which market quotations are not available; and (6) requires Morgan Asset and Morgan Keegan to certify in writing to the staff of the Commission that they have complied with the undertakings.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of an . . . administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in the letter submitted by Morgan Asset and Morgan Keegan, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, **IT IS ORDERED,** pursuant to Section 27A(b) of the Securities Act and Section 27E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Morgan Asset and Morgan Keegan, their affiliates, and other offering participants resulting from the entry of the Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **June 2011,** with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(87 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 2, 2011

In the Matter of **InPhonic, Inc.** **File No. HO-10671**	**ORDER COMPELLING** **WITNESS TO TESTIFY**

The Securities and Exchange Commission ("Commission"), deciding the testimony of Samuel Sina Bahreini, who has refused to testify or provide other information, based on his privilege against self-incrimination, to be necessary to the public interest, finds it necessary and appropriate and hereby

ORDERS, pursuant to Title 18, Sections 6002 and 6004 of the United States Code and the attached authorization of the Attorney General, that Samuel Sina Bahreini be and hereby is compelled to testify and to provide other information relating to all matters of which he has knowledge, direct or indirect, in the above-captioned case.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038–AD46

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 33–9204A; 34–64372A; File No. S7–16–11]

RIN 3235-AK65

Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping

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

ACTION: Joint proposed rules; proposed interpretations; correction.

SUMMARY: The Commodity Futures Trading Commission and the Securities and Exchange Commission published a document in the Federal Register of May 23, 2011 that referenced an incorrect RIN and an incorrect cite in an authority citation. This correction is being published to correct both the RIN and the authority citation.

FOR FURTHER INFORMATION CONTACT: CFTC: Julian E. Hammar, Assistant General Counsel, at 202–418–5118, jhammar@cftc.gov, Mark Fajfar, Assistant General Counsel, at 202–418– 6636, mfajfar@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, NW., Washington, DC 20581; SEC: Matthew A. Daigler, Senior Special Counsel, at 202–551–5578, Cristie L. March, Attorney-Adviser, at 202–551–5574, or Leah M. Drennan, Attorney-Adviser, at 202–551–5507, Division of Trading and Markets, or Michael J. Reedich, Special Counsel, or Tamara Brightwell, Senior Special Counsel to the Director, at 202–551– 3500, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–7010

CORRECTION

In the Federal Register of May 23, 2011, in FR Doc. 2011-11008, on page 29818, in the 10th line of the first column, the Security and Exchange Commission's RIN is corrected to read as noted above.

In the Federal Register of May 23, 2011, in FR Doc. 2011-11008, on page 29888, the authority citation in the second column reads 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, 6r, 7, 7a, 7b, 8, 9, 10, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 21, 23, and 24.

Commodity Futures Trading Commission.

David A. Stawick
Secretary

Securities and Exchange Commission.

Elizabeth M. Murphy
Secretary

Dated: June 1, 2011

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64587 / June 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14408

In the Matter of **LODAVINA GROSNICKLE,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From February through May 2007, Grosnickle was the co-founder and vice president of TG Capital LLC ("TG Capital"). During that period, Grosnickle was neither registered with the Commission as a broker-dealer nor associated with a registered broker-dealer. In connection with the sale of membership units of TG Capital, Grosnickle acted as an unregistered broker or dealer. Grosnickle, age 55, is a resident of Chula Vista, California.

B. ENTRY OF THE INJUNCTION

2. On May 9, 2011, a default judgment was entered against Grosnickle, permanently enjoining her from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. TG Capital LLC, et al., Civil Action Number SACV 07-00579-CJC (ANx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, from at least February through May 2007, Grosnickle, acting in concert with Thanh Viet Jeremy Cao ("Cao"), raised at least $3.78 million from approximately 33 investors from the sale of membership units in TG Capital that purportedly would pay investors guaranteed returns of 28% to 30% per year. The complaint further alleged that Grosnickle, knowingly or recklessly: (1) misrepresented to investors that TG Capital would use investor funds to invest in bank instruments backed by bank guarantees and gold, invest in gold by purchasing letters of credit or standby letters of credit, or would loan money to a named bank, when in fact TG Capital sent $1.78 million of investor funds overseas to purportedly make a personal loan on behalf of Cao to a third person and paid Grosnickle undisclosed commissions ranging from 4% to 10% of the total contributed by investors she brought into TG Capital; (2) misrepresented to investors that their investment in TG Capital was guaranteed by three named banks and by gold, when in fact none of the named banks had any relationship with TG Capital and TG Capital had no gold; and (3) provided to an investor or investors purported documents from banks referencing bank guarantees, when in fact the documents were forged.

III.

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

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

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

IV.

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

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

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

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

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. §201.360.

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

For the Commission, by its Secretary, pursuant to delegated authority.

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. 64588 / June 2, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3286 / June 2, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14177

In the Matter of **CARL W. JASPER, CPA** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO RULE 102(e)(3) OF THE COMMISSION'S RULES OF PRACTICE**

I.

On January 7, 2011, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Rule 102(e)(3)[1] of the Commission's Rules of Practice against Carl W. Jasper ("Respondent" or "Jasper").

II.

In connection with 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 prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. §201.100, et seq., 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

[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.

admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Rule 102(e) of the Commission's Rules of Practice, as set forth below.

III.

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

1. Jasper, age 54, is and has been a certified public accountant ("CPA") licensed to practice in the State of California. From April 1999 through January 2007, Respondent served as Vice President, Chief Financial Officer, and Principal Accounting Officer of Maxim Integrated Products, Inc. ("Maxim"), a San Jose semiconductor company. From 1983 to 1995, Respondent worked as an auditor for Ernst & Young, LLP. Respondent's CPA license was inactive during his tenure at Maxim.

2. On November 5, 2010, the United States District Court for the Northern District of California entered an amended final judgment against Respondent. *SEC v. Jasper*, C-07-6122 JW (N.D. Cal. Dec. 4, 2007). The Amended Final Judgment followed a jury trial in which the jury found that Respondent violated Section 17(a)(1) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 thereunder, and aided and abetted Maxim's violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

3. The Amended Final Judgment against Respondent, among other things, permanently enjoins him from future violations, direct or indirect, of Section 17(a)(1) of the Securities Act and Section 10(b) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1, and 13b2-2 thereunder, and from aiding and abetting any violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder. It also bars Respondent, for a period of two years, from acting as an officer or director for any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, 15 U.S.C. § 78*l*, or that is required to file reports pursuant to Section 15(d) of the Exchange Act, 15 U.S.C. § 78o(d), and requires Respondent to reimburse Maxim $1,869,639 and pay a civil penalty of $360,000.

4. The Commission's first amended complaint alleged that Respondent, from at least 2000 through 2005, engaged in a scheme to illegally backdate stock options granted to Maxim's employees and directors, concealing millions of dollars in expenses from investors and significantly overstating Maxim's income. It further alleged that Respondent was aware that Maxim granted options on purported dates that had been selected with hindsight and that he knew, or was reckless in not knowing, that Maxim was failing to report expenses for those in-the-money options and was falsely reporting that it only granted options at fair market value. It further alleged that Respondent signed several of Maxim's public filings, including annual, quarterly, and current reports and registration statements that were materially false and misleading.

IV.

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

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

A. Jasper 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 license is current and he has resolved all other disciplinary issues with the applicable boards of accountancy. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64600 / June 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14409

In the Matter of **GIUSEPPE TULLIO ABATEMARCO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

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

III.

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

1. Respondent is employed by AXA Winterthur. He is 40 years old and resides in Switzerland. AXA is a broker-dealer and investment adviser registered with the Commission.

2. Martek Biosciences Corporation was a Delaware corporation with its headquarters in Columbia, Maryland. Martek's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was quoted on the NASDAQ Global Select Market under the ticker symbol MATK. Options in its common stock traded on, among other places, the following exchanges located in New York, New York: NYSE Amex operated by NYSE Amex LLC, NYSE Arca operated by NYSE Arca, Inc., and the International Securities Exchange.

3. On May 24, 2011, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder, in the civil action entitled Securities and Exchange Commission v. Giuseppe Tullio Abatemarco, No. 10-cv-9527 (WHP), in the United States District Court for the Southern District of New York.

4. The Commission's amended complaint alleged that in the days preceding the announcement that another company would commence a cash tender offer to acquire all the outstanding shares of the common stock of Martek, Respondent purchased 2,616 Martek call option contracts based on material non-public information he acquired from the common-law wife of an employee of the offeror in violation of Sections 10(b) and 14(e) of the Exchange Act and Exchange Act Rules 10b-5 and 14e-3. The Commission further alleged that upon selling the call option contracts shortly after the announcement, Respondent netted illegal trading profits of almost $1.2 million.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL 111-203, July 21, 2010, 124 Stat. 1376, that Respondent be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Respondent be, and is hereby, 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.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64598 / June 3, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Rel. No. 3287 / June 3, 2011

Admin. Proc. File No. 3-14323

In the Matter of MICHAEL C. PATTISON, CPA	ORDER DENYING MOTION TO LIFT TEMPORARY SUSPENSION AND DIRECTING HEARING

On April 5, 2011, we issued an order instituting proceedings ("OIP") against Michael C. Pattison, a certified public accountant ("CPA"), pursuant to Commission Rule of Practice 102(e)(3),[1] that temporarily suspended him from appearing or practicing before the

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1 Rule of Practice 102(e)(3)(i), 17 C.F.R. § 201.102(e)(3)(i), provides, in pertinent part, that:

> (i) The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any . . . accountant . . . who has been by name:
>
> (A) permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or
>
> (B) found by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Commission as an accountant.[2] Pattison has filed a petition, pursuant to Rule 102(e)(3)(ii),[3] requesting that his temporary suspension be lifted.

Pattison was controller of Embarcadero Technologies, Inc. ("Embarcadero"), from January 2000 through July 2005.[4] On September 9, 2008, the Commission filed a complaint in the United States District Court for the Northern District of California, alleging that Pattison, among other things, knowingly falsified numerous books, records, and accounts in connection with the backdating of stock options granted to Embarcadero's employees from 2000 through 2005. The complaint further alleged that Pattison knowingly circumvented Embarcadero's internal accounting controls to avoid recording compensation expenses related to the backdated, in-the-money, stock options during the same time period.

A jury found that Pattison violated Section 13(b)(5) of the Securities Exchange Act of 1934, which prohibits persons from "knowingly circumvent[ing] . . . a system of internal accounting controls or knowingly falsify[ing] any [required] book, record, or account."[5] The jury also found that Pattison violated Exchange Act Rule 13b2-1, which prohibits persons from "directly or indirectly, falsify[ing] any [required] book, record, or account."[6] On February 23, 2011, the district court entered an amended final judgment against Pattison permanently enjoining him from violating Exchange Act Section 13(b)(5) and Exchange Act Rule 13b2-1.[7] The final judgment, as amended, further ordered Pattison to pay $74,446 in disgorgement, plus prejudgment interest, and a second-tier civil monetary penalty of $50,000.

In issuing the OIP, we found it "appropriate and in the public interest" that Pattison be temporarily suspended from appearing or practicing before the Commission, based on the district court's final judgment. We stated that the temporary suspension would become permanent unless Pattison filed a petition challenging it within thirty days of service of the order, pursuant to Rule of Practice 102(e)(3)(ii). We further advised that, pursuant to Rule of Practice 102(e)(3)(iii),

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2 *Michael C. Pattison, CPA*, Securities Exchange Act Rel. No. 64190 (Apr. 5, 2011), __ SEC Docket __.

3 17 C.F.R. § 201.102(e)(3)(ii).

4 *Pattison*, __ SEC Docket at ___.

5 15 U.S.C. § 78m(b)(5).

6 17 C.F.R. § 240.13b2-1.

7 *SEC v. Pattison*, C-08-4238 EMC, 2011 U.S. Dist. LEXIS 23427 (N.D. Cal. Feb. 23, 2011). The district court noted, in enjoining Pattison, that he "currently holds a position as an accountant in a private trading company, and is still a licensed CPA, eligible to return to the public accounting field." *Id.* at *7.

upon receipt of such a petition, we would either "lift the temporary suspension, or set the matter down for hearing . . . , or both."

In his petition, Pattison argues that the temporary "suspension is premature" because he has filed a "meritorious motion to amend the [final judgment]" with the district court and because he "will appeal any adverse ruling on his motion." He requests that the Commission lift the temporary suspension "until that motion, and the potential appeal, are decided." Pattison also contends that the "suspension is inappropriate and excessive in light of the nature of the case," noting that the jury dismissed several charges against him, "absolv[ing]" him of any wrongdoing with respect to the "antifraud and disclosure provisions of the . . . Exchange Act." He further contends that the district court used "an improper standard for the requisite intent" under Exchange Act Section 13(b)(5) and challenges the evidence used against him at trial, claiming the Commission improperly relied on Embarcadero's financial statements and "elicit[ed] improper expert testimony about complicated accounting rules from lay witnesses." In addition, Pattison also claims that the OIP erroneously states that he was enjoined from "indirect" violations of Section 13(b)(5), urges the Commission to issue a more "definitive statement" regarding his misconduct, and requests the opportunity "to present additional briefing . . . and proposed findings . . . before any administrative hearing and decision." The Division of Enforcement opposes Pattison's petition.

Rule 102(e)(3) permits the Commission to suspend any accountant or other professional or expert who has been "permanently enjoined from violating . . . the Federal securities laws or of the rules and regulations thereunder; or . . . found by any court of competent jurisdiction in an action brought by the Commission . . . to have violated . . . the . . . Federal securities laws or rules and regulations thereunder.'"[8] Although Pattison is entitled to appeal the underlying case against him, neither the pendency of his current motion before the district court nor the possibility of an appeal to the court of appeals "alter[s] the effect" of the jury's finding of securities law violations or the court's imposition of an injunction, here.[9] Generally, a respondent in a "follow-on" proceeding is precluded from challenging the basis for, or findings in, the underlying injunctive action.[10] At this stage, it appears that the findings made in the injunctive proceeding and the injunction issued against him justify continuing his suspension "until it can be determined what,

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8 17 C.F.R. § 201.102(e)(3)(i).

9 *Daniel S. Lezak*, 57 S.E.C. 997, 1000 n.16 (2004); *see also Michael T. Studer*, 57 S.E.C. 890, 897 (2004) (noting that "the fact that Studer is still litigating that action [on appeal] does not affect our statutory authority to conduct this proceeding"), *aff'd*, 148 F. App'x 58 (2d Cir. 2005).

10 *See, e.g., Jose P. Zollino*, Exchange Act Rel. No. 55107 (Jan. 16, 2007), 89 SEC Docket 2598, 2604-05 n.20 (noting the appropriate forum for respondent's challenges to underlying litigation is the appellate court).

if any, action may be appropriate to protect the Commission's processes."[11] As provided in Rule 102(e)(3)(iii), therefore, we will set the matter down for public hearing. We note that Pattison's other claims concerning the present proceeding – *i.e.*, that the OIP is incorrect and that a more definitive statement is needed – are more appropriately addressed, in the first instance, by the law judge in the context of administering the hearing. The law judge may order and schedule the filing of an answer to the OIP, pursuant to Rule of Practice 220.[12] We express no opinion as to the merits of Pattison's claims.

Accordingly, IT IS ORDERED that this proceeding be set down for public hearing before an administrative law judge in accordance with Rule of Practice 110. As specified in Rule of Practice 102(e)(3)(iii), the hearing in this matter shall be expedited in accordance with Rule of Practice 500; it is further

ORDERED that the administrative law judge shall issue an initial decision no later than 210 days from the date of service of this order; and it is further

ORDERED that the temporary suspension of Michael C. Pattison, entered on April 5, 2011, remain in effect pending a hearing and decision in this matter.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[11] *Lezak*, 57 S.E.C. at 1001.

[12] 17 C.F.R. § 201.220.

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

JUNE 6, 2011

IN THE MATTER OF ARTFEST INTERNATIONAL, INC. File No. 500-1	: : : : :	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Artfest International, Inc. ("Artfest") because of questions regarding the accuracy and adequacy of assertions by Artfest, in its 2010 Form 10-K and amended Form 10-K filed with the Commission, concerning, among other things, an independent audit of Artfest's financial statements for the fiscal year ended December 31, 2010, which was not performed, and financial statements for the 2010 period that are referenced in the filings as "audited," when they were not.

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on Monday, June 6, 2011 and terminating at 11:59 p.m. EDT on Friday, June 17, 2011.

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. 64610 / June 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14411

In the Matter of **D'Brit Corp.,** **Dair Ventures, Inc.,** **DATEQ Information Network, Inc. (n/k/a LexisNexis Risk Solutions, Inc.),** **D.C. Trading & Development Corp.,** **Delsoft Consulting, Inc.,** **Dev-Tech Corp. (n/k/a Dev Sec, Inc.),** **Digital Products Corp., and** **Dollar Time Group, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents D'Brit Corp., Dair Ventures, Inc., DATEQ Information Network, Inc. (n/k/a LexisNexis Risk Solutions, Inc.), D.C. Trading & Development Corp., Delsoft Consulting, Inc., Dev-Tech Corp. (n/k/a Dev Sec, Inc.), Digital Products Corp., and Dollar Time Group, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. D'Brit Corp. (CIK No. 771858) is a void Delaware corporation located in McLean, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). D'Brit 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, 1997, which reported a net loss of over $108,000 for the prior six months.

2. Dair Ventures, Inc. (CIK No. 1139511) is a dissolved Florida corporation located in Miami Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dair Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported no income or loss for the prior three months.

3. DATEQ Information Network, Inc. (n/k/a LexisNexis Risk Solutions, Inc.) (CIK No. 878775) is a Georgia corporation located in Norcross, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DATEQ Information Network is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 1995, which reported a net loss of over $1.8 million for the prior six months.

4. D.C. Trading & Development Corp. (CIK No. 27448) is a void Delaware corporation located in Arlington, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). D.C. Trading & Development 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, 1993, which reported a net loss of over $680,000 for the prior twelve months.

5. Delsoft Consulting, Inc. (CIK No. 1029424) is a revoked Georgia corporation located in Roswell, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Delsoft Consulting is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2000, which reported a net loss of over $610,000 for the prior six months.

6. Dev-Tech Corp. (n/k/a Dev Sec, Inc.) (CIK No. 818970) is a dissolved Florida corporation located in West Palm Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dev-Tech is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1995, which reported a net loss of over $989,000 for the prior nine months.

7. Digital Products Corp. (CIK No. 28895) is a dissolved Florida corporation located in Pompano Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Digital Products 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, 1995, which reported a net loss of over $993,000 for the prior nine months. On April 3, 1997, Digital Products filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of Florida, and the case was terminated on June 29, 2004.

8. Dollar Time Group, Inc. (CIK No. 859791) is a Nevada corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dollar Time Group 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 March 25, 1995, which reported a net loss of over $12.4 million for the prior twelve months. On July 24, 1995, Dollar Time Group filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida, which was converted to Chapter 7, and the case was terminated on August 8, 2003.

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.

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64611 / June 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14412

In the Matter of **Consolidated Resources Health Care Fund III,** **Consolidated Resources Health Care Fund IV,** **Consolidated Resources Health Care Fund V,** **Consolidated Resources Health Care Fund VI, and** **Continental American Transportation, 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 Consolidated Resources Health Care Fund III, Consolidated Resources Health Care Fund IV, Consolidated Resources Health Care Fund V, Consolidated Resources Health Care Fund VI, and Continental American Transportation, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Consolidated Resources Health Care Fund III (CIK No. 744594) is a Georgia limited partnership located in Atlanta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Consolidated Resources

Health Care Fund III 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, 1991, which reported a net operating loss of over $408,000 for the prior twelve months.

2. Consolidated Resources Health Care Fund IV (CIK No. 752895) is a Georgia limited partnership located in Atlanta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Consolidated Resources Health Care Fund IV 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, 1997.

3. Consolidated Resources Health Care Fund V (CIK No. 764544) is a Georgia limited partnership located in Atlanta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Consolidated Resources Health Care Fund V is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1996.

4. Consolidated Resources Health Care Fund VI (CIK No. 777953) is a Georgia limited partnership located in Atlanta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Consolidated Resources Health Care Fund VI 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, 1997, which reported a net loss of over $412,000 for the prior nine months.

5. Continental American Transportation, Inc. (CIK No. 866457) is a delinquent Colorado corporation located in Calhoun, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Continental American Transportation 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, 1997, which reported a net loss of $7.5 million for the prior nine months. On May 26, 1998, an involuntary Chapter 7 petition was filed against Continental American Transportation in the U.S. Bankruptcy Court for the Northern District of Georgia, which was terminated on October 20, 2008.

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.

8. 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

Elizabeth M. Murphy
Secretary

Commissioner Walter
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 29690 / June 6, 2011

In the Matter of

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

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

UBS ALTERNATIVE AND QUANTITATIVE INVESTMENT LLC
677 Washington Boulevard
Stamford, CT 06901

UBS WILLOW MANAGEMENT, L.L.C.
UBS EUCALYPTUS MANAGEMENT, L.L.C.
UBS JUNIPER MANAGEMENT, L.L.C.
299 Park Avenue
29th Floor
New York, NY 10171

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

UBS GLOBAL ASSET MANAGEMENT (US) INC.
1285 Avenue of the Americas
12th Floor
New York, NY 10019

(812-13902)

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

UBS AG, UBS IB Co-Investment 2001 GP Limited, UBS Financial Services Inc. ("UBSFS"), UBS Alternative and Quantitative Investment LLC, UBS Willow Management, L.L.C., UBS Eucalyptus Management, L.L.C., UBS Juniper Management, L.L.C., UBS Global Asset Management (Americas) Inc., and UBS Global Asset Management (US) Inc. (collectively, "Applicants") filed an application on May 9, 2011 requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which UBSFS is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to an injunction entered by the United States District Court for the District of New Jersey on May 6, 2011.

On May 9, 2011, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 29666) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

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

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by UBS AG, et al. (File No. 812-13902) that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act; operative solely as a result of an injunction, described in the application, entered by the United States District Court for the District of New Jersey on May 6, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Cathy Ahn

By: Cathy Ahn
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64607 / June 6, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3288 / June 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14410

In the Matter of **LIVINGSTON & HAYNES, P.C.,** **KEVIN F. HOWLEY, CPA and** **WILLIAM W. WOOD, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Livingston & Haynes, P.C. ("L&H"); Kevin F. Howley, CPA; and William W. Wood, CPA ("Respondents") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and

[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.

Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

II.

In anticipation of the institution of these proceedings, the Respondents have each submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[3] that:

A. SUMMARY

1. This matter concerns violations of Section 10A of the Exchange Act by L&H, Howley and Wood in connection with L&H's 2005 and 2006 year-end audits and quarterly interim reviews of the financial statements of LocatePlus Holdings Corporation ("LocatePlus") (collectively "the Engagements"). Howley served as the Engagement Partner and Wood served as the Concurring Partner on the Engagements.

2. This matter also concerns improper professional conduct within the meaning of Rule 102(e) of the Commission's Rules of Practice by L&H, Howley and Wood in connection with the Engagements.

3. On October 14, 2010, the Commission filed a complaint against LocatePlus alleging, in part, that LocatePlus' former CEO and CFO fraudulently inflated the company's publically-reported revenue in its periodic filings with the Commission for at least fiscal years 2005 and 2006.[4] The complaint alleges that, as part of LocatePlus' fraud, its CEO and CFO

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[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.

[4] *See SEC v. LocatePlus Holdings Corp et. al.*, Docket No. 1:10-cv-11751 (DPW) (D. Mass.).

created a fictitious customer called Omni Data Services, Inc. ("Omni Data") and that LocatePlus then improperly recognized revenue from Omni Data. The improper Omni Data revenue was included in LocatePlus' financial statements that were part of quarterly and annual reports for fiscal years 2005 and 2006 and were included in filings with the Commission. In total, LocatePlus falsely reported more than $6 million from Omni Data for fiscal years 2005 and 2006, representing over 25% of LocatePlus' total revenue for those two years. On November 10, 2010, the Commission amended its complaint to include charges against Jon R. Latorella, LocatePlus' former CEO, and James C. Fields, LocatePlus' former CFO, alleging that, among other violations, they each violated the antifraud provisions, and aided and abetted LocatePlus' violations of the reporting provisions, of the federal securities laws. Also on November 10, 2010, an indictment was unsealed in the District of Massachusetts charging Fields and Latorella with, among other things, criminal violations of the federal securities laws stemming from the same conduct alleged in the Commission's complaint.[5]

4. During the course of L&H's 2005 and 2006 year-end audits of LocatePlus, L&H, Howley and Wood failed to include procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts and thus each of them violated Section 10A(a)(1) of the Exchange Act.

5. During the course of L&H's 2005 and 2006 year-end audits of LocatePlus, L&H, Howley and Wood became aware of multiple allegations of illegal acts at LocatePlus, including allegations that the Omni Data revenue was fictitious, yet they failed to determine whether it was likely that an illegal act had occurred. Based on this conduct, each of them violated Section 10A(b)(1) of the Exchange Act.

6. During the course of L&H's 2005 and 2006 year-end audits of LocatePlus, L&H, and Howley became aware of red flags indicating that the Omni Data revenue was fictitious yet they failed to ensure that very risk area was properly audited. Moreover, L&H and Howley failed to properly plan the audits, adequately test the Omni Data revenue, obtain sufficient competent evidential matter to serve as a basis for L&H's audit reports, exercise due professional care, apply skepticism, and properly assess the risks of material misstatement due to fraud. Wood was also aware of the red flags indicating that the Omni Data revenue may be fictitious and that these matters were unresolved, yet he concurred with the issuance of audit reports containing unqualified opinions on LocatePlus' 2005 and 2006 financial statements. Based on the Respondents' highly unreasonable conduct, Respondents engaged in improper professional conduct within the meaning of Rule 102(e)(ii).

B. RESPONDENTS

7. Kevin F. Howley, age 50 and a resident of Wrentham, Massachusetts, is a Certified Public Accountant ("CPA") licensed in Massachusetts, California and Vermont. Howley served as the engagement partner on LocatePlus' audits and interim reviews for the years ended 2005 and

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[5] *See United States v. Latorella, et. al*, 10-CR-10388 (NRG) (D. Mass.).

2006. Howley generally serves as the engagement partner for all of L&H's public company clients. Howley is an approximately two percent shareholder in L&H.

8. William W. Wood, Jr., age 64 and a resident of Townsend, Massachusetts, is a CPA licensed in Massachusetts. Wood served as the concurring partner on the LocatePlus audits and interim reviews for the years ended 2005 and 2006. Wood also serves as L&H's technical partner and as the concurring partner for all of L&H's SEC clients. Wood is an approximately ten percent shareholder in L&H.

9. Livingston & Haynes, P.C. is an accounting and auditing firm registered with the Public Company Accounting Oversight Board (the "PCAOB") based in Wellesley, Massachusetts. The firm provides tax preparation services as well as services to public companies registered with the Commission and to private equity clients. L&H served as the auditors on LocatePlus' audits and interim reviews for the fiscal years-ended 2005 and 2006 from which L&H received approximately $227,800 in fees.

C. OTHER RELEVANT PERSONS AND ENTITIES

10. James C. Fields, age 42, resides in Brookline, Massachusetts. During the relevant time period, Fields was a director of Paradigm Tactical Products, Inc. ("Paradigm"). Fields also held several positions with LocatePlus before resigning in early 2009, including Acting Chief Financial Officer and Chief Executive Officer. In testimony before the staff, he asserted his Fifth Amendment privilege against self incrimination to all questions.

11. Jon R. Latorella, age 47, resides in Marblehead, Massachusetts. Latorella was a founder of Paradigm and, at various times between 2002 and early 2009, held different positions with LocatePlus' including Chief Executive Officer, President and Chairman of the Board. He resigned in early 2009. In testimony before the staff, he asserted his Fifth Amendment privilege against self incrimination to all questions.

12. LocatePlus Holdings Corporation, a Delaware corporation, is located in Beverly, Massachusetts and provides online access to public record databases for investigative searches. LocatePlus' stock is registered pursuant to Section 12(g) of the Exchange Act and is currently quoted on FINRA's OTC Bulletin Board. It has a fiscal year ending on December 31.

D. FACTS

LocatePlus' Fraud

13. LocatePlus is a provider of public information made available via either a CD-ROM based product or via a proprietary internet accessible database. The LocatePlus product contains searchable information on individuals throughout the United States, including, for example, social security numbers, prior residences and real estate holdings. In addition to direct purchasers, LocatePlus sells its product through "channel partner" arrangements, by which third parties access their databases in consideration for a royalty.

14. In 2005 and 2006, LocatePlus claimed to have secured a significant "channel partner" arrangement with Omni Data, a company that purportedly conducted its business over the Internet. Under the terms of the alleged agreement, Omni Data had unlimited access to LocatePlus' data via the Internet in exchange for a royalty fee of $300,000 per month. The agreement also stated that LocatePlus would build and maintain a website for Omni Data in exchange for $500,000.

15. In fact, Omni Data was a sham customer of LocatePlus created by Fields and Latorella to record false revenue. Through this fraudulent scheme, Omni Data would "buy" services from LocatePlus and make purported "payments" to LocatePlus. Fields and Latorella then caused LocatePlus to record these fictitious payments as revenue in its financial results, which were included in periodic filings with the Commission.

16. To fund these purported payments to LocatePlus, Latorella and Fields funneled approximately $2 million in cash to Omni Data through a series of transactions which included (1) a "round trip" transaction in which LocatePlus made a $650,000 payment to an entity controlled by Fields, who then transferred $600,000 to Omni Data, which then paid the $600,000 back to LocatePlus as purported payment for services; and (2) transferring at least $250,000 of the proceeds from the unregistered sales of Paradigm stock first to Omni Data and then to LocatePlus, again as payment for purported services.

17. LocatePlus made numerous false and misleading statements regarding, among other things, its revenue in a number of periodic filings with the Commission, including in its Forms 10-KSB and 10-QSB for fiscal years 2005 and 2006. For fiscal years 2005 and 2006, LocatePlus improperly recognized $3.6 million and $2.7 million, respectively, in fictitious revenue from Omni Data. This caused LocatePlus to overstate its 2005 annual results by 46% and its 2005 quarterly results by 53% for the first quarter, 44% for the second quarter and 43% for the third quarter. LocatePlus overstated its 2006 annual results by 28% and its 2006 quarterly results by 41% for the first quarter, 34% for the second quarter and 36% for the third quarter.

18. L&H performed LocatePlus' 2005 and 2006 year-end audits and quarterly reviews. The audit reports issued for both years included an explanatory paragraph stating that LocatePlus' substantial net losses raise substantial doubt about the Company's ability to continue as a going concern.

Events Leading Up to L&H's Fiscal Year 2005 and 2006 Year-End Audits and Quarterly Reviews of LocatePlus

19. On December 10, 2004, LocatePlus' former auditor, resigned. In a resignation letter addressed to LocatePlus' Audit Committee Chairman, and filed with LocatePlus' December 13, 2004 Form 8-K/A, LocatePlus' former auditor cited "concerns about the timeliness of information we receive and about the reliability of certain representations of your company's management."

20. In January 2005, Fields contacted Howley to inquire about L&H becoming LocatePlus' new auditors.

21. On February 16, 2005, Howley and Wood visited the former auditor's offices and met with the partner formerly responsible for the LocatePlus engagement. The former auditor's audit partner detailed multiple reasons for its resignation, including: (1) difficulty getting information from management; (2) management providing contradictory explanations to its questions; (3) management providing unsigned contracts as audit evidence; and, (4) difficulty getting management to accept its proposed audit adjustments.

22. Following the February 16, 2005 meeting, LocatePlus' former auditor provided L&H with access to LocatePlus' 2003 work papers and provided a copy of a February 4, 2005 letter from the former auditor to LocatePlus' Audit Committee that described allegations by a former member of LocatePlus' management that Andover Secured Resources ("ASR"), an entity to which LocatePlus purportedly loaned $2,000,000, was not a legitimate entity.

23. After L&H's meeting with LocatePlus' former auditor, Howley, Wood and L&H's President met and determined to accept LocatePlus as a client. Because of the concerns expressed by LocatePlus' former auditor, however, L&H determined to "use extensive care" and treat LocatePlus as a high risk audit client.

24. During the 2004 audit (which occurred from March through May 2005), L&H encountered difficulty verifying the existence and valuation of the ASR note receivable, so much so that it was ultimately fully reserved for, meaning that the ASR note was ultimately valued at $0 on LocatePlus' balance sheet.

25. Also during the 2004 audit, L&H had difficulties getting information from LocatePlus' management about significant transactions, to the extent that, on April 11, 2005, L&H pulled out of the field because they were unable to remain productive with the amount of information they had to work with. L&H also had difficulties confirming significant balance sheet items, including the Paradigm and ASR notes receivable, which resulted in a valuation of the ASR note at $0 on LocatePlus' balance sheet.

<u>L&H Discovered Red Flags During the 2005 Interim Reviews</u>

26. During the course of its 2005 interim reviews of quarterly filings, L&H became aware of multiple red flags concerning the revenue recognized from Omni Data and the resulting receivable on LocatePlus' balance sheet. In a June 1, 2005, e-mail from Howley to Fields, Howley noted that: (1) L&H was unable to find records for Omni Data on the Connecticut Secretary of State's website (<u>i.e.,</u> the state where Omni Data was purportedly located); (2) that the alleged President of Omni Data was not listed for any of the Omni Data entities that they did find; and (3) that L&H could not locate a website for Omni Data, despite the fact that Omni Data was purportedly a business doing data sales over the Internet.

27. Howley accepted management's explanations for the inconsistencies. For example, in response to an L&H inquiry about the scarcity of information available on Omni Data, LocatePlus' in-house accountant told Howley in a June 7, 2005 e-mail that "we don't make it common practice to research companies extensively with which we do business." In addition, in a June 9, 2005 e-mail, Fields claimed that "[Omni Data] does not have a corp[sic] web site because they are trying to keep a low profile" and that Omni Data's web site was, in fact, under the name "findyourpeeps.com."

28. As of June 30, 2005, the Omni Data receivable was approximately $1.8 million reflecting revenue of the same amount recognized in 2005. No collections had been received as of June 30, 2005 from Omni Data for revenues earned in 2005.

<u>L&H Received Allegations of Illegal Acts Prior to and During the Course of the 2005 Audit</u>

29. On or about August 26, 2005, Howley received a message that a former LocatePlus Board member ("the informant") wanted to speak with him. During a telephone conversation with Howley shortly thereafter, the informant made a number of allegations of wrongdoing by LocatePlus, Fields and Latorella. Among other things, the informant questioned the validity of the Omni Data transactions and indicated that the alleged President of Omni Data was a former girlfriend of Latorella. Shortly after the telephone conversation, Howley relayed the substance of the informant's allegations to Wood.

30. Between at least December 2005 and March 2006, the informant contacted Howley via telephone and e-mail on numerous occasions regarding his concerns about fraud at LocatePlus. During the course of multiple e-mail exchanges with Howley, the informant provided the following information (hereinafter the "informant's allegations"):

a. that Omni Data revenue was phony and there was no evidence that Omni Data existed;
b. that the Omni Data contract was signed five months before Delaware incorporation records showed that the company was incorporated;
c. that the alleged President of Omni Data was a "stooge set up by Latorella to mask phony sales"; that she was, in fact, a ballet teacher and Latorella's former girlfriend; and, that when confronted by the informant, she admitted knowing nothing about Omni Data;
d. that Latorella told the informant that Omni Data was a start-up that "might not be around";
e. that LocatePlus' Audit Committee Chairman had a conflict of interest because he had pledged assets to secure a loan to Latorella;
f. that Latorella had been buying off LocatePlus' Audit Committee Chairman through extending him high interest loans (at 30% to 40%);
g. that Paradigm, which had a revolving line of credit with LocatePlus, and was not identified as a related party, was owned and controlled by Fields and Latorella;

31. Wood read the informant's e-mails and discussed them with Howley prior to and during the course of the 2005 year-end audit. Wood also discussed the allegations with L&H's President. Howley forwarded the e-mails from the informant to LocatePlus' Audit Committee Chairman. In e-mail correspondence Howley recommended to LocatePlus' Audit Committee Chairman that the Audit Committee Chairman should plan a meeting with the informant, the Audit Committee's legal counsel and Howley to address the informant's allegations. The meeting never occurred.

Failure to Adequately Test the Omni Data Revenue and Receivable

32. According to the AICPA Codification of Statements on Auditing Standards (as adopted and amended by the PCAOB in April 2003), the objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present, in all material respects, financial position, results of operations, and its cash flows in conformity with GAAP. (*See PCAOB Standards and Related Rules,* AU § 110, *Responsibilities and Functions of the Independent Auditor*, at .01.)[6] The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. (*See PCAOB Standards and Related Rules*, AU § 110.02.) "Sufficient competent evidential matter is to be obtained" by the auditor "to afford a reasonable basis for an opinion regarding the financial statements under audit." (*See PCAOB Standards and Related Rules*, AU § 326, *Evidential Matter*, at .01.) PCAOB Auditing Standards state that "representations from management are part of the evidential matter the independent auditor obtains, but they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." (*See PCAOB Standards and Related Rules* AU §333, *Management Representations*, at .02.) When fraud risk factors are present at a client, such as they were at LocatePlus, and heighten the auditor's concern about the risk of material misstatement, the auditor should consider this in determining the nature, timing, or extent of procedures. (*See PCAOB Standards and Related Rules* AU § 312, *Audit Risk and Materiality in Conducting an Audit*, at .16-.17.)

33. GAAP provides generally that revenue may be recognized when: 1) persuasive evidence of an arrangement exists; 2) delivery has occurred; 3) the seller's price is fixed or determinable; and 4) collectability is reasonably assured (see: AICPA Statement of Position 97-2, *Software Revenue Recognition;* SEC Staff Accounting Bulletin ("SAB") No. 101, *Revenue Recognition in Financial Statements* (as superseded in part by SAB No. 104, *Revenue Recognition*).

2005 Audit

34. L&H identified numerous risk factors indicating that LocatePlus had a high risk for fraud during the 2005 year-end audit (which occurred during March through May 2006). In a fraud "brainstorming" memo included in L&H's 2005 audit work papers, L&H specifically identified "overstated and/or fictitious revenues/accounts receivable" relative to Omni Data and

[6] All references herein to PCAOB standards are to the PCAOB standards in effect at the time of the conduct.

Paradigm as a particular risk for fraud. The memo went on to state that "L&H will approach the audit with much skepticism."

35. Despite having identified the Omni Data transactions as a high risk area and being aware of the allegations that Omni Data was fictitious, L&H, under Howley's direction, failed to obtain sufficient competent evidential matter that LocatePlus had delivered its product to Omni Data as required by the PCAOB standards. Although L&H tested delivery of products and services for other LocatePlus' customers, it did not test delivery to Omni Data even though it accounted for approximately one-third of LocatePlus' revenue. For other customers, L&H compared the amounts billed and recognized as revenue to LocatePlus' data usage logs to ensure that the customer had agreed to purchase the product and had actually used it. However, L&H never looked at the usage logs for Omni Data. Had L&H reviewed Omni Data's usage logs, they would have discovered that there was no activity or usage in 2005. Instead, L&H relied upon the executed agreement between LocatePlus and Omni Data and confirmation received from Omni Data regarding the monies earned and owed.

36. L&H's concerns about the validity of the Omni Data receivable caused it to specifically require LocatePlus' management to make representations about it in its 2005 management representation letter (dated March 22, 2006). The letter, signed by Fields and Latorella, stated, among other things, "I have no knowledge of any fraud or suspected fraud affecting the Company," "I have no knowledge of any allegations of fraud or suspected fraud affecting the Company," and "I did not personally benefit from the . . . Omni Data transaction[]."

37. Wood was involved in audit planning discussions for the 2005 year-end audit, including discussions about the design of testing for revenue recognition and, in particular, the testing for the Omni Data receivable.

2006 Audit

38. Questions persisted at L&H throughout the 2006 year-end audit of LocatePlus (which occurred during approximately March through May 2007) about the existence and collectability of the growing Omni Data receivable balance.[7] As of December 31, 2006, the Omni Data receivable balance was $5.1 million representing approximately 88% of LocatePlus' total receivables. In a work paper included in L&H's 2006 year-end audit work papers, L&H noted that "there is questionability regarding the Omni Data receivable and the existence of Omni Data (whether it is a viable entity)." The purported Omni Data agreement had been amended, as of October 1, 2006, to extend Omni Data's payment terms to $45,000 per month for the approximately $4.2 million outstanding balance. Under the original contract terms, payments were due thirty days from the invoice date. As a result of the Amendment, LocatePlus reclassified $3.8 million dollars of the Omni Data receivable from current accounts receivable to long-term accounts receivable. It also recorded a discount and an allowance on the receivable which was approximately $1.9 million as of December 31, 2006.

[7] As noted above, determining that collectability is reasonably assured is the fourth criterion of revenue recognition.

39. Again, during the 2006 year-end audit, L&H required LocatePlus' management to include in its 2006 management representation letter, dated May 1, 2007, the statements, "I have no knowledge of any fraud or suspected fraud affecting the Company," "I have no knowledge of any allegations of fraud or suspected fraud affecting the Company" and "I did not personally benefit from the . . . Omni Data transaction[]."

40. Despite these developments and the open question as to whether Omni Data was a viable entity, L&H failed to obtain sufficient competent evidential matter that the Omni Data transaction was properly stated in the financial statements.

41. An L&H document, drafted by Howley and entitled "LocatePlus Memorandum – Gallagher Allegations," summarizes the allegations made by the informant and purports to recount certain conversations Howley had with representatives at LocatePlus regarding those allegations. Among other things, Howley wrote that he had discussed the allegations with the Audit Committee Chairman and that the Audit Committee Chairman indicated he did not believe there was any basis to the allegations. Howley also wrote that he had discussed the allegations with LocatePlus' outside counsel who indicated that he had investigated the allegations, found no basis for them, and that he believed the informant's allegations were related to a personal debt between Latorella and the Informant. The document, however, is undated and was not contained in either L&H's 2005 or 2006 LocatePlus work papers.

<u>Failure to Adequately Plan the 2005 and 2006 Year-End Audits</u>

42. When planning an audit, "the auditor should consider, among other matters: [c]onditions that may require extension or modification of audit tests, such as the risk of material error or fraud. . ." (*See PCAOB Standards and Related Rules*, AU § 311, *Planning and Supervision,* at.03.)

43. L&H, under Howley's direction, failed to adequately plan the 2005 and 2006 year-end audits of LocatePlus by designing procedures that would account for the heightened risk of fraud and, specifically, for the possibility that the Omni Data revenue was fictitious, as had been alleged. L&H's testing procedures for the Omni Data revenue included relying on the confirmation process and the existence of an executed contract and checking cash receipts. Omni Data, however, was not paying within its contract terms and, as Wood acknowledged during October 6, 2010 testimony before the Commission, if LocatePlus "set up a dummy company," as had been alleged, then the confirmation process "would not be adequate evidence."[8]

44. Howley, as the engagement partner, was responsible for planning the 2005 and 2006 year-end audits. Wood was also involved in planning the 2005 and 2006 year-end audits.

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[8] The original Omni Data contract stated that payment was due 30 days from the invoice date. If any payment was not received within 60 days of the due date (or 90 days from the invoice date) Omni Data was required to pay a late fee. Only $250,000 in payments from Omni Data was collected out of approximately $3.6 in revenue recognized in 2005 despite the fact that Omni Data revenue was recognized ratably over the year 2005, including approximately $1 million recognized in the first quarter ended March 31, 2005.

Failure to Competently Evaluate Evidence Obtained by the Confirmation Process

45. In general, it is presumed that "[a]udit evidence is more reliable when it is obtained from knowledgeable independent sources outside the entity." (*See PCAOB Standards and Related Rules*, AU §326.21)

46. During the 2005 year-end audit, L&H failed to competently evaluate the reliability of the audit evidence obtained by the confirmation process. First, L&H initially sent its confirmation to the President of Omni Data—a person alleged by the informant to be a "stooge" of Latorella—at the address LocatePlus had provided. Moreover, the confirmation was initially returned to L&H by the U.S. Postal Service as "undeliverable." Ultimately, a confirmation was received, signed by a person purporting to be President of Omni Data.

47. During the 2006 year-end audit, the confirmation sent to the Omni Data address that LocatePlus had provided was *again* returned as "undeliverable." When Howley questioned LocatePlus about the confirmation, he was told that Omni Data had a new President, and that it was doing business under a completely different name: Economics Data Solutions. Howley researched the new President but was unable to confirm that he was related to Omni Data. In fact, the only research contained in L&H's 2006 work papers regarding the alleged new President was a December 8, 2005 newspaper article describing an individual by the same name as an attendee at tryouts for the reality television show *Ultimate Fighting*. L&H ultimately received a confirmation signed by a person purporting to be the new President of Omni Data.

48. L&H, Howley and Wood had no reason to believe that the successive Presidents of Omni Data were knowledgeable (*PCAOB Standards and Related Rules*, AU § 330, *The Confirmation Process*, at.26) or, in the case of the Omni Data President alleged to be a "stooge" of Latorella, objective (*PCAOB Standards and Related Rules*, AU § 330.27).

Failure to Assess the Risk of Material Misstatement Due to the Omni Data Transaction

49. AU § 316, *Consideration of Fraud in a Financial Statement Audit*, requires the auditor to assess the risks of material misstatement due to fraud. (*See PCAOB Standards and Related Rules*, AU § 316.)

50. Although L&H became aware of the informant's allegations prior to and during the course of the 2005 year-end audit, it took few steps to investigate the informant's allegations during the 2005 year-end audit. Moreover, to the extent to which L&H developed any evidence regarding the informant's allegations, the evidence corroborated many of the informant's claims. For example, L&H searched Connecticut and Massachusetts corporate records, but found no evidence that Omni Data was incorporated. Howley attempted to contact the alleged President of Omni Data, but was initially unable to reach her as the first confirmation sent to Omni Data was returned as undeliverable. With regard to Paradigm, a company that LocatePlus had represented was independent from LocatePlus, Wood and Howley learned in September 2005 that Latorella was listed as the registrant and administrative contact for Paradigm's web site, suggesting that Paradigm was, in fact, not independent from LocatePlus, just as the informant had alleged.

51. In addition, L&H discovered additional red flags regarding the Omni Data transaction during the 2005 interim reviews and year-end audit. For example, L&H discovered:

a. that the Omni Data receivable comprised approximately 76% of the overall accounts receivable but LocatePlus had collected only $250,000 in payments in 2005 from Omni Data out of approximately $3.6 million in revenue recognized;
b. payments totaling approximately $10,000 from LocatePlus to the alleged President of Omni Data, and;
c. payments totaling approximately $325,000 to Latorella.

52. Although L&H's work papers document the informant's allegations, they do not document the procedures specifically designed to assess these risks. In fact, L&H's "Fraud Risk Assessment Form," for the 2005 year-end audit, which lays out procedures intended to facilitate compliance with AU Section 316, is blank. Moreover, an item on L&H's audit program (completed at the conclusion of the audit) specifically instructs "[i]f you believe that fraud or an illegal act may have occurred, document the circumstances identified" and "apply the procedures for potential fraud or illegal acts in additional procedures section of this audit program." The work paper states "none noted" next to the proposed procedure indicating that L&H never applied the additional procedures in its own audit program. Howley testified that he reviewed this work paper.

53. L&H's 2005 year-end work papers do not document that L&H came to *any* conclusion about the merits of the informant's allegations. Indeed, L&H's 2006 year-end work papers document that the very existence of Omni Data was still an open question through the 2006 year-end audit and that L&H did not come to a final conclusion about the informant's allegations until, at the earliest, April 2007.

54. Despite the numerous red flags and lingering questions about the existence of the Omni Data receivable, L&H's 2006 year-end work papers also do not document an assessment of the risks of material misstatement due to fraud.

55. Despite being aware of the informant's allegations of fraud (and thus the risks of material misstatement), Howley did not undertake adequate audit procedures during the 2005 or 2006 year-end audits to assess these risks.

Failure to Use Due Professional Care and Exercise Skepticism

56. An auditor must exercise due professional care in the planning and performance of the audit and the preparation of the audit report. (*See PCAOB Standards and Related Rules*, AU § 230, *Due Professional Care in the Performance of Work*, at .01.) Further, statements on auditing standards note that "[d]ue professional care requires the auditor to exercise professional skepticism," (*see PCAOB Standards and Related Rules*, AU § 230.07) and "[i]n exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest," (*see PCAOB Standards and Related Rules*, AU §

230.09). Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. (*See PCAOB Standards and Related Rules*, AU § 230.07) The auditor's exercise of professional skepticism is important when considering the risk of material misstatement due to fraud. (*See PCAOB Standards and Related Rules*, AU § 316.13.)

57. L&H's 2005 year-end audit work papers document that L&H accepted management's explanations for the red flags without applying a high degree of skepticism. For example, with regard to the Omni Data receivable, Howley accepted LocatePlus' management's representation that it was collectable despite L&H's difficulties verifying its existence and Omni Data's failure to make payments under the terms of the purported contact. With regard to the Latorella payments, Howley accepted the explanation that the payments were "bonuses" approved by the Board even though the bonuses did not go through LocatePlus' payroll system. In addition, L&H did not obtain LocatePlus' Board minutes to attempt to verify the explanation. Finally, with regard to the payments to the alleged President of Omni Data, Howley accepted LocatePlus' explanation that they were "referral fees" despite allegations that the alleged President was a figurehead installed by Latorella.

58. When additional red flags arose during the 2006 year-end audit, L&H again failed to exercise due care and professional skepticism and relied heavily on management representations regarding the Omni Data receivable. For example, L&H's 2006 year-end audit work papers indicate that L&H performed research on Omni Data to confirm its existence but was unable to confirm that Omni Data was a registered business at the address that had been provided by LocatePlus.

59. In yet another red flag example, L&H's 2006 year-end audit work papers document that LocatePlus was mentioned in a September 2006 complaint by the Massachusetts Securities Division ("MSD") involving securities violations by a former LocatePlus vendor. L&H's work papers also document that Latorella was deposed during the MSD investigation and that the complaint was available on MSD's website. Howley never read the complaint publically available on MSD's web site. The MSD's complaint, dated September 6, 2006, contained allegations that, "[e]ven the most cursory review of LocatePlus' [sic] business would reveal that many aspects of its business were either highly exaggerated or fictitious" and that, "[ASR] has never been incorporated nor organized in any state and is a fictitious entity."

60. Howley, as the engagement partner, knew that the 2005 and 2006 year-end audits required a high level of skepticism, yet he did not undertake additional procedures to address the red flags indicating that the Omni Data transaction was fictitious. Wood was also aware of management's responses to the auditor's inquiries during the 2005 and 2006 year-end audits.

<u>Failure to Issue Accurate Audit Reports</u>

61. PCAOB standards require that the auditor's report contain an opinion on the financial statements taken as a whole and contain a clear indication of the character of the auditor's work (*See PCAOB Standards and Related Rules*, AU § 508, *Reports on Audited Financial Statements*, at.04). The auditor can determine that he is able to issue an audit report

only if he has conducted his audit in accordance with PCAOB standards and the financial statements have been prepared in conformity with GAAP (*See PCAOB Standards and Related Rules*, AU § 508.07.)

62. A concurring partner's responsibilities are outlined in the Interim Quality Control Standards adopted by the PCAOB in April 2003; specifically, AICPA SEC Practice Section ("SECPS") § 1000.08(f) and Appendix E of SECPS § 1000.39. [9] Pursuant to the Interim Quality Control Standards, a concurring partner fulfills his or her responsibilities by (a) discussing significant matters with the engagement partner (b) discussing the audit team's identification and audit of high-risk transactions and account balances, (c) reviewing documentation of the resolution of significant matters, (d) reviewing a summary of unadjusted audit differences, (e) reading the financial statements and auditor's report, and (f) confirming with the audit partner that there are no significant unresolved matters.

63. As the Engagement Partner on L&H's 2005 and 2006 year-end audits of LocatePlus, Howley reviewed L&H's audit work papers. As described above, the work papers contained red flags requiring additional procedures to determine whether the Omni Data revenue was fictitious, yet Howley approved the issuance of the 2005 and 2006 unqualified audit reports (dated March 22, 2006 and May 1, 2007 respectively) that stated that audits had been conducted in accordance with PCAOB standards and that the financial statements had been prepared in conformity with GAAP.

64. As the Concurring Partner on the year-end 2005 and 2006 LocatePlus audits, Wood was aware of the informant's allegations and of certain red flags requiring additional procedures to determine whether the Omni-Data revenue was fictitious. He also was aware of L&H's response to the allegations and that the allegations, including the allegation that Omni Data was fictitious, were unresolved, yet he concurred in the approval of the issuance of audit reports containing unqualified opinions that stated that audits had been conducted in accordance with PCAOB standards and that the financial statements had been prepared in conformity with GAAP.

E. VIOLATIONS

65. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. Section 4C and Rule 102(e)(1)(ii) provide, in part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct. Rule 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants.

66. Under Rule 4C(b)(2) and Rule 102(e)(1)(iv)(B) the term "improper professional conduct" means, in part, "[a] single instance of highly unreasonable conduct that results in a

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[9] This references concurring partner review standards set by the AICPA which were adopted by the PCAOB following the passage of the Sarbanes-Oxley Act of 2002.

violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted."

67. In light of the specific allegations that the Omni Data transaction was fictitious, L&H's and Howley's failure to adequately design testing procedures to address that very risk, and Wood's concurrence in the approval of the issuance of L&H's 2005 and 2006 audit reports when he knew that significant matters were unresolved, constituted highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which each knew, or should have known, that heightened scrutiny was warranted. The failure of L&H and Howley to properly plan the audits, adequately test the Omni Data revenue, obtain sufficient competent evidence to serve as a basis for L&H's audit reports, exercise due professional care, apply skepticism, and properly assess the risks of material misstatement due to fraud, and the failure of Wood to address these deficiencies also constituted highly unreasonable conduct that resulted in a violation of applicable professional standards in circumstances in which each knew, or should have known, that heightened scrutiny was warranted.

68. As a result of the conduct alleged above, L&H, Howley and Wood violated Section 10A(a)(1) of the Exchange Act, which requires each audit to include procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts.

69. As a result of the conduct alleged above, L&H, Howley and Wood violated Section 10A(b)(1) of the Exchange Act, which requires that if, in the course of conducting an audit, the auditor becomes aware of information indicating that an illegal act "has or may have occurred," the auditor is required to "determine whether it is likely that an illegal act has occurred" in that they each failed to determine whether it was likely that the Omni Data transaction was fictitious.

F. FINDINGS

a. Based on the foregoing, the Commission finds that L&H, Howley and Wood engaged in improper professional conduct pursuant to Rules 102(e)(1)(ii) of the Commission's Rules of Practice and Section 4C of the Exchange Act.

b. Based on the foregoing, the Commission finds that L&H, Howley and Wood violated Section 10A(a)(1) and 10A(b)(1) of the Exchange Act.

G. UNDERTAKINGS

L&H undertakes the following:

1. <u>Acceptance of New Public Company Audit Clients</u>. The goal of this undertaking is to provide adequate time for L&H to implement the undertakings concerning auditing and professional development matters described below and implement such other adjustments to its audit practice required by the suspension of Wood and Howley from appearing or practicing before the Commission. L&H undertakes that, following the issuance of this Order, it will not

accept new engagements for public company audits prior to the later of one (1) year from the date of this Order, or the date that L&H certifies in writing compliance with each of the undertakings in the form described in paragraph 5, below (the "Certificate of Compliance"). A public company audit is defined as an engagement to audit the financial statements of an "issuer" as that term is defined in Section 3(a)(8) of the Securities Exchange Act of 1934.

2. Auditing Matters. The goal of this undertaking is to require L&H to engage in an internal review of its existing policies and procedures concerning compliance with the relevant professional, regulatory and firm requirements with respect to public company audit engagements. Within 90 days of this Order, L&H will evaluate its existing system of quality control in conducting an audit practice and revise, as may be necessary, and then engage in steps to implement and enforce, such policies and procedures so as to provide reasonable assurance that L&H will comply with its obligations under professional, regulatory and firm requirements with respect to public company audit engagements. L&H shall review its policies and procedures concerning:

a. Identification and monitoring of high risk engagements, including policies covering mandatory procedures for high risk engagements. Additionally, L&H shall designate a partner, within the firm responsible for risk management, including, but not limited to, client acceptance and continuance procedures.

b. Completion of planning prior to the commencement of audit fieldwork. Such policies and procedures shall provide reasonable assurance that, prior to the commencement of any significant audit procedures:

(i) Work papers identifying significant audit areas, documenting risks of material misstatements, and planned extent of testing are finalized and reviewed and approved by the engagement partner, and, when appropriate, the engagement quality reviewer; and

(ii) Written audit programs are tailored to address identified risks of material misstatements and specify in reasonable detail the procedures expected to be performed to accomplish the objectives of the audit.

c. Detection and Reporting of Illegal Client Activity (Section 10A Compliance). L&H shall make such revisions as may be necessary in order to adopt, implement and enforce written policies and procedures providing reasonable assurance that L&H complies with Section 10A of the Securities Exchange Act of 1934, as amended, including without limitation, for each audit subject to Section 10A, procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts, and to comply with all requirements under the standards of the Commission, the PCAOB, and Section 10A to determine whether or not it is likely that an illegal act has occurred; and if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages, and report suspected illegal acts.

d. Engagement Quality Control. L&H shall undertake a review of its existing procedures to provide reasonable assurance that it complies with the PCAOB's Auditing Standard No. 7, *Engagement Quality Review*.

e. Documentation. L&H shall implement enhanced documentation procedures to provide reasonable assurance that L&H complies with Auditing Standard No. 3, *Audit Documentation*, on each of its public company audit engagements. Such procedures shall emphasize that documentation must be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached and require that any additions made after the documentation date[10] must identify the date the information was added, the name of the person who prepared the additional documentation, and the reason for adding it. Additionally, L&H shall adopt a policy making it mandatory that engagement partners on public company audit engagements review each audit area designated as having a significant risk of material misstatement (whether due to fraud or error) to ensure compliance with both PCAOB standards and related rules and firm policies and procedures.

3. Professional Development. The goal of this undertaking is to require L&H to establish, implement, and enforce written policies and procedures designed to provide reasonable assurance that L&H's professionals serving public company audit clients participate in professional development activities in accordance with firm guidelines, in subjects that are relevant to their responsibilities, and will contribute to their technical training and proficiency as an auditor. Within 90 days of this Order, L&H will evaluate its existing professional development policy and shall make such revisions as may be necessary in order to adopt, implement, and enforce written policies and procedures to provide that professionals serving public company audit clients participate in professional development activities in accordance with firm guidelines, in subjects that are relevant to their responsibilities, including, but not limited to, revenue recognition, and will contribute to their technical training and proficiency as an auditor. Additionally, prior to December 31, 2011, L&H will require each audit professional serving public company audit clients to undergo:

a. A Minimum of 16 Hours of Audit-Related Training. The audit-related training requirement shall cover topics including, but not limited to: (1) assessing risks of

[10] PCAOB Auditing Standard No. 3, paragraph 15, states, "A complete and final set of audit documentation should be assembled for retention as of a date not more than 45 days after the report release date (documentation completion date). If a report is not issued in connection with an engagement, then the documentation completion date should not be more than 45 days from the date that fieldwork was substantially completed. If the auditor was unable to complete the engagement, then the documentation completion date should not be more than 45 days from the date the engagement ceased."

material misstatements and developing responsive audit plans, and (2) obtaining and evaluating sufficient competent evidential matter, including corroboration of management's representations; (3) audit documentation relating to the above. The audit-related training requirement may be fulfilled by participating in or completing course(s) conducted by or offered by the American Institute of Certified Public Accountants (AICPA) or another comparable organization.

b. A Minimum of 8 Hours of Fraud-Detection Training. L&H shall ensure that audit professionals assigned to public company engagements undergo fraud detection training conducted by the Association of Certified Fraud Examiners or another comparable organization. The training will include techniques in detecting and responding to possible fraud by audit clients or by employees, officers or directors of audit clients.

4. Cooperation. L&H agrees that L&H (including its partners, principals, officers, agents and employees) shall cooperate fully with the Commission with respect to any matter relating to the Commission's investigation of LocatePlus or its current or former officers, directors or employees, including but not limited to any litigation or other proceeding related to or resulting from that investigation, including litigation in *SEC v. LocatePlus Holdings Corp et. al.*, Docket No. 1:10-cv-11751 (DPW) (D. Mass.). Such cooperation shall include, but is not limited to, upon reasonable notice, and without subpoena:

a. Producing any document, record, or other tangible evidence reasonably requested by Commission staff in connection with the Commission's investigation, litigation or other proceedings;

b. Providing all information reasonably requested by Commission staff in connection with the Commission's investigation; and

c. Using its best efforts to secure the attendance and truthful statements or testimony of any L&H partner, principal, officer, agent, or employee, excluding any such person who is a party to litigation with the Commission, at any meeting, interview, testimony, deposition, trial, or other legal proceeding reasonably requested by the Commission staff.

5. Certification of Compliance. L&H 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 L&H agrees to provide such evidence. The certification and supporting material shall be submitted to LeeAnn G. Gaunt, Assistant Director, Boston Regional Office or her successor, with copies to the Office of Chief Counsel of the Enforcement Division no later than one (1) year from the date of this Order.

In determining whether to accept the Offer of L&H, the Commission has considered these undertakings.

IV.

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

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

L&H

A. L&H shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(1) and 10A(b)(1) of the Exchange Act.

B. L&H shall pay a civil money penalty in the amount of $130,000 to the United States Treasury. Payment shall be made in the following installments: $65,000 to be paid with the entry of this Order and $65,000 to be paid within one-year from the date of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payments 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, 100 F Street, NE, Mail Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Livingston & Haynes 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 LeeAnn Gaunt, Division of Enforcement, Securities and Exchange Commission, Boston Regional Office, 33 Arch Street, Boston, 23rd Floor, Boston, MA 02110.

C. L&H is censured pursuant to Rule 102(e)(ii) of the Commission's Rules of Practice; and

D. L&H shall comply with the undertakings enumerated in Sections III.G.1-3 and Section III.G.5 above.

Howley

A. Howley shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(1) and 10A(b)(1) of the Exchange Act.

B. Howley is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After three (3) years from the date of this order, Howley 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 Howley'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) Howley, 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) Howley, 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 Howley's or the firm's quality control system that would indicate that Howley will not receive appropriate supervision;

(c) Howley 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) Howley acknowledges his responsibility, as long as Howley appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Howley 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 Howley's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

<u>Wood</u>

A. Wood shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(1) and 10A(b)(1) of the Exchange Act.

B. Wood is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After three (3) years from the date of this order, Wood 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 Wood'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) Wood, 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) Wood, 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 Wood's or the firm's quality control system that would indicate that Wood will not receive appropriate supervision;

(c) Wood 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) Wood acknowledges his responsibility, as long as Wood appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Wood 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 Wood's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 7, 2011

IN THE MATTER OF AMERICAN PACIFIC RIM COMMERCE GROUP ANYWHERE MD, INC. CALYPSO WIRELESS, INC. CASCADIA INVESTMENTS, INC. CYTOGENIX, INC. EMERGING HEALTHCARE SOLUTIONS, INC. EVOLUTION SOLAR CORPORATION GLOBAL RESOURCE CORPORATION GO SOLAR USA, INC. KORE NUTRITION, INC. LAIDLAW ENERGY GROUP, INC. MIND TECHNOLOGIES, INC. MONTVALE TECHNOLOGIES, INC. MSGI TECHNOLOGY SOLUTIONS, INC. (F/K/A MGSI SECURITY SOLUTIONS, INC.) PRIME STAR GROUP, INC. SOLAR PARK INITIATIVES, INC. UNITED STATES OIL & GAS CORPORATION File No. 500-1	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of the issuers listed below. As set forth below for each issuer, questions have arisen regarding the accuracy of publicly disseminated information, concerning, among other things: (1) the company's assets; (2) the company's business

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operations, (3) the company's current financial condition; and/or (4) issuances of shares in company stock.

1. American Pacific Rim Commerce Group is a California corporation based in Florida. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's revenues.

2. Anywhere MD, Inc. is a Nevada corporation with its principal place of business in California. Questions have arisen concerning the adequacy and accuracy of publicly available information about the company.

3. Calypso Wireless, Inc. is a Delaware corporation based in Texas. Questions have arisen concerning the adequacy of publicly available information about the company.

4. Cascadia Investments, Inc. is a Nevada corporation based in Washington State. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and assets.

5. CytoGenix, Inc. is a Nevada corporation based in Texas. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and financing transactions.

6. Emerging Healthcare Solutions, Inc. is a Wyoming corporation based in Texas. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and assets.

7. Evolution Solar Corporation is a Colorado corporation based in Arizona. Questions have arisen concerning the adequacy and accuracy of the company's website and press releases concerning the company's operations and revenues.

8. Global Resource Corporation is a Nevada corporation based in North Carolina. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and the adequacy of publicly available information about the company.

9. Go Solar USA, Inc. is a Nevada corporation based in Louisiana. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's products and operations.

10. Kore Nutrition, Inc. is a Nevada corporation based in Nevada. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations.

11. Laidlaw Energy Group, Inc. is a New York corporation based in New York. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations, the accuracy of its financial statements, and stock promoting activity by the company.

12. Mind Technologies, Inc. is a Nevada corporation based in California. Questions have arisen concerning the accuracy of its financial statements.

13. Montvale Technologies, Inc. is a New Jersey corporation based in New Jersey. Questions have arisen concerning the adequacy and accuracy of publicly available information about the company.

14. MSGI Technology Solutions, Inc. (f/k/a MSGI Security Solutions, Inc.) is a Nevada corporation based in New York. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and financing transactions.

15. Prime Star Group, Inc. is a Nevada corporation based in Nevada. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations.

16. Solar Park Initiatives, Inc. is a Nevada corporation based in Florida. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and revenues.

17. United States Oil & Gas Corporation is a Delaware corporation based in Texas. Questions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations and stock promoting activity by the company.

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT, on June 7, 2011 through 11:59 p.m. EDT, on June 20, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64613 / June 7, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3289 / June 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14413

In the Matter of Mark C. Schwartzhoff, 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 Mark C. Schwartzhoff ("Respondent" or "Schwartzhoff") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Schwartzhoff, age 43, resides in Odessa, Missouri. From July 1992 to July 1995, he worked as an internal auditor for Thor Industries, Inc.'s corporate headquarters in Jackson Center, Ohio. From July 1995 to January 2007, he was employed by Dutchmen Manufacturing, Inc. ("Dutchmen"), a Thor operating subsidiary located in Goshen, Indiana. He served as Dutchmen's Controller from July 1995 to approximately May 1997. He served as Dutchmen's Vice President of Finance, Dutchmen's senior financial officer position, from approximately May 1997 through January 2007. In February 2007, Respondent's employment with Dutchmen was terminated effective January 19, 2007.

2. Thor Industries, Inc. ("Thor") is a Delaware corporation based in Jackson Center, Ohio. Thor produces and sells a wide range of recreation vehicles and small and mid-size buses in the U.S. and Canada. At all relevant times, Thor's common stock has been registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange under the symbol THO. Dutchmen Manufacturing, Inc. is one of Thor's principal operating subsidiaries.

3. On May 23, 2011, a final judgment was entered against Respondent, permanently enjoining him from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5, 13b2-1, and 13b2-2 thereunder, and aiding and abetting violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Exchange Act Rules 12b-20, 13a-1, and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Thor Industries Inc., et al., Civil Action Number 1:11-cv-00889 (RMC), in the United States District Court for the District of Columbia. The final judgment also prohibits Respondent from serving as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act. In addition, the final judgment orders Respondent to pay disgorgement of $299,805, together with prejudgment interest thereon in the amount of $95,025, for a total $394,830, but provides that such

amount shall be deemed satisfied upon the entry of an order in a parallel criminal proceeding requiring Respondent to pay restitution in an amount equal to or greater than $394,830.

4. The Commission's complaint alleged, among other things, that during the second quarter of fiscal 2003 through the second quarter of fiscal 2007, Respondent created and recorded fraudulent accounting entries and related documentation to hide inventory losses occurring at Dutchmen. Instead of properly recording increased cost of goods sold, Respondent hid inventory losses in various balance sheet accounts, including accounts receivable, accounts payable, and cash. These entries resulted in overstating Dutchmen's pretax income by approximately $26 million during fiscal 2004 to 2006 and into the second quarter of fiscal 2007. As a result, as alleged in the complaint, Thor's annual and quarterly financial statements filed with the Commission during this period were false and misleading. In June 2007, Thor filed restated financial statements with the Commission for fiscal years 2004 to 2006 and the first quarter of fiscal 2007.

IV.

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

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

Schwartzhoff 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

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64618 / June 7, 2011

ADMINISTRATIVE PROCEEDINGS
File No. 3-14414

In the Matter of LOUIS W. ZEHIL, 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 Louis W. Zehil ("Respondent" or "Zehil") 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 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 Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

III.

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

1. Zehil, age 44, is and has been an attorney licensed to practice in the State of New York.

2. On May 10, 2011, a final judgment was entered against Zehil, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and rule 10b-5 thereunder, in a civil action entitled Securities and Exchange Commission v. Louis W. Zehil, et al., Civil Action Number 07 Civ. 1439 (LAP), in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged, among other things, that Zehil, a corporate attorney, and two entities he controlled, Strong Branch Ventures IV LP ("Strong") and Chestnut Capital Partners II, LLC ("Chestnut") from approximately January 2006 to February 2007, engaged in a fraudulent scheme to obtain and sell to the investing public millions of shares of securities in violation of the antifraud and registration provisions of the federal securities laws. Between January 2006 and February 2007, Zehil represented seven public companies in issuing their stock in PIPE transactions (private investments in public equity). The seven public companies were Gran Tierra Energy, Inc., Foothills Resources, Inc., MMC Energy, Inc., Alternative Energy Sources, Inc., Ethanex Energy, Inc., GoFish Corp., and Kreido BioFuels, Inc. At all relevant times, their common stock was registered with the Commission and quoted on the OTC-BB. In these PIPE transactions (as in PIPEs generally), the investors purchased restricted stock at a discount to market price. Zehil personally invested in the issuers' PIPE transactions through Strong and Chestnut. In the subscription agreements for each PIPE transaction, Zehil, and Strong and Chestnut, through Zehil, agreed (as all the PIPE subscribers did) that the shares they received would be issued with restrictive legends until such time as the issuers filed registration statements with the Commission and the Commission declared them effective. As counsel for the issuers, Zehil then sent letters to the issuers' transfer agents directing the issuance of shares to the PIPE subscribers. Zehil's letters instructed that all the shares should bear restrictive legends except the shares issued to his entities, Strong and Chestnut. Zehil's letters stated, falsely, that the shares issued to Strong and Chestnut satisfied legal criteria to be issued without restrictive legend. As a result of this fraudulent conduct, Zehil, individually and through Strong and Chestnut, was able to receive shares without restrictive legends, which they quickly sold into the public market, and generated illicit profits of at least $17 million.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that Zehil is suspended from appearing or practicing before the Commission as an attorney.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9216 / June 8, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14415

In the Matter of **Michael Migliozzi II and** **Brian William Flatow** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against Michael Migliozzi II and Brian William Flatow ("Migliozzi" and "Flatow," respectively, "Respondent," individually, or, "Respondents, " collectively).

II.

In anticipation of the institution of these proceedings, each 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, each Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings stem from the Respondents' making an unregistered offering of securities in violation of Section 5 of the Securities Act during the period November 2009 through April 2010.

Respondents

1. Michael Migliozzi II, age 45, resides in California and, during the relevant period, was the Managing Partner and sole owner of Forza Migliozzi, an advertising agency.

2. Brian William Flatow, age 41, resides in Connecticut and, during the relevant period, was the President of The Ad Store, an advertising agency.

Facts

3. In November 2009, Migliozzi, in his capacity as Managing Partner and sole owner of Forza Migliozzi, and Flatow, in his capacity as President of The Ad Store, jointly created the BuyaBeerCompany.com website. The stated purpose of the website was to solicit investors via crowdsourcing to invest $300 million to purchase Pabst Brewing Company ("Pabst") from its owner, a private charitable trust which was then looking for a buyer. Crowdsourcing is the use of social media and the Internet to organize a large group of individuals to achieve a common goal, in this instance, to raise capital.

4. The BuyaBeerCompany.com website explained that the solicitation was to be effected in two stages. The first stage sought pledges. The only information required to be supplied by each pledgor was an e-mail address, first name, last name, and pledge amount. Each pledgor received a confirmation e-mail and his or her information was stored on a server. The website featured a countdown timer which identified how much money remained to be pledged to meet the $300 million goal, and explicitly stated, "SEND NO MONEY!" If $300 million in pledges were received, the second stage would consist of collecting the pledges and undertaking to purchase Pabst.

5. In the event the $300 million threshold was met and the monies collected, the BuyaBeerCompany.com website further explained that each investor would receive a "crowdsourced certificate of ownership," as well as beer of a value equal to the amount invested.

6. In addition to publicizing the offering through the BuyaBeerCompany.com website, Migliozzi and Flatow created a Facebook page and a Twitter account to advertise the website.

[1] The findings herein are made pursuant to the Respondents' Offers of Settlement, and are not binding on any other person or entity in this or any other proceeding.

They also issued press releases relating to the BuyaBeerCompany.com website, which referred to pledging parties as "investors" who would receive "crowdsourced ownership in Pabst . . . ."

7. The BuyaBeerCompany.com website elicited $14.75 million in pledges during its first three weeks of operation.

8. The Respondents announced in a subsequent February 22, 2010 press release that the BuyaBeerCompany.com website had received over $200 million in pledges from more than five million pledgors. In the same release, they also announced that their search for a firm to assist in the acquisition was underway. Flatow subsequently met with an attorney in New York on or about February 26, 2010, to discuss how to go about collecting the pledges by incorporating an acquisition vehicle. The possibility of an initial public offering was discussed.

9. A March 15, 2010 article in The Daily Deal reported that Migliozzi and Flatow had retained counsel and planned to incorporate Buy a Beer Company LLC. Thus, in lieu of a certificate of ownership, pledgors would receive stock in the acquisition corporation. The entity was never incorporated.

10. The BuyaBeerCompany.com website continued to solicit pledges until the Respondents took the website down in April 2010. No monies were ever collected.

Legal Discussion

11. Securities Act Section 5(c) makes it unlawful for any person, directly or indirectly, to make use of any means or instrument of transportation or communication in interstate commerce to offer to sell any security unless a registration statement has been filed with the Commission. Scienter is not an element of a Section 5 violation. *SEC v. Softpoint, Inc.*, 958 F. Supp. 846, 859-60 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

12. Section 2(a)(3) of the Securities Act defines "offer to sell," "offer for sale," and "offer" to include, "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value."

13. The Respondents made use of the jurisdictional means to effect an offering of securities. *American Library Ass'n. v. Pataki*, 969 F. Supp. 160, 173 (S.D.N.Y. 1997) ("[T]he Internet represents an instrument of interstate commerce").

14. The Respondents failed to register the offering with the Commission and there was no applicable exemption from registration.

15. Since the offer of the securities was not registered with the Commission, nor exempt from registration, Migliozzi and Flatow violated Section 5(c) of the Securities Act.

IV.

In view of the foregoing, the Commission deems it appropriate to accept Migliozzi's and Flatow's Offers of Settlement.

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby ORDERED that:

Respondents Michael Migliozzi II and Brian William Flatow cease and desist from committing or causing any violations and from committing or causing any future violations of Section 5(c) of the Securities Act.

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. 9217 / June 8, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64622 / June 8, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14163

In the Matter of	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO RESPONDENT MMR INVESTMENT BANKERS, LLC (d/b/a MMR, INC.)
MMR INVESTMENT BANKERS, LLC (d/b/a MMR, INC.),	
WILLIAM G. MARTIN, JR.,	
EUGENE R. RANKIN,	
JOHN A. HUBERT, and	
AARON D. FIMREITE,	
Respondents.	

I.

On December 14, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 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").

II.

In connection with these proceedings, Respondent MMR Investment Bankers, LLC (d/b/a MMR, Inc.) ("MMR" or "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 and the facts stated in paragraphs III.1 through 5, which are admitted, Respondent MMR consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Respondent MMR Investment Bankers, LLC (d/b/a MMR, Inc.) ("Order"), as set forth below.

III.

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

1. At all relevant times, Respondent MMR, located in Wichita, Kansas, was registered with the Commission as a broker-dealer.

2. At all relevant times, Respondent Martin was the president and majority owner of MMR. He holds Series 7, 24, 27, 53, 63, and 79 licenses.

3. At all relevant times, Respondent Rankin was the vice-president and assistant compliance officer of MMR. He holds Series 7, 63 and 79 licenses.

4. At all relevant times, Respondent Hubert was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

5. At all relevant times, Respondent Fimreite was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

6. From 2005 through 2008, Respondents recommended, offered, and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies.

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

7. The debenture companies were Dynamic Distribution, Inc.; El Pegasu Developmental, Inc.; Equity Capital Source, Inc.; Havoc Distribution, Inc.; MLP Associates, LLC ("MLP"); Partners in Care; Southfield Energy Corp.; and Vending Ventures, Inc.

8. All but one of the eight debenture companies are now in default on payments of interest and/or principal.

9. Disclosure documents prepared by Respondents Martin and Rankin failed to disclose that Martin and Rankin created a new company, Sunflower Management Group, LLC ("Sunflower"), to manage the proceeds of the debenture sales; that Martin, Rankin, Fimreite, and Hubert's wife all owned shares in Sunflower; that Sunflower received management fees in the amount of 1/12 of 1% of the total outstanding debentures, charged to the offering companies[2]; that in 2008, one of the offering companies, MLP, defaulted on maturing debentures from its 2005 offering; or that Martin, Rankin, Hubert, and Fimreite had received shares in some of the offering companies pursuant to Sunflower's management agreements with the companies.

10. Respondent MMR, through Martin, Rankin, Hubert, and Fimreite, was reckless in not knowing of these material omissions.

11. The debentures were unsuitable investments for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. Nevertheless, MMR through its registered representatives recommended and sold the debentures to numerous such customers.

12. Respondent MMR, through Martin, Rankin, Hubert, and Fimreite, was reckless in not knowing that MMR was selling debentures to customers for whom the debentures were unsuitable investments.

13. As a result of the conduct described above, Respondent MMR 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.

14. As a result of the conduct described above, Respondent 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.

15. As a result of the conduct described above, Respondent 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.

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[2] In their disclosure documents for all but one of the offerings, Respondents did disclose the fact that a company affiliated with MMR received a management fee for managing the proceeds of the debenture sales, but did not disclose the amount of the fee.

16. Respondent MMR has submitted a sworn Statement of Financial Condition dated January 28, 2011 and other evidence and has asserted its inability to pay a civil penalty.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent MMR shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Sections 10(b) and 15(c) of the Exchange Act, and Rules 10b-5 and 17a-3(a)(17)(i)(B)(1) thereunder,

B. Respondent MMR shall be censured.

C. MMR's broker-dealer registration with the Commission shall be, and is, revoked.

D. Any reapplication for registration by Respondent MMR 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,

E. Based upon Respondent's sworn representations in its Statement of Financial Condition dated January 28, 2011 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9218 / June 8, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64623 / June 8, 2011

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 MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO RESPONDENT WILLIAM G. MARTIN, JR.

I.

On December 14, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 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").

II.

In connection with these proceedings, Respondent William G. Martin, Jr. ("Martin" or "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 facts stated in paragraphs III.1 and 2, which are admitted, Respondent Martin consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Respondent William G. Martin ("Order"), as set forth below.

III.

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

1. At all relevant times, Respondent MMR, located in Wichita, Kansas, was registered with the Commission as a broker-dealer.

2. At all relevant times, Respondent Martin was the president and majority owner of MMR. He holds Series 7, 24, 27, 53, 63, and 79 licenses.

3. At all relevant times, Respondent Rankin was the vice-president and assistant compliance officer of MMR. He holds Series 7, 63 and 79 licenses.

4. At all relevant times, Respondent Hubert was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

5. At all relevant times, Respondent Fimreite was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

6. From 2005 through 2008, Respondents recommended, offered, and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies.

7. The debenture companies were Dynamic Distribution, Inc.; El Pegasu Developmental, Inc.; Equity Capital Source, Inc.; Havoc Distribution, Inc.; MLP Associates, LLC ("MLP"); Partners in Care; Southfield Energy Corp.; and Vending Ventures, Inc.

8. All but one of the eight debenture companies are now in default on payments of interest and/or principal.

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

9. Disclosure documents prepared in part by Respondent Martin failed to disclose that Martin and Rankin created a new company, Sunflower Management Group, LLC ("Sunflower"), to manage the proceeds of the debenture sales; that Martin, Rankin, Fimreite, and Hubert's wife all owned shares in Sunflower; that Sunflower received management fees in the amount of 1/12 of 1% of the total outstanding debentures, charged to the offering companies[2]; that in 2008, one of the offering companies, MLP, defaulted on maturing debentures from its 2005 offering; or that Martin, Rankin, Hubert, and Fimreite had received shares in some of the offering companies pursuant to Sunflower's management agreements with the companies.

10. Respondent Martin was reckless in not knowing of these material omissions.

11. The debentures were unsuitable investments for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. Nevertheless, MMR through its registered representatives recommended and sold the debentures to numerous such customers.

12. Respondent Martin was reckless in not knowing that MMR was selling debentures to customers for whom the debentures were unsuitable investments.

13. As a result of the conduct described above, Respondent Martin 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.

14. As a result of the conduct described above, Respondent Martin willfully aided and abetted and caused MMR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

15. As a result of the conduct described above, Respondent Martin willfully aided and abetted and caused MMR's violation of 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.

16. As a result of the conduct described above, Respondent Martin willfully aided and abetted and caused MMR's violation of 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.

17. As a result of the wrongful conduct described above, Respondent Martin received ill-gotten gains of $25,200.

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[2] In their disclosure documents for all but one of the offerings, Respondents did disclose the fact that a company affiliated with MMR received a management fee for managing the proceeds of the debenture sales, but did not disclose the amount of the fee.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Martin shall 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 and from aiding and abetting or causing violations of Sections 10(b), 15(c), and 17(a) and Rules 10b-5 and 17a-3(a)(17)(i)(B)(1) thereunder;

B. Respondent Martin be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

C. Respondent Martin 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.

D. Any reapplication for association by Respondent Martin 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.

E. Respondent Martin shall, within 15 days of the entry of this Order, pay disgorgement of $25,200.00 and prejudgment interest of $2,292.32 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies William G. Martin, Jr. as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

F. Respondent Martin shall, within 15 days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies William G. Martin, Jr. as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

G. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraphs E and F above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that he shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that he is entitled to, nor shall he further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9219 / June 8, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64624 / June 8, 2011

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 MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO RESPONDENT EUGENE R. RANKIN

I.

On December 14, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 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").

II.

In connection with these proceedings, Respondent Eugene R. Rankin ("Rankin" or "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 facts stated in paragraphs III. 1 and 3, which are admitted, Respondent Rankin consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Respondent Eugene R. Rankin ("Order"), as set forth below.

III.

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

1. At all relevant times, Respondent MMR, located in Wichita, Kansas, was registered with the Commission as a broker-dealer.

2. At all relevant times, Respondent Martin was the president and majority owner of MMR. He holds Series 7, 24, 27, 53, 63, and 79 licenses.

3. At all relevant times, Respondent Rankin was the vice-president and assistant compliance officer of MMR. He holds Series 7, 63 and 79 licenses.

4. At all relevant times, Respondent Hubert was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

5. At all relevant times, Respondent Fimreite was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

6. From 2005 through 2008, Respondents recommended, offered, and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies.

7. The debenture companies were Dynamic Distribution, Inc.; El Pegasu Developmental, Inc.; Equity Capital Source, Inc.; Havoc Distribution, Inc.; MLP Associates, LLC ("MLP"); Partners in Care; Southfield Energy Corp.; and Vending Ventures, Inc.

8. All but one of the eight debenture companies are now in default on payments of interest and/or principal.

[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.

9. Disclosure documents prepared in part by Respondent Rankin failed to disclose that Martin and Rankin created a new company, Sunflower Management Group, LLC ("Sunflower"), to manage the proceeds of the debenture sales; that Martin, Rankin, Fimreite, and Hubert's wife all owned shares in Sunflower; that Sunflower received management fees in the amount of 1/12 of 1% of the total outstanding debentures, charged to the offering companies[2]; that in 2008, one of the offering companies, MLP, defaulted on maturing debentures from its 2005 offering; or that Martin, Rankin, Hubert, and Fimreite had received shares in some of the offering companies pursuant to Sunflower's management agreements with the companies.

10. Respondent Rankin was reckless in not knowing of these material omissions.

11. The debentures were unsuitable investments for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. Nevertheless, MMR through its registered representatives recommended and sold the debentures to numerous such customers.

12. Respondent Rankin was reckless in not knowing that MMR was selling debentures to customers for whom the debentures were unsuitable investments.

13. As a result of the conduct described above, Respondent Rankin 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.

14. As a result of the conduct described above, Respondent Rankin willfully aided and abetted and caused MMR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

15. As a result of the conduct described above, Respondent Rankin willfully aided and abetted and caused MMR's violation of 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.

16. As a result of the conduct described above, Respondent Rankin willfully aided and abetted and caused MMR's violation of 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.

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2 In their disclosure documents for all but one of the offerings, Respondents did disclose the fact that a company affiliated with MMR received a management fee for managing the proceeds of the debenture sales, but did not disclose the amount of the fee.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Rankin shall 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 and from aiding and abetting or causing violations of Sections 10(b), 15(c), and 17(a) and Rules 10b-5 and 17a-3(a)(17)(i)(B)(1) thereunder;

B. Respondent Rankin shall be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

C. Respondent Rankin shall 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.

D. Any reapplication for association by Respondent Rankin 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,

E. Respondent Rankin shall, within 15 days of the entry of this Order, pay a civil money penalty in the amount of $15,000 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Eugene R. Rankin as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

E. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the penalties referenced in paragraph E above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that he shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that he is entitled to, nor shall he further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9220 / June 8, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64625 / June 8, 2011

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 MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO RESPONDENT JOHN A. HUBERT

I.

On December 14, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 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").

II.

In connection with these proceedings, Respondent John A. Hubert ("Hubert" or "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 facts stated in paragraphs III.1 and 4, which are admitted, Respondent Hubert consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Respondent John A. Hubert ("Order"), as set forth below.

III.

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

1. At all relevant times, Respondent MMR, located in Wichita, Kansas, was registered with the Commission as a broker-dealer.

2. At all relevant times, Respondent Martin was the president and majority owner of MMR. He holds Series 7, 24, 27, 53, 63, and 79 licenses.

3. At all relevant times, Respondent Rankin was the vice-president and assistant compliance officer of MMR. He holds Series 7, 63 and 79 licenses.

4. At all relevant times, Respondent Hubert was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

5. At all relevant times, Respondent Fimreite was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

6. From 2005 through 2008, Respondents recommended, offered, and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies.

7. The debenture companies were Dynamic Distribution, Inc.; El Pegasu Developmental, Inc.; Equity Capital Source, Inc.; Havoc Distribution, Inc.; MLP Associates, LLC ("MLP"); Partners in Care; Southfield Energy Corp.; and Vending Ventures, Inc.

8. All but one of the eight debenture companies are now in default on payments of interest and/or principal.

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

9. Respondent Hubert recommended and sold the debentures without disclosing that Martin and Rankin had created a new company, Sunflower Management Group, LLC ("Sunflower"), to manage the proceeds of the debenture sales; that Martin, Rankin, Fimreite, and Hubert's wife all owned shares in Sunflower; that Sunflower received management fees in the amount of 1/12 of 1% of the total outstanding debentures, charged to the offering companies[2]; that in 2008, one of the offering companies, MLP, defaulted on maturing debentures from its 2005 offering; or that Martin, Rankin, Hubert, and Fimreite had received shares in some of the offering companies pursuant to Sunflower's management agreements with the companies.

10. Respondent Hubert was reckless in not knowing of these material omissions.

11. The debentures were unsuitable investments for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. Nevertheless, Respondent Hubert recommended and sold the debentures to numerous such customers.

12. Respondent Hubert was reckless in not knowing that he was selling debentures to customers for whom the debentures were unsuitable investments.

13. As a result of the conduct described above, Respondent Hubert 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.

14. As a result of the conduct described above, Respondent Hubert willfully aided and abetted and caused MMR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

15. As a result of the conduct described above, Respondent Hubert willfully aided and abetted and caused MMR's violation of 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.

16. As a result of the conduct described above, Respondent Hubert willfully aided and abetted and caused MMR's violation of 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.

17. As a result of the wrongful conduct described above, Respondent Hubert received ill-gotten gains of $39,615.18.

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[2] In their disclosure documents for all but one of the offerings, Respondents did disclose the fact that a company affiliated with MMR received a management fee for managing the proceeds of the debenture sales, but did not disclose the amount of the fee.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Hubert shall 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 and from aiding and abetting or causing violations of Sections 10(b), 15(c), and 17(a) and Rules 10b-5 and 17a-3(a)(17)(i)(B)(1) thereunder;

B. Respondent Hubert shall be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

C. Respondent Hubert shall 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.

D. Any reapplication for association by Respondent Hubert 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.

E. Respondent Hubert shall, within 15 days of the entry of this Order, pay disgorgement of $39,615.18 and prejudgment interest of $3,603.58 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies John A. Hubert, Jr. as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

F. Respondent Hubert shall, within 15 days of the entry of this Order, pay a civil money penalty in the amount of $20,000 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies John A. Hubert as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

G. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraphs E and F above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that he shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that he is entitled to, nor shall he further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9221 / June 8, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64626 / June 8, 2011

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 MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO RESPONDENT AARON D. FIMREITE**

I.

On December 14, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 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").

II.

In connection with these proceedings, Respondent Aaron D. Fimreite ("Fimreite" or "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 facts stated in paragraphs III. 1 and 5, which are admitted, Respondent Fimreite consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Respondent Aaron D. Fimreite ("Order"), as set forth below.

III.

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

1. At all relevant times, Respondent MMR, located in Wichita, Kansas, was registered with the Commission as a broker-dealer.

2. At all relevant times, Respondent Martin was the president and majority owner of MMR. He holds Series 7, 24, 27, 53, 63, and 79 licenses.

3. At all relevant times, Respondent Rankin was the vice-president and assistant compliance officer of MMR. He holds Series 7, 63 and 79 licenses.

4. At all relevant times, Respondent Hubert was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

5. At all relevant times, Respondent Fimreite was a registered representative associated with MMR. He holds Series 7, 63, and 79 licenses.

6. From 2005 through 2008, Respondents recommended, offered, and sold eleven best-efforts, no minimum private placement debenture offerings for eight small start-up companies.

7. The debenture companies were Dynamic Distribution, Inc.; El Pegasu Developmental, Inc.; Equity Capital Source, Inc.; Havoc Distribution, Inc.; MLP Associates, LLC ("MLP"); Partners in Care; Southfield Energy Corp.; and Vending Ventures, Inc.

8. All but one of the eight debenture companies are now in default on payments of interest and/or principal.

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

9. Respondent Fimreite recommended and sold the debentures without disclosing that Martin and Rankin had created a new company, Sunflower Management Group, LLC ("Sunflower"), to manage the proceeds of the debenture sales; that Martin, Rankin, Fimreite, and Hubert's wife all owned shares in Sunflower; that Sunflower received management fees in the amount of 1/12 of 1% of the total outstanding debentures, charged to the offering companies[2]; that in 2008, one of the offering companies, MLP, defaulted on maturing debentures from its 2005 offering; or that Martin, Rankin, Hubert, and Fimreite had received shares in some of the offering companies pursuant to Sunflower's management agreements with the companies.

10. Respondent Fimreite was reckless in not knowing of these material omissions.

11. The debentures were unsuitable investments for numerous MMR customers given the level of risk in light of the customers' investment objectives, advanced age, annual income, and net worth. Nevertheless, Respondent Fimreite recommended and sold the debentures to numerous such customers.

12. Respondent Fimreite was reckless in not knowing that he was selling debentures to customers for whom the debentures were unsuitable investments.

13. As a result of the conduct described above, Respondent 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.

14. As a result of the conduct described above, Respondent Fimreite willfully aided and abetted and caused MMR's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

15. As a result of the conduct described above, Respondent Fimreite willfully aided and abetted and caused MMR's violation of 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.

16. As a result of the conduct described above, Respondent Fimreite willfully aided and abetted and caused MMR's violation of 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.

17. As a result of the wrongful conduct described above, Respondent Fimreite received ill-gotten gains of $2,644.78.

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[2] In their disclosure documents for all but one of the offerings, Respondents did disclose the fact that a company affiliated with MMR received a management fee for managing the proceeds of the debenture sales, but did not disclose the amount of the fee.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Fimreite shall 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 and from aiding and abetting or causing violations of Sections 10(b), 15(c), and 17(a) and Rules 10b-5 and 17a-3(a)(17)(i)(B)(1) thereunder;

B. Respondent Fimreite shall be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

C. Respondent Fimreite 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.

D. Any reapplication for association by Respondent Fimreite 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.

E. Respondent Fimreite shall, within 15 days of the entry of this Order, pay disgorgement of $ 2,644.78 and prejudgment interest of $240.60 to the Securities and Exchange Commission. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Aaron D. Fimreite as a Respondent in these proceedings and states the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Polly Atkinson, 1801 California Street, Suite 1500, Denver, Colorado, 80202.

F. Based upon Respondent Fimreite's sworn representations in his Statement of Financial Condition dated January 28, 2011 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent Fimreite.

G. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraph E above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that he shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that he is entitled to, nor shall he further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64621 / June 8, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3290 / June 8, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14416

In the Matter of **Edwin Reese Davis, Jr. CPA** **Respondent.**	**ORDER OF FORTHWITH SUSPENSION PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to issue an order of forthwith suspension of Edwin Reese Davis, Jr. ("Respondent" or "Davis") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice. [1]

II.

The Commission finds that:

A. Respondent

1. Edwin Reese Davis, Jr., age 62, of Cedar City, Utah, was a certified public accountant ("CPA") in Utah from October 29, 1977 until his license expired on September 30, 2008. Davis has never been licensed in any other state. Davis is the sole principal of Davis Accounting Group P.C. ("Davis Accounting") and Etania Audit Group P.C. ("Etania,") both Utah companies.

[1] Rule 102(e)(2) provides, in relevant part, that "any person whose license to practice as an accountant . . . has been revoked or suspended in any State; or any person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

B. Davis's License was Revoked on November 4, 2010.

On November 4, 2010, Utah's Division of Occupational & Professional Licensing revoked Davis' CPA license, for failure to pay required fees and for continuing to practice as a CPA after his license had expired on September 30, 2008.

C. Davis Continued to hold Himself out as a CPA after his Licensed was Revoked.

Despite having his license revoked, Davis continued to hold himself out to clients as a CPA and to prepare audit reports that were filed with the Commission. Davis prepared at least twenty-three audit reports that were filed with the Commission after his license had expired on September 30, 2008.

III.

In view of the foregoing, the Commission finds that Davis's license to practice as an accountant has been revoked within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, IT IS ORDERED that Edwin Reese Davis, Jr. is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-64628; File No. S7-10-11]

RIN 3235-AK98

BENEFICIAL OWNERSHIP REPORTING REQUIREMENTS AND SECURITY-BASED SWAPS

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; confirmation.

SUMMARY: We are readopting without change the relevant portions of Rules 13d-3 and 16a-1. Readoption of these provisions will preserve the application of our existing beneficial ownership rules to persons who purchase or sell security-based swaps after the effective date of new Section 13(o) of the Securities Exchange Act of 1934. Section 13(o) provides that a person shall be deemed a beneficial owner of an equity security based on the purchase or sale of a security-based swap only to the extent we adopt rules after making certain determinations with respect to the purchase or sale of security-based swaps. After making the necessary determinations, we are readopting the relevant portions of Rules 13d-3 and 16a-1 to confirm that, following the July 16, 2011 statutory effective date of Section 13(o), persons who purchase or sell security-based swaps will remain within the scope of these rules to the same extent as they are now.

EFFECTIVE DATE: The effective date of this confirmation is July 16, 2011.

FOR FURTHER INFORMATION CONTACT: Nicholas Panos, Senior Special Counsel, at (202) 551-3440, or Anne Krauskopf, Senior Special Counsel, at (202) 551-3500, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are readopting without change portions of Rules 13d-3[1] and 16a-1[2] under the Securities Exchange Act of 1934 ("Exchange Act").[3]

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1 17 CFR 240.13d-3.

2 17 CFR 240.16a-1.

3 15 U.S.C. 78a et seq.

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I. OVERVIEW AND BACKGROUND

A. Overview

Section 766 of the Dodd-Frank Act amends the Exchange Act by adding Section 13(o), which provides that "[f]or purposes of this section and section 16, a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap, only to the extent that the Commission, by rule, determines after consultation with the prudential regulators and the Secretary of the Treasury, that the purchase or sale of the security-based swap, or class of security-based swap, provides incidents of ownership comparable to direct ownership of the equity security, and that it is necessary to achieve the purposes of this section that the purchase or sale of the security-based swaps, or class of security-based swap, be deemed the acquisition of beneficial ownership of the equity security." Section 766 and Section 13(o)[4] become effective on July 16, 2011.[5]

The reason for this rulemaking, as discussed in more detail below, is to preserve the existing scope of our rules relating to beneficial ownership after Section 766 of the Dodd-Frank Act becomes effective. Absent rulemaking under Section 13(o), Section 766 may be interpreted to render the beneficial ownership determinations made under Rule 13d-3 inapplicable to a person who purchases or sells a security-based swap.[6] In that circumstance,

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4 Pub. L. No. 111–203, 124 Stat. 1797.

5 See Section 774 of the Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat 1376 (2010), which states that Section 766 becomes effective "360 Days after the date of enactment."

6 A "security-based swap" is defined in Section 3(a)(68) [15 U.S.C. 78c(a)(68), added by Section 761(a) of the Dodd-Frank Act]. Section 712(d) of the Dodd-Frank Act provides that the Commission and the Commodity Futures Trading Commission ("CFTC"), in consultation with the Board of Governors of

it could become possible for an investor to use a security-based swap to accumulate an influential or control position in a public company without public disclosure. Similarly, a person who holds a security-based swap that confers beneficial ownership of the referenced equity securities under Section 13 and Rule 13d-3, or otherwise conveys such beneficial ownership through an understanding or relationship based upon the purchase or sale of the security-based swap, may no longer be considered a ten percent holder subject to Section 16 of the Exchange Act.[7] Further, an insider may no longer be subject to Section 16 reporting and short-swing profit recovery through transactions in security-based swaps that confer a right to receive either the underlying equity securities or cash. In addition, private parties may have difficulty making, or exercising private rights of action to seek to have made, determinations of beneficial ownership arising from the purchase or sale of a security-based swap.

On March 17, 2011, we proposed to readopt the portions of Rules 13d-3 and 16a-1(a) that relate to determinations of beneficial ownership as they pertain to persons who use

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the Federal Reserve System ("Federal Reserve"), shall jointly further define, among others, the terms "swap," "security-based swap," and "security-based swap agreement." These terms are defined in Sections 721 and 761 of the Dodd-Frank Act. The definitions of the terms "swap," "security-based swap," and "security-based swap agreement," and regulations regarding mixed swaps also are expected to be the subject of a separate rulemaking by the Commission and the CFTC. In addition, Section 721(c) and 761(b) of the Dodd-Frank Act provide the CFTC and the Commission with the authority to define the terms "swap" and "security-based swap," among other terms, to include transactions that have been structured to evade the requirements of subtitles A and B of Title VII, respectively, of the Dodd-Frank Act. To assist the Commission and the CFTC in further defining the terms specified above, the Commission and the CFTC have sought comment from interested parties. See Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 34-62717 (Aug. 13, 2010) [75 FR 51429] (advance joint notice of proposed rulemaking regarding definitions); See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Release No. 34-64372 (Apr. 29, 2011) [76 FR 29818] (proposing product definitions for swaps).

7 15 U.S.C. 78p.

security-based swaps.[8] To preserve the application of our beneficial ownership rules to persons who purchase or sell security-based swaps after the effective date of Section 13(o), we proposed to readopt without change the relevant portions of Rules 13d-3 and 16a-1. Readoption of the existing rules was proposed in order to ensure their continued application by the Commission on the same basis that they currently apply to persons who use security-based swaps.[9] While this rulemaking is only intended to preserve the existing application of the beneficial ownership rules as they relate to security-based swaps, our staff is engaged in a separate project to develop proposals to modernize reporting under Exchange Act Sections 13(d)[10] and 13(g).[11]

We received five comment letters, all of which supported the proposal to readopt the relevant provisions of our rules. The commentators believed that the proposal, if adopted, would meet our objective of preserving the regulatory status quo.[12] Consistent with the proposal, we are readopting without change the relevant portions of Rules 13d-3 and 16a-1.

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8 See Release No. 34-64087 (March 17, 2011) [76 FR 15874] (the "Proposing Release").

9 In addition, the readoption of the relevant portions of Rules 13d-3 and 16a-1(a) is neither intended nor expected to change any existing administrative or judicial application or interpretation of the rules.

10 15 U.S.C. 78m(d).

11 15 U.S.C. 78m(g).

12 The comment letters were submitted by the Business Law Section of the American Bar Association (Federal Regulation of Securities Committee), the American Business Conference, the Managed Funds Association, Chris Barnard, and the law firm of Wachtell, Lipton, Rosen & Katz, which described this action as "both timely and necessary." The commentators also provided their views on possible future rulemaking to modernize reporting under Exchange Act Sections 13(d) and 13(g).

B. Sections 13(d) and 13(g) and Rule 13d-3

Sections 13(d) and 13(g) require a person who is the beneficial owner of more than five percent of certain equity securities[13] to disclose information relating to such beneficial ownership. While these statutory sections do not define the term "beneficial owner," the Commission has adopted rules that determine the circumstances under which a person is or may be deemed to be a beneficial owner. In order to provide objective standards for determining when a person is or may be deemed to be a beneficial owner subject to Section 13(d), the Commission adopted Exchange Act Rule 13d-3.[14] Application of the standards within Rule 13d-3 allows for case-by-case determinations as to whether a person is or becomes a beneficial owner, including a person who uses a security-based swap.

If beneficial ownership, as determined in accordance with Rule 13d-3, exceeds the designated thresholds, beneficial owners are required to provide specified disclosures. The disclosures are intended to be required of persons who have the potential to influence or gain control of the issuer.[15] Specifically, Section 13(d) and the rules thereunder require that a

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13 Section 13(d)(1) applies to any equity security of a class that is registered pursuant to Section 12 of the Exchange Act, any equity security issued by a "native corporation" pursuant to Section 37(d)(6) of the Alaska Native Claims Settlement Act, and any equity security described in Exchange Act Rule 13d-1(i) [17 CFR 240.13d-1(i)]. Rule 13d-1(i) explains that for purposes of Regulation 13D-G, "the term 'equity security' means any equity security of a class which is registered pursuant to section 12 of that Act, or any equity security of any insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940; Provided, Such term shall not include securities of a class of non-voting securities."

14 Adoption of Beneficial Ownership Disclosure Requirements, Release No. 34-13291 (Feb. 24, 1977) [42 FR 12342].

15 S. Rep. No. 550, at 7 (1967); H.R. Rep. No. 1711, at 8 (1968); Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids, Hearings on S. 510 before the S. Banking and Currency Comm., 90th Cong. 16 (1967) ("The bill now before you has a much closer relationship to existing provisions of the Exchange Act regulating solicitation of proxies, since acquisitions of blocks of voting

person file with the Commission, within ten days after acquiring, directly or indirectly, beneficial ownership of more than five percent of a class of equity securities, a disclosure statement on Schedule 13D,[16] subject to certain exceptions.[17] Section 13(g) and the rules thereunder enable certain persons who are the beneficial owners of more than five percent of a class of certain equity securities to instead file a short form Schedule 13G,[18] assuming certain conditions have been met.[19] These statutory provisions and corresponding rules also impose obligations on beneficial owners to report changes in the information filed.

The beneficial ownership disclosure requirements of Schedules 13D and 13G were designed to provide disclosures to security holders regarding persons holding significant positions in public companies, such as the identity of the beneficial owners, the amount of beneficial ownership, the existence of a beneficial owner group, and in the case of persons who file a Schedule 13D, plans or proposals regarding the issuer. The disclosures made in

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securities are typically alternatives to proxy solicitations, as methods of capturing or preserving control."); Takeover Bids, Hearings on H.R. 14475 and S.510 before the Subcomm. on Commerce and Fin. of the H. Comm. on Interstate and Foreign Commerce, 90th Cong. (1968).

16 17 CFR 240.13d-101.

17 See Section 13(d)(6) and Rule 13d-1(b) and (d).

18 17 CFR 240.13d-102.

19 See Amendments to Beneficial Ownership Reporting Requirements, Release No. 34-39538 (Jan. 12, 1998) [63 FR 2854] for a description of the types of persons eligible to file a Schedule 13G. The investors eligible to report beneficial ownership on Schedule 13G are commonly referred to as qualified institutional investors under Rule 13d-1(b), passive investors under Rule 13d-1(c), and exempt investors under Rule 13d-1(d). Unlike Section 13(d), Section 13(g) applies regardless of whether beneficial ownership has been "acquir[ed]" within the meaning of Section 13(d) or is viewed as not having been acquired for purposes of Section 13(d). For example, persons who obtain all their securities before the issuer registers the subject securities under the Exchange Act are not subject to Section 13(d) and persons who acquire not more than two percent of a class of subject securities within a 12-month period are exempt from Section 13(d) by Section 13(d)(6)(B), but in both cases are subject to Section 13(g).

Schedules 13D and 13G have been viewed as contributing to the information available to help investors make fully informed investment decisions with respect to their securities.[20] An additional regulatory objective served by these disclosures is to provide management of the issuer with information to "appropriately protect the interests of its security holders."[21] In enacting the original Section 13(d) legislation, Congress made clear that it intended to avoid "tipping the balance of regulation either in favor of management or in favor of the person [potentially] making the takeover bid."[22] In addition to providing information to issuers and security holders, Section 13(d) was adopted with a view toward alerting "the marketplace to every large, rapid aggregation or accumulation of securities, regardless of technique employed, which might represent a potential shift in corporate control."[23] On the

20 See Computer Network Corp. v. Spohler [1982 Transfer Binder] Fed Sec. L. Rep (CCH) ¶ 98,623 at 93,087 (D.D.C. March 23, 1982). See also, San Francisco Real Estate Investors v. REIT of America, [1982 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 98,874, at 94,557 (D. Mass. Nov. 19, 1982), aff'd in part, rev'd in part 701 F.2d 1000 (1st Cir. 1983). The Commission also has recognized that Section 13(d) was enacted primarily to provide "adequate disclosure to stockholders in connection with any substantial acquisition of securities within a relatively short time." Adoption of Beneficial Ownership Disclosure Requirements, Release No. 34-13291, (Feb. 24, 1977) [42 FR 12342] citing S. Rep. No. 550, at 7 (1967).

21 H.R. Rep. No. 1655, at 3 (1970); see, e.g., Additional Consumer Protection in Corporate Takeovers and Increasing the Sec. Act Exemptions for Small Businessmen, Hearing Before the Sec. Subcomm. of the S. Banking and Currency Comm. on S. 336 and S. 343, 91st Cong. (1970). See also Bath Indus. v. Blot, 427 F.2d 97, 113 (7th Cir. 1970). Disclosures made in compliance with Sections 13(d) and 13(g) also provide issuers that file registration statements, annual reports, proxy statements and other disclosure documents with the information they use to disclose all beneficial owners of more than five percent of certain classes of the issuer's equity securities as required by Item 403 of Regulation S-K. [17 CFR 229.403]. See generally H.R. Rep. No. 1655.

22 H.R. Rep. No. 1711, at 4 (1968); S. Rep. No. 550, at 3 (1968). Both the House and Senate reports emphasized that Section 13(d) was enacted "to require full and fair disclosure for the benefit of investors while at the same time providing the offeror and management equal opportunity to fairly present their case."

23 GAF Corp. v. Milstein, 453 F.2d 709, 717 (2d. Cir. 1971), cert. denied, 406 U.S. 910 (1972), cited by the Commission at note 16 in the following administrative proceeding: In the Matter of Harvey Katz,

basis of the information disclosed, the market would "value the shares accordingly"[24] due to the increased prospects for price discovery.[25]

C. Application of the Section 13 Beneficial Ownership Regulatory Provisions to Persons Who Purchase or Sell Security-Based Swaps

As noted above, the term "security-based swap" is defined in Section 3(a)(68) of the Exchange Act.[26] As explained in more detail below, in cases where a security-based swap confers voting and/or investment power (or a person otherwise acquires such power based on the purchase or sale of a security-based swap), grants a right to acquire an equity security, or is used with the purpose or effect of divesting or preventing the vesting of beneficial ownership as part of a plan or scheme to evade the reporting requirements, our existing regulatory regime may require the reporting of beneficial ownership.[27]

Release No. 34-20893 (April 25, 1984). A measure of what Congress considered to be large and rapid acquisitions is Section 13(d)(6)(B), which exempts acquisitions of two percent or less in the preceding twelve months.

[24] General Aircraft Corp. v. Lampert, 556 F.2d 90, 94 (1st Cir. 1977); see also S. Rep. No. 550, at 3 ("But where no information is available about the persons seeking control, or their plans, the shareholder is forced to make a decision on the basis of a market price which reflects an evaluation of the company based on the assumption that the present management and its policies will continue. The persons seeking control, however, have information about themselves and about their plans which, if known to investors, might substantially change the assumptions on which the market price is based.").

[25] Takeover Bids, Hearings on 14475 and S. 510 before the Subcomm. on Commerce and Fin. of the H. Comm. on Interstate and Foreign Commerce, 90th Cong. 12 (1968) (statement of Hon. Manuel F. Cohen, Chairman, U.S. Securities and Exchange Commission, "But I might ask, how can an investor evaluate the adequacy of the price if he cannot assess the possible impact of a change in control? Certainly without such information he cannot judge its adequacy by the current or recent market price. That price presumably reflects the assumption that the company's present business, control and management will continue. If that assumption is changed, is it not likely that the market price might change?").

[26] See note 6 above.

[27] Except with respect to the discussion of Section 16 (text accompanying notes 45-47), and the statements contained in note 54, this release does not address whether, or under what circumstances, an agreement, contract, or transaction that is labeled a security-based swap (including one which confers voting and/or investment power, grants a right to acquire one or more equity securities, or is used with

First, under Rule 13d-3(a), to the extent a security-based swap provides a person, directly or indirectly, with exclusive or shared voting and/or investment power over the equity security through a contractual term of the security-based swap or otherwise, the person becomes a beneficial owner of that equity security. Under Rule 13d-3(a), a person may become a beneficial owner even though the person has not acquired the equity security.[28]

Second, Rule 13d-3(b) generally provides that a person is deemed to be a beneficial owner if that person uses any contract, arrangement, or device as part of a plan or scheme to evade the beneficial ownership reporting requirements. To the extent a security-based swap is used with the purpose or effect of divesting a person of beneficial ownership or preventing the vesting of beneficial ownership as part of a plan or scheme to evade Sections 13(d) or 13(g), the security-based swap may be viewed as a contract, arrangement or device within the meaning of those terms as used in Rule 13d-3(b). A person using a security-based swap, therefore, may be deemed a beneficial owner under Rule 13d-3(b) in this context.

Finally, under Rule 13d-3(d)(1), a person is deemed a beneficial owner of an equity security if the person has a right to acquire the equity security within 60 days or holds the right with the purpose or effect of changing or influencing control of the issuer of the security

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the purpose or effect of divesting or preventing the vesting of beneficial ownership as part of a plan or scheme to evade the beneficial ownership reporting requirements) would be a purchase or sale of the underlying securit(ies) and treated as such for purposes of the federal securities laws, instead of a security-based swap. In this regard, among other things, the definition of "swap" (and therefore the definition of "security-based swap") specifically excludes the purchase or sale of one or more securities on a fixed or contingent basis, unless the agreement, contract, or transaction predicates the purchase or sale on the occurrence of a bona fide contingency that might reasonably be expected to affect or be affected by the creditworthiness of a party other than a party to the agreement, contract, or transaction. See Sections 1a(47)(B)(v) and (vi) of the Commodity Exchange Act, 7 U.S.C. 1a(47)(B)(v) and (vi).

28 Exchange Act Section 13(d)(1) applies after a person directly or indirectly acquires beneficial ownership, regardless of whether the person has made an acquisition of the equity securities.

for which the right is exercisable, regardless of whether the right to acquire originates in a security-based swap or an understanding in connection with a security-based swap. This type of right to acquire an equity security, if obtained through the purchase or sale of a security-based swap, is treated the same as any other right to acquire an equity security. Acquisition of such a right, regardless of its origin, results in a person being deemed a beneficial owner under Rule 13d-3(d)(1).

D. Section 16 and Rules 16a-1(a)(1) and 16a-1(a)(2)

Section 16 was designed both to provide the public with information about securities transactions and holdings of every person who is the beneficial owner of more than ten percent of a class of equity security registered under Exchange Act Section 12[29] ("ten percent holder"), and each officer and director (collectively, "insiders") of the issuer of such a security, and to deter such insiders from profiting from short-term trading in issuer securities while in possession of material, non-public information. Upon becoming an insider, or upon Section 12 registration of the class of equity security, Section 16(a)[30] requires an insider to file an initial report with the Commission disclosing his or her beneficial ownership of all equity securities of the issuer.[31] Section 16(a) also requires insiders to report subsequent changes in such ownership.[32] To prevent misuse of inside information by insiders, Section 16(b)[33] provides the issuer (or shareholders suing on the issuer's behalf) a strict liability

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29 15 U.S.C. 78l.

30 15 U.S.C. 78p(a).

31 Insiders file these reports on Form 3 [17 CFR 249.103].

32 Insiders file transaction reports on Form 4 [17 CFR 249.104] and Form 5 [17 CFR 249.105].

private right of action to recover any profit realized by an insider from any purchase and sale (or sale and purchase) of any equity security of the issuer within a period of less than six months.[34]

As applied to ten percent holders, Congress intended Section 16 to reach persons presumed to have access to information because they can influence or control the issuer as a result of their equity ownership.[35] Because Section 13(d) specifically addresses these relationships, the Commission adopted Rule 16a-1(a)(1) to define ten percent holders under Section 16 as persons deemed ten percent beneficial owners under Section 13(d) and the rules thereunder.[36] The Section 13(d) analysis, such as counting beneficial ownership of the equity securities underlying derivative securities exercisable or convertible within 60 days,[37] is imported into the ten percent holder determination for Section 16 purposes. The application of Rule 16a-1(a)(1) is straightforward; if a person is a ten percent beneficial owner as determined pursuant to Section 13(d) and the rules thereunder, the person is deemed a ten percent holder under Section 16.[38]

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33 15 U.S.C. 78p(b).

34 In addition, insiders are subject to the short sale prohibitions of Section 16(c) [15 U.S.C. 78p(c)].

35 See S. Rep. No. 1455, at 55, 68 (1934); See also S. Rep. No. 792, at 20-1 (1934); S. Rep. No. 379, at 21-2 (1963).

36 Ownership Reports and Trading By Officers, Directors and Principal Security Holders, Release No. 34-28869 (Feb. 21, 1991) [56 FR 7242].

37 Rule 13d-3(d).

38 For example, the Commission applied an analysis derived from Rule 13d-3(d)(1) in publishing its views regarding when equity securities underlying a security future that requires physical settlement should be counted for purposes of determining whether the purchaser of the security future is subject to Section 16 as a ten percent holder by operation of Rule 16a-1(a)(1). Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934,

For purposes of Section 16(a) reporting obligations and Section 16(b) short-swing profit recovery, Rule 16a-1(a)(2) uses a different definition of "beneficial owner." Once a person is subject to Section 16, for reporting and profit recovery purposes, Rule 16a-1(a)(2) defines "beneficial owner" based on whether the person has or shares a direct or indirect pecuniary interest in the securities. A "pecuniary interest" in any class of equity securities means "the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities."[39] An "indirect pecuniary interest" in any class of equity securities includes, but is not limited to "a person's right to acquire equity securities through the exercise or conversion of any derivative security, whether or not presently exercisable."[40] "Derivative securities" are "any option, warrant, convertible security, stock appreciation right, or similar right with an exercise or conversion privilege at a price related to an equity security, or similar securities with a value derived from the value of an equity security, but shall not include [...] rights with an exercise or conversion privilege at a price that is not fixed."[41] Equity securities of an issuer are "any equity security or derivative security relating to an issuer, whether or not issued by that issuer."[42]

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and Rules thereunder to Trading in Security Futures Products, Release No. 34-46101 (June 21, 2002) [67 FR 43234] ("Futures Interpretive Release") at Q 7.

39 Rule 16a-1(a)(2)(i).

40 Rule 16a-1(a)(2)(ii)(F).

41 Rule 16a-1(c)(6).

42 Rule 16a-1(d). Further, Rule 16a-4(a) [17 CFR 240.16a-4(a)] provides that for purposes of Section 16, both derivative securities and the underlying securities to which they relate are deemed to be the same class of equity securities, except that the acquisition or disposition of any derivative security must be separately reported.

This framework recognizes that holding derivative securities is functionally equivalent to holding the underlying equity securities for Section 16 purposes because the value of the derivative securities is a function of or related to the value of the underlying equity security.[43] Just as an insider's opportunity to profit begins upon purchasing or selling issuer common stock, the opportunity to profit begins when an insider engages in transactions in derivative securities that provide an opportunity to obtain or dispose of the stock at a fixed price.[44] Establishing or increasing a call equivalent position[45] (or liquidating or decreasing a put equivalent position[46]) is deemed a purchase of the underlying security, and establishing or increasing a put equivalent position (or liquidating or decreasing a call equivalent position) is deemed a sale of the underlying security.[47]

Rule 16a-1(a)(2) and the related rules described above recognize the functional equivalence of derivative securities and the underlying equity securities by providing that transactions in derivative securities are reportable, and matchable with transactions in other

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43 For example, the Futures Interpretive Release, at Q&A Nos. 8-13, explains the status of a security future as a derivative security for purposes of Section 16(a) reporting and Section 16(b) short-swing profit recovery.

44 Ownership Reports and Trading By Officers, Directors and Principal Security Holders, Release No. 34-28869, at Section III.A (Feb. 21, 1991) [56 FR 7242].

45 Rule 16a-1(b) provides that a "call equivalent position" is "a derivative security position that increases in value as the value of the underlying equity security increases, including, but not limited to, a long convertible security, a long call option, and a short put option position."

46 Rule 16a-1(h) provides that a "put equivalent position" is "a derivative security position that increases in value as the value of the underlying equity decreases, including, but not limited to, a long put option and a short call option."

47 Rule 16b-6(a).

derivative securities and in the underlying equity.[48] For example, short-swing profits obtained by buying call options and selling the underlying stock, or buying the underlying stock and buying put options, are recoverable. This functional equivalence extends to all fixed-price derivative securities, whether issued by the issuer or a third party, and whether the form of settlement is cash or stock.[49]

E. Application of the Section 16 Beneficial Ownership Regulatory Provisions to Holdings and Transactions in Security-Based Swaps

As described above, solely for purposes of determining who is subject to Section 16 as a ten percent holder, Rule 16a-1(a)(1) uses the beneficial ownership tests applied under Section 13(d) and its implementing rules, including Rules 13d-3(a), 13d-3(b), and Rule 13d-3(d)(1). As a result, for example, a person who has the right to acquire securities that would cause the person to own more than ten percent of a class of equity securities through a security-based swap that confers a right to receive equity at settlement or otherwise would be subject to Section 16 as a ten percent holder under Rule 16a-1(a)(1). Once a person is subject to Section 16, in order to determine what securities are subject to Section 16(a)

48 Rule 16b-6(b) generally exempts from Section 16(b) short-swing profit recovery the exercise or conversion of a fixed-price derivative security, provided that it is not out-of-the-money. Rule 16b-6(c) provides guidance for determining short-swing profit recoverable from transactions involving the purchase and sale or sale and purchase of derivative and other securities.

49 Former Rule 16a-1(c)(3), adopted in Release No. 34-28869, excluded from the definition of "derivative securities" "securities that may be redeemed or exercised only for cash and do not permit the receipt of equity securities in lieu of cash, if the securities either: (i) are awarded pursuant to an employee benefit plan satisfying the provisions of [former] §240.16b-3(c); or (ii) may be redeemed or exercised only upon a fixed date or dates at least six months after award, or upon death, retirement, disability or termination of employment." As a corollary to adopting a broader Rule 16b-3 exemption, the Commission rescinded former Rule 16a-1(c)(3) in 1996, stating that "because the opportunity for profit based on price movement in the underlying stock embodied in a cash-only instrument is the same as for an instrument settled in stock, cash-only instruments should be subject to Section 16 to the same extent as other issuer equity securities." Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-37260, at Section III.A (May 31, 1996) [61 FR 30376].

reporting and Section 16(b) short-swing profit recovery for any insider (whether an officer, director or ten percent holder), Rule 16a-1(a)(2) looks to the insider's pecuniary interest (i.e., opportunity to profit) in the securities. This concept includes an indirect pecuniary interest in securities underlying fixed-price derivative securities, including security-based swaps, whether settled in cash or stock. Consistent with the derivative securities analysis, the Commission has stated that Section 16 consequences would arise from an equity swap transaction where either party to the transaction is a Section 16 insider with respect to a security to which the swap agreement relates.[50] The Commission has provided interpretive guidance regarding how equity swap transactions should be reported,[51] and adopted transaction code "K" to be used in addition to any other applicable code in reporting equity swap and similar transactions so that they can be easily identified.[52] An equity swap involving a single security, or a narrow-based security index, is a security-based swap as defined in Section 3(a)(68).

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50 Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-34514, at Section III.G (Aug. 10, 1994) [59 FR 42449]; Ownership Reports and Trading by Officers, Directors and Principal Security Holders, Release No. 34-37260, at Section IV.H (May 31, 1996) [61 FR 30376].

51 Each report must provide the following information: (1) the date of the transaction; (2) the term; (3) the number of underlying shares; (4) the exercise price (i.e., the dollar value locked in); (5) the non-exempt disposition (acquisition) of shares at the outset of the term; (6) the non-exempt acquisition (disposition) of shares at the end of the term (and at such earlier dates, if any, where events under the equity swap cause a change in a call or put equivalent position); (7) the total number of shares held after the transaction; and (8) any other material terms. Release No. 34-37260, at Section IV.H.

52 General Instruction 8 to Form 4 [17 CFR 249.104] (U.S. SEC 1475 (08-07)) and Form 5 [17 CFR 249.105] (U.S. SEC 2270 (1-05)), as amended in Release No. 34-37260, at Section IV.I.

II. DISCUSSION OF THE READOPTED RULES AND COMMISSION CONFIRMATION

New Section 13(o) provides that a person shall be deemed a beneficial owner of an equity security based on the purchase or sale of a security-based swap only to the extent we adopt rules after making certain determinations with respect to security-based swaps and consulting with the prudential regulators and the Secretary of the Treasury. The regulatory provisions under which beneficial ownership determinations have been made to date with respect to security-based swaps were enacted or adopted before Section 13(o). Accordingly, we are readopting the relevant portions of Rules 13d-3 and 16a-1 following consultation with the prudential regulators and the Secretary of Treasury to assure that these provisions continue to apply to a person who purchases or sells a security-based swap upon effectiveness of Section 13(o).

The purpose of this rulemaking is solely to preserve the regulatory status quo and provide the certainty and protection that market participants have come to expect with the existing disclosures required by the rules promulgated under Sections 13(d), 13(g) and 16(a). While the use of security-based swaps has not been frequently disclosed in Schedule 13D and 13G filings, we are readopting Rules 13d-3(a), (b) and (d)(1) and the relevant portions of Rules 16a-1(a)(1) and (a)(2) to further the policy objectives of, and foster compliance with, these rules upon the effectiveness of Section 13(o).

Given the language in Section 13(o), as well as the newly amended Sections 13(d) and 13(g),[53] we are readopting these rules to remove any doubt that they will continue to allow for the same determinations of beneficial ownership that they do today. Readoption of these rule provisions is intended to confirm that persons who use security-based swaps remain subject to the Section 13(d), Section 13(g) and Section 16 regulatory regimes to the same extent such persons were prior to readoption. Moreover, the rulemaking is designed to preserve the private right of action provided by Section 16(b) and not disturb any other existing right of action.

.Section 13(o), once effective, will not render the existing beneficial ownership regulatory provisions inapplicable to persons who obtain beneficial ownership independently from a security-based swap. For example, Rule 13d-3(d)(1) will continue to apply to persons who obtain a right to acquire equity securities if the right does not arise from the purchase or sale of a security-based swap. Rights, options, warrants, or conversion or certain revocation privileges, if acquired or held by persons under circumstances that do not arise from the purchase or sale of a security-based swap, will remain subject to Sections 13(d), 13(g) and 16 and may continue to be treated under Rule 13d-3(d)(1) as the acquisition of beneficial ownership,[54] and Rules 16a-1(a)(1) and 16a-1(a)(2) will continue to apply. Furthermore,

[53] See Section 766(b) of the Dodd-Frank Act, which amends Sections 13(d) and 13(g) to provide that a person "becomes or is deemed to become a beneficial owner…upon the purchase or sale of a security-based swap that the Commission may define by rule…."

[54] These rights to acquire beneficial ownership are not security-based swaps within the meaning of Section 13(o); rather, they are purchases and sales of securities. In this regard, the definition of "swap" in Section 721 of the Dodd-Frank Act (and therefore the definition of "security-based swap") excludes purchases and sales of securities, whether on a fixed or contingent basis. Under the Dodd-Frank Act, the term "security" is as defined in the Securities Act and the Exchange Act, which includes options, warrants, and rights to subscribe to or purchase a security and any convertible securities as well as the

Schedule 13D will continue to require certain disclosures relating to the purchase or sale of security-based swaps notwithstanding Section 13(o).[55]

A. Beneficial Ownership Determinations under Section 13

Section 13(o) provides that a person shall be deemed to acquire beneficial ownership of an equity security based on the purchase or sale of a security-based swap only to the extent that the Commission meets certain conditions and adopts a rule. Although readoption of Rule 13d-3(a), Rule 13d-3(b), and Rule 13d-3(d)(1) is being made in part pursuant to Section 13(o), we are not making any revision to the existing rule text. The rules we are readopting are the same as the existing rules in all respects.

1. Rule 13d-3(a)

We are readopting without change Rule 13d-3(a) to address any uncertainty with regard to the application of Rule 13d-3(a) to a person who purchases or sells a security-based swap. Under readopted Rule 13d-3(a), a determination may continue to be made that a beneficial owner of equity securities includes any person who, directly or indirectly, through

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securities issuable upon exercise or conversion of such securities. In addition, Section 721 of the Dodd-Frank Act excludes from the definition of "swap" any put, call, straddle, option or privilege on any security, certificate of deposit, or group or index of securities, including any interest therein or based on the value thereof, that is subject to the Securities Act of 1933 and the Exchange Act. Furthermore, Section 13(o) does not affect the treatment of "security-based swap agreements" as defined in the Dodd-Frank Act. For example, Section 762(d)(5) of the Dodd-Frank Act clarifies that Section 16 continues to apply to security-based swap agreements.

[55] For example, beneficial owners who file a Schedule 13D and use a security-based swap will remain subject to the obligation to comply with Items 6 ("Contracts, Arrangements, Understandings or Relationships With Respect to Securities of the Issuer") and 7 ("Material to be Filed as Exhibits") and provide disclosures relating to the security-based swap depending upon the security-based swap's terms. In addition, beneficial owners who file a Schedule 13G pursuant to Rule 13d-1(b) or otherwise rely upon Rule 13d-1(b) to govern a future reporting obligation may be required to make disclosures on Schedule 13D instead based upon their purchase or sale of a security-based swap. See In the Matter of Perry Corp., Release No. 34-60351 (July 21, 2009).

any contract, arrangement, understanding, relationship or otherwise, has or shares voting power and/or investment power over the securities based on the purchase or sale of a security-based swap.

Following consultation with the prudential regulators[56] and the Secretary of the Treasury, we believe that:

- A person's possession of voting and/or investment power in an equity security based on the purchase or sale of a security-based swap is no different from voting or investment power in an equity security that exists independently from a security-based swap when (1) a security-based swap confers, or (2) an arrangement, understanding or relationship based on the purchase or sale of the security-based swap conveys, voting and/or investment power in an equity security. Security-based swaps therefore can provide incidents of ownership comparable to direct ownership of the underlying equity security within the meaning of Section 13(o) to the extent that the security-based swap confers, or an arrangement, understanding or relationship based upon the purchase or sale of the security-based swap conveys, voting and/or investment power in an equity security; and
- Retaining the existing regulatory treatment of security-based swaps in Rule 13d-3(a) is necessary to achieve the purpose of Section 13 so that Sections 13(d) and 13(g) continue to require the filing of beneficial ownership reports that produce disclosure by persons who have the ability or potential to change or influence control of the

[56] Our staff has consulted with the Federal Reserve, the Office of the Comptroller of the Currency, the Farm Credit Administration, the Federal Housing Finance Agency, and the Federal Deposit Insurance Corporation. Our staff also consulted with the CFTC.

issuer. In addition, these persons may have the means to acquire significant amounts of equity securities wholly or partly based upon the purchase or sale of a security-based swap. As a result, these persons may have the potential to effect a change of control transaction or preserve or influence control of an issuer. In the case of Schedule 13D filers, these persons would be required to disclose their plans or proposals. Disclosures made in beneficial ownership reports are in the public interest and necessary for the protection of investors because they provide information about certain transactions and related acquisitions of beneficial ownership that: could disclose a potential shift in corporate control; impact the transparency and efficiency of our capital markets; and contribute to price discovery.

2. Rule 13d-3(b)

We are readopting without change Rule 13d-3(b) to address any uncertainty with regard to the continued application of Rule 13d-3(b) to a person who purchases or sells a security-based swap. Rule 13d-3(b) provides that a person is deemed to be a beneficial owner if that person uses any contract, arrangement, or device as a means to divest or prevent the vesting of beneficial ownership as part of a plan or scheme to evade the beneficial ownership reporting requirements. Under readopted Rule 13d-3(b), any person that uses a security-based swap as part of a plan or scheme to evade reporting beneficial ownership continues to be subject to the requirement to disclose the accumulation of an influential or control position in a public issuer.

Following consultation with the prudential regulators and the Secretary of the Treasury, we believe that:

- A person's use of a security-based swap to divest or prevent the vesting of beneficial ownership as part of a plan or scheme to evade the application of Sections 13(d) or 13(g) is no different from a plan or scheme that uses a contract, arrangement or device that exists independently from a security-based swap. In this context, a person would be deemed to have beneficial ownership, and thus incidents of ownership comparable to direct ownership within the meaning of Section 13(o), but for the plan or scheme based in whole or in part upon the purchase or sale of a security-based swap; and
- Retaining the existing regulatory treatment of security-based swaps in Rule 13d-3(b) is necessary to achieve the purpose of Section 13 so that Sections 13(d) and 13(g) continue to require the filing of beneficial ownership reports that produce disclosure by persons who have the ability or potential to change or influence control of the issuer. In addition, these persons may have the means to acquire significant amounts of equity securities based in whole or in part upon the purchase or sale of a security-based swap, and therefore the potential to effect a change of control transaction or preserve or influence control of an issuer. In the case of Schedule 13D filers, these persons would be required to disclose their plans or proposals. Disclosures made in beneficial ownership reports are in the public interest and necessary for the protection of investors because they provide information about certain transactions and related acquisitions of beneficial ownership that: could disclose a potential shift in corporate control; impact the transparency and efficiency of our capital markets; and contribute to price discovery.

3. Rule 13d-3(d)(1)

We are readopting without change Rule 13d-3(d)(1) to address any uncertainty with regard to the continued application of Rule 13d-3(d)(1) to a person who purchases or sells a security-based swap. Rule 13d-3(d)(1) provides that a person will be deemed to be a beneficial owner of equity securities if the person has the right to acquire beneficial ownership of the securities within 60 days, or at any time if the right is held for the purpose of changing or influencing control. Readopted Rule 13d-3(d)(1) continues to apply to any person that obtains such a right based on the purchase or sale of a security-based swap.

The Commission has long recognized the importance of having the beneficial ownership reporting regime account for contingent interests in equity securities arising from investor use of derivatives, such as options, warrants or rights. The Commission adopted Rule 13d-3, the predecessor to Rule 13d-3(d)(1), on August 30, 1968,[57] approximately one month after Congress enacted Section 13(d).[58] The Commission also has treated futures contracts for equity securities the same as options, warrants, or rights for purposes of determining beneficial ownership.[59] When a right to acquire may be exercised within 60 days or less, or if a right has been acquired for the purpose or with the effect of changing or influencing control of the issuer of securities, we believe that treating the holder of the right as if the person is a beneficial owner under Rule 13d-3(d)(1) is necessary to achieve the

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57 Acquisitions, Tender Offers, and Solicitations, Release No 34-8392 (Aug. 30, 1968) [33 FR 14109].

58 See Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (July 29, 1968).

59 The Futures Interpretive Release provides two examples at Q & A No. 17 that explain when equity securities underlying a security future that requires physical settlement should be counted for purposes of determining whether the purchaser of the security future is subject to Regulation 13D-G by operation of Rule 13d-3(d)(1).

regulatory purpose of Section 13 given the person's potential to influence or change control of the issuer.[60]

Following consultation with the prudential regulators and the Secretary of the Treasury, we believe that:

- A person's right to acquire an equity security within 60 days based on the purchase or sale of a security-based swap is no different from a right to acquire the underlying equity security that exists independently from a security-based swap. A right to acquire an equity security within 60 days is comparable to direct ownership of the equity security because direct ownership is contingent, in some cases, only upon the exercise of that right and may result in the potential to change or influence control of the issuer upon acquisition of the equity security for which the right is exercisable. Security-based swaps, therefore, can provide incidents of ownership comparable to direct ownership of the underlying equity security within the meaning of Section 13(o) to the extent that the security-based swap confers a right to acquire an equity security within 60 days;
- A person who acquires or holds, with the purpose or effect of changing or influencing control of an issuer, a right to acquire an equity security based on the purchase or sale of a security-based swap is no different from a person who acquires or holds a right to acquire an equity security with the purpose of changing or influencing control of the issuer that exists independently from a security-based swap. Rights acquired or held

60 See Filing and Disclosure Requirements Relating to Beneficial Ownership, Release No. 34-14692 (Apr. 21, 1978) [43 FR 18484].

in this context may be used in furtherance of a plan or proposal to change control of the issuer, and such rights to acquire equity securities may otherwise influence an issuer if held by a person intending to effect a change of control transaction or preserve or influence control of an issuer. Security-based swaps, therefore, can provide incidents of ownership comparable to direct ownership of the underlying equity security within the meaning of Section 13(o) to the extent that the security-based swap confers a right to acquire an equity security to a person that holds the right with the purpose or with the effect of changing or influencing control of the issuer or otherwise in connection with or as a participant in any transaction having such purpose or effect; and

- Retaining the existing regulatory treatment of security-based swaps under Rule 13d-3(d)(1) is necessary to achieve the purpose of Section 13 so that Sections 13(d) and 13(g) continue to require the filing of beneficial ownership reports that disclose certain transactions by persons who have the ability or potential to change or influence control of the issuer. These persons may have the means to acquire significant amounts of equity securities based in whole or in part upon the purchase or sale of a security-based swap, and therefore the potential to effect a change of control transaction or preserve or influence control of an issuer. In the case of Schedule 13D filers, these persons would be required to disclose their plans or proposals. Disclosures made in beneficial ownership reports are in the public interest and necessary for the protection of investors because they provide information about certain transactions and related acquisitions of beneficial ownership that: could disclose a potential shift in corporate control; impact the transparency and efficiency of our capital markets; and contribute to price discovery.

B. Section 16 Beneficial Ownership Rules

1. Rule 16a-1(a)(1)

We are readopting without change a portion of Rule 16a-1(a)(1)[61] to preserve, solely for purposes of determining whether a person is a ten percent holder, the application of the relevant provisions within Rule 13d-3 to a person who uses a security-based swap. Readoption of Rule 16a-1(a)(1) does not change the rule's provision that shares held by institutions eligible to file beneficial ownership reports on Schedule 13G that are held for clients in a fiduciary capacity in the ordinary course of business are not counted for purposes of determining ten percent holder status.[62]

Following consultation with the prudential regulators and the Secretary of the Treasury, we believe that:

- For the same reasons and in the same circumstances as described above for Rule 13d-3(a), Rule 13d-3(b) and Rule 13d-3(d)(1), solely for purposes of determining whether

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61 We are readopting the portion of Rule 16a-1(a)(1) that precedes the proviso applicable to qualified institutions. The relevant portion of Rule 16a-1(a)(1) that we are readopting reads as follows: "(a) The term beneficial owner shall have the following applications: (1) Solely for purposes of determining whether a person is a beneficial owner of more than ten percent of any class of equity securities registered pursuant to section 12 of the Act, the term "beneficial owner" shall mean any person who is deemed a beneficial owner pursuant to section 13(d) of the Act and the rules thereunder...."

62 Securities not held in such a fiduciary capacity, however, must be counted in determining whether a Schedule 13G qualified institutional investor is a ten percent holder. This exclusion applies only to qualified institutions who acquire or hold securities of the issuer in the ordinary course of business without the purpose or effect of influencing or changing control, and thereby qualify to use Schedule 13G pursuant to Rule 13d-1(b)(1)(i). The exclusion does not apply to persons who qualify to use Schedule 13G as passive investors pursuant to Rule 13d-1(c), or as exempt investors pursuant to Rule 13d-1(d).

a person is a ten percent holder subject to Section 16, the purchase or sale of a security-based swap, or class of security-based swap, can provide incidents of ownership comparable to direct ownership of the equity security within the meaning of Section 13(o); and

- The inclusion of equity securities based on the purchase or sale of a security-based swap, or class of security-based swap, for purposes of calculating ten percent holder status is necessary to achieve the purpose of Section 16, so that Section 16 continues to reach all persons that, under the Section 16 regime, are presumptively deemed to have access to inside information based on influence or control of the issuer through ownership of equity securities.

2. Rule 16a-1(a)(2)

We are readopting without change a portion of Rule 16a-1(a)(2)[63] solely to preserve the existing Section 16(a) reporting of security-based swap holdings and transactions and, correspondingly, to prevent the potential use of security-based swaps to engage in short-swing trading outside the scope of Section 16(b) short-swing profit recovery. Readoption

63 We are readopting the portion of Rule 16a-1(a)(2) that precedes subparagraph (ii). The relevant portion of Rule 16a-1(a)(2) we are readopting reads as follows: "(2) Other than for purposes of determining whether a person is a beneficial owner of more than ten percent óf any class of equity securities registered under Section 12 of the Act, the term beneficial owner shall mean any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares a direct or indirect pecuniary interest in the equity securities, subject to the following: (i) The term pecuniary interest in any class of equity securities shall mean the opportunity, directly or indirectly, to profit or share in any profit derived from a transaction in the subject securities."

does not change or otherwise affect any aspect of the pecuniary interest analysis and treatment of derivative securities under Section 16.

Following consultation with the prudential regulators and the Secretary of the Treasury, we believe that:

- Because an insider's opportunity to profit through a security-based swap is no different from the opportunity to profit through transactions in any other fixed-price derivative security, and hence no different from the opportunity to profit through transactions in the underlying equity security, holdings and transactions in security-based swaps that are fixed-price derivative securities can provide incidents of ownership comparable to direct ownership of the underlying equity security within the meaning of Section 13(o); and
- Retaining the existing treatment of security-based swaps is necessary to achieve the purpose of Section 16 so that Section 16 continues to reach holdings and transactions that insiders can potentially use to profit based on misuse of inside information.

III. PAPERWORK REDUCTION ACT

The readopted rules affect "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[64] 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. We already have control numbers for Schedules 13D (OMB Control No. 3235-0145) and 13G (OMB Control No. 3235-0145) and Forms 3 (OMB Control No. 3235-0104), 4 (OMB Control No. 3235-0287), and 5 (OMB Control No. 3235-

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[64] 44 U.S.C. 3501 et seq.

0362). These schedules and forms contain item requirements that outline the information a reporting person must disclose.

A. Background

We are readopting without change portions of the rules enabling determinations of beneficial ownership to be made for purposes of Sections 13(d), 13(g) and 16 of the Exchange Act. Readoption is intended to confirm that following the effective date of Section 13(o), persons who use security-based swaps will remain within the scope of these rules to the same extent as they were before the readoption. We did not receive any comments concerning our Paperwork Reduction Act Reduction Analysis in the proposing release.

B. Burden and Cost Estimates Related to the Readoption

Preparing and filing a report on any of these schedules or forms is a collection of information. The hours and costs associated with preparing the disclosure, filing the schedules or forms and retaining records required by these rules constitute reporting and cost burdens imposed by each collection of information. Readoption of the rules ensures that reporting persons will remain obligated to disclose the same information that they were previously required to report on these schedules or forms. We therefore believe that the overall information collection burden will remain the same because beneficial ownership will remain reportable on the same basis as before the readoption.

IV. ECONOMIC ANALYSIS

A. Introduction

Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact on competition that the rules we adopt would have, and prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of that Act.[65] Further, Section 3(f) of the Exchange Act[66] and Section 2(c) of the Investment Company Act[67] 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. We have considered and discussed below the effects of the readopted rules on efficiency, competition, and capital formation, as well as the benefits and costs associated with the rulemaking.

In order to more fully analyze the potential effects of readopting portions of our rules to preserve the regulatory status quo upon the effectiveness of Section 13(o), we have performed the analysis below in two separate ways. First, we analyze the impact of the readoption compared to the status quo, in which the rules already apply to a person who purchases or sells a security-based swap. Second, we analyze the impact as if our rules did not already apply to persons who purchase or sell security-based swaps. We believe the economic effect will be minimal. Commentators supported the readopted rules on the grounds that they preserved the regulatory status quo. They did not identify any cost that would result from the rulemaking.

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65 15 U.S.C. 78w(a)(2).

66 15 U.S.C. 78c(f).

67 15 U.S.C. 80a-2(c).

B. Benefits and the Impact on Efficiency, Competition and Capital Formation

1. When the Rules We Readopt Already Apply to Persons Who Purchase or Sell Security-Based Swaps

Readoption of certain provisions of Rule 13d-3 and Rule 16a-1 preserves the continued administration of existing rules adopted to improve the transparency of information available to investors, issuers and the marketplace. Readoption is intended to preserve that transparency regarding beneficial ownership positions and the intentions of persons who hold such positions, as well as the holdings of and transactions by Section 16 insiders. We are readopting, without change, rules that, when applied, may result in disclosure of beneficial ownership and insiders' holdings and transactions in equity securities. In addition, one of the readopted rules, Rule 16a-1(a)(2), also identifies transactions that may be subject to the private right of action to recover short-swing profit for the issuer provided by Section 16(b).

The rules are readopted solely to preserve the regulatory status quo regarding beneficial ownership reporting under Sections 13(d) and (g), Section 16 insider status as a ten percent holder, insider holding and transaction reporting under Section 16(a), and insider short-swing profit liability under Section 16(b). Continued application of the rules also will provide certainty regarding the Section 16(b) private right of action to recover insiders' short-swing profits for the issuer. Because the rules we readopt are already in place and will remain unchanged, readoption and effectiveness of these rules should have minimal benefits, and little, if any, new effect on efficiency, competition, or capital formation or on the persons required to make the disclosures as a result of the application of the rules. Beneficial owners who use security-based swaps are already subject to these rules and are required to make any applicable disclosures. Because only a limited number of beneficial ownership reports contain disclosure that relates to security-based swaps, the potential effect of this rulemaking should be minimal. Shareholders, issuers, market participants and any other persons who rely upon the disclosures being made as a result of application of the rules similarly will receive little, if any, new benefit and are unlikely to experience any new impact on efficiency, competition or capital formation because the regulatory environment will remain the same as before readoption.

2. If the Rules We Readopt Did Not Already Apply to Persons Who Purchase or Sell Security-Based Swaps

If one were to analyze the effect of readopting these rules as if they did not already apply to a person who purchases or sells a security-based swap, there would be new benefits, as well as a beneficial effect on efficiency, competition and capital formation. These benefits could extend to persons relying upon these disclosures, including prospective investors, shareholders, issuers, and other market participants. These benefits also may extend to beneficial owners required to comply with disclosure requirements as a result of the application of the rules we readopt. Any such benefits, if realized, would be attributable both to the removal of any regulatory uncertainty and to the resulting preservation of transparency.

Applying the rules to a person who purchases or sells a security-based swap confers a benefit to market participants by providing market transparency and removing, in some cases, information asymmetry. Prospective investors, shareholders, issuers and other market participants benefit from the transparency provided through disclosure made available by persons subject to Sections 13 and 16. For example, a Schedule 13D filing may disclose a potential change of control transaction and assist a shareholder in making an investment decision that would maximize the return on an investment. Disclosures made on Schedule 13G may identify for the marketplace important investment decisions made by institutional investors and other large shareholders or may provide notice to investors, issuers and the market regarding voting blocks of securities that have the potential to affect or influence control of an issuer.

Applying the rules to a person who purchases or sells a security-based swap assures that Section 16 will reach a person that, under the Section 16 regime, is presumptively deemed to have access to inside information based on influence or control of the issuer through equity ownership. In addition, applying the rules to a person who purchases or sells a security-based swap means that an insider (whether an officer, director, or ten percent holder) is required to report beneficial ownership with respect to transactions and holdings in a security-based swap that confers an indirect pecuniary interest in issuer equity securities. These reports, like other Section 16(a) reports, may provide shareholders and other market participants with useful information regarding insiders' views of the performance or prospects of the issuer.

Transparency of trading by persons covered by Sections 13 and 16, and transparency of accumulations of material ownership blocks or voting power based on the purchase or sale of a security-based swap, would increase informational efficiency in securities markets in particularly important areas, especially where a Schedule 13D filing may be the first required disclosure of an intended change of control of an issuer. Transparency confers a benefit by assuring the availability of information upon which investors may rely to make informed investment and voting decisions.

The level of transparency provided by Rules 13d-1(a) and 16a-1 also may contribute to market efficiency because it could help facilitate the accurate pricing of securities. If the rules did not apply to a person who purchases or sells a security-based swap, investors and market participants, such as financial analysts and broker dealers, would not have information regarding the use of security-based swaps by persons subject to Sections 13 and 16, including major investors. The transparency provided by the application of our rules should help the market accurately price securities and may enable purchasers and sellers of securities to receive a benefit by avoiding costs, if any, associated with participation in transactions based on mispriced securities. For example, market efficiency should increase because the market will have readily available information about acquisitions of securities that involve the potential to change or influence control of an issuer in connection with the purchase or sale of a security-based swap. If persons who purchase or sell security-based swaps were excluded from this regulatory scheme, an incentive could arise to use security-based swaps to affect or influence the outcome of a change of control transaction. In addition, the pricing of a security would not readily reflect, if at all, ownership interests in the issuer derived from security-based swaps. In such circumstances, the application of the rules we readopt would have the benefit of eliminating this incentive while increasing the quality of information available to price securities.

Public availability of information about the existence of persons who use security-based swaps and have the potential to change or influence control of the issuer affects competition in the market for corporate control. If bidders that use securities-based swaps comply with the beneficial ownership disclosure requirements, the balance Congress sought to strike between issuers and prospective bidders will not tip away from issuers.[68] Providing equal access to information regarding persons who use security-based swaps and have the ability to change or influence control of an issuer reinforces a legislative objective of Section 13(d) by assuring that a person will not be able to implement a change of control transaction by means of a large, undisclosed position. Applying our rules to persons who purchase or sell security-based swaps enables issuers to consider information about competitors in the market for corporate control, including those who may be able to offer a new or competing strategic alternative. Schedule 13D and 13G filings also may deliver greater certainty to market participants who make strategic, voting, or investment decisions wholly or partly based upon the information disclosed, and could reduce speculation about future plans or proposals relating to an issuer. For example, market participants may not be discouraged from introducing strategic plans or proposals to an issuer out of concern that an undisclosed interest in the issuer derived from a security-based swap could interrupt execution of their plan or proposal.

Section 16 is intended to provide the public with information about the securities transactions and holdings of officers, directors, and ten percent holders, and to mitigate informational advantages they may have in trading issuer securities. Applying Rule 16a-1(a)(1) to beneficial ownership based on the purchase or sale of a security-based swap discourages persons from unfairly profiting in trades based on the ability to become a ten

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68 See note 22 above.

percent holder partly or wholly based on the use of security-based swaps without becoming subject to Section 16. Applying Rule 16a-1(a)(2), which defines "beneficial ownership" based on pecuniary interest in issuer equity securities, to persons who purchase or sell security-based swaps prevents the development of a trading market potentially favoring any insider (whether an officer, director, or ten percent holder) to the extent that:

- holdings and transactions involving security-based swaps may not be reported, thereby depriving investors of potentially useful information; and
- insiders have the opportunity to misuse their potential informational advantages in trading without regard to potential short-swing profit liability.

Making information publicly available generally lowers an issuer's cost of capital and facilitates capital formation, in comparison to what the cost of capital otherwise might be if the rules did not already apply to a person who purchases or sells a security-based swap. If the rules apply to a person who purchases or sells a security-based swap, the resulting transparency could favorably affect investor confidence in the capital markets and thereby not compromise capital formation.[69] If our rules require persons who use security-based swaps to provide disclosures in Schedules 13D and 13G and Forms 3, 4 and 5, investors will not insist on a higher risk premium in publicly-traded equity securities and consequently reduce capital formation. Informed investor decisions generally promote capital formation.[70]

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69 See Luigi Guiso et al., Trusting the Stock Market, 63 J. FIN. 2557 (2008) (finding that trust in the fairness of the financial system is correlated with higher levels of stock market participation).

70 See Merritt B. Fox, Randall Morck, Bernard Yeung & Artyom Durnev, Law, Share Price Accuracy, and Economic Performance: the New Evidence, 102 Mich L. Rev. 331 (2003) (empirical study of the value of disclosure requirements in enhancing investment efficiency); see also Studies in Resource

In addition, market participants would benefit from the predictability associated with a regulatory environment in which all persons who have the potential to influence or change control of an issuer are definitively subject to the same beneficial ownership reporting rules. If there were questions as to whether our rules applied to persons who purchase or sell security-based swaps, market participants would have to accept more operational and legal risk because of the potentially unregulated treatment of persons who use security-based swaps with incidents of ownership comparable to direct ownership, as well as persons who have arrangements, understandings, or relationships concerning voting and/or investment power, the opportunity to acquire equity securities, or a plan or scheme to evade Sections 13(d) and 13(g) in connection with the purchase or sale of a security-based swap. By applying our rules to all persons who have the potential to influence or change control of the issuer, market participants would have assurance that securities pricing may reflect information derived from security-based swaps when Sections 13(d), 13(g), and 16 require reporting. The certainty provided by this consistent regulatory treatment should foster investor confidence and participation in the capital markets generally, and should not impair capital formation.

The rules we readopt also would provide the Commission access to ownership and transaction information that would not be available if the rules did not already apply to a person who purchases or sells a security-based swap. The availability of this data should enhance the ability of the Commission and its staff to study and address issues that relate to

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Allocation Processes at p. 413 (Kenneth J. Arrow & Leonid Hurwicz eds., 2007) (explaining the relationship between informational efficiency and Pareto efficiency of resource allocation).

this information. Ready access to this information also will continue to enable the Commission to exercise efficiently its enforcement mandate in this market segment, and thereby confer a benefit to all market participants by offering assurance that the integrity of security pricing is protected, and is otherwise consistent with the legislative purpose of Sections 13(d), 13(g), 13(o), and 16.

C. Costs and the Impact on Efficiency, Competition and Capital Formation

1. When the Rules We Readopt Already Apply to Persons Who Purchase or Sell Security-Based Swaps

We believe that the rules we readopt will not, as a practical matter, impose any new costs on market participants, given that the rulemaking is intended only to preserve the regulatory status quo. Although it is difficult to determine the number of entities and the costs to entities that are required to comply with the rules we readopt, we believe that readoption of the rules will result in minimal, if any, costs to any person or entity (either small or large) and will have little, if any, burden on efficiency, competition or capital formation because the regulatory environment will remain unchanged.

Regulation 13D-G currently applies to any person that acquires or is deemed to acquire or hold beneficial ownership of more than five percent of certain classes of equity securities. The readoption of the relevant provisions of Rule 13d-3 will not result in any change to the beneficial ownership reporting obligations of the persons previously subject to the beneficial ownership regulatory provisions. Similarly, Section 16 applies to any person that acquires or is deemed to acquire more than ten percent of certain classes of equity securities, and the readoption of Rule 16a-1(a)(1) will not result in any change in determining whether a person is subject to Section 16 as a ten percent holder. Further, for all insiders, the requirements for Section 16(a) reporting and Section 16(b) liability are based on whether the insider has a pecuniary interest in the securities, including indirectly through ownership of and transactions in fixed-price derivative securities, such as security-based swaps, whether settled in cash or stock. Accordingly, the readoption of Rule 16a-1(a)(2) will not result in any change in determining reportable holdings and transactions, or transactions subject to short-swing profit recovery.

Because the rules we readopt already apply in determining whether a person is required to report beneficial ownership and insiders' holdings and transactions on Schedules 13D and 13G and Forms 3, 4 and 5, we do not believe the readopted rules will alter the costs associated with compliance. These schedules and forms already prescribe beneficial ownership information that a reporting person must disclose, and the rulemaking does not broaden the scope of the information required to be reported on the respective schedules and forms. The compliance burden associated with completion of the relevant schedule or form may be greater or lesser depending on the relative simplicity of the beneficial ownership interest. We recognize that the cost of complying with the beneficial ownership reporting regime can include the cost of analyzing whether the particular interest requires reporting. If it is determined that the interest held constitutes beneficial ownership, and the amount of the beneficial ownership interest exceeds the relevant threshold, the owner must complete and file a schedule and/or form. The compliance burden associated with the readopted rules, however, including costs associated with legal and other professional fees, may decrease because of the regulatory certainty that readoption provides. Furthermore, the persons incurring this compliance burden may already be subject to a reporting obligation based on an earlier application of these rules, and may not be reporting beneficial ownership for the first time as a direct result of the purchase or sale of security-based swaps.

Under the readopted rules, reporting persons will remain obligated to disclose the information currently required to be reported on these schedules or forms. We therefore believe that the overall compliance burden of the rules will remain the same. In addition, we do not believe that compliance costs, or the disclosure provided to effect compliance, will affect competition among filers.

We also believe that shareholders, issuers, market participants and any other persons who rely upon the disclosures being made as a result of application of the rules similarly will not be subjected to any new cost, or experience any new impact on efficiency, competition or capital formation because the rules we readopt are already in place and will remain unchanged.

2. If the Rules We Readopt Did Not Already Apply to Persons Who Purchase or Sell Security-Based Swaps

Costs could increase for a person who purchases or sells a security-based swap and immediately or eventually incurs the cost of filing or amending a beneficial ownership report if the person did not already determine that a reporting obligation existed based on his or her purchase or sale of a security-based swap. Further, an insider could incur costs from potential short-swing profit recovery arising out of a transaction in a security-based swap.

Application of our rules to a person who purchases or sells a security-based swap may affect competition. For example, a person who becomes a ten percent holder partly or wholly based on the use of a security-based swap would not be in a position to profit in trades prompted by a statutorily presumed informational advantage accentuated by the absence of a reporting requirement. In addition, beneficial owners who compete in the market for corporate control would lose a competitive advantage upon the required disclosure of their beneficial ownership positions and any plans or proposals.

Upon application of the rules we readopt, beneficial owners may accomplish certain objectives with less efficiency. For example, the completion of change of control transactions may be delayed due to potential interruptions that may arise or alternatives that might emerge as a result of public disclosures. If our rules did not already apply to a person who purchases or sells a security-based swap, that person could accumulate a large beneficial ownership position through the use of a security-based swap without public disclosure. This beneficial ownership position otherwise could have been used to implement or influence the outcome of a change of control transaction without alerting an issuer or the marketplace of these intentions. We believe, however, that the benefits of our readopted rules justify these costs.

The impact, if any, of the rule readoption on capital formation should be insignificant. Compliance costs arising under the beneficial ownership reporting regime based on the purchase or sale of a security-based swap are not expected to redirect capital that otherwise could have been allocated to capital formation. Capital formation should not be affected by a possible decline in the use of security-based swaps resulting from the application of our rules to a person who purchases or sells a security-based swap, given that capital formation ordinarily is not dependent upon the proceeds from transactions in security-based swaps.

V. REGULATORY FLEXIBILITY ACT CERTIFICATION

We certified pursuant to 5 U.S.C. 605(b) that this readoption of our rules would not have a significant economic impact on a substantial number of small entities. This rulemaking relates to beneficial ownership reporting and reporting by insiders of their transactions and holdings. Readoption does not amend existing rules or introduce new rules, and relates only to the readoption of existing rules. For this reason, it does not change the regulatory status quo and therefore should not have a significant economic impact on a substantial number of small entities.

The proposing release encouraged written comment regarding this certification. None of the commentators addressed the certification or described any impact that this readoption would have on small entities.

VI. STATUTORY AUTHORITY

The readoption of rules contained in this release is made under the authority set forth in Sections 3(a)(11), 3(b), 13, 16, 23(a) of the Exchange Act and Sections 30 and 38 of the Investment Company Act of 1940.

List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

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

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

The general authority citation for Part 240 is revised and the following citations are added 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, 78n-1, 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.

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Section 240.13d-3 is also issued under Pub. L. 111-203 §766, 124 Stat. 1799 (2010).

Section 240.16a-1(a) is also issued under Pub. L. 111-203 §766, 124 Stat. 1799 (2010).

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By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: June 8, 2011

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 43
Docket No. OCC-2011-0002
RIN 1557-AD40

FEDERAL RESERVE SYSTEM
12 CFR Part 244
Docket No. 2011-1411
RIN 7100-AD70

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 373
RIN 3064-AD74

U.S. SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 246
Release No. 34-64603; File No. S7-14-11
RIN 3235-AK96

FEDERAL HOUSING FINANCE AGENCY
12 CFR Part 1234
RIN 2590-AA43

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
24 CFR Part 267
RIN 2501-AD53

Credit Risk Retention

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); U.S. Securities and Exchange Commission (Commission); Federal Housing Finance Agency (FHFA); and Department of Housing and Urban Development (HUD).

ACTION: Proposed rule; extension of comment period.

SUMMARY: On April 29, 2011, the OCC, Board, FDIC, Commission, FHFA and HUD (collectively, the "Agencies") published in the Federal Register a joint notice of proposed rulemaking for public comment to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15 U.S.C. § 78o-11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Credit Risk NPR" or "proposed rule").

Due to the complexity of the rulemaking and to allow parties more time to consider the impact of the Credit Risk NPR on affected markets, the Agencies have determined that an extension of the comment period until August 1, 2011 is appropriate. This action will allow interested persons additional time to analyze the proposed rules and prepare their comments.

DATES: Comments on the Credit Risk NPR must be received on or before August 1, 2011.

ADDRESSES: You may submit comments by any of the methods identified in the Credit Risk NPR.[1]. Please submit your comments using only one method.

FOR FURTHER INFORMATION CONTACT:

OCC: Chris Downey, Risk Specialist, Financial Markets Group, (202) 874-4660; Kevin Russell, Director, Retail Credit Risk, (202) 874-5170; Darrin Benhart, Director, Commercial Credit Risk, (202) 874-5670; or Jamey Basham, Assistant Director, or Carl Kaminski, Senior Attorney, Legislative and Regulatory Activities Division, (202) 874-5090, Office of the Comptroller of the Currency, 250 E Street SW, Washington, DC 20219.

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[1] See 76 FR 24090.

Board: Benjamin W. McDonough, Counsel, (202) 452-2036; April C. Snyder, Counsel, (202) 452-3099; Sebastian R. Astrada, Attorney, (202) 452-3594; or Flora H. Ahn, Attorney, (202) 452-2317, Legal Division; Thomas R. Boemio, Manager, (202) 452-2982; Donald N. Gabbai, Senior Supervisory Financial Analyst, (202) 452-3358; or Sviatlana A. Phelan, Financial Analyst, (202) 912-4306, Division of Banking Supervision and Regulation; Andreas Lehnert, Deputy Director, Office of Financial Stability Policy and Research, (202) 452-3325; or Brent Lattin, Counsel, (202) 452-3367, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington , D.C. 20551.

FDIC: Beverlea S. Gardner, Special Assistant to the Chairman, (202) 898-3640; Mark L. Handzlik, Counsel, (202) 898-3990; Phillip E. Sloan, Counsel, (703) 562-6137; Petrina R. Dawson, Counsel, (703) 562-2688; or Jeannette Roach, Counsel, (202) 898-3785, Federal Deposit Insurance Corporation, 550 17th Street, NW, Washington, DC 20429.

Commission: Jay Knight, Special Counsel, or Katherine Hsu, Chief, Office of Structured Finance, Division of Corporation Finance, at (202) 551-3753, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-3628.

FHFA: Patrick J. Lawler, Associate Director and Chief Economist, Patrick.Lawler@fhfa.gov, (202) 414-3746; Austin Kelly, Associate Director for Housing Finance Research, Austin.Kelly@fhfa.gov, (202) 343-1336; Phillip Millman, Principal Capital Markets Specialist, Phillip.Millman@fhfa.gov, (202) 343-1507; or Thomas E. Joseph, Senior Attorney Advisor, Thomas.Joseph@fhfa.gov, (202) 414-3095; Federal Housing Finance Agency, Third Floor, 1700 G Street, NW, Washington, DC 20552.

The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877-8339.

HUD: Robert C. Ryan, Deputy Assistant Secretary for Risk Management and Regulatory Affairs, Office of Housing, Department of Housing and Urban Development, 451 7th Street, SW, Room 9106, Washington, DC 20410; telephone number (202) 402-5216 (this is not a toll-free number). Persons with hearing or speech impairments may access this number through TTY by calling the toll-free Federal Information Relay Service at 800-877-8339.

SUPPLEMENTARY INFORMATION:

On April 29, 2011, the Credit Risk NPR was published in the Federal Register.[2] The Credit Risk NPR proposes to implement the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934 (15 U.S.C. § 78o–11), as added by section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Section 15G generally requires the securitizer of asset-backed securities ("ABS") to retain an economic interest of no less than five percent in the credit risk of the assets collateralizing the ABS. Section 15G includes a variety of exemptions from this requirement, including an exemption for asset-backed securities that are collateralized exclusively by ''qualified residential mortgages,'' as such term is defined by the Agencies by rule.

The Credit Risk NPR would specify credit risk retention requirements for securitizers of ABS. In designing the proposed rules, the Agencies sought to ensure that the amount of credit risk retained would be meaningful—consistent with the purposes of

[2] See 76 FR 24090.

section 15G—while reducing the potential for the proposed rules to negatively affect the availability and cost of credit to consumers and businesses. In recognition of the complexities of the rulemaking and the variety of considerations involved in its impact and implementation, the Agencies requested that commenters respond to numerous questions. The Credit Risk NPR stated that the public comment period would close on June 10, 2011.[3]

The Agencies have received requests from the public for an extension of the comment period to allow for sufficient time for data gathering and impact analyses related to the provisions of the proposed rule.[4] The Agencies believe that it is important for interested persons to have additional time to fully review the provisions of the proposed rule and the questions posed by the Agencies, and to conduct appropriate data collection and analysis on the potential impact of the Credit Risk NPR prior to submitting comment. Therefore, the Agencies are extending the comment period for the Credit Risk NPR from June 10, 2011 to August 1, 2011.

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[3] See id.

[4] See, e.g., comment letters to the Agencies from American Bankers Association et al. (May 13, 2011) and The Loan Syndications and Trading Association (May 26, 2011); and press release from Realogy Corporation (May 10, 2011).

ORIGINAL

[THIS SIGNATURE PAGE RELATES TO THE EXTENSION OF THE COMMENT PERIOD OF THE PROPOSED RULE TITLED "CREDIT RISK RETENTION"]

Dated: 6-3-11

John Walsh

John Walsh,
Acting Comptroller of the Currency.

Billing Code: 4810-33-P

Dated: June 3, 2011

____

John Walsh,
Acting Comptroller of the Currency.

[THIS SIGNATURE PAGE RELATES TO THE EXTENSION OF THE COMMENT PERIOD OF THE PROPOSED RULE TITLED "CREDIT RISK RETENTION"]

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary under delegated authority, June 6, 2011.

Jennifer J. Johnson

Jennifer J. Johnson,
Secretary of the Board.

BILLING CODE 6210-01-P

By order of the Board of Governors of the Federal Reserve System, acting through the Secretary under delegated authority, June 6, 2011.

Jennifer J. Johnson,
Secretary of the Board.

[THIS SIGNATURE PAGE RELATES TO THE EXTENSION OF THE COMMENT PERIOD OF THE PROPOSED RULE TITLED "CREDIT RISK RETENTION"]

Dated at Washington, D.C., this 3rd day of June 2011.
Federal Deposit Insurance Corporation.

Valerie J. Best

Valerie J. Best
Assistant Executive Secretary

Billing Code: 6714-01-P

Dated at Washington, D.C., this 3rd of June 2011.
By order of the Board of Directors.
Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: June 6, 2011

[THIS SIGNATURE PAGE RELATES TO THE EXTENSION OF THE COMMENT PERIOD OF THE PROPOSED RULE TITLED "CREDIT RISK RETENTION"]

Edward J. DeMarco
Edward J. DeMarco,
Acting Director, Federal Housing Finance Agency.

6-2-2011
Date

Billing Code: 8070-01-P

Edward J. Demarco,
Acting Director, Federal Housing Finance Agency

June 2, 2011
Date

[THIS SIGNATURE PAGE RELATES TO THE EXTENSION OF THE COMMENT PERIOD OF THE PROPOSED RULE TITLED "CREDIT RISK RETENTION"]

Jointly prescribed with the Agencies

By the Department of Housing and Urban Development

Robert C. Ryan,
Acting Assistant Secretary for Housing—
Federal Housing Commissioner

6/6/11
Date

Billing Code:

By the Department of Housing and Urban Development

____
Shaun Donovan,
Secretary

June 6, 2011
Date

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230, 240 and 260

[Release Nos. 33-9222; 34-64639; 39-2474; File No. S7-22-11]

RIN 3235-AL16

EXEMPTIONS FOR SECURITY-BASED SWAPS ISSUED BY CERTAIN CLEARING AGENCIES

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: We are proposing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps issued by certain clearing agencies satisfying certain conditions. The proposed rules would exempt transactions by clearing agencies in these security-based swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, as well as exempt these security-based swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.

DATES: Comments on the proposed rules should be received on or before July 25, 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 S7-22-11 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 S7-22-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Tamara Brightwell, Senior Special Counsel to the Director, Michael J. Reedich, Special Counsel, Office of Chief Counsel, or Andrew Schoeffler, Special Counsel, Office of Capital Market Trends, Division of Corporation Finance, at (202) 551-3500, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-4561.

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

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

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

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

I. BACKGROUND

On July 21, 2010, the President signed the Dodd-Frank Act into law.[4] 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.[5] Title VII of the Dodd-Frank Act provides the Securities and Exchange Commission ("SEC" or the "Commission") and the Commodity Futures Trading Commission ("CFTC") with the authority to regulate over-the-counter ("OTC") derivatives in light of the recent financial crisis.

The Dodd-Frank Act provides that the CFTC will regulate "swaps," the SEC will regulate "security-based swaps," and the CFTC and SEC will jointly regulate "mixed swaps."[6] The Dodd-Frank Act amends the Exchange Act to require, among other things, the following: (1) transactions in security-based swaps must be submitted for clearing to a clearing agency if such security-based swap is one that the Commission has determined is required to be cleared, unless an exception from mandatory clearing applies;[7] (2) transactions in security-based swaps must be

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4 The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

5 See Pub. L. No. 111-203, Preamble.

6 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 ("CEA"), 7 U.S.C. 1a(18), as re-designated and amended by Section 721 of the Dodd-Frank Act. See Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 34-62717 (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); and Product Definitions Contained in Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Release No. 33-9204; 34-64372 (Apr. 29, 2011) 76 F.R. 29818.

7 See Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

reported to a registered security-based swap data repository ("SDR") or the Commission;[8] and (3) if a security-based swap is subject to mandatory clearing, transactions in security-based swaps must be executed on an exchange or a registered or exempt security-based swap execution facility ("security-based SEF"), unless no exchange or security-based SEF makes such security-based swap available for trading or the security-based swap transaction is subject to the clearing exception in Exchange Act Section 3C(g).[9] In this release, we are proposing exemptions from the registration requirements of the Securities Act and the Exchange Act, and from the qualification requirements of the Trust Indenture Act, to facilitate implementation of these new requirements.

We believe that the increased use of central clearing for security-based swaps should help to promote robust risk management, foster greater efficiencies, improve investor protection, and promote transparency in the market for security-based swaps.[10] The Dodd-Frank Act seeks to ensure that, wherever possible and appropriate, security-based swaps are cleared.[11] Paragraph (a)(1) of new Exchange Act Section 3C establishes a mandatory clearing requirement for certain

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8 See Pub. L. No. 111-203, §§ 763(i) and 766(a) (adding Exchange Act Sections 13(m)(1)(G) and 13A(A)(1), respectively).

9 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")), and Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011) 76 FR 10948 (Feb. 28, 2011).

10 See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC, Release No. 34-63107 (Oct. 14, 2010), 75 FR 65881 (Oct. 26, 2010), Section III.A.2.a.

11 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.").

security-based swaps.[12] Exchange Act Section 3C(b) sets forth a process by which we would determine whether a security-based swap or any group, category, type or class of security-based swap that a clearing agency plans to accept for clearing is required to be cleared.[13] If we make a determination that a security-based swap is required to be cleared, then parties may not engage in such a security-based swap without submitting it for clearing, unless an exception applies.[14] If we make a determination 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 it has rules that permit it to clear such security-based swap.[15]

Clearing agencies are broadly defined under the Exchange Act and may undertake a variety of functions.[16] One such function is to act as a central counterparty ("CCP").[17] For

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12 Section 763(a) of the Dodd-Frank Act added Section 3C to the Exchange Act. See also 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, Release No. 34-63557 (Dec. 15, 2010), 75 FR 82490 (Dec. 30, 2010) ("Mandatory Clearing Proposing Release").

13 See Exchange Act Section 3C(b) and Mandatory Clearing Proposing Release. In the Mandatory Clearing Proposing Release, we proposed rules 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 swap 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.

14 See Exchange Act Section 3C(g) and Mandatory Clearing Proposing Release. Section 3C(g)(1) 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.

15 See 15 U.S.C. 78s(b) and 12 U.S.C. 5465(e). See also Mandatory Clearing Proposing Release.

16 See Exchange Act Section 3(a)(23).

17 A CCP is an entity that interposes itself between the counterparties to a securities transaction, acting functionally as the buyer to every seller and the seller to every buyer. See Clearing Agency Standards for Operation and Governance, Release No. 34-64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) ("Clearing Agency Standards Proposing Release").

example, when a security-based swap between two counterparties that are members of a CCP is executed and submitted for clearing, the original contract is extinguished and is replaced by two new contracts where the CCP is the buyer to the seller and the seller to the buyer.[18] At that point, the original counterparties are no longer counterparties to each other. As a result, the creditworthiness and liquidity of the CCP is substituted for the creditworthiness and liquidity of the original counterparties.[19]

Under the rules we recently proposed regarding mandatory clearing, to meet the clearing requirement in Exchange Act Section 3C, the parties would be required to submit security-based swaps required to be cleared to a clearing agency that functions as a CCP for central clearing.[20] The proposed rules also would establish procedures for a clearing agency to submit to us for a review each security-based swap, or group, category, type or class of security-based swap, that the clearing agency plans to accept for clearing. We would review the submission and make a determination about whether the security-based swap, or group, category, type or class of security-based swap, is required to be cleared.[21] Under the statute and the proposed rules, the submission would be publicly available and a public comment period would be provided with respect to whether the clearing requirement will apply.[22]

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

19 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.

20 See Mandatory Clearing Proposing Release and proposed Rule 3Ca-2.

21 See Mandatory Clearing Proposing Release and Pub. L. No. 111-203, § 763(a) (adding Exchange Act Section 3C).

22 Id.

If we determine that a security-based swap, or group, category, type, or class of security-based swap is required to be cleared, counterparties would be required to submit such security-based swaps negotiated and entered into bilaterally to the clearing agency for novation.[23] Thus, for security-based swaps submitted for novation, the CCP will be the issuer of new security-based swaps. Because the definition of "security" in the Securities Act was amended in the Dodd-Frank Act to include security-based swaps,[24] the novation of a security-based swap by a clearing agency functioning as a central counterparty involves an offer and sale by the clearing agency of a security (the security-based swap) under the Securities Act.

The Securities Act requires that any offer and sale of a security must either be registered under the Securities Act or made pursuant to an exemption from registration.[25] Certain provisions of the Exchange Act relating to the registration of classes of securities and the indenture qualification provisions of the Trust Indenture Act also potentially would apply to security-based swaps. The provisions of Section 12 of the Exchange Act could, without an exemption, require that security-based swaps be registered before a transaction could be effected on a national securities exchange.[26] In addition, registration of a class of security-based swaps under Section 12(g) would be required if the security-based swap is considered an equity security and there are more than 500 record holders of a particular class of security-based swaps at the

23 See Exchange Act Section 3C and proposed Exchange Act Rule 3Ca-2.

24 See Pub. L. No. 111-203, Section 761(a) (amending Section 3(a) of the Exchange Act).

25 See Section 5 of the Securities Act [15 U.S.C. 77e].

26 We note that a registered security-based SEF would not be a national securities exchange for purposes of the Exchange Act. Therefore, Exchange Act Sections 12(a) and (b) would not be applicable to transactions effected through such facilities.

end of a fiscal year. Further, without an exemption, the Trust Indenture Act would require qualification of an indenture for security-based swaps considered to be debt.[27]

The provisions of the Dodd-Frank Act do not contain an exemption from Securities Act or Exchange Act registration, or from Trust Indenture Act qualification, for security-based swaps, and we believe that compliance with the registration and qualification provisions of these Acts likely would be impracticable and frustrate the purposes of the Dodd-Frank Act. We have taken action in the past to facilitate clearing of certain credit default swaps by clearing agencies functioning as CCPs. For example, prior to enactment of the Dodd-Frank Act, we permitted five clearing agencies to clear certain credit default swaps ("eligible CDS") on a temporary conditional basis.[28] To facilitate the operation of clearing agencies as CCPs for eligible CDS, we

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27 See 15 U.S.C. § 77aaa et seq.

28 See Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of ICE Clear Europe Limited Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009), Order Extending Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of ICE Clear Europe, Limited Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63389 (Nov. 29, 2010), 75 FR 75520 (Dec. 3, 2010); Order Granting Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of Eurex Clearing AG Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009), Order Extending and Modifying Temporary Conditional Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of Eurex Clearing AG Related to Central Clearing of Credit Default Swaps, and Request for Comment, Release No. 34-61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request on Behalf of Eurex Clearing, AG Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63390 (Nov. 29, 2010), 75 FR 75518 (Dec. 3, 2010); Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request of Chicago Mercantile Exchange Inc. and Citadel Investment Group, L.L.C. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing of Credit Default Swaps, and Request for Comments; Release No. 34-61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010), and Order Extending Temporary Conditional Exemptions under the Securities Exchange Act of 1934 in Connection with Request of Chicago Mercantile Exchange Inc. Related to Central Clearing

also adopted interim temporary exemptions from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, subject to certain conditions.[29] In the adopting release, we noted that we believed that the existence of CCPs for CDS would be important in helping to reduce counterparty risks inherent in the CDS market.[30] In addition to those actions with respect to eligible CDS, as discussed further below, the exemptions we are proposing today are similar to exemptions under the Securities Act and the Exchange Act for security futures products and certain standardized options.[31]

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of Credit Default Swaps and Request for Comment, Release No. 34-63388 (Nov. 29, 2010), 75 FR 75522 (Dec. 3, 2010); Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE US Trust LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request from ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009); Order Extending Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, Release No. 34-61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010), and Order Extending and Modifying Temporary Exemptions under the Securities Exchange Act of 1934 in Connection with Request of ICE Trust U.S. LLC Related to Central Clearing of Credit Default Swaps and Request for Comment, Release No. 34-63387 (Nov. 29, 2010), 75 FR 75502 (Dec. 3, 2010); and Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with Request of LIFFE Administration and Management and LCH.Clearnet Ltd. Related to Central Clearing Of Credit Default Swaps, and Request for Comments, Release No. 34-59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (collectively, "CDS Clearing Exemption Orders"). LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

29 See Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) ("Temporary CDS Exemptions Release"). The interim final temporary rules exempted eligible credit default swaps from all provisions of the Securities Act, other than the Section 17(a) anti-fraud provisions, the Exchange Act registration requirements, and the provisions of the Trust Indenture Act, provided certain conditions were met.

30 See id. We extended the expiration date of the final temporary rules until July 16, 2011. See Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, Release No. 33-9158 (Nov. 19, 2010), 75 FR 72660 (Nov. 26, 2010).

31 See Exemption for Standardized Options From Provisions of the Securities Act of 1933 and From the Registration Requirements of the Securities Exchange Act of 1934, Release No. 33-8171 (Dec. 23, 2002), 68 FR 1 (Jan. 2, 2003) ("Standardized Options Release").

The rules proposed in this release are intended to further the goal of central clearing of security-based swaps by providing exemptions for the issuance of security-based swaps in connection with novation by a registered or exempt clearing agency functioning as a CCP from certain regulatory provisions that might otherwise interfere with such clearing activities. Without an exemption, a clearing agency functioning as a CCP would be required to register the security-based swap transaction, which could unnecessarily impede the central clearing of security-based swaps.[32] In addition, the clearing agency would be subject to Exchange Act registration and reporting requirements, and to the requirements of the Trust Indenture Act. We believe that the proposed exemptions from the Securities Act, Exchange Act, and Trust Indenture Act are necessary to facilitate the intent of the Dodd-Frank Act with respect to mandatory clearing of security-based swaps. As noted above, these proposed exemptions are similar to the exemptions we adopted for eligible CDS and standardized options, as well as the exemptions that are provided in the Securities Act and the Exchange Act for security futures products. In addition to our interest in facilitating clearing of security-based swaps, we believe that security-based swaps can be used for financial purposes similar to those served by standardized options and security futures products, and thus we believe that it is appropriate to establish comparable regulatory treatment for security-based swaps. By doing so, we believe that the proposed exemptions would allow for economically similar regulatory treatment under the Securities Act and Exchange Act.[33]

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32 In addition, because the novation generally occurs after the counterparties have agreed to enter into the bilateral security-based swap being novated the investment decision by the counterparties already has occurred.

33 Standardized options and security futures products are only traded on a national securities exchange and thus are subject to listing standards. This differs from the regulatory treatment of security-based swaps under the provisions of the Dodd-Frank Act, which provide that a security-based swap may be cleared by the clearing agency but does not require such security-based swap to be traded on a national securities exchange. We note, however, that security-based swap transactions must be registered under the Securities

II. DISCUSSION OF THE PROPOSED RULES AND AMENDMENTS

We are proposing rules and amendments to existing rules (collectively, "proposed rules") to provide certain exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for security-based swaps issued by clearing agencies functioning as CCPs.

A. Securities Act Rule 239

We are proposing Securities Act Rule 239 to exempt the offer and sale of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a clearing agency that is registered under Section 17A of the Exchange Act[34] or exempt from such registration[35] by rule, regulation or order of the Commission ("registered or exempt clearing agency") in its function as a CCP, from all provisions of the Securities Act, except the anti-fraud provisions of Section 17(a), subject to certain conditions.[36] Thus, proposed Securities Act Rule 239 will permit the offer and sale of security-based swaps to eligible contract participants that are or will be issued by, and in a transaction involving, a registered or exempt

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Act and traded on an exchange if offered or sold to non-eligible contract participants. See Pub. L. No. 111-203 § 768(b) (adding Securities Act Section 5(d)) and Pub. L. No. 111-203 §763(e) (adding Exchange Act Section 6(l)).

34 Section 763(b) of the Dodd-Frank Act provides that certain security-based swap clearing agencies will be deemed registered as clearing agencies for the purpose of clearing security-based swaps. The deemed registered provision, which becomes effective on July 16, 2011, applies if the entity is: (i) a depository institution that cleared swaps as a multilateral clearing organization before July 21, 2010, or (ii) a derivatives clearing organization registered with the CFTC that cleared swaps pursuant to a clearing agency exemption of the Commission before July 21, 2010. Currently, four security-based swap clearing agencies have temporary conditional exemptions from clearing agency registration under Section 17A solely to perform the functions of a clearing agency for certain CDS. See CDS Clearing Exemption Orders.

35 The Dodd-Frank Act contains provisions permitting the Commission to provide exemptions from clearing agency registration with respect to security-based swaps in limited instances. See footnote 42 below. The Commission has the authority to, jointly with the CFTC, prescribe regulations regarding mixed swaps as may be necessary to carry out the provisions of Title VII of the Dodd-Frank Act. The proposed rules would cover security-based swaps, including mixed swaps, issued by clearing agencies that the Commission specifically exempts from registration by rule, regulation, or order.

36 15 U.S.C. §77q. This exemption is similar to the Securities Act exemptions for standardized options and security futures products. See Securities Act Rule 238 [17 CFR 230.238] and Section 3(a)(14) [15 U.S.C. §77c(a)(14)].

clearing agency in its function as a CCP without requiring compliance with Section 5 of the Securities Act.[37]

For the reasons described below, under the proposed rule, the offer and sale of a security-based swap would be exempt from the provisions of the Securities Act, other than Section 17(a), if the following conditions are satisfied:

- The security-based swap is or will be issued by a clearing agency that is registered with us or exempt from such registration by rule, regulation or order of the Commission;
- The Commission has determined that the security-based swap is required to be cleared or the registered or exempt clearing agency is permitted to clear the security-based swap pursuant to its rules;
- The security-based swap is sold only to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act) in a transaction involving the

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37 The proposed exemption for the security-based swap transaction from Securities Act registration would not apply to any securities that may be delivered in settlement or payment of any obligations under the security-based swap (e.g. a physically settled credit default swap). With respect to such securities transactions, the parties to the security-based swap must either be able to rely on another exemption from the registration requirements of the Securities Act or must register such transaction. In evaluating the availability of an exemption from the Securities Act registration requirements, if such a security-based swap may be settled or paid through the delivery of a security, then the transaction in the underlying or referenced security will be considered to occur at the same time as the transaction in the related security-based swap. In this connection, we note that the Dodd-Frank Act amended Section 2(a)(3) of the Securities Act to provide that security-based swaps could not be used by an issuer, its affiliates, or underwriters to circumvent the registration requirements of Securities Act Section 5 with respect to the issuer's securities underlying the security-based swap. As amended, Section 2(a)(3) provides that "[a]ny offer or sale of a security-based swap by or on behalf of the issuer of the securities upon which such security-based swap is based or is referenced, an affiliate of the issuer, or an underwriter, shall constitute a contract for sale of, sale of, offer to for sale, or offer to sell such securities." As a result, such issuer, affiliate, or underwriter would have to comply with the registration requirements of the Securities Act with respect to such underlying or referenced security, unless another exemption from registration was available.

registered or exempt clearing agency in its function as a CCP with respect to the security-based swap;[38] and

- For each security-based swap that would be offered or sold in reliance upon this exemption, the following information is included in an agreement covering the security-based swap the registered or exempt clearing agency provides to, or makes available to, its counterparty or is posted on a publicly available website maintained by the registered or exempt clearing agency:
  - A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
  - A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
  - A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting

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38 Eligible contract participant is defined in CEA Section 1a(18) (as re-designated and amended by Section 721 of the Dodd-Frank Act. See also Pub. L. No. 111-203, § 761(a) (adding Exchange Act Section 3(a)(65), which refers to the definition of eligible contract participant in the CEA. The definition of eligible contract participant contained the CEA (as amended by the Dodd-Frank Act) includes: financial institutions; insurance companies; investment companies; other entities and employee benefit plans; State and local municipal entities; market professionals, such as broker dealers, futures commission merchants, floor brokers, and investment advisors; and natural persons with a specified dollar amount invested on a discretionary basis. For certain of the entities and market professionals, the definition also contains certain conditions relating to the amount of assets or amount of monies invested on a discretionary basis. For a complete description of the definition, see CEA Section 1a(18) and Section 721 of the Dodd-Frank Act.

requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

We believe that the proposed rule exempting offers and sales of such security-based swaps by a registered or exempt clearing agency in its function as a CCP will further the goal in the Dodd-Frank Act of central clearing of security-based swaps. Without exempting the offers and sales of such security-based swaps by a registered or exempt clearing agency in its function as a CCP from the Securities Act (other than Section 17(a)), we believe that a registered or exempt clearing agency may not be able to clear security-based swaps in the manner contemplated by the Dodd-Frank Act and our proposed rules implementing its provisions. Further, we believe that with the above conditions, an exemption from the Securities Act is necessary and appropriate in the public interest and consistent with the protection of investors.[39]

Request for Comment

1. Should we provide an exemption from the provisions of the Securities Act, other than the antifraud provisions of Section 17(a), for the offer and sale of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP? Why or why not?
2. If we provide an exemption, are the proposed conditions to the exemption appropriate? Why or why not? Are there additional or different conditions that we should impose? Should we require more specificity as to the terms of the security-based swaps?

39 We believe that if the conditions to the proposed exemption are satisfied, then the protections provided for in the exemption for security futures arising from the requirement for exchange trading, such as compliance with the statutory listing standards, are not needed here. See Section 6(h) of the Exchange Act [15 U.S.C. 78f(h)]. Unlike security future products that may be purchased by any person, security-based swaps issued by a registered or exempt clearing agency in its function as a CCP may only be entered into by eligible contract participants (unless the security-based swap transaction is on a national securities exchange and there is an effective registration statement under the Securities Act covering transactions in such security-based swap). See Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)) and § 768(b) (adding Securities Act Section 5(d)).

1. Registered or Exempt Clearing Agency Issuing Security-Based Swaps in its Function as a CCP

The proposed Securities Act exemption would apply only to offers and sales of security-based swaps that are or will be issued by, and in a transaction involving, a clearing agency in its function as a CCP that is either registered with us or exempt from such registration by rule, regulation or order of the Commission. Registered clearing agencies are regulated by us under the Exchange Act and must comply with the standards in Exchange Act Section 17A.[40] The activities of such clearing agencies relating to the clearing or submission for clearing of security-based swaps are subject to regulation under the Exchange Act and applicable rules thereunder.[41] The proposed rule also would be available for security-based swaps that are issued by a clearing agency that we have exempted from registration with us by rule, regulation, or order, subject to such terms and conditions contained in any exemption.[42] We believe it is appropriate to make the proposed Securities Act exemption available to security-based swaps issued by exempt clearing agencies because in granting an exemption the Commission could impose conditions to the availability of the exemption that would provide protection to investors.

The proposed exemption would only apply to the extent the clearing agency will issue or is issuing the security-based swap in its function as a CCP and will apply to transactions

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40 15 U.S.C. 78q-1. See also discussion in Mandatory Clearing Proposing Release.

41 Id.

42 Section 763(b) of the Dodd-Frank Act amended the Exchange Act and added Section 17(k), which provides that "[t]he Commission may exempt, conditionally or unconditionally, a clearing agency from registration under this section for the clearing of security-based swaps if the Commission determines that the clearing agency is subject to comparable, comprehensive supervision and regulation by the Commodity Futures Trading Commission or the appropriate government authorities in the home country of the agency. Such conditions may include, but are not limited to, requiring that the clearing agency be available for inspection by the commission and make available all information requested by the Commission." Thus, although we have the authority under the Exchange Act, as amended by the Dodd-Frank Act, to provide exemptions from clearing agency registration, our authority to grant an exemption from registration for clearing agencies that clear security-based swaps is more limited than it is for other clearing agencies.

involving such clearing agency.[43] We note that a clearing agency's role as a CCP and an issuer of security-based swaps is similar to a clearing agency's role with respect to standardized options.[44] We believe that a clearing agency's role as a CCP for security-based swaps, similar to a clearing agency's role with respect to standardized options, is fundamentally different from a conventional issuer that registers transactions in its securities under the Securities Act. For example, the purchaser of a security-based swap does not, except in the most formal sense, make an investment decision regarding the clearing agency.[45] Rather, the security-based swap investment decision is based on the referenced security, loan, narrow-based security index, or issuer. In this circumstance, coupled with the other conditions to the proposed exemption, we do not believe that Securities Act registration of the offer and sale of security-based swaps by a clearing agency in its function as a CCP to eligible contract participants is necessary.

Request for Comment

3. Is the proposed exemption appropriately conditioned on the registered or exempt clearing agency issuing the security-based swap in its function as a CCP? Why or why not? Should there be a distinction between registered and exempt clearing agencies for this purpose?

2. Security-Based Swaps the Commission Determines are Required to be Cleared or that a Clearing Agency is Permitted to Clear Pursuant to its Rules

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43 As we noted above, when functioning as a CCP, a clearing agency's creditworthiness and liquidity are substituted for the creditworthiness and liquidity of the original counterparties. See footnote 19 above and accompanying text.

44 See Standardized Options Release.

45 We note, however, that a member or other user of a clearing agency may have an interest in the financial condition of the clearinghouse because the member or user will be relying on the ability of the clearinghouse to meet its obligations with respect to cleared transactions. Registered clearing agencies are required to make their audited financial statements and other information about themselves publicly available. See 15 U.S.C. 78j(b).

We recently proposed rules to implement the provisions of the Dodd-Frank Act regarding mandatory and voluntary clearing of security-based swaps, or groups, categories, or types or classes of security-based swaps.[46] Our proposed rules would establish procedures for a clearing agency to submit for a review the security-based swap, or group, category, type or class of security-based swap, that the clearing agency plans to accept for clearing. As proposed, we would review the submission and make a determination of whether the security-based swap, or group, category, type or class of security-based swap, is required to be cleared.[47]

Consistent with the purposes of the Dodd-Frank Act, our proposed exemption is intended to facilitate clearing of security-based swaps that the Commission determines are subject to mandatory clearing, or that are permitted to be cleared pursuant to the clearing agency's rules. Consequently, under proposed Rule 239, a registered or exempt clearing agency would be entitled to rely on the exemption to issue, in its function as a CCP, security-based swaps that we determine are required to be cleared. In addition, the exemption would be available to a registered or exempt clearing agency issuing a security-based swap, in its function as a CCP, that is not subject to mandatory clearing but is permitted to be cleared pursuant to the clearing agency's rules. The proposed exemption would not be available for security-based swaps issued by a registered or exempt clearing agency in its function as a CCP that are not required to be cleared or permitted by its rules to be cleared.

The Dodd-Frank Act also provides that if a security-based swap is subject to the mandatory clearing requirement, it must be traded on an exchange or a registered or exempt

46 See Mandatory Clearing Proposing Release.

47 See Mandatory Clearing Proposing Release. For those security-based swaps that are submitted and not required to be cleared, the clearing agency in its function as a CCP may still clear those security-based swaps if it is permitted by its rules.

security-based SEF, unless no security-based SEF makes such security-based swap available for trading.[48] Thus, it is possible that a security-based swap could be subject to mandatory clearing without being traded on an exchange or security-based SEF. Proposed Rule 239 would be available for security-based swaps that are subject to the mandatory clearing requirement or are permitted to be cleared pursuant to the clearing agency's rules,[49] regardless of whether such security-based swaps also are traded on a national securities exchange or through a security-based SEF.[50] We believe that if the conditions to the proposed exemption are satisfied, then the protections provided for in the analogous exemption for security futures arising from the requirement for exchange trading, such as compliance with the statutory listing standards, are not needed here. Unlike security future products that may be purchased by any person, under the Dodd-Frank Act security-based swaps may only be offered and sold to eligible contract participants either pursuant to an exemption from the registration requirements of the Securities Act and in transactions not effected on a national securities exchange or in registered offerings effected on a national securities exchange. No offers or sales of security-based swaps may be made to non-eligible contract participants unless there is an effective registration statement under

48 Exchange Act Section 3C(h) specifies that transactions in security-based swaps that are subject to the clearing requirement of Exchange Act Section 3C(a)(1) must be executed on an exchange or on a security-based SEF registered with us (or a security-based SEF exempt from registration), unless no exchange or security-based SEF makes the security-based swap available to trade or the security-based swap transaction is subject to the clearing exception in Exchange Act Section 3C(g). See Pub. L. No. 111-203, § 763 (adding Section 3C(h) of the Exchange Act) Exchange Act Section 3D(e) allows the Commission to exempt a security-based SEF from registration if the Commission finds that the security-based SEF is subject to comparable comprehensive supervision and regulation on a consolidated basis by the CFTC.

49 The exemption would be limited to security-based swaps issued by and in a transaction involving a registered or exempt clearing agency in its function as a CCP.

50 See Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011). In this regard, we note that a security-based swap may be required or permitted to be cleared, but neither a national securities exchange nor a security-based SEF may make the security-based swap available for trading.

the Securities Act covering transactions in such security-based swap[51] and any security-based swap transaction with a non-eligible contract participant must be effected on a national securities exchange.[52] As a result, security-based swaps issued by a registered or exempt clearing agency in its function as a CCP may only be offered and sold to eligible contract participants, unless there is an effective registration statement and the transaction is on a national securities exchange. Thus, because only eligible contract participants may enter into the security-based swaps not traded on a national securities exchange, we do not believe it is necessary to condition the exemption on whether the security-based swap is traded on a national securities exchange. In addition, including such a provision could frustrate the goals of the provisions of the Dodd-Frank Act because the Dodd-Frank Act did not restrict transactions with eligible contract participants to transactions on national securities exchanges. Consequently, the proposed exemption does not include such a requirement.

Request for Comment

4. Should we condition the availability of the exemption on the security-based swap being subject to the mandatory clearing requirement, or being permitted to be cleared pursuant to the clearing agency's rules, as proposed?
5. Should the exemption be limited to security-based swaps that are subject to the mandatory clearing requirement, and not include those that are permitted to be cleared?
6. Should the exemption be available to security-based swaps that are not traded on an exchange or a security-based SEF, as proposed?

3. Sales only to Eligible Contract Participants

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[51] See Pub. L. No. 111-203, § 768(b) (adding Securities Act Section 5(d)).

[52] See Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)).

Under the Dodd-Frank Act, only an eligible contract participant may enter into security-based swaps other than on a national securities exchange.[53] In addition, security-based swaps that are not registered pursuant to the Securities Act can only be sold to eligible contract participants.[54] New Section 5(d) of the Securities Act specifically provides that it is unlawful to offer to buy, purchase, or sell a security-based swap to any person that is not an eligible contract participant, unless the transaction is registered under the Securities Act.[55] Given that Congress determined it is appropriate to limit the availability of registration exemptions under the Securities Act to eligible contract participants, we believe it is appropriate to limit the proposed Securities Act exemption to security-based swaps entered into with eligible contract participants.

Request for Comment

7. Should we limit the Securities Act exemption to transactions with eligible contract participants, as proposed?

4. Disclosures Relating to the Security-Based Swaps

The proposed rule would require the registered or exempt clearing agency to disclose, either in its agreement regarding the security-based swap or on its publicly available website, certain information with respect to the security-based swap. This information would include the following:

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53 See also Pub. L. No. 111-203, § 763(e) (adding Exchange Act Section 6(l)).

54 See Pub. L. No. 111-203, § 768(b) (adding Securities Act Section 5(d)).

55 See Section 768(b) of the Dodd-Frank Act (adding new Securities Act Section 5(d)) ("Notwithstanding the provisions of section 3 or 4, unless a registration statement meeting the requirements of section 10(a) is in effect as to a security-based swap, it shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant as defined in section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)).").

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
- A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan, or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available, and, if so, the location where the information is available.

The purpose of the proposed requirement relating to the availability of information is to inform investors about whether there is publicly available information about the issuer of the referenced security or the referenced issuer.[56] We are not proposing to condition the exemption on whether the issuer is subject to Exchange Act reporting or whether there is publicly available financial information about such issuer. As noted above, the proposed exemption for offers and sales of security-based swaps issued by, and in a transaction involving, a registered or exempt clearing

[56] For issuers that are not subject to Exchange Act reporting requirements, the following are some non-exclusive examples of issuers that may have information publicly available, including financial information about the issuer, or circumstances in which public information about a security may be available: (1) an entity that voluntarily files Exchange Act reports; (2) an entity that makes Securities Act Rule 144(d)(4) information available to any person; (3) a foreign private issuer whose securities are listed outside the United States; (4) a foreign sovereign issuer with outstanding debt; (5) for periods before July 21, 2010 an asset-backed security issued in a registered transaction with publicly available distribution reports (for periods after July 21, 2010, asset-backed issuers will continue to be subject to reporting); and (6) an asset-backed security issued or guaranteed by the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") or the Government National Mortgage Association ("Ginnie Mae").

agency in its function as a CCP would be limited to security-based swaps entered into with an eligible contract participant. The Dodd-Frank Act did not restrict eligible contract participants' ability to enter into security-based swaps based on whether or not there is publicly-available information about the issuer of the referenced security or loan or the referenced issuer.[57] As a result, and in light of the nature of the other regulatory safeguards,[58] we are not proposing to condition the proposed exemption on the actual availability or delivery of such information. While the Dodd-Frank Act does not condition clearing of security-based swaps on the availability of such information, we believe it is important for eligible contract participants to understand whether such information is publicly available. The availability (or absence) of public information is generally important to eligible contract participants and the registered or exempt clearing agency in evaluating and pricing the security-based swap. Therefore, our proposed rule would require disclosure about whether such information is available.

If the issuer of the referenced security or loan or the referenced issuer is not subject to Exchange Act reporting, but there is publicly available information about the issuer, the clearing agency would be required under the proposal to disclose that fact and disclose where the

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57 We note that eligible contract participants may enter into security-based swaps on a bilateral basis in reliance on an available exemption from the registration requirements of the Securities Act. The proposed exemption in this release to facilitate clearing of security-based swaps does not apply to these bilateral transactions.

58 As part of the process for submitting security-based swaps to us for a determination of whether such security-based swaps are subject to mandatory clearing, the Dodd-Frank Act requires us to take into account several factors, such as the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data, when reviewing a submission to clear security-based swaps by a clearing agency. Much of the information that the registered or exempt clearing agency will be required to include in its agreement or on its website, as a condition to the proposed exemption, likely will already be included in the description of the security-based swaps that the clearing agency identifies publicly that it is going to clear. In addition to the security-based swap submission provisions, the Dodd-Frank Act and the rules proposed under the Act relating to reporting requirements, trade acknowledgments and verification, and business conduct would require certain disclosures relating to security-based swaps, some of which would overlap with the information requirement we are proposing. See, e.g., Mandatory Clearing Proposing Release and Trade Acknowledgment and Verification of Security-Based Swap Transactions, Release No. 34-63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011) ("Trade Acknowledgement and Verification Proposing Release").

information is available. This disclosure could include, for example, a statement that the issuer is listed on a particular foreign exchange and where information about issuers on such exchange can be found.

Under our proposal, the required information could be provided in the agreement covering the security-based swap the registered or exempt clearing agency provides or makes available to the counterparty or on a publicly available website maintained by the clearing agency. We understand that master agreements and related schedules for security-based swaps generally contain detailed information about the terms of the security-based swaps.[59] In addition, each registered clearing agency is required to post and maintain a current and complete version of its rules on its website. Thus, we believe that parties engaging in security-based swaps transactions would be familiar with looking to the agreements or a clearing agency's website to obtain information. Given that clearing agencies generally provide information in agreements and maintain publicly available websites, we believe that providing the information we are proposing be required to be disclosed in the agreement for the security-based swap or on the

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[59] In addition, under the rules proposed in the Trade Acknowledgement and Verification Proposing Release and Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, Release No. 63346 (Nov. 19, 2010), 75 FR 75207 (Dec. 2, 2010) ("SBSR Proposing Release"), which were proposed under the Dodd-Frank Act and for which action has not yet been taken with respect to final rules, the information that would be required to be reported to the security-based swap data repository includes the basic terms of the security-based swap: the asset class of the security-based swap, identification of the security-based swap instrument and the specific asset(s) or issuer of a security on which the security-based swap is based; the notional amount(s), and the currenc(ies) in which the notional amount(s) is expressed; the date and time of execution, and the effective date and scheduled termination date; the price; the terms of any fixed or floating rate payments, and the frequency of any payments; the amount(s) and currenc(ies) of any up-front payment(s) and a description of the terms and contingencies of the payment streams of each counterparty to the other; the title of any master agreement, or any other agreement governing the transaction (including the title of any document governing the satisfaction of margin obligations), incorporated by reference and the date of any such agreement; and the data elements necessary for a person to determine the market value of the transaction. To the extent we adopt these or similar information reporting requirements, the parties to the security-based swap transaction would have to know detailed information about the terms of the security-based swap transaction to comply with the reporting requirements.

clearing agency's publicly available website would not pose significant burdens for clearing agencies.

Request for Comment

8. Should we require a registered or exempt clearing agency to provide or make available information about the security-based swap it will issue, as proposed?

9. Is the proposed requirement that a registered or exempt clearing agency indicate whether there is public information available about the referenced issuer or security upon which the security-based swap is based appropriate? If not, why not?

10. Should we require a registered or exempt clearing agency to provide or make available any additional or different information? Are any of the proposed disclosures unnecessary?

11. Should the exemption be limited to circumstances where the security-based swap relates to an Exchange Act reporting issuer?

12. Should we require, as proposed, that if the issuer is not an Exchange Act reporting company but there is publicly available information, that the location of that information be disclosed?

13. Should we provide the alternatives of including the disclosure in the agreement covering the security-based swap or on the clearing agency's publicly available website, as proposed? Should we require that all agreements include the information, or, alternatively, require the information to be posted on the clearing agency's publicly available website in any case? As another alternative, should we require that the information be made available to clearing members and eligible contract participants rather than require that the information be publicly available? Will the registered or

exempt clearing agency already provide some or all of the proposed disclosures on its website? If so, what information? Is the information proposed to be required to be provided publicly available from sources other than the registered or exempt clearing agency? If so, where?

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

Section 12(a) of the Exchange Act makes it unlawful for any broker or dealer to effect a transaction in a non-exempt security on a national securities exchange unless the security has been registered under Section 12(b) for trading on that exchange. Section 12(g)(1), as modified by rule, requires any issuer with more than $10,000,000 in total assets and a class of equity securities held by 500 or more persons to register such security with us.[60]

Rule 12b-1 under the Exchange Act prescribes the procedures for registration under both Section 12(b) and Section 12(g). Absent an exemption, security-based swaps that will be traded on national securities exchanges would be required to be registered under Section 12(b) of the Exchange Act. A registered or exempt clearing agency issuing a security-based swap as a result of novation would be required, without an available exemption, to register the security-based swaps under Section 12(b) before such security-based swaps could be traded on a national securities exchange. In addition, if the security-based swaps were considered equity securities of the registered or exempt clearing agency, the registration provisions of Section 12(g) of the Exchange Act could apply.

As noted above, just as a registered or exempt clearing agency is different from a conventional issuer that registers transactions in its securities under the Securities Act, it is also different with respect to registering a class of its securities, in this case the security-based swap

60 15 U.S.C. 78l(g) and Rule 12g-1 (17 CFR 240.12g-1).

issued by the registered or exempt clearing agency, under the Exchange Act. Therefore, we are proposing two rules relating to Exchange Act registration of security-based swaps that are or have been issued by a registered or exempt clearing agency in its function as a CCP.

We are proposing new Exchange Act Rule 12a-10 to exempt security-based swaps that are or have been issued by a registered or exempt clearing agency in reliance on the proposed exemption under the Securities Act from Section 12(a) of the Exchange Act under certain conditions.[61] Specifically, proposed Exchange Act Rule 12a-10 would provide that Exchange Act Section 12(a) does not apply to any security-based swap that:

- is or will be issued by a registered or exempt clearing agency in its function as a CCP with respect to the security-based swap;
- the Commission has determined is required to be cleared, or that the clearing agency is permitted to clear pursuant to its rules;
- is sold to an eligible contract participant in reliance on Securities Act Rule 239; and
- is traded on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act.

We also are proposing an amendment to Exchange Act Rule 12h-1 to exempt security-based swaps that are or have been issued by a registered or exempt clearing agency from the provisions of Section 12(g) of the Exchange Act under certain conditions.[62] Proposed Exchange Act Rule 12h-1(h) would exempt from Section 12(g) of the Exchange Act security-based swaps that are issued by a registered or exempt clearing agency in its function as a CCP, whether or not such security-based swap is traded on a national securities exchange registered pursuant to

61 15 U.S.C. 78l(a).

62 15 U.S.C. 78l(g).

Section 6(a) of the Exchange Act or a registered or exempt security-based SEF.[63] In addition, the security-based swaps being issued by the registered or exempt clearing agency in its function as a CCP must be required to be cleared, or be permitted to be cleared pursuant to the clearing agency's rules, and may only be sold to eligible contract participants.

As we noted in the discussion of the proposed Securities Act exemption, we believe the interest of investors in the security-based swap is primarily with respect to the referenced security or loan, referenced issuer or referenced narrow-based security index, and not with respect to the registered or exempt clearing agency functioning as the CCP.[64] Therefore, we preliminarily believe that requiring clearing agencies to register security-based swaps under the Exchange Act would not provide additional useful information or meaningful protection to investors with respect to the security-based swap. In addition, the other consequences of Exchange Act registration, such as requirements for ongoing periodic reporting and application of the proxy rules to the clearing agency, would not be meaningful in the context of security-based swaps. At the same time, requiring such registration likely would impose burdens on clearing agencies issuing security-based swaps.[65] Therefore, we believe that subjecting the registered or exempt clearing agency to the requirements of the Exchange Act arising from Section 12(a) or 12(g) is not necessary or appropriate in the public interest.

In addition, we note that similar Exchange Act exemptions exist for standardized options issued by a registered options clearing agency and security futures products issued by a

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63 Exchange Act Rules 12h-1(d) and 12h-1(e) provide similar exemptions for options and futures, respectively.

64 As noted above, a member or other user of the clearing agency may have an interest in the financial condition of the clearinghouse.

65 See Pub. L. No. 111-203 § 763(b).

registered or exempt clearing agency.[66] We believe that it is appropriate to establish comparable regulatory treatment for security-based swaps issued by a registered or exempt clearing agency with respect to the applicability of Section 12 of the Exchange Act to security-based swaps issued by a registered or exempt clearing agency. Moreover, we believe it is important to further the goal of facilitating clearing of security-based swaps while maintaining appropriate investor protection.

Security-based swaps that will not be cleared by a registered or exempt clearing agency in its function as a CCP but are listed for trading on a national securities exchange or registered or exempt security-based SEF will not be able to rely on the proposed exemption from registration under Section 12(b) or Section 12(g) of the Exchange Act.[67]

Request for Comment

14. Should we provide an exemption, as proposed, from Section 12(a) and Section 12(g) of the Exchange Act for security-based swaps that are or have been issued to eligible contract participants by a registered or exempt clearing agency in its function as a CCP? Why or why not?

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66 See Exchange Act Section 12(a) [15 U.S.C. 78l(a)] and Exchange Act Rule 12a-9 [17 CFR 240.12a-9] and Rules 12h-1(d) and (e) [17 CFR 240.12h-1(d) and (e)].

67 We recognize that security-based swaps that will be issued by a clearing agency, as well as security-based swaps that will not be cleared, may be traded on or through a national securities exchange or a security-based SEF. If the national securities exchange or security-based SEF is acting only in its capacity as a system or platform for trading securities, we do not believe it would be offering or selling the security-based swaps that are being traded or transacted by market participants on or through its system or platform, for purposes of either the Securities Act or the Exchange Act registration provisions applicable to security-based swaps. If the security-based swap being traded on or through the national securities exchange or security-based SEF will, by its terms, be cleared by a clearing agency in its function as a CCP, the security-based swap will be issued by such clearing agency, similar to standardized options and security-future products that are traded on national securities exchanges and cleared by registered clearing agencies. For a security-based swap that will not, by its terms, be cleared by a clearing agency in its function as a CCP, market participants must evaluate the availability of exemptions under the Securities Act and the Exchange Act for their security-based swap transactions.

15. If we should provide an exemption, are the proposed conditions to the exemption appropriate? Why or why not? Are there additional conditions that we should impose?
16. Should we provide an exemption from Section 12(a) and Section 12(g) of the Exchange Act for security-based swaps traded on a national securities exchange but that are not cleared? Why or why not?
17. Should we provide an exemption from Section 12(g) of the Exchange Act for security-based swaps traded on a registered or exempt security-based SEF but that are not cleared? Why or why not?

C. Implications of Security-Based Swaps as Securities

Transactions involving the offer and sale of security-based swaps that are not issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP would not be able to rely on the proposed exemptions under the Securities Act and Exchange Act. Thus, the proposed exemptions would not be available for transactions involving security-based swaps that will not be cleared ("uncleared security-based swaps") that may be entered into on organized markets, such as a security-based SEF or a national securities exchange. It is our understanding that transactions involving uncleared security-based swaps occur today on organized platforms that would likely register as security-based SEFs, and we expect this activity will continue after the effective date of the Dodd-Frank Act.[68] As of the effective date of the Dodd-Frank Act, however, such security-based swaps will be included in the definition of security under the Securities Act and the Exchange Act and subject to the full panoply of the federal securities laws, including the registration requirements of Section 5 of the Securities Act and Section 12 of the Exchange Act. Because the proposed exemptions are limited to security-

68 See Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposed rules relating to security-based SEFs would allow for transactions in uncleared security-based swaps to occur on registered security-based SEFs).

based swaps that are issued or will be issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP, counterparties engaging in an uncleared security-based swap would have to either rely on other available exemptions from the registration requirements of the Securities Act, the Exchange Act, and, if applicable, the Trust Indenture Act or consider whether to register such transaction or class of security.

Request for Comment

18. How will the proposed exemptions affect, if at all, the manner in which security-based swaps are transacted today and are expected to be transacted once the provisions of Title VII of the Dodd-Frank Act become effective?
19. Will the counterparties to uncleared security-based swaps be able to rely on other available exemptions from registration under the Securities Act and Exchange Act? If not, why? Is further guidance or rules needed in this regard? If so, what type of guidance or rules would be helpful?
20. Are security-based swaps transacted today or expected to be transacted once the provisions of Title VII of the Dodd-Frank Act become effective in a manner that would not permit the parties to rely on existing exemptions under the Securities Act and Exchange Act? If so, please explain in detail why existing exemptions would not be available.
21. Should we consider additional exemptions under the Securities Act and Exchange Act for security-based swaps traded on a national securities exchange or security-based SEFs with eligible contract participants but that are not cleared? Should an exemption from Exchange Act registration be provided if all holders of the class of security-based swap

are eligible contract participants? Why or why not? What conditions to any such exemption would be appropriate, if any?

22. Should we consider providing an exemption under the Securities Act that would allow a public offering of security-based swaps to eligible contract participants on a registered security-based SEF or national securities exchange? Why or why not? What conditions to any such exemption would be appropriate, if any?

D. Trust Indenture Act Rule 4d-11

We are proposing Rule 4d-11 under Section 304(d) of the Trust Indenture Act that would exempt any security-based swap offered and sold in reliance on Securities Act Rule 239 from having to comply with the provisions of the Trust Indenture Act.[69] We adopted a similar exemption on a temporary basis for eligible CDS.[70]

The Trust Indenture Act is aimed at addressing problems that unregulated debt offerings posed for investors and the public,[71] and provides a mechanism for debtholders to protect and enforce their rights with respect to the debt. We do not believe that the protections contained in the Trust Indenture Act are needed to protect eligible contract participants to whom a sale of a security-based swap is made in reliance on proposed Securities Act Rule 239. The identified problems that the Trust Indenture Act is intended to address generally do not occur in the offer

69 The Trust Indenture Act applies to debt securities sold through the use of the mails or interstate commerce. Section 304 of the Trust Indenture Act exempts from the Trust Indenture Act a number of securities and transactions. Section 304(a) of the Trust Indenture Act exempts securities that are exempt under Securities Act Section 3(a) but does not exempt from the Trust Indenture Act securities that are exempt by Commission rule. Accordingly, while proposed Securities Act Rule 239 would exempt the offer and sale of security-based swaps satisfying certain conditions from all the provisions of the Securities Act (other than Section 17(a)), the Trust Indenture Act would continue to apply absent proposed Rule 4d-11.

70 See Rule 4d-11T [17 CFR 260.4d-11T].

71 See 15 U.S.C.77bbb(a).

and sale of security-based swaps.[72] For example, security-based swaps are contracts between two parties and, as a result, do not raise the same problem regarding the ability of parties to enforce their rights under the instruments as would, for example, a debt offering to the public. Moreover, through novation, the clearing agency functionally becomes the counterparty to the buyer and the seller, and, in the case where buyer and seller are both members of the CCP, each would look directly to the clearing agency to satisfy the obligations under the security-based swap. As a consequence, enforcement of contractual rights and obligations under the security-based swap would occur directly between such parties, and the Trust Indenture Act provisions would not provide any additional meaningful substantive or procedural protections.

Accordingly, due to the nature of security-based swaps as contracts that will be or have been issued by a registered or exempt clearing agency in its function as a CCP, we do not believe the protections contained in the Trust Indenture Act are needed with respect to these instruments. Therefore, we believe the proposed exemption is necessary or appropriate in the public interest, consistent with the protection of investors and the purposes fairly intended by the Trust Indenture Act.

Request for Comment

23. The proposed rules include an exemption from the application of the Trust Indenture Act for security-based swaps that are offered and sold in reliance on proposed Securities Act Rule 239. Is this exemption appropriate or are there contractual protections in the Trust Indenture Act that should be included as mandatory provisions of a security-based swap contract that is or will be issued by a registered or exempt clearing agency? If yes, please explain in detail.

72 15 U.S.C. 77bbb(a).

E. Transition Matters

As we discuss above, we adopted temporary rules to exempt eligible credit default swaps from all provisions of the Securities Act (other than the Section 17(a) anti-fraud provisions), Exchange Act registration requirements, and the provisions of the Trust Indenture Act, provided certain conditions were met.[73] We subsequently extended the expiration date of the temporary rules until July 16, 2011.[74] The rules proposed in this release would create permanent exemptions that would supplant the temporary rules. However, the current termination date for the temporary rules may pass before the rules proposed in this release are adopted. We plan to provide an appropriate transition from the temporary rules to any permanent rules. In the event the permanent rules are not in place by July 16, 2011, we may consider extending the temporary rules in order to continue facilitating the clearing of certain credit default swaps by clearing agencies functioning as CCPs.

III. GENERAL REQUEST FOR COMMENT

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

24. We are interested in understanding what type of security-based swaps would not be eligible for these proposed exemptions. We noted above that the proposed exemptions would not be available for transactions involving uncleared security-based swaps that may be entered into on organized markets, such as a security-based SEF or a national securities exchange. Are there other security-based swaps that would not be

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73 See Temporary CDS Exemptions Release.

74 See footnote 30 above.

encompassed within the scope of the proposed exemptions? Should these other security-based swaps be covered by the proposed exemptions? If so, why?

25. What are the amounts and types of security-based swaps that may not satisfy the conditions for the proposed exemptions?

26. We have not proposed an amendment to Securities Act Rule 146 for security-based swaps transactions because the Dodd-Frank Act provides that states may not regulate these transactions (except under their general antifraud authority).[75] Therefore, we do not believe it is necessary to propose that eligible contract participants that are sold security-based swaps in reliance on proposed Securities Act Rule 239 be defined as "qualified purchasers" under Section 18(b)(3) of the Securities Act. Were we to add such a definition, such security-based swaps that are or will be issued by a registered or exempt clearing agency would be included as "covered securities" under Section 18 of the Securities Act and exempt from state securities registration ("blue sky") laws. Would defining eligible contract participants that are sold security-based swaps pursuant to Securities Act Rule 239 as "qualified purchasers" for purposes of Section 18 of the Securities Act (and thus making the security-based swaps that are or will be issued by a registered or exempt clearing agency "covered securities,") provide any benefit or greater certainty than that provided by the language in Exchange Act Section 28(a)(4)?

27. The conditions of the proposed Exchange Act and Trust Indenture Act exemptions are the same as the conditions to the proposed Securities Act exemption. Is this appropriate or should there be different conditions relating to the Exchange Act and Trust Indenture Act exemptions? If yes, please explain.

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[75] Exchange Act Section 28(a)(4) (added by Section 767 of the Dodd-Frank Act).

28. Are there transition issues we should consider relating to the temporary rules for eligible CDS and the proposed permanent rules?

IV. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of proposed Securities Act Rule 239 would result in "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[76] The Commission is submitting proposed Rule 239 to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[77] 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 title for this collection of information is:

- "Rule 239" (a proposed new collection of information).

Rule 239 is a newly proposed collection of information under the Securities Act. This new collection of information relates to the proposed information requirements for clearing agencies seeking to rely on the proposed exemption. There is no mandatory retention period for the information disclosed, and the information disclosed would be made publicly available on the clearing agency's website or in an agreement the clearing agency provides or makes available to its counterparty to the security-based swap transaction. The collection of information would be mandatory and it would not be kept confidential.

B. Summary of Collection of Information

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[76] 44 U.S.C. 3501 et seq.

[77] Although we are proposing additional rule amendments, we do not anticipate burdens or costs associated with those rules for purposes of the PRA because eligibility for those rules will be dependent on reliance on proposed Rule 239.

As discussed above, one condition to the availability of the exemption provided in proposed Securities Act Rule 239 for offers and sales of security-based swaps issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP is that such registered or exempt clearing agency has an agreement covering the security-based swap that is provided or made available to its counterparty or a publicly available website maintained by the registered or exempt clearing agency that contains the following:

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;
- A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

The other provisions of proposed Rule 239 and other rules we are proposing relate to exemptions and eligibility requirements for those exemptions; therefore, we do not expect that those other provisions would create any new filing, reporting, recordkeeping, or disclosure requirement for registered or exempt clearing agencies.

C. Paperwork Reduction Act Burden Estimates

For purposes of the Paperwork Reduction Act, we estimate that there will be an annual incremental increase in the paperwork burden for clearing agencies as issuers of security-based swaps to comply with our proposed collection of information requirements. The disclosure provisions of proposed Rule 239 would apply to registered or exempt clearing agencies relying on the proposed exemption from the registration requirements of the Securities Act of 1933. The disclosure provisions of the proposed rule would make certain information about security-based swaps that may be cleared by the registered or exempt clearing agency available to eligible contract participants and other market participants.

Currently, four clearing agencies are authorized to clear credit default swaps, which include security-based swaps,[78] pursuant to temporary conditional exemptions under Exchange Act Section 36.[79] The obligation to centrally clear certain security-based swap transactions is a new requirement under Title VII of the Dodd-Frank Act, and we anticipate that clearing agencies operating under temporary conditional exemptions will register or will be deemed registered as clearing agencies eligible to clear security-based swaps.[80] 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,[81] we preliminarily estimate that four to six clearing agencies may plan to centrally clear security-based swaps and seek to rely on the

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78 These clearing agencies are ICE Trust, CME, ICE Clear Europe, and Eurex. The Commission authorized five entities to clear credit default swaps. See CDS Clearing Exemption Orders. LIFFE A&M and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

79 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 of the Dodd-Frank Act.

80 See Pub. L. No. 111-203, § 763(b).

81 We do 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.

proposed exemptions, and therefore, would be subject to the collection of information. For purposes of the PRA, we estimate six clearing agencies would seek to rely on the proposed exemptions.

We preliminarily believe that a registered or exempt clearing agency issuing security-based swaps in its function as a CCP could incur some costs associated with disclosing, or providing or making available, certain information in accordance with proposed Rule 239, either in its agreement regarding the security-based swap or on its publicly available website, with respect to the security-based swap. A clearing agency also could incur costs associated with updating the information on its website or in its agreements, if necessary. The purpose of the proposed requirement is to inform investors about whether there is publicly available information about the issuer of the referenced security or referenced issuer and we believe that a clearing agency likely already would be collecting and making public the type of information required by the proposed rule.[82]

We preliminarily estimate that each registered or exempt clearing agency issuing security-based swaps in its function as a CCP will spend approximately 2 hours each time it provides or updates the information in its agreements relating to security-based swaps or on its website.[83] We estimate that each registered or exempt clearing agency will provide or update the

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82 As noted above, we proposed rules in the Mandatory Clearing Proposing Release and the SBSR Proposing Release that would require some of the same information as the requirements proposed here (e.g., information relating to the identity of the security or issuer underlying the security-based swap) Although the proposed information requirements also may be required to be made public by the registered or exempt clearing agencies by these other proposed rules, we are calculating the PRA burden for each process individually without accounting for any reduction due to the anticipated overlap. We have decided to calculate the burdens in this manner in order to provide a conservative estimate.

83 In the Mandatory Clearing Proposing Release, we estimated that four hours 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). We believe that the information that would be required to rely on the exemptions proposed in this release is less extensive than the information that would be required in a security-based swap submission. Therefore, we estimate that the burden to include the information that would be required to rely on the proposed

information 20 times per year.[84] Therefore, we preliminarily estimate that the total annual reporting burden for clearing agencies to provide the information in their agreements relating to security-based swaps or on their website to comply with proposed Rule 239(c) will be 240 hours (20 x 2 hours x 6 respondents). We estimate that 75% of the burden of preparation is carried by the clearing agency internally and that 25% of the burden is carried by outside professionals retained by the clearing agency at an average cost of $400 per hour. We request comment on all of the above estimates.

D. Recordkeeping Requirements

There is no recordkeeping requirement associated with proposed Rule 239.

E. Request for Comment

Pursuant to 44 U.S.C. § 3506(c)(2), we request comments in order to evaluate:

- whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility;
- the accuracy of our estimate of the burden of the proposed collection of information;
- whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

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exemptions in an agreement or on the clearing agency's website would be less than the burden to post a security-based swap submission.

84 In the Mandatory Clearing Proposing Release, we estimated that each clearing agency will submit 20 security-based swap submissions annually. Thus, we are using that estimate as the basis for our estimate as to how many times per year a clearing agency would be required to provide the information in reliance on the proposed exemptions.

- 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.

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.

The Commission requests comment on all aspects of its burden estimates. In particular, we request comment on the following:

1. Is the proposed collection of information important for eligible contract participants and other market participants?
2. How many entities would incur collection of information burdens pursuant to Rule 239?
3. Should the estimates be different depending on whether a clearing agency chooses to include information required to rely on proposed Rule 239 in an agreement relating to a security-based swap or on its publicly available website?
4. Are there additional burdens that we have not addressed in our preliminary burden estimates?

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, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-22-11. 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. S7-22-11, and be submitted to the Securities and Exchange Commission, Records Management, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

V. Cost-Benefit Analysis

As discussed above, we are proposing rules and amendments to existing rules to provide certain exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for security-based swaps issued by a registered or exempt clearing agency in its function as a CCP.

A. Benefits

The proposed rules are intended to further the goal of central clearing of security-based swaps by providing exemptions for the issuance of security-based swaps by a registered or exempt clearing agency in its function as a CCP from certain regulatory provisions that might otherwise interfere with such clearing activities. Without an exemption, 1) a clearing agency issuing a security-based swap in its function as a CCP would be required to register the security-based swap transaction; 2) the security-based swaps that are or have been issued or cleared by a registered or exempt clearing agency in its function as a CCP would have to be registered as a class of securities under the Exchange Act; and 3) the provisions of the Trust Indenture Act would apply. We believe that requiring compliance with these provisions likely would unnecessarily impede central clearing of security-based swaps and that the proposed exemptions are necessary to facilitate the intent of the Dodd-Frank Act with respect to mandatory clearing of security-based swaps. Absent these proposed exemptions, we believe that registered or exempt clearing agencies would incur additional costs due to compliance with the registration requirements of the Securities Act and the Exchange Act solely because of their clearing functions.[85]

The proposed exemptions would treat security-based swaps issued or cleared by a registered or exempt clearing agency in its function as a CCP in the same manner as similar types of securities, such as security futures products and standardized options.[86] The proposed exemptions are similar to those provided for CDS under our temporary rules.[87] A registered or exempt clearing agency issuing security-based swaps in its function as a CCP would benefit from the proposed exemptions because it would not have to file registration statements covering the offer and sale of the security-based swaps. If a registered or exempt clearing agency is not required to register the offer and sale of security-based swaps, it would not have to incur the costs of such registration, including legal and accounting costs. Some of these costs, such as the costs of obtaining audited financial statements, may still be incurred by the clearing agency as a result of other regulatory requirements for clearing agencies.

Proposed Exchange Act Rule 12a-10 would provide that the Exchange Act Section 12(a) does not apply to any security-based swap that is issued by a registered or exempt clearing agency in reliance on proposed Securities Act Rule 239 and traded on a national securities exchange. In addition, proposed Exchange Act Rule 12h-1(h) would exempt from Section 12(g)

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85 See, e.g., the rules proposed in the Mandatory Clearing Proposing Release and the Clearing Agencies Proposing Release.

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

87 See Temporary CDS Exemptions Release.

security-based swaps that are issued by a registered or exempt clearing agency in reliance on proposed Securities Act Rule 239, whether or not such security-based swap is traded on a national securities exchange or a registered or exempt security-based SEF. Thus, the clearing agency would not incur the costs of registration or the costs associated with Exchange Act periodic reporting. The availability of exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act would mean that registered or exempt clearing agencies would not incur the costs associated with registering transactions or classes of securities, such as costs associated with preparing documents describing security-based swaps, preparing indentures, or arranging for the services of a trustee.

B. Costs

The proposed rules exempting offers and sales of security-based swaps that are or will be issued by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP should facilitate the use by eligible contract participants at minimal cost to the CCP or eligible contract participants. Because reliance on the proposed exemptions will not require any filing with or submission to us, other than costs incurred to comply with the information condition of proposed Rule 239, the costs of being able to rely on such exemptions, we believe, are minimal.

We recognize that a consequence of the proposed exemptions would be the unavailability of certain remedies under the Securities Act and the Exchange Act and certain protections under the Trust Indenture Act. Absent an exemption, a clearing agency may have to file a registration statement covering the offer and sale of the security-based swaps, may have to register the class of eligible security-based swaps that it has issued or cleared under the Exchange Act, and may have to satisfy the applicable provisions of the Trust Indenture Act, which would provide investors with civil remedies in addition to antifraud remedies. A registration statement covering the offer and sale of security-based swaps may provide certain information about the clearing agency, security-based swap contract terms, and the identification of the particular reference securities, issuers, loans underlying the security-based swap. However, it would not necessarily provide the type of information necessary to assess the risk of the reference issuer, security, narrow-based security index, or loan. Further, while a registration statement would provide information to eligible contract participants, as well as to the market as a whole, registered clearing agencies already are required to make their audited financial statements and other information about themselves publicly available.[88] While an investor would be able to pursue an antifraud action in connection with the purchase and sale of security-based swaps under Exchange Act Section 10(b),[89] it would not be able to pursue civil remedies under Sections 11 or 12 of the Securities Act.[90] We could still pursue an antifraud action in the offer and sale of security-based swaps issued by a clearing agency.[91]

As previously discussed in the PRA, proposed Rule 239(c) would require a clearing agency availing itself of the Securities Act exemption to include in an agreement covering the security-based swap the clearing agency provides or makes available to its counterparty or include on a publicly available website maintained by the clearing agency:

- A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;

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88 See Regulation of Clearing Agencies, Release No. 34-16900 and Exchange Act Rule 19b-4(l) and (m).

89 15 U.S.C. 78j(b).

90 15 U.S.C. 77k and 77l.

91 See 15 U.S.C. 77q and 15 U.S.C. 78j(b).

- A statement indicating the securities or loans to be delivered (or class of securities or loans), or if cash settled, the securities, loans or narrow-based security index (or class of securities or loans) whose value will determine the settlement obligation under the security-based swap; and
- A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Exchange Act Section 13 or Section 15(d) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

We preliminarily believe some of the information the clearing agency would make available would be the same information the clearing agency would be required to provide us under proposed Rule 19b-4 in connection with the mandatory clearing requirement, and the same information is 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. A clearing agency may incur costs in providing or making available this information in order to rely on the proposed exemption. We believe that the information requirements of proposed Rule 239 would be less burdensome to the clearing agency to the extent that it is already required to provide the information pursuant to Rule 19b-4 if adopted as proposed.

C. Request for Comment

We request that commentators provide views and supporting information regarding the costs and benefits associated with the proposed rules. We seek estimates of these costs and benefits, as well as any costs and benefits not already identified herein. We also request 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.

VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION

Section 23(a)(2) of the Exchange Act[92] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, Section 2(b)[93] of the Securities Act and Section 3(f)[94] of the Exchange Act require us, when engaging in rulemaking where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider whether the action will promote efficiency, competition, and capital formation.

The rules we are proposing would exempt offers and sales of security-based swaps that are or will be issued to eligible contract participants by, and in a transaction involving, a registered or exempt clearing agency in its function as a CCP from all provisions of the Securities Act, other than the Section 17(a) antifraud provision, as well as from the registration requirements under Section 12 of the Exchange Act and the provisions of the Trust Indenture Act. Because these exemptions are available to any registered or exempt clearing agency offering and selling security-based swaps to an eligible contract participant, in its function as a CCP, we do not believe that the proposed exemptions impose a burden on competition. In contrast, we believe the proposed exemption would facilitate moving security-based swaps into

92 15 U.S.C. 78w(a)(2).

93 15 U.S.C. 77b(b).

94 15 U.S.C. 78c(f).

centralized clearing, furthering the goal of the Dodd-Frank Act to reduce systemic risk while improving market access to hedging instruments that can contribute to lower costs of raising capital. In addition, we believe the proposal would promote efficiency by treating security-based swaps issued by clearing agencies in a manner similar to standardized options and security futures issued by clearing agencies. Harmonizing the regulatory treatment of these securities under the Securities Act, Exchange Act, and the Trust Indenture Act should reduce the potential for regulatory arbitrage between such products.

We also believe that the ability to novate security-based swaps with registered or exempt clearing agencies functioning as CCPs would improve the transparency of the security-based swap market and provide greater assurance to participants as to the capacity of the counterparty to perform its obligations under the security-based swap. We preliminarily believe that clearing agencies providing the information as would be required by proposed Rule 239(c) may promote competition and transparency among clearing agencies because it will make it easier for clearing agencies and eligible contract participants to determine what security-based swaps are being cleared. We preliminarily believe that increased transparency in the security-based swap market could help to limit market turmoil and thereby facilitate the capital formation process.

We generally request comment on the competitive or anticompetitive effects of the proposed exemptions on any market participants if adopted as proposed. We also request comment on what impact the exemptions, if adopted, would have on efficiency and capital formation. We request that commentators provide analysis and empirical data, if available, to support their views regarding any such effects. We also request comment regarding the competitive effects of pursuing alternative regulatory approaches that are consistent with the Dodd-Frank Act. In addition, we request 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 exemptions.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

Under the Small Business Regulatory Enforcement Fairness Act of 1996,[95] 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. We request comment on the potential impact of the proposed exemptions 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. Commentators 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")[96] requires the Commission, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[97] of the Administrative Procedure Act,[98] 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 rulemaking on "small entities."[99] Section 605(b) of the RFA states that this requirement shall not

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95 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).

96 5 U.S.C. 601 et seq.

97 5 U.S.C. 603(a).

98 5 U.S.C. 551 et seq.

99 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

apply to any proposed rule which, if adopted, would not have a significant economic impact on a substantial number of small entities.[100]

The exemptions would apply to all registered or exempt clearing agencies that issue or will issue security-based swaps in its function as a CCP. As noted above, 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. Based on our understanding of the market, we preliminarily believe that between four and six clearing agencies will clear security-based swaps and would seek to avail themselves of the proposed exemptions.[101]

For the purposes of our 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 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.[102] 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

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accordance with the RFA. These definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10 [17 CFR 240.0-10].

100 See 5 U.S.C. 605(b).

101 See also Section VIII. of the Mandatory Clearing Proposing Release.

102 17 CFR 240.0-10(d).

$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.[103]

Based on our 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, we preliminarily do not believe that any such entities would be "small entities" as defined in Exchange Act Rule 0-10.[104] Furthermore, we believe it is unlikely that clearing agencies functioning as CCPs for security-based swaps would have annual receipts of less than $6.5 million. Accordingly, we believe that any clearing agencies issuing security-based swaps in their function as CCPs in such transactions will exceed the thresholds for "small entities" set forth in Exchange Act Rule 0-12. We encourage written comments regarding this certification.

IX. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS

The rules and amendments described in this release are being proposed under the authority set forth in Sections 19 and 28 of the Securities Act; Sections 3C, 12(h), 23(a) and 36 of the Exchange Act; and Section 304(d) of the Trust Indenture Act.

List of Subjects in 17 CFR Parts 230, 240 and 260

Reporting and recordkeeping requirements, Securities.

TEXT OF THE RULES AND AMENDMENTS

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103 13 CFR 121.201, Sector 52.

104 See 17 CFR 240.0-10(d).

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

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

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

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

* * * * *

2. Section 230.239 is added to read as follows:

§ 230.239 Exemption for offers and sales of certain security-based swaps.

(a) Provided that the conditions of paragraph (b) of this section are satisfied and except as expressly provided in paragraph (c) of this section, the Act does not apply to any offer or sale of a security-based swap that (i) is issued or will be issued by a clearing agency that is either registered as a clearing agency under Section 17A of the Securities Exchange Act of 1934 (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Securities Exchange Act of 1934 pursuant to a rule, regulation, or order of the Commission ("eligible clearing agency"), and (ii) the Commission has determined is required to be cleared or that is permitted to be cleared pursuant to the eligible clearing agency's rules.

(b) The exemption provided in paragraph (a) of this section applies only to an offer or sale of a security-based swap described in paragraph (a) of this section if the following conditions are satisfied:

(1) The security-based swap is offered or sold in a transaction involving the eligible clearing agency in its function as a central counterparty with respect to such security-based swap;

(2) The security-based swap is sold only to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(12)); and

(3) The eligible clearing agency posts on its publicly available website at a specified Internet address or includes in its agreement covering the security-based swap that the eligible clearing agency provides or makes available to its counterparty the following:

(i) A statement identifying any security, issuer, loan, or narrow-based security index underlying the security-based swap;

(ii) A statement indicating the security or loan to be delivered (or class of securities or loans), or if cash settled, the security, loan, or narrow-based security index (or class of securities or loans) whose value is to be used to determine the amount of the settlement obligation under the security-based swap; and

(iii) A statement of whether the issuer of any security or loan, each issuer of a security in a narrow-based security index, or each referenced issuer underlying the security-based swap is subject to the reporting requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m and 78o) and, if not subject to such reporting requirements, whether public information, including financial information, about any such issuer is available and where the information is available.

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

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

3. The authority citation for Part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78s, 78u-5, 78w, 78x, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., 18 U.S.C. 1350, and 12 U.S.C. 5221(e)(3), unless otherwise noted.

* * * * *

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

§ 240.12a-10 Exemption of security-based swaps from section 12(a) of the Act.

The provisions of Section 12(a) of the Act (15 U.S.C. 78l(a)) do not apply to any security-based swap that:

(a) Is issued or will be issued by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission, in its function as a central counterparty with respect to the security-based swap;

(b) The Commission has determined is required to be cleared or that is permitted to be cleared pursuant to the clearing agency's rules;

(c) Is sold to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) in reliance on Rule 239 under the Securities Act of 1933 (17 CFR 230.239); and

(d) is traded on a national securities exchange registered pursuant to Section 6(a) of the Act (15 U.S.C. 78f(a)).

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

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

* * * * *

(h) Any security-based swap that is issued by a clearing agency registered as a clearing agency under Section 17A of the Act (15 U.S.C. 78q-1) or exempt from registration under Section 17A of the Act pursuant to a rule, regulation, or order of the Commission in its function as a central counterparty that the Commission has determined must be cleared or that is permitted to be cleared pursuant to the clearing agency's rules, and that was sold to an eligible contract participant (as defined in Section 1a(18) of the Commodity Exchange Act (7 U.S.C. 1a(18)) in reliance on Rule 239 under the Securities Act of 1933.

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

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

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

* * * * * *

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

§ 260.4d-11 Exemption for security-based swaps offered and sold in reliance on Rule 239 under the Securities Act of 1933 (17 CFR 230.239).

Any security-based swap offered and sold in reliance on Rule 239 of this chapter (17 CFR § 230.239), whether or not issued under an indenture, is exempt from the Act.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: June 9, 2011

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-64638; File Nos. 4-633 and S7-39-10]

Joint Public Roundtable on Proposed Dealer and Major Participant Definitions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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 Thursday, June 16, 2011, commencing at 9:00 a.m. and ending at 3:45 p.m., staff of the Agencies will hold a public roundtable meeting at which invited participants will discuss various issues related to the proposed definitions of the terms "swap dealer," "security-based swap dealer," "major swap participant," and "major security-based swap participant" under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"). See 75 FR 80174 (Dec. 21, 2010). 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: (866) 844-9416
- International Toll: information on international dialing can be found at the following link: http://www.cftc.gov/PressRoom/PressReleases/internationalnumbers021811.html
- Conference ID: 7731946

A transcript of the public roundtable discussion will be published at http://www.cftc.gov/PressRoom/Events/2011/index.htm. The roundtable discussion will take place in the Conference Center at the CFTC's headquarters, 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 Thursday, June 16, 2011, commencing at 9:00 a.m. and ending at 3:45 p.m. Members of the public who wish to comment on the topics addressed at the discussion, 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 via visiting http://comments.cftc.gov/PublicComments/ReleasesWithComments.aspx and submitting comments through the CFTC's website; and/or by email to rule-comments@sec.gov (all emails must reference the file numbers 4-633 and S7-39-10 in the subject field) 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 website 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 Commodity Futures Trading Commission.

David A. Stawick
Secretary

June 9, 2011

By the Securities and Exchange Commission.

Elizabeth M. Murphy
Secretary

June 9, 2011

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64637 / June 9, 2011

Admin. Proc. File No. 3-14256

In the Matter of

GLOBAL SENTRY EQUITY TRANSFER, INC.

ORDER AMENDING ORDER INSTITUTING PROCEEDINGS

On February 14, 2011, the Commission issued an Order Instituting Proceedings ("OIP") in the matter of Global Sentry Equity Transfer, Inc. ("Global Sentry"), a registered transfer agent. On March 15, 2011, the Division moved to amend the OIP to include additional allegations related to alleged misconduct by Global Sentry that the Division learned of after the OIP had been issued. As discussed below, we have determined to grant the motion.

I.

In the OIP, the Division alleges that Global Sentry failed to keep certain required records required to be maintained by registered transfer agents, including cancelled stock certificates and master securityholder files, and to timely file reports on Form TA-2 for the years ended December 31, 2008 and December 31, 2009. The Division further alleges in the OIP that Global Sentry thereby violated Sections 17(a)(1) and 17A(d)(1) of the Securities Exchange Act of 1934 and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.[1] The OIP orders the institution of proceedings to determine whether these charges are true and if so, what, if any, remedial action is appropriate in the public interest, including but not limited to disgorgement and civil penalties, and whether Global Sentry should be ordered to cease and desist from committing or causing violations or future violations of these provisions.

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1 15 U.S.C. §§ 78q(a)(1), 78q-1(d)(1) and 17 C.F.R. §§ 240.17Ad-6, .17Ad-7, .17Ad-10, .17Ad-19, .17Ac2-2.

On February 15, a hearing officer was designated and the hearing in this matter was scheduled to begin on March 28. On March 2, Division staff requested an adjournment of the hearing due to the staff's inability to confirm that Global Sentry had been served with the OIP. On March 8, however, the Office of the Secretary sent the Division a signed, certified mail receipt showing that Global Sentry had been served with the OIP on March 3 through its registered corporate agent in Nevada.[2]

II.

In its motion to amend, the Division makes the following assertions about events occurring on February 7-8, 2001: On February 7, the Office of Compliance Inspections and Examinations commenced a cause examination of Global Sentry, based in part on a complaint posted on the Commission's Tips, Complaints and Referrals System. Also on February 7, OCIE staff visited Global Sentry's offices in Mississauga, Ontario, Canada. A Global Sentry representative told the staff to contact an attorney (the "Global Attorney"). The Global Attorney, when reached by telephone later that day, told the staff that Global Sentry "respectfully decline[d the] request to come and examine" it.[3] Later that day, a Global Sentry receptionist told OCIE staff that Global Sentry was no longer taking visitors that afternoon, and asked the staff to leave the premises.

Later on February 7, OCIE staff again contacted the Global Attorney to confirm both that Global Sentry understood the seriousness of refusing an OCIE examination and that Global Sentry's refusal was final and definitive. The Global Attorney affirmed that his client would not permit the examination. On February 8, the Global Attorney sent OCIE a letter that further confirmed that he had advised his client not to cooperate with the OCIE examination.[4]

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2 The Division states that, on March 10, Division staff sent Global Sentry a letter offering its investigative file for inspection, pursuant to Rule of Practice 230. As of March 15, when the Division filed its motion to amend the OIP, Global Sentry had not contacted the Division to arrange to inspect the file.

3 According to the Division, the Global Attorney stated that the OCIE examination would be "improper" in light of anticipated administrative proceedings against Global Sentry. The Division states that Division staff had informed the Global Attorney of impending proceedings after the Commission had authorized the instant proceedings, but before the OIP had been issued.

4 The Division states that the Global Attorney advised his client not to cooperate on the basis that the examination represented an improper attempt by Commission staff to engage in litigation discovery.

The Division states that on February 17, OCIE referred to the Division its finding that Global Sentry had violated Section 17(b)(1) of the Exchange Act[5] by refusing to submit to the OCIE examination.

III.

Rule of Practice 200(d)(1) provides that the Commission may at any time, upon motion by a party, amend an OIP to include new matters of fact and law.[6] The allegations that Global Sentry refused to permit OCIE to conduct an examination on February 7, 2011 involve new matters of both fact and law. The Division asserts, however, that the proposed amendment would "permit the Division to seek the same relief for this new violation that it already seeks for the existing claims against Global Sentry: a cease-and-desist order; disgorgement, if any; civil money penalties pursuant to Section 21B of the Exchange Act; and a determination of what, if any, other remedial action is in the public interest." If the OIP is not amended to include these new allegations, the Division may seek to commence a separate administrative proceeding against Global Equity based on the alleged violation of Exchange Act Section 17(b)(1). It appears that considering the new allegations together with the allegations in the OIP in a single proceeding would be more efficient than conducting separate proceedings. Initiating a second proceeding would require additional Division and hearing officer resources, and perhaps Commission resources as well.[7] Amending the OIP would not appear to prejudice Global Sentry, which has not yet filed an answer and has not filed an opposition to the motion to amend.

Accordingly, IT IS ORDERED that the Order Instituting Proceedings issued in the matter of Global Sentry Equity Transfer, Inc. on February 14, 2011 be, and it hereby is, amended to include allegations of a violation of Section 17(b)(1) of the Securities Exchange Act of 1934, as provided in the form attached hereto.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Cathy Ahn
Deputy Secretary

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5 15 U.S.C. § 78q(b)(1).

6 17 C.F.R. § 201.200(d)(1).

7 *See* Rule of Practice 201.103, 17 C.F.R. § 201.103(a) ("The Rules of Practice shall be construed and administered to secure the just, speedy, and inexpensive determination of every proceeding.").

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No.

ADMINISTRATIVE PROCEEDING
File No. 3-14256

In the Matter of GLOBAL SENTRY EQUITY TRANSFER, INC., Respondent.	AMENDED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 17A(c)(3) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 17A(c)(3) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Global Sentry Equity Transfer, Inc. ("Respondent" or "Global Sentry").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. **Global Sentry Equity Transfer, Inc. ("Global Sentry")** is a Nevada corporation with its principal place of business in Ontario, Canada. Global Sentry has been registered with the Commission as a transfer agent since July 30, 2007, pursuant to Section 17A of the Exchange Act. During 2008, Global Sentry was the transfer agent of record for, among other entities, Infinity Medical Group, Inc. ("Infinity"), Cannon Exploration Inc. ("Cannon"), and China Jiangsu Golden Horse Steel Ball Inc. ("China Jiangsu").

B. OTHER RELEVANT PERSON AND ENTITIES

1. Christopher Wheeler, age 43, is a resident of Victor, New York. He is the owner of OTCStockExchange.com, a stock promotion website. Wheeler does not hold any securities licenses, and is not associated with any entity that is registered with the Commission.

2. Infinity was incorporated in Nevada in 1989 as D.V. Holdings, Inc. Between June 1999 and August 2007, the company operated at various times under the names Iceberg Corporation of America, Royal Alliance Entertainment, Inc., and Infinity. Infinity purports to be a specialty healthcare company and initially listed its principal place of business as Ontario, Canada. During the relevant period, Infinity did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, Infinity's shares were quoted on the Pink Sheets operated by Pink OTC Markets Inc. ("Pink Sheets").

3. Cannon was incorporated in Delaware in 1983 as Citisource, Inc. ("Citisource"). In June 2006, the company changed its name from Citisource to China Shuangji Cement Corporation, but changed it back to Citisource in October 2007. In April 2008, the company changed its name to Cannon. Cannon purports to be a mining and exploration company and listed its principal place of business as Ontario, Canada. During the relevant period, Canon did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, Cannon's shares were quoted on the Pink Sheets.

4. China Jiangsu was incorporated in Nevada in 1999 as Puppettown.com, Inc. The company changed its name to Business Translation Services, Inc. in December 2001, to Muller Media, Inc. in February 2002, and to China Jiangsu in October 2007. Since late 2008, the company has operated as Santana Mining, Inc. During the relevant period, the company's principal place of business was China, and it purported to be a manufacturer and supplier of ball bearings. During the relevant period, China Jiangsu did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, China Jiangsu's shares were quoted on the Pink Sheets.

C. GLOBAL SENTRY'S FAILURE TO COMPLY WITH EXCHANGE ACT PROVISIONS CONCERNING TRANSFER AGENTS

1. In at least 2008, Infinity, Cannon, and China Jiangsu issued a total of approximately 3.5 million purportedly unrestricted shares to Wheeler. Global Sentry, acting in its capacity as transfer agent, issued stock certificates in Wheeler's name, which Wheeler's brokerage firm credited to Wheeler's account and from which Wheeler subsequently sold the shares. Specifically, Global Sentry failed to comply with the Exchange Act and related rule provisions as follows:

a. Section 17(a)(1) of the Exchange Act requires, in relevant part, that "[e]very . . . registered transfer agent . . . 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 this [Act]." Section 17A(d)(1) of the Exchange Act provides, in relevant part, that "[n]o . . . registered transfer agent shall, directly or indirectly, engage in any activity as . . . [a] transfer agent in contravention of such rules and regulations [] as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Act]. . . . " Pursuant to this authority, the Commission adopted Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19 and 17Ac2-2.

b. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-6(c) thereunder require that, "every registered transfer agent which, under the terms of its agency, maintains securityholder records for an issue shall, with respect to such issue, retain each cancelled registered bond, debenture, share, warrant or right, other registered evidence of indebtedness, or other certificate of ownership and all accompanying documentation, except legal papers returned to the presentor." Under these provisions, Global Sentry was required to maintain cancelled stock certificates. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-6.

c. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-7(d) thereunder require that "the records required under Rule 17Ad-6(c) shall be maintained for a period of not less than six years . . . ." Under this Rule, to the extent that Global Sentry failed to maintain documents as required under 17Ad-6(c) identified in paragraph b. above, Global Sentry was required to maintain cancelled Infinity, Cannon, and China Jiangsu stock certificates that it issued to Wheeler for not less than six years. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-7.

d. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-10(a)(1) thereunder require that "[e]very recordkeeping transfer agent shall promptly and accurately post to the master securityholder file debits and credits containing minimum and appropriate certificate detail representing every security transferred, purchased, redeemed or issued; *Provided, however,* That if a security transferred or redeemed contains certificate detail different from that currently posted to the master securityholder file, the credit shall be posted to the master securityholder file and the debit and related certificate detail shall be maintained in a subsidiary file until resolved." Rule 17Ad-10(b) requires that "every recordkeeping transfer agent shall maintain and keep current an accurate master securityholder file. . . ." Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain accurate "master securityholder files" as required under Rule 17Ad-10.

e. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-19(b) thereunder require registered transfer agents "involved in the handling, processing, or storage of securities certificates [to]establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates." Rule 17Ad-19(d) provides that a transfer agent "shall maintain records that demonstrate compliance with the requirements set forth" under Rule 17Ad-19. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain records as required under Rule 17Ad-19, in particular the stock certificates relating to the transfer of Infinity, Cannon, and China Jiangsu shares issued to Wheeler.

f. Exchange Act Section 17(b)(1) requires that registered transfer agents "are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission and the appropriate regulatory agency for such persons as the Commission and the appropriate regulatory agency for such persons deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title." Global Sentry violated Section 17(b)(1) of the Exchange Act by refusing to allow an on-site examination of its transfer agent records on February 7, 2011, by the staff of the Commission's Office of Compliance Inspections and Examinations.

g. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Exchange Act Rule 17Ac2-2(a) require every transfer agent registered on December 31 to file a report covering the reporting period on Form TA-2 by March 31 following the end of the reporting period. Global Sentry has failed to make timely filings for the years ended December 31, 2008, and December 31, 2009, as required.

D. VIOLATIONS

1. As a result of the conduct described above, Global Sentry willfully violated Sections 17(a)(1), 17(b)(1), and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Global Sentry pursuant to Section 17A(c)(3) of the Exchange Act including, but not limited to, disgorgement, if any, and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of, and any future violations of, Sections 17(a)(1), 17(b)(1), and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64646 / June 10, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14419

In the Matter of **WILLIAM J. HAMMONS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

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

III.

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

1. Hammons, age 66, is a Utah resident. Hammons is not registered as or associated with a broker or dealer registered with the Commission. However, Hammons acted as an unregistered broker or dealer. Hammons sold VesCor Capital Corp. and other related entities' ("VesCor") securities to investors and received transaction-based compensation for those sales.

2. On February 24, 2011, Hammons was convicted of three counts of securities fraud in violation of Utah Code Ann §§ 61-1-1 and 61-1-21 and three counts of sales by an unlicensed agent in violation of Utah Code Ann §§ 61-1-3(3) and 61-1-21 before the Fifth Judicial District Court, Washington County, Utah in State of Utah v. Hammons (Case No. 091500166).

3. The counts of the indictment for which Hammons was convicted alleged, inter alia, that Hammons, in connection with the offer or sale of securities to investors, directly or indirectly, made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit. The counts also alleged that Hammons, in connection with the offer or sale of VesCor securities, willfully engaged in the offer or sale of securities without being licensed to sell securities.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL-111-203, July 21, 2010, 124 Stat. 1376, Respondent Hammons be, and hereby is barred from association with any broker or dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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 of any penny stock.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9223 / June 10, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14418

In the Matter of **the Registration Statements of** **China Intelligent Lighting and Electronics, Inc.** **c/o Corporation Service Company** **2711 Centerville Road, Suite 400** **Wilmington, DE 19808,** **HO-11603**	**ORDER FIXING TIME AND PLACE OF PUBLIC HEARING AND INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933**

I.

The Commission's public official files disclose that:

A. On June 16, 2010, China Intelligent Lighting and Electronics, Inc. ("Respondent") filed an amended Form S-1 registration statement with the Commission that became effective on June 17, 2010, concurrently registering up to 3,852,500 shares of common stock for sale to the public by the Respondent and up to 1,377,955 shares of common stock for resale by selling shareholders (the "June Registration Statement").

B. On December 13, 2010, Respondent filed an amended Form S-1 registration statement with the Commission that became effective on December 15, 2010, registering up to 1,858,323 shares of common stock for resale by selling shareholders (the "December Registration Statement").

II.

The Division of Enforcement alleges, as set forth in the Statement of Matters of the Division of Enforcement attached hereto and incorporated herein by reference, that the June and December Registration Statements each includes an untrue statement of a material fact because the registration statements purport to contain audited financial statements and the report of an independent registered public accounting firm thereon when in fact the auditor has withdrawn its audit report for the reasons described in the Statement of Matters; and that the June and December Registration Statements each omits to state material facts, including that the company's auditor has resigned and withdrawn its audit report and the reasons for the auditor's resignation, and that the financial statements included in the registration statements cannot be relied upon.

III.

The Commission, having considered the aforesaid, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be instituted with respect to the June and December Registration Statements to determine whether the allegations of the Division of Enforcement, as set forth in the Statement of Matters attached hereto and incorporated herein by reference, are true; to afford the Respondent with an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the June and December Registration Statements referred to herein.

Accordingly, IT IS ORDERED that public proceedings be and hereby are instituted under Section 8(d) of the Securities Act, such hearing to be commenced at 9:30 a.m. on June 24, 2011, at the Commission's offices at 100 F Street N.E., Washington, DC 20549, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

IT IS FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, pursuant to Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220. If the Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against the Respondent 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), 221(f) and 201.310. This Order shall be served forthwith upon the Respondent personally.

report and the reasons for the auditor's resignation, and that the financial statements included in the registration statement cannot be relied upon.

III.

The Commission, having considered the aforesaid, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be instituted with respect to the Registration Statement to determine whether the allegations of the Division of Enforcement, as set forth in the Statement of Matters attached hereto and incorporated herein by reference, are true; to afford the Respondent with an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the Registration Statement referred to herein.

Accordingly, IT IS ORDERED that public proceedings be and hereby are instituted under Section 8(d) of the Securities Act, such hearing to be commenced at 11:00 a.m. on June 24, 2011, at the Commission's offices at 100 F Street N.E., Washington, DC 20549, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

IT IS FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, pursuant to Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220. If the Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against the Respondent 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), 221(f) and 201.310. This Order shall be served forthwith upon the Respondent personally.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 60 days from the date of service of this Order, pursuant to Rule 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

Elizabeth M. Murphy
Secretary

Commissioner Casey
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9224 / June 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14421

In the Matter of the Registration Statement of China Century Dragon Media, Inc. c/o Corporation Service Company 2711 Centerville Road, Suite 400 Wilmington, DE 19808, HO-11603	ORDER FIXING TIME AND PLACE OF PUBLIC HEARING AND INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933

I.

The Commission's public official files disclose that:

A. On February 4, 2011, China Century Dragon Media, Inc. ("Respondent") filed an amended Form S-1 registration statement with the Commission that became effective on February 7, 2011, concurrently registering for sale up to 1,610,000 shares that Respondent offered to the public and registering for resale up to 1,034,403 shares owned by selling shareholders (the "Registration Statement").

II.

The Division of Enforcement alleges, as set forth in the Statement of Matters of the Division of Enforcement attached hereto and incorporated herein by reference, that the Registration Statement includes an untrue statement of a material fact because the registration statement purports to contain audited financial statements and the report of an independent registered public accounting firm thereon when in fact the auditor has withdrawn its audit report for the reasons described in the Statement of Matters; and that the Registration Statement omits to state material facts, including that the company's auditor has resigned and withdrawn its audit

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 60 days from the date of service of this Order, pursuant to Rule 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

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64651 / June 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13446

In the Matter of **AMERICAN SKANDIA INVESTMENT SERVICES, INC.** **Respondents.**	**ORDER DIRECTING DISBURSEMENT OF FAIR FUND**

On May 13, 2010, the United States Securities and Exchange Commission ("Commission") published a plan of distribution ("Distribution Plan") and issued a Notice of Proposed Distribution Plan and Opportunity for Comment (Exchange Act Rel. No. 62106) 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, within thirty (30) days of the date of the Notice. No comments were received by the Commission in response to the Notice. On August 16, 2010, the Commission issued an Order Approving Plan of Distribution, Appointing Fund Administrator, and Waiving Bond (Exchange Act Rel. No. 62733).

The Distribution Plan provides that the Commission will arrange for distribution of the Fair Fund when an electronic payment file listing the payees and the payment amounts with the identification information required to make the distribution has been received and accepted. The validated electronic payment file has been received and accepted for tranche two of the distribution in the amount of $7,148,968.27, which represents 10.5% of the total distribution amount.

Accordingly, it is ORDERED that the Commission staff shall transfer the Fair Fund to the escrow bank in the amount stated in the validated electronic payment file of $7,148,968.27, 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. 64648 / June 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14420

In the Matter of **Apparel America, Inc.** **(n/k/a HSK Industries, Inc.),** **Decora Industries, Inc.,** **Diversicon Holdings Corp.,** **Flagship Global Health, Inc.,** **Integrated Transportation Network Group, Inc., and** **Premier Wealth Management, Inc.** **(a/k/a Premiere Wealth Management, 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 Apparel America, Inc. (n/k/a HSK Industries, Inc.), Decora Industries, Inc., Diversicon Holdings Corp., Flagship Global Health, Inc., Integrated Transportation Network Group, Inc., and Premier Wealth Management, Inc. (a/k/a Premiere Wealth Management, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Apparel America, Inc. (n/k/a HSK Industries, Inc.) ("APAR") [1] (CIK No. 4319) is a Delaware corporation located in Vestal, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). APAR is delinquent in its periodic filings

[1] The short form of each issuer's name is also its stock symbol.

with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 1998, which reported a net loss of $1,408,000 for the prior six months. On June 12, 1998, APAR filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York, which was terminated on July 8, 1999. As of June 9, 2011, the common stock of APAR was quoted on OTC Link, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Decora Industries, Inc. ("DECO") (CIK No. 743029) is a void Delaware corporation located in Fort Edward, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DECO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2000, which reported a net loss of $3,587,000 for the prior three months. On March 5, 1992, DECO filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania, which was terminated on July 11, 1994. As of June 9, 2011, the common stock of DECO was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Diversicon Holdings Corp. ("DVSH") (CIK No. 944897) is a void Delaware corporation located in Staten Island, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DVSH is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 1998, which reported a net loss of $1,569,318 for the prior nine months. On June 13, 2000, DVSH filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, which was dismissed on January 10, 2002. As of June 9, 2011, the common stock of DVSH was quoted on OTC Link, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Flagship Global Health, Inc. ("FGHH") (CIK No. 1051985) is a forfeited Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FGHH 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, 2008, which reported a net loss of $2,433,486 for the prior three months. On August 19, 2008, FGHH filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of New York, which was still pending as of June 8, 2011. As of June 9, 2011, the common stock of FGHH was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Integrated Transportation Network Group, Inc. ("ITRT") (CIK No. 1057561) 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). ITRT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1999, which reported a net loss of $5,996,000 for the prior nine months. As of June 9, 2011, the common stock of ITRT was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Premier Wealth Management, Inc. (a/k/a Premiere Wealth Management, Inc.) ("PWMG") (CIK No. 1226944) 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). PWMG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $1,235,081 for the prior nine months. As of June 9, 2011, the common stock of PWMG was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

7. As described 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 domestic issuers to file quarterly reports

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 64650 / June 13, 2011

Administrative Proceeding
File No. 3-12341

In the Matter of	
WEISS RESEARCH, INC., MARTIN WEISS, AND LAWRENCE EDELSON	**ORDER APPROVING APPLICATION OF DISTRIBUTION ADMINISTRATOR FOR FEES AND EXPENSES**
Respondents.	

On June 22, 2006, the Commission instituted settled administrative proceedings against Weiss Research, Inc., Martin Weiss, and Lawrence Edelson (collectively, "Respondents") for violations of the Investment Advisers Act of 1940 in connection with their operation of an unregistered investment adviser and the production and distribution of materially false and misleading marketing materials. See Order Instituting Public Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 (Advisers Act Rel. No. 2525) (June 22, 2006) ("Order"). Among other things, the Commission ordered the Respondents to pay a total of $2,166,142 in disgorgement, prejudgment interest, and penalties, and authorized the creation of a Fair Fund to distribute this money to the harmed investors.

On July 5, 2007, the Commission published a notice of the Distribution Plan ("Plan") proposed by the Division of Enforcement in connection with this proceeding (Exchange Act Rel. No. 56011). No comments were received. On August 23, 2007, the Commission approved the Plan. Order Approving Distribution Plan (Exchange Act Rel. No. 56310). On April 22, 2009, the Commission issued an order authorizing the distribution of $1,462,208 to harmed investors in accordance with the Plan. Order Directing Disbursement of Fair Fund (Exchange Act Rel. No. 59813).

The Administrator has submitted invoices dated August 27, 2010 and January 18, 2011, detailing his fees and expenses. The Commission staff, having reviewed the invoices, finds the total fees and expenses of $13,402.19 to be reasonable and in accordance with the Plan. The Commission staff has requested that the Commission authorize payment of the Administrator's fees and expenses in the amount of $13,402.19 from the Fair Fund.

Accordingly, IT IS HEREBY ORDERED, pursuant to Rule 1105(d) of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F. R. § 201.1105(d), that the Administrator's current fees and expenses in the amount of $13,402.19 be paid from the Fair Fund.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 13, 2011

In the Matter of **Apparel America, Inc.** **(n/k/a HSK Industries, Inc.),** **Decora Industries, Inc.,** **Diversicon Holdings Corp.,** **Flagship Global Health, Inc.,** **Integrated Transportation Network Group, Inc., and** **Premier Wealth Management, Inc.** **(a/k/a Premiere Wealth Management, Inc.),** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Apparel America, Inc. (n/k/a HSK Industries, Inc.) because it has not filed any periodic reports since the period ended January 31, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Decora Industries, Inc. because it has not filed any periodic reports since the period ended June 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Diversicon Holdings Corp. because it has not filed any periodic reports since the period ended December 31, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Flagship Global Health, Inc. because it has not filed any periodic reports since the period ended March 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Integrated Transportation Network Group, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Premier Wealth Management, Inc. (a/k/a Premiere Wealth Management, Inc.) because it has not filed any periodic reports since the period ended September 30, 2007.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 13, 2011, through 11:59 p.m. EDT on June 24, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 200

[Release No. 34-64649]

Delegation of Authority to the Director of its Division of Enforcement

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending its rules to delegate authority to the Director of the Division of Enforcement ("Division") to issue witness immunity orders to compel individuals to give testimony or provide other information. This delegation is intended to conserve Commission resources, enhance the Division's ability to detect violations of the federal securities laws, increase the effectiveness and efficiency of the Division's investigations, and improve the success of the Commission's enforcement actions.

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

FOR FURTHER INFORMATION CONTACT: Samuel Waldon, Assistant Chief Counsel, (202) 551-4710.

SUPPLEMENTARY INFORMATION: The Commission is amending its rules governing delegations of authority to the Director of the Division of Enforcement. The amendment to Rule 30-4(a)(14) (17 CFR 200.30-4(a)(14)) authorizes the Division Director to issue orders to compel individuals to give testimony or provide other information pursuant to 18 U.S.C. §§ 6002 - 6004. This delegation follows on the Commission's prior delegation, effective January 19, 2010, of the authority to submit witness immunity requests to the Department of Justice, in connection with judicial proceedings, to compel testimony or the production of other information by witnesses who have provided or have the potential to provide substantial assistance in the Commission's investigations and related enforcement actions. *See* 75 FR 3122 (January 19, 2010). This delegation is intended to further conserve Commission resources, enhance the Division's ability to detect violations of the federal securities laws, increase the effectiveness and efficiency of the Division's investigations, and improve the success of the Commission's enforcement actions. Notwithstanding anything in the foregoing, in any case in which the Director believes it appropriate, the Director may submit the matter to the Commission. The Commission is adopting this amendment for a period of 18 months, and, at the end of that period, will evaluate whether to extend the delegation to issue immunity orders.

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

LIST OF SUBJECTS IN 17 CFR PART 200:

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

TEXT OF AMENDMENT:

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

PART 200--ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for Part 200, Subpart A, continues to read in part as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78*ll* (d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Section 200.30-4, paragraph (a)(14) is revised to read as follows:

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

* * * * *

(a) * * *

(14) To submit witness immunity requests to the U.S. Attorney General pursuant to 18 U.S.C. §§ 6002 - 6004, and, upon approval by the U.S. Attorney General, to seek or, for the period from [insert date of publication in the Federal Register] through [insert date 18 months after publication in the Federal Register], to issue orders compelling an individual to give testimony or provide other information pursuant to subpoenas that may be necessary to the public interest in connection with investigations and related enforcement actions pursuant to section 22(b) of the Securities Act of 1933 (15 U.S.C. 77v(b)), section 21(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(c)), section

42(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-41(c)) and section 209(c) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-9(c)).

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: June 13, 2011

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64657 / June 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14193

In the Matter of

CARY R. KAHN,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the offer of settlement submitted by Cary R. Kahn ("Kahn" or "Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of the public administrative proceedings instituted against Respondent on January 14, 2011 pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

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 Making Findings, and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. From September 2002 through January 2009, Respondent, an unregistered investment adviser, was the manager and general partner of the Double Eagle Fund, an unregistered investment company. For a portion of the time in which he engaged in the conduct underlying the information described below, Respondent was associated with broker-dealers registered with the Commission.

2. On March 24, 2010, Kahn pled guilty to the felony of mail fraud in violation of Title 18 United States Code, Section 1341 before the United States District Court for the District of Colorado, in United States v. Cary Richard Kahn, Crim. Case No. 10-CR-00116-WYD. On June 28, 2010, a judgment in the criminal case was entered against Kahn. He was sentenced to a prison term of sixty (60) months, and five (5) years of supervision upon his release from prison, and ordered to make restitution in the amount of $1,812,559.11.

3. The criminal information to which Kahn pled guilty alleged, among other things, that between September 3, 2002 and January 22, 2009, Kahn defrauded investors and obtained money and property by means of materially false and misleading statements in connection with the purchase and sale of securities and in connection with the sale of "flex options" or "option conversions." The information alleged that, as part of the scheme, Kahn represented himself as an experienced and successful securities trader in order to obtain approximately $2,121,098.70 from investors. The information further alleged that Kahn misrepresented to the investors in his Double Eagle Fund that he would use their money to buy and sell securities and that they could expect profits of fourteen to eighteen percent per year. In addition, the information alleged that Kahn sold some investors "flex options" and "option conversions," with guaranteed returns of between fifteen and nineteen percent within either six months or one year. The information also alleged that Kahn failed to use most of the investor money to trade securities, converted most of the money to his own use and benefit, used a portion of the money to make payments to other investors, and sent investors account statements misrepresenting profits earned as a result of his trading.

4. In addition, on July 20, 2004 the Commission entered an Order Making Findings and Imposing Remedial Sanctions by Default, Admin. Proc. File No. 3-11468, in which Kahn was ordered to cease-and desist from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. He was also ordered to disgorge $12,186.21, plus $1,217.54 in prejudgment interest. Kahn failed to comply with the disgorgement order and the Commission filed a complaint in U. S. District Court for the District of Colorado, Civil Action No. 04-Z-2692 (BNB). The U.S. District Court entered the default judgment in favor of the Commission on March 11, 2005. Kahn has not paid the ordered disgorgement or interest.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Kahn be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

That Respondent Kahn 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.

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; and

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. 64661 / June 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14422

In the Matter of **Dawn Technologies, Inc.,** **Distinctive Devices, Inc.,** **Haber, Inc., and** **Independence Brewing 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 Dawn Technologies, Inc., Distinctive Devices, Inc., Haber, Inc., and Independence Brewing Co.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Dawn Technologies, Inc. ("DAWN") [1] (CIK No. 831752) is a forfeited Delaware corporation located in Caldwell, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DAWN 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, 1999, which reported a net loss of $75,037 for the prior nine months. On September 1, 1999, DAWN filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Middle District of Pennsylvania, which was converted to a Chapter 7 proceeding on February 26, 2002, and closed on June 3, 2003. As of June 9, 2011, the common stock of DAWN was quoted on

[1]The short form of each issuer's name is also its stock symbol.

OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Distinctive Devices, Inc. ("DDVS") (CIK No. 59963) is a void Delaware corporation located in Fort Lee, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DDVS 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, 2004, which reported a net loss of $11,589,920 for the prior nine months. As of June 9, 2011, the common stock of DDVS was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Haber, Inc. ("HABE") (CIK No. 355699) is a void Delaware corporation located in Arlington, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HABE 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 May 31, 2007, which reported a net loss of $1,071,719 for the prior year. On January 29, 1993, HABE consented to the entry of a permanent injunction against committing or causing any violations of Exchange Act Section 13(a) and Rules 12b-25, 13a-1 and 13a-13 thereunder based on its failure to file timely and accurate periodic and other reports with the Commission. *SEC v. Haber, Inc.*, 93-0176 (D.D.C. Jan. 28, 1993). As of June 9, 2011, the common stock of HABE was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3). As of June 9, 2011, the preferred stock of HABE (symbol HABEP) was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Independence Brewing Co. ("IBCO") (CIK No. 1009863) is a Pennsylvania corporation located in Philadelphia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IBCO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 1999, which reported a net loss of $238,058 for the prior three months. As of June 9, 2011, the common stock of IBCO was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

5. As described 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.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports

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

III.

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

A. Whether the allegations contained in Section II 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

June 14, 2011

In the Matter of **Samaritan Pharmaceuticals, Inc.** **Seaena, Inc.,** **Seirios International, Inc. (f/k/a Exactly Sportswear, Inc.),** **Sento Corp.,** **Shoe Pavilion, Inc.,** **Silver Eagle Resources Ltd. (n/k/a Mercator Minerals Ltd.),** **Simex Technologies, Inc. (n/k/a CT Holdings, Inc.), and** **Sola Resource Corp. (n/k/a Cancana Resources Corp.)** **File No. 500-1**

ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Samaritan Pharmaceuticals, Inc. because it has not filed any periodic reports since the period ended December 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Seaena, Inc. because it has not filed any periodic reports since the period ended June 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Seirios International, Inc.

(f/k/a Exactly Sportswear, Inc.) because it has not filed any periodic reports since September 30, 1995.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sento Corp. because it has not filed any periodic reports since the period ended December 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Shoe Pavilion, Inc. because it has not filed any periodic reports since the period ended March 29, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Silver Eagle Resources Ltd. (n/k/a Mercator Minerals Ltd.) because it has not filed any periodic reports since January 16, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Simex Technologies, Inc. (n/k/a CT Holdings, Inc.) because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sola Resource Corp. (n/k/a Cancana Resources Corp.) because it has not filed any periodic reports since the period ended January 31, 2003.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 14, 2011, through 11:59 p.m. EDT on June 27, 2011.

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

June 14, 2011

In the Matter of **Dawn Technologies, Inc.,** **Distinctive Devices, Inc.,** **Haber, Inc., and** **Independence Brewing Co.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Dawn Technologies, Inc. because it has not filed any periodic reports since the period ended September 30, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Distinctive Devices, Inc. because it has not filed any periodic reports since the period ended September 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Haber, Inc. because it has not filed any periodic reports since the period ended May 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Independence Brewing Co. because it has not filed any periodic reports since the period ended March 31, 1999.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 14, 2011, through 11:59 p.m. EDT on June 27, 2011.

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. 64664 / June 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14423

In the Matter of **Samaritan Pharmaceuticals, Inc.,** **Seaena, Inc.,** **Seirios International, Inc. (f/k/a Exactly Sportswear, Inc.),** **Sento Corp.,** **Shoe Pavilion, Inc.,** **Silver Eagle Resources Ltd. (n/k/a Mercator Minerals Ltd.),** **Simex Technologies, Inc. (n/k/a CT Holdings, Inc.), and** **Sola Resource Corp. (n/k/a Cancana Resources 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 Samaritan Pharmaceuticals, Inc., Seaena, Inc., Seirios International, Inc. (f/k/a Exactly Sportswear, Inc.), Sento Corp., Shoe Pavilion, Inc., Silver Eagle Resources Ltd. (n/k/a Mercator Minerals Ltd.), Simex Technologies, Inc. (n/k/a CT Holdings, Inc.), and Sola Resource Corp. (n/k/a Cancana Resources Corp.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Samaritan Pharmaceuticals, Inc. (CIK No. 1057377) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Samaritan 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 over $6.2 million for the prior twelve months. As of June 2, 2011, the company's stock (symbol "SPHC") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Seaena, Inc. (CIK No. 1091356) is a revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Seaena 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, 2008, which reported a net loss of over $1.13 million for the prior six months. As of June 2, 2011, the company's stock (symbol "SEAI") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Seirios International, Inc. (f/k/a Exactly Sportswear, Inc.) (CIK No. 1038662) is a California corporation located in Addison, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Seirios is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended September 30, 1995, which reported a net loss of over $1.5 million for the prior nine months. As of June 2, 2011, the company's stock (symbol "SRIN") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Sento Corp. (CIK No. 4317) is an expired Utah corporation located in Orem, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sento 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, 2006, which reported a net loss of over $7 million for the prior nine months. As of June 2, 2011, the company's stock (symbol "SNTO") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Shoe Pavilion, Inc. (CIK No. 1051009) is a void Delaware corporation located in Sherman Oaks, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Shoe Pavilion 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 29, 2008, which reported a net loss of over $6.2 million for the prior thirteen weeks. On July 15, 2008, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, and the case was terminated on February 12, 2010. As of June 2, 2011, the company's stock (symbol

"SHOEQ") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Silver Eagle Resources Ltd. (n/k/a Mercator Minerals Ltd.) (CIK No. 850398) is a Yukon corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Silver Eagle is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on January 16, 1998, which reported a net loss of $822,763 (Canadian) for the year ended March 31, 1997. As of June 2, 2011, the company's stock (symbol "MLKKF") was quoted on OTC Link, had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Simex Technologies, Inc. (n/k/a CT Holdings, Inc.) (CIK No. 1089499) is a Delaware corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Simex is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $467,644 for the prior three months. As of June 2, 2011, the company's stock (symbol "CTHS") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

8. Sola Resource Corp. (n/k/a Cancana Resources Corp.) (CIK No. 1018591) is a British Columbia corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sola Resource 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 January 31, 2003, which reported a net loss of $151,899 (Canadian) for the prior twelve months. As of June 3, 2011, the company's stock (symbol "SORSF") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3)

B. DELINQUENT PERIODIC FILINGS

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

10. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public

under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64668 / June 14, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3291 / June 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-11940

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

On June 2, 2005, John Van Fleet, CPA ("Van Fleet") was denied the privilege of appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against Van Fleet pursuant to Rule 102(e)(1) of the Commission's Rules of Practice.[1] Van Fleet consented to the entry of the order without admitting or denying the findings therein. This order is issued in response to Van Fleet'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 found that Van Fleet, while serving as corporate controller of Huntington Bancshares, Inc. ("Huntington"), willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Section 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act"), and Rule 13b2-1 thereunder. The Commission further found that Van Fleet caused Huntington's violations of Sections 13(a) and 13(b)(2)(A) and (B) of the Exchange Act, and Rules 12b-20 and 13a-1 thereunder. The Commission's findings related to inflated earnings reported in Huntington's financial statements filed with the Commission in annual reports for fiscal years 2001 and 2002. Huntington's improper accounting allowed them to meet or exceed Wall Street analyst earnings per share expectations and to meet internal targets that determined the bonuses of senior management.

[1] *See* Accounting and Auditing Enforcement Release No. 2252 dated June 2, 2005. Van Fleet was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Van Fleet 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. Van Fleet 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, Van Fleet'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 Van Fleet, it appears that he has complied with the terms of the June 2, 2005 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 Van Fleet, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64670 / June 14, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3293 / June 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-11783

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

On December 27, 2004, Laurence D. Cohen, CPA ("Cohen") 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 Cohen pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1] Cohen consented to the entry of the order without admitting or denying the findings therein. This order is issued in response to Cohen'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 found that Cohen had been permanently enjoined by a United States District Court from violating Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1, and 13b2-2 thereunder in an action brought against him and other defendants by the Commission. In its complaint, the Commission alleged that Cohen, as the controller of Robotic Vision Systems, Inc. ("Robotic"), participated in the preparation of financial statements that he knew, or was reckless in not knowing, contained material overstatements of revenue and net income resulting from improper recognition of revenue, that he failed to disclose relevant information to Robotic's external auditors, and that he violated and aided and abetted violations of the books and records and internal controls provisions of the Exchange Act.

[1] *See* Accounting and Auditing Enforcement Release No. 2157 dated December 27, 2004. Cohen was permitted, pursuant to the order, to apply for reinstatement after five years upon making certain showings.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Cohen 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. Cohen 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, Cohen'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 Cohen, it appears that he has complied with the terms of the December 27, 2004 order suspending him from 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 Cohen, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Laurence D. Cohen, 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

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECU[illegible] [illegible]XCHANGE ACT OF 1934
Rel[illegible] [illegible]569 / June 14, 2011

[illegible]NG AND AUDITING ENFORCEMENT
[illegible]. 3292 / June 14, 2011

[illegible]ISTRATIVE PROCEEDING
[illegible]. 3-13711

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

On December 10, 2009, Gregory Pasko, CPA ("Pasko") 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 Pasko pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1] Pasko 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 Pasko'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 SafeNet, Inc. engaged in a scheme to meet or exceed quarterly earnings per share targets through the use of improper accounting adjustments from the third quarter of 2004 through the second quarter of 2005. During this period, Pasko served as SafeNet's Director of External Reporting from January 2005 through May 2005 and as SafeNet's U.S. controller beginning in May 2005. The complaint alleged that Pasko and others made, or caused others to make, certain improper accounting adjustments in SafeNet's books and records. The complaint further alleged that, as a result of these inappropriate adjustments, SafeNet's periodic reports, registration statements, and press releases contained materially misstated financial results and materially false and misleading information concerning SafeNet's financial condition.

[1] *See* Accounting and Auditing Enforcement Release No. 3078 dated December 10, 2009. Pasko was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Pasko 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. Pasko 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, Pasko'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 Pasko, it appears that he has complied with the terms of the December 10, 2009 order suspending him from 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 Pasko, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Gregory Pasko, 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

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[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).

Commissioner Walter
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3214 / June 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14424

In the Matter of

THOMAS C. HARDIN,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Thomas C. Hardin ("Hardin" 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, III.3 and III.5 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Hardin, age 33, was a managing director at Lanexa Management, LLC (f/k/a Camber Global Management) ("Lanexa"), an unregistered New York-based hedge fund investment adviser, until he was laid off in February 2009. Hardin graduated from the Wharton School of the University of Pennsylvania in 1999 with a bachelor's degree in Economics. He held Series 7 and 55 securities licenses.

2. On November 12, 2010, the Commission filed a civil action against Hardin in SEC v. Thomas C. Hardin, Civil Action No. 1:10-CV-8600. On June 6, 2011, the Court entered an order permanently enjoining Hardin, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder.

3. On November 12, 2010, the Commission filed a civil action against Hardin in SEC v. Lanexa Management LLC and Thomas C. Hardin, Civil Action No. 1:10-CV-8599. On April 25, 2011, the Court entered an order permanently enjoining Hardin, by consent, from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

4. The Commission's complaints alleged that, in connection with the purchase, offer or sale of securities, Hardin knew, recklessly disregarded, or should have known, that material non-public information he received from a tipper was disclosed or misappropriated in breach of a fiduciary duty, or similar relationship of trust and confidence, and Hardin is liable for the trading that occurred in Lanexa because he effectuated trades on behalf of Lanexa and/or unlawfully tipped inside information to Lanexa.

5. On December 21, 2009, Hardin pled guilty to one count of securities fraud and one count of conspiracy to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 18 U.S.C. § 371 before the United States District Court for the Southern District of New York in United States v. Thomas Hardin, 10-CR-00399.

6. The counts of the criminal information to which Hardin pled guilty alleged, inter alia, that Hardin, and others, participated in a scheme to defraud by executing securities trades based on material, nonpublic information regarding certain inside information concerning public companies that had been misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Hardin be, and hereby is barred from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 15, 2011

IN THE MATTER OF VOICE ONE CORP. File No. 500-1	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Voice One Corp. because of questions regarding the accuracy of assertions by Voice One Corp., and by others, in public statements concerning, among other things: (1) the company's management and (2) financing provided by related parties.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of Voice One Corp.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of Voice One Corp. is suspended for the period from 9:30 a.m. EDT on June 15, 2011, through 11:59 p.m. EDT, on June 28, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

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

Commissioner Casey.
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3215 / June 15, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14425

In the Matter of **PEGASUS INVESTMENT MANAGEMENT, LLC, PETER BENJAMIN BORTEL, AND DOUGLAS WAYNE SAKSA,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND 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 Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Pegasus Investment Management, LLC ("PIM") and Sections 203(f) and 203(k) of the Advisers Act against Peter Benjamin Bortel ("Bortel") and Douglas Wayne Saksa ("Saksa") or ("Respondents" collectively).

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, 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

Bainbridge Island, Washington hedge fund manager Pegasus Investment Management, LLC ("PIM") received undisclosed cash payments for enabling a proprietary trading firm to combine PIM's futures trades with its own for all futures trades placed through a common broker. By combining PIM's trading volume with its own, the trading firm was able to obtain reduced commission rates for itself from the broker – a concession which the firm rewarded through undisclosed cash payments to PIM. Under the arrangement, and over the course of about ten months, PIM received a total of $90,000. The payments stopped once the Commission's Investment Adviser/Investment Company examination staff began asking questions about the payments.

PIM Vice President and co-owner Peter Bortel, under the supervision of President and co-owner Douglas Saksa, did not disclose the arrangement to fund investors, and retained the money for PIM rather than passing it along to the investors. PIM improperly treated the undisclosed payments as its own asset rather than an asset of the funds it managed. Accordingly, PIM and Bortel's conduct operated as a fraud or deceit upon the funds, in violation of Section 206(2) of the Investment Advisers Act. Moreover, Saksa failed to reasonably supervise Bortel within the meaning of Section 203(e)(6).

Respondents

1. Respondent PIM is a Washington limited liability company and an investment adviser located in Bainbridge Island, Washington. PIM is the general partner of two private funds, Pegasus Investment Partners, L.P. and Pegasus Market Neutral Fund, L.P. (together, the "Funds"). As of February 2009, PIM had approximately $26 million in assets under management. At the time of the conduct at issue, PIM was registered with the Commission as an investment adviser.

2. Respondent Bortel, age 41, resides in Gig Harbor, Washington. He was PIM's Vice President and 30% owner at the time of the conduct and was subject to Saksa's supervision. Bortel left PIM in April 2010 to start another investment advisory firm.

3. Respondent Saksa, age 65, resides in Bainbridge Island, Washington. He is PIM's President and Chief Compliance Officer. Saksa owned 70% of PIM at the time of the conduct and had supervisory responsibility over Bortel.

Facts

4. In the spring of 2008, a proprietary trading firm that was developing a software trading platform (the "Firm") became interested in adding commodities futures strategies to its

business. The Firm believed it would need a commissions rate of approximately $0.10 per trade to make its futures business profitable. The Firm approached an introducing futures broker (the "Broker") to see whether it could obtain such a rate, or a lower rate, to make its nascent futures business cost-effective. But because the Firm had no existing futures business, the Broker advised that its best rate for the Firm would be approximately $1.10 per trade, well above the Firm's target commission rate of $0.10 per trade.

5. Subsequently, the Firm considered other ways to obtain the rate of $0.10 per futures trade. A principal of the Firm had dealt with PIM previously, finding investors for PIM's Funds. He knew that PIM actively traded futures for its Funds through the Broker, and he convinced the Broker to take both the Firm's and PIM's trade volume into account when determining a commission rate for the Firm.

6. Under the Firm's arrangement with the Broker, the Firm received the discounted commission rate that it would not have been eligible for without the Funds' volume, and, in exchange, the Firm made monthly cash payments to PIM. PIM also agreed to assist the Firm in developing its software platform for trading and to share market research.

7. The amount of the monthly cash payments to PIM changed, but the payments were tied to the volume of trades by PIM's Funds through the Broker. The Firm paid $0.50 per trade for each trade that PIM's Funds placed with the Broker. The Firm also provided Bortel with monthly reconciliation statements with entries for total revenue generated – a line item that equated to $0.50 per trade.

8. Between 2008 and 2009, the Firm paid $90,000 in cash to PIM under this unwritten agreement. PIM treated the $90,000 as its own asset (not a Fund asset), and PIM did not disclose the arrangement to its investors in the Funds' offering documents or partnership agreements, or in PIM's Form ADV, a disclosure document used by investment advisers to register with the Commission. The payments stopped once the Commission's Investment Adviser/Investment Company examination staff began an examination of PIM.

Legal Analysis

9. Bortel reported to, and was supervised by, Saksa. As President and Chief Compliance Officer of PIM, Saksa also oversaw the legal, compliance, and operational functions of the adviser. Despite this, there were no policies requiring that fund assets be used for the benefit of the Funds or requiring that cash compensation received by PIM in connection with the Funds' activities be disclosed to investors or remitted to the Funds. PIM operated informally, and Saksa failed to supervise Bortel in this area. As a result, PIM received undisclosed cash payments from the Firm for nearly a year.

10. As a result of the conduct described above, PIM and Bortel willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. As such, investment advisers must act in "utmost good faith," use reasonable care to avoid misleading clients, and fully and fairly disclose conflicts of interest, such as payments

from third parties to give investment advice and arrangements that limit an adviser's loyal and disinterested advice. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194, 201. This includes the obligation to seek "best execution" of clients' transactions under the circumstances of the particular transaction. 1986 Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 23170 (April 23, 1986). *See also* Delaware Management Co., 43 SEC 392, 396 (1967). The fundamental obligation of the adviser to act in the best interest of his client also generally precludes the adviser from using client assets for the adviser's own benefit or the benefit of other clients, at least without client consent. Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 54165 (July 18, 2006); RESTATEMENT (SECOND) OF TRUSTS § 170 cmt. a, § 216 (1959).

11. As a result of the conduct described above, PIM and Saksa failed to reasonably supervise Bortel within the meaning of Section 203(e)(6) of the Advisers Act with a view to preventing and detecting Bortel's violations of Section 206(2).

IV.

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

Accordingly, pursuant to Sections 203(e), 203(f), and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents PIM, Bortel, and Saksa are censured.

B. Respondents PIM and Bortel cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act;

C. Respondent PIM, within 30 days of the entry of this Order, pay disgorgement of $90,000 and prejudgment interest of $5,469.66 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Pegasus Investment Management, LLC as a Respondent in these proceedings and the file number of these proceedings. A copy of which cover letter and money order or check shall be sent to Michael S. Dicke, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

D. Respondent Bortel, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Peter Benjamin Bortel as a Respondent in these proceedings and the file number of these proceedings. A copy of which cover letter and money order or check shall be sent to Michael S. Dicke, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

E. Respondent Saksa, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $25,000 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Douglas Wayne Saksa as a Respondent in these proceedings and the file number of these proceedings. A copy of which cover letter and money order or check shall be sent to Michael S. Dicke, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, CA 94104.

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. 34-64676; File No. S7-23-11

RIN 3235-AK56

Broker-Dealer Reports

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is proposing amendments to the broker-dealer financial reporting rule under the Securities Exchange Act of 1934 (the "Exchange Act"). The first set of amendments would, among other things, update the existing requirements of Exchange Act Rule 17a-5, facilitate the ability of the Public Company Accounting Oversight Board (the "PCAOB") to implement oversight of independent public accountants of broker-dealers as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), and eliminate potentially redundant requirements for certain broker-dealers affiliated with, or dually-registered as, investment advisers. The second set of amendments would require broker-dealers that either clear transactions or carry customer accounts to consent to allowing the Commission and designated examining authorities ("DEAs") to have access to independent public accountants to discuss their findings with respect to annual audits of the broker-dealers and to review related audit documentation. The third set of amendments would enhance the ability of the Commission and examiners of a DEA to oversee broker-dealers' custody practices by requiring broker-dealers to file a new Form Custody.

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

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-23-11 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 S7-23-11. 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 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; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Deputy Associate Director, at (202) 551-5521; Randall W. Roy, Assistant Director, at (202) 551-5522; and Mark M. Attar, Branch Chief, at

(202) 551-5889, Division of Trading and Markets; or John F. Offenbacher, Senior Associate Chief Accountant, at (202) 551-5300, Office of the Chief Accountant, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: The Commission is requesting public comment on proposed amendments to Exchange Act Rule 17a-5 and proposed Form Custody.

I. INTRODUCTION

The Commission is proposing three sets of amendments to Exchange Act Rule 17a-5 – the broker-dealer financial reporting rule.[1] The first set of amendments (collectively, the "Annual Reporting Amendments") relates to the requirement that a broker-dealer file annual financial reports with the Commission. The Annual Reporting Amendments are designed to, among other things: (1) update the existing requirements of Rule 17a-5; (2) facilitate the ability of the PCAOB to implement oversight of independent public accountants of broker-dealers as required by the Dodd-Frank Act;[2] and (3) eliminate potentially redundant requirements for certain broker-dealers affiliated with, or dually-registered as, investment advisers.

The second set of amendments (collectively, the "Access to Audit Documentation Amendments") would require broker-dealers that either clear transactions or carry customer accounts to consent to provide the Commission and DEAs with access to independent public accountants to discuss their findings with respect to annual audits of broker-dealers and to review related audit documentation.[3]

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1 17 CFR 240.17a-5 ("Rule 17a-5").

2 Pub. L. No. 111-203 (Jul. 21, 2010).

3 PCAOB Auditing Standard 3 defines "Audit documentation" as the "written record of the basis for the auditor's conclusions that provides the support for the auditor's representations, whether those representations are contained in the auditor's report or otherwise. Audit documentation also facilitates the planning, performance, and supervision of the engagement, and is the basis for the review of the quality of the work because it provides the reviewer with written documentation of the evidence supporting the auditor's significant conclusions. Among other things, audit documentation includes records of the

The third set of amendments (collectively, the "Form Custody Amendments") would enhance the ability of the Commission and examiners of a DEA to oversee broker-dealers' custody practices by requiring broker-dealers to file on a quarterly basis a new Form Custody. Form Custody would elicit information as to whether and how a broker-dealer maintains custody of cash and securities of customers and others.

II. THE PROPOSED ANNUAL REPORTING AMENDMENTS

A. Background

Sections 17(a) and (e) of the Exchange Act and Rule 17a-5 together require a broker-dealer to, among other things, file an annual report (an "Annual Audit Report") containing audited financial statements, supporting schedules, and supplemental reports, as applicable, with the Commission and the broker-dealer's DEA.[4] The financial statements must be comprised of a statement of financial condition, a statement of income, a statement of cash flows, a statement of changes in stockholders' or partners' or sole proprietor's equity, and a statement of changes in liabilities subordinated to claims of general creditors.[5] The supporting schedules must be comprised of a computation of required and actual net capital under Exchange Act Rule 15c3-1, and, for broker-dealers that maintain custody of customer funds or securities ("carrying broker-dealers"), a computation of the customer reserve requirement and information relating to the possession or control requirements under Exchange Act Rule 15c3-3.[6] The supplemental reports include: (1) a report of an independent public accountant that is the result of a review of, among other things, the broker-dealer's accounting system, internal accounting control and procedures

planning and performance of the work, the procedures performed, evidence obtained, and conclusions reached by the auditor. Audit documentation also may be referred to as work papers or working papers."

4 See 15 U.S.C 78q(a), 15 U.S.C 78q(e), and Rule 17a-5(d).

5 See Rule 17a-5(d)(2).

6 See Rule 17a-5(d)(3). See also 17 CFR 240.15c3-1 ("Rule 15c3-1") and 17 CFR 240.15c3-3 ("Rule 15c3-3").

for safeguarding securities, and practices and procedures in complying with various Commission financial responsibility rules and Regulation T of the Board of Governors of the Federal Reserve System;[7] (2) a report of an independent public accountant provided to, among others, the Securities Investor Protection Corporation ("SIPC") to help administer the collection of assessments from broker-dealers for purposes of establishing and maintaining its broker-dealer liquidation fund (the "SIPC Fund");[8] and (3) for broker-dealers that compute net capital under an alternative model-based standard, a report of an independent public accountant indicating the results of the accountant's review of the internal risk management control system established and documented by the broker-dealer in accordance with Exchange Act Rule 15c3-4.[9]

Paragraph (g) of Rule 17a-5, entitled "Audit objectives," describes the objectives that should be achieved by an independent public accountant in preparing a report for the broker-dealer to file with its Annual Audit Report.[10] For example, the audit is required to be performed in accordance with generally accepted auditing standards ("GAAS").[11] In addition, paragraph (g)(1) of Rule 17a-5 requires that the audit include a "review" and appropriate tests of the broker-dealer's accounting system, internal accounting control and procedures for safeguarding securities for the period since the prior examination date.[12] The paragraph further states that the scope of the audit and review of the accounting system, internal accounting control, and procedures for safeguarding securities shall be sufficient to provide reasonable assurance that

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7 See Rule 17a-5(g). See also 12 CFR 220 et seq. ("Regulation T").

8 See Rule 17a-5(e)(4). These reports will be collectively referred to in this release as the "SIPC Reports." As part of the Annual Reporting Amendments, the Commission is proposing to amend how the SIPC Reports are filed; see infra Section II.C.

9 See Rule 17a-5(k); see also 17 CFR 240.15c3-4.

10 See Rule 17a-5(g).

11 Auditing and attestation standards for broker-dealers are currently established by the American Institute of Certified Public Accountants (the "AICPA").

12 See Rule 17a-5(g)(1).

any material inadequacies existing in those items, including in the procedures for obtaining and maintaining physical possession and control of all fully paid and excess margin securities, complying with Regulation T, and making the quarterly securities examinations, counts, verifications, and comparisons and recordation of differences required by Exchange Act Rule 17a-13 would be disclosed.[13] Currently, with respect to these requirements, independent public accountants for broker-dealers issue a report describing a "study" of these practices and procedures and, if applicable, notification to the Commission of the discovery of any material inadequacies (the "Study"). The form of the report that describes the Study is specified in an AICPA publication entitled AICPA Audit & Accounting Guide: Brokers and Dealers in Securities;[14] however, the form of the report does not specify the level of assurance required to be obtained by the independent public accountant when performing the Study.

Professional auditing standards provide for three levels of attestation engagement by an accountant.[15] Under the highest level of attestation engagement, the accountant obtains "reasonable assurance" with respect to the matter that is the subject of the accountant's attestation engagement and provides an opinion. This standard is required with respect to audits and examinations.[16] The second level of attestation engagement is a review, which results in the accountant obtaining a moderate level of assurance with respect to the matter that is the subject of the accountant's attestation engagement. The third type of attestation engagement is one in which the accountant performs agreed-upon procedures, which results in no assurance, but rather

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13 Id. See also 17 CFR 240.17a-13 ("Rule 17a-13"). The term "material inadequacy" is defined in Rule 17a-5(g)(3).

14 See the AICPA Audit & Accounting Guide: Brokers and Dealers in Securities (Jul. 2010) (the "Broker-Dealer Audit Guide").

15 Professional auditing standards include both GAAS and standards promulgated by the PCAOB.

16 This proposing release generally refers to an "audit" of a broker-dealer's financial statements and an "examination" of the broker-dealer's compliance with a particular rule or implementation of controls designed to achieve compliance with a particular rule.

a reporting of the accountant's findings after the performance of procedures that have been agreed to by specified parties. Rule 17a-5 currently requires that a broker-dealer engage an independent public accountant to audit the broker-dealer's financial statements. Some of the supporting schedules are also subject to financial statement audit procedures.

Rule 17a-5 also requires that a broker-dealer that is claiming an exemption from the requirements of Rule 15c3-3 file a report with the Commission.[17] Rule 15c3-3(k) sets forth certain conditions that a broker-dealer must meet to be exempt from the rule's requirements. Generally, the broker-dealer would be exempt if it does not hold customer funds or securities, or, if it does, it promptly forwards all funds and securities received. Rule 17a-5 provides that the independent public accountant engaged by the broker-dealer must "ascertain that the conditions of the exemption were being complied with as of the examination date and that no facts came to the independent public accountant's attention to indicate that the exemption had not been complied with during the period since the independent public accountant's last examination."[18] This requirement has resulted in independent public accountants providing a statement concerning whether they have ascertained that the broker-dealer was complying with the conditions of the exemption.[19]

Many of the requirements currently contained in Rule 17a-5 have existed since 1975, and, for the most part, have remained substantially unchanged.[20] For example, as noted above, to comply with the requirement of paragraph (g) of Rule 17a-5 to conduct an audit and review of

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17 See Rule 17a-5(g)(2).

18 Id.

19 See Broker-Dealer Audit Guide, supra note 14 at Section 3.32.

20 See Broker-Dealer Reports, Exchange Act Release No. 11935 (Dec. 17, 1975), 40 FR 59706 (Dec. 30, 1975). In this release, the Commission adopted amendments to Rule 17a-5, which included, among other things, the adoption of the requirement for broker-dealers to file Financial and Operational Combined Uniform Single (or "FOCUS") Reports.

the identified matters, independent public accountants currently issue a report based on a Study. The practice of conducting the Study is relatively unique to broker-dealer audits and, while audit literature at one time referred to the performance of a "study," the performance of a study is no longer included in contemporary audit standards governing the work to be performed by an independent public accountant.

In addition, recent legislation and Commission rulemaking have further prompted the need to reexamine the requirements pertaining to the Annual Audit Report. First, Section 982 of the Dodd-Frank Act amended the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act")[21] to provide the PCAOB with explicit authority to, among other things, establish, subject to Commission approval, 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.[22] The Dodd-Frank Act also authorizes the PCAOB to inspect registered public accounting firms that provide audit reports for broker-dealers and to enforce standards relative to their audits.

Further, in December 2009, the Commission amended Rule 206(4)-2 (the "IA Custody Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"),[23] which governs investment advisers' custody practices.[24] Among other requirements, registered investment advisers that have custody of client funds or securities must maintain those assets at a qualified custodian, such as a bank or broker-dealer.[25] If an investment adviser that also is, for example, a

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21 17 U.S.C. 7202 et seq.

22 See Section 982 of the Dodd-Frank Act.

23 17 CFR 275.206(4)-2 ("Rule 206(4)-2").

24 See Custody of Funds or Securities by Investment Advisers, Advisers Act Release No. 2876 (May 20, 2009), 74 FR 25354 (May 27, 2009) ("IA Custody Proposing Release"); Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456 (Jan. 11, 2010) ("IA Custody Adopting Release").

25 See Rule 206(4)-2.

bank, or its related person, serves as a qualified custodian for advisory client funds or securities, the adviser must annually obtain, or receive from its related person, a written internal control report prepared by an independent public accountant registered with, and subject to regular inspection by, the PCAOB. Broker-dealers that also are registered as investment advisers may, acting in their capacity as broker-dealers, maintain client funds and securities as qualified custodians in connection with advisory services provided to clients, and under the IA Custody Rule are required to obtain internal control reports. Broker-dealers acting as qualified custodians also may maintain advisory assets in connection with advisory services provided by related or affiliated investment advisers. In such instances, these broker-dealers are also required to provide internal control reports to their related investment advisers.

For the reasons discussed above, the Commission is proposing amendments to Rule 17a-5. The amendments proposed by the Commission are intended to update the broker-dealer audit requirements and provide for an examination of compliance, and internal control over compliance, with key regulatory requirements that would provide the Commission with greater assurance as to a broker-dealer's compliance with the requirements. In addition, the proposed changes are intended to facilitate the ability of the PCAOB to set standards for, and implement its inspection authority over, broker-dealers' independent public accountants by providing an improved foundation for the PCAOB to establish new broker-dealer audit standards. Moreover, the proposed changes, as they pertain to compliance with requirements concerning the custody of customer funds and securities, are intended to complement and reinforce the regulatory changes effected by the IA Custody Rule. In particular, the Commission preliminarily believes that broker-dealers that also are registered as investment advisers and hold advisory client funds or securities, or that hold funds or securities for related investment advisers, would be able to use the Examination Report described below to satisfy the internal control report requirements under both Rule 17a-5, as it is proposed to be amended, and the IA Custody Rule.

As discussed below, the proposed changes would provide, as to broker-dealers subject to the requirements of Rule 15c3-3, for an examination of compliance, and internal control over compliance, with respect to Rule 15c3-1, Rule 15c3-3, Rule 17a-5, and rules prescribed by DEAs requiring broker-dealers to send account statements to customers ("Account Statement Rules"). Rule 15c3-1 requires broker-dealers to maintain at all times a minimum amount of net liquid assets, or "net capital." Under Rule 15c3-1, broker-dealers must perform two calculations: (1) a computation of required minimum net capital;[26] and (2) a computation of actual net capital.[27]

Rule 15c3-3 imposes two key requirements on carrying broker-dealers. First, each carrying broker-dealer must obtain physical possession or control over customers' fully paid and excess margin securities.[28] "Control" means the broker-dealer must hold these securities free of lien in one of several locations specified in the rule (e.g., a bank or clearing agency).[29] Under Rule 15c3-3, the broker-dealer must make a daily determination from its books and records (as of the preceding day) of the quantity of fully paid and excess margin securities in its possession

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26 A broker-dealer's required minimum net capital is the greater of a fixed-dollar amount prescribed in Rule 15c3-1, or an amount computed using one of two financial ratios. The first financial ratio generally provides that a broker-dealer shall not permit its aggregate indebtedness to exceed 1500% of its net capital. See Rule 15c3-1(a)(1)(i). The second financial ratio provides that a broker-dealer shall not permit its net capital to be less than 2% of aggregate customer debit items. See Rule 15c3-1(a)(1)(ii). Customer debit items – computed pursuant to Exhibit A to Rule 15c3-3, which is described below – consist of, among other things, margin loans to customers and securities borrowed to effectuate customer deliveries of securities on short sales.

27 A broker-dealer computes its actual net capital by first calculating its net worth using United States ("U.S.") generally accepted accounting principles. Second, qualifying subordinated loans are added to net worth. Third, illiquid assets such as real estate, fixtures, furniture, goodwill, and most unsecured receivables are subtracted from net worth. Illiquid securities also must be deducted. Finally, the broker-dealer must reduce ("haircut") the market value of the liquid securities it owns by a percentage amount. This "haircut" provides a cushion against adverse market movements and other risks faced by the broker-dealer.

28 See Rule 15c3-3(b)(1).

29 See Rule 15c3-3(c).

or control and the quantity of fully paid and excess margin securities not in its possession or control.[30] If the amount in the broker-dealer's possession and control is less than the amount indicated as being held for customers on the broker-dealer's books and records, the broker-dealer generally must initiate steps to retrieve customer securities from non-control locations or otherwise obtain possession of them or place them in control locations.[31]

The second key requirement in Rule 15c3-3 is that the carrying broker-dealer must maintain at a bank or banks cash or qualified securities[32] on deposit in a "Special Reserve Bank Account for the Exclusive Benefit of Customers" equaling at least the net amount computed by adding customer credit items (e.g., cash in securities accounts) and subtracting from that amount customer debit items (e.g., margin loans).[33] Rule 15c3-3 is designed to protect customer funds and securities by generally segregating them from the broker-dealer's proprietary business activities. If the carrying broker-dealer fails, customer funds and securities should be readily available for return to customers. The rule requires carrying broker-dealers to compute the customer reserve requirement on a weekly basis, except where customer credit balances do not exceed $1 million (in which case the computation can be performed monthly, although, in this case, the broker-dealer must maintain 105% of the required deposit amount).[34]

Rule 17a-13 requires a broker-dealer that holds securities (proprietary, customer, or both), on a quarterly basis, to examine and count the securities it physically holds, account for the securities that are subject to its control or direction but are not in its physical possession (e.g., securities held at a control location), verify the securities, and compare the results of the count

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[30] See Rule 15c3-3(d).

[31] Id.

[32] The term "qualified security" is defined in Rule 15c3-3 to include securities issued by the U.S. or guaranteed by the U.S. with respect to principal and interest. See Rule 15c3-3(a)(6).

[33] See Rule 15c3-3(e).

[34] See Rule 15c3-3(e)(3).

and verification with its records. The broker-dealer must take an operational capital charge under Rule 15c3-1 for all short securities differences (which include securities positions reflected on the broker-dealer's securities record that are not susceptible to either count or confirmation) unresolved after discovery.[35] The differences also must be recorded on the broker-dealer's records.[36]

The Account Statement Rules of DEAs require member broker-dealers to send, at least once every calendar quarter, a statement of account containing a description of any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity during the period since the last such statement was sent to the customer.[37]

B. Proposed Audit Reports and Changes to Applicable Auditing Standards

As part of the Annual Reporting Amendments, the Commission is proposing changes that would revise the reports that broker-dealers file under Rule 17a-5. While the requirement that broker-dealers file a report consisting of the audited financial statements and supporting schedules that are currently required under Rule 17a-5 (the "Financial Report") would remain unchanged, carrying broker-dealers would be required to file a new report asserting to compliance with specified rules and related internal controls (the "Compliance Report"). These

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35 See Rule 15c3-1(c)(2)(v).

36 See Rule 17a-3(a)(4)(vi).

37 For example, NASD Rule 2340 requires broker-dealers that are members of FINRA that conduct a general securities business to send account statements to customers at least quarterly. The current FINRA rulebook consists of: (1) FINRA rules; (2) NASD rules; and (3) rules incorporated from the NYSE ("Incorporated NYSE Rules") (together, the NASD rules and Incorporated NYSE Rules are referred to as the "Transitional Rulebook"). While the NASD rules generally apply to all FINRA members, the Incorporated NYSE Rules apply only to those members of FINRA that are also members of the NYSE. The FINRA rules apply to all FINRA members, unless such rules have a more limited application by their terms. For more information see FINRA's Information Notice, Mar. 12, 2008 (Rulebook Consolidation Process). If a broker-dealer's DEA is the Chicago Board Options Exchange (the "CBOE"), the broker-dealer would be subject to CBOE's account statement rule, CBOE Rule 9.12.

broker-dealers also would be required to file a report from their independent public accountants (the "Examination Report") that addresses the assertions in the Compliance Report. Broker-dealers that do not hold customer funds or securities would be required to file a report asserting their exemption from the requirements of Rule 15c3-3 (the "Exemption Report) and a report from their independent public accountants that would be the result of a review of the broker-dealer's assertion that it is exempt from Rule 15c3-3. Finally, the proposed amendments would change the audit standards applicable to broker-dealer audits and compliance examinations from GAAS to standards promulgated by the PCAOB.

To implement these changes, the Commission proposes a number of amendments to Rule 17a-5. The Commission proposes that paragraph (d) of Rule 17a-5 be re-titled from "Annual filing of audited financial statements" to "Annual reports," because under the proposed revisions to paragraph (d), broker-dealers would generally be required to file a Financial Report and a Compliance Report or an Exemption Report with the Commission.[38] Paragraph (d)(1) of Rule 17a-5 would be amended to set forth the general requirement for broker-dealers to file annual financial reports with the Commission. These reports would include: (1) a "Financial Report" as described in paragraph (d)(2), which would consist of the audited financial statements and supporting schedules that broker-dealers are currently required to file with the Commission;[39] (2) a Compliance Report as described in paragraph (d)(3) unless the broker-dealer is exempt from

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38 Paragraph (d) of Rule 17a-5, currently titled "Annual filing of audited financial statements," is being renamed to reflect that the Commission will now require broker-dealers to file two reports with the Commission (i.e., a Financial Report and a Compliance Report, or a Financial Report and an Exemption Report).

39 Proposed paragraph (d)(1)(i)(A) of Rule 17a-5. See also Rule 17a-5(d)(2), which lists the requirements to be included in the Financial Report and would continue to do so because the Commission is not proposing any amendment to the financial statements and supporting schedules required of the broker-dealer. The Commission proposes a technical amendment, to rename the annual audit report to "Financial Report," to reflect that proposed paragraph (d)(2) relates to the financial audit requirements.

the provisions of Rule 15c3-3,[40] or an Exemption Report as described in paragraph (d)(4) if the broker-dealer claims an exemption from the provisions of Rule 15c3-3;[41] and (3) reports prepared by the independent public accountant pursuant to the engagement provisions in paragraph (g), unless the broker-dealer is exempt from the requirement to either file the annual audit report or engage an independent public accountant pursuant to paragraphs (d)(1) and (e)(1) of Rule 17a-5.[42] The proposed requirements for the Compliance Report and Exemption Report are described in greater detail below.

1. Compliance Report

Under the proposed amendments to paragraph (d) of Rule 17a-5, each carrying broker-dealer would be required annually to file a Compliance Report containing a statement and assertions concerning compliance, and internal control over compliance, with specified rules. Specifically, the Compliance Report would include a statement as to whether the broker-dealer has established and maintained a system of internal control to provide the broker-dealer with reasonable assurance[43] that any instances of material non-compliance with Rule 15c3-1, Rule

40 Proposed paragraph (d)(1)(i)(B)(1) of Rule 17a-5.

41 Proposed paragraph (d)(1)(i)(B)(2) of Rule 17a-5.

42 Proposed paragraph (d)(1)(i)(C) of Rule 17a-5. Specifically, Rule 17a-5(d)(1)(ii) states that "a broker or dealer succeeding to and continuing the business of another broker or dealer need not file a report … if the predecessor broker or dealer has filed a report in compliance with [Rule 17a-5(d)]… ." Rule 17a-5(d)(1)(iii) contains an exemption for broker-dealers from filing an annual audit report if the broker-dealer is a member of a national securities exchange and "has transacted a business in securities solely with or for other members of a national securities exchange, and has not carried any margin account, credit balance or security for any person who is defined as a 'customer' in paragraph (c)(4) of [Rule 17a-5]." Rule 17a-5(e)(1) provides that for certain broker-dealers, the financial statements that must be filed pursuant to Rule 17a-5(d) need not be audited. The exceptions in paragraphs (e)(1)(A)-(B) of Rule 17a-5 are applicable when either: (1) the broker-dealer's securities business has been limited to acting as broker (agent) for an issuer in soliciting subscriptions for securities of the issuer and the broker has promptly transmitted to the issuer all funds and promptly delivered to the subscriber all securities received in connection with the issuance, and the broker has not otherwise held funds or securities for or owed money or securities to customers; or (2) the broker-dealer's securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests, and the broker-dealer has not carried any margin account, credit balance or security for any securities customer.

43 Exchange Act Section 13(b)(7) defines ''reasonable assurance'' and ''reasonable detail'' as ''such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.'' 15

15c3-3, Rule 17a-13, or the Account Statement Rule (collectively, the "Financial Responsibility Rules") will be prevented or detected on a timely basis. The Compliance Report is intended to enhance a broker-dealer's focus on compliance with the specified rules and provide a foundation for the proposed "Compliance Examination" described below in Section II.B.2 of this release.[44]

In addition, the Compliance Report would include the following three assertions by the broker-dealer: (1) whether the broker-dealer was in compliance in all material respects with the Financial Responsibility Rules as of its fiscal year-end;[45] (2) whether the information used to assert compliance with the Financial Responsibility Rules was derived from the books and records of the broker-dealer;[46] and (3) whether internal control over compliance with the Financial Responsibility Rules was effective during the most recent fiscal year such that there were no instances of material weakness.[47] Further, the Compliance Report would be required to contain a description of each identified instance of material non-compliance and each identified material weakness in internal control over compliance with the specified rules.[48]

Rule 17a-5(g) currently requires that the audit include a review of compliance with and controls pertaining to Rule 15c3-1, Rule 15c3-3, and Rule 17a-13. As described above, these rules contain important baseline protections concerning broker-dealer capital adequacy and the protection of customer funds and securities, and the Commission preliminarily believes that it is

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U.S.C. 78m(b)(7). The Commission has long held that ''reasonableness'' is not an ''absolute standard of exactitude for corporate records.'' See Foreign Corrupt Practices Act of 1977, Exchange Act Release No. 17500 (Jan. 29, 1981), 46 FR 11544, 11546 (Feb. 9, 1981). These concepts differ from the concept of "reasonable assurance" in an audit context.

44 The Compliance Examination is discussed below in Section II.B.2 of this release. As is discussed in Section II.B.2, the Commission does not propose the statement in the Compliance Report to be included within the scope of the Compliance Examination.

45 See proposed paragraph (d)(3)(i)(B)(1) of Rule 17a-5.

46 See proposed paragraph (d)(3)(i)(B)(2) of Rule 17a-5.

47 See proposed paragraph (d)(3)(i)(B)(3) of Rule 17a-5.

48 See proposed paragraph (d)(3)(i)(C) of Rule 17a-5.

important that they be addressed in any annual report of a carrying broker-dealer. The proposed Compliance Report would not cover Regulation T, which is currently addressed in existing Rule 17a-5(g)(1)(iii). The Commission believes that the inclusion of Regulation T in the scope of the Compliance Report would not be necessary given the broker-dealer's assertion in the Compliance Report of its compliance with Rule 15c3-1. In particular, a broker-dealer's failure to comply with Regulation T, which governs broker-dealers' extensions of credit on securities, could require a broker-dealer to reduce its net capital by the amount of any deficit in customer unsecured and partly secured accounts after calls for margin.[49]

The Commission also is proposing to require that the Compliance Report include a statement and three assertions concerning the Account Statement Rule. The Account Statement rule provides a key safeguard for customers by ensuring that they receive on a regular basis information concerning securities positions and other assets held in their accounts. Customers can use that information to identify discrepancies and monitor the performance of their accounts. The Commission believes that, taken together, the objectives of the Compliance Report are consistent with the control objectives of the internal control report required under the IA Custody Rule.[50]

The assertions contained in the Compliance Report would pertain to compliance at year-end and also over the course of a fiscal quarter, depending on the particular requirement.[51] The proposed assertions with respect to compliance with Rules 15c3-1 and 15c3-3 would relate to compliance as of the broker-dealer's fiscal year-end. The assertions as to compliance with Rule

49 See Rule 15c3-1(c)(2)(iv)(B).

50 See Section II.B.4 of this release for a discussion of the IA Custody Rule and the control objectives required under the IA Custody Rule.

51 The broker-dealer is required to be in compliance with the Financial Responsibility Rules at all times. The assertions made by the broker-dealer for purposes of the Compliance Report are as of a point in time to facilitate the independent public accountant's attestation to the broker-dealer's assertions.

17a-13 and the Account Statement Rule also would be made as of the broker-dealer's fiscal year-end. However, because these rules impose obligations on a quarterly basis (the broker-dealer must conduct the quarterly count of securities and must send statements to all customers at least once during each quarter, but not necessarily on the last day of the quarter), to be able to make the assertions in the Compliance Report, the broker-dealer would need to determine that it had satisfied the requirements over the course of the fiscal quarter immediately preceding the broker-dealer's fiscal year-end. In contrast, the broker-dealer's assertions related to the effectiveness of internal control over compliance with the Financial Responsibility Rules would not pertain to a fixed point in time, but instead would cover the entire fiscal year. The proposed time periods related to internal control over compliance would be consistent with those in the IA Custody Rule.[52]

The Commission preliminarily believes that broker-dealers would be able to make assertions regarding both compliance and the effectiveness of internal control over compliance with the Financial Responsibility Rules. The Commission is <u>not</u> proposing that effectiveness of internal control over financial reporting be included as one of the assertions made by the broker-dealer in the Compliance Report.[53] The Commission preliminarily believes that the Compliance Report should focus on oversight of custody arrangements and protection of customer assets, and therefore, should be focused on compliance with the Financial Responsibility Rules.

The proposed amendments to Rule 17a-5 would provide that a broker-dealer could not assert compliance with the Financial Responsibility Rules, as of its most recent fiscal year-end, if

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52 <u>See</u> Rule 206(4)-2(a)(6).

53 For example, the Commission is not proposing an assessment of internal control over financial reporting similar to the assessment required under Section 404 of the Sarbanes-Oxley Act for issuers.

it identifies one or more instances of material non-compliance.[54] Instead, the broker-dealer would need to identify and describe any instance of material non-compliance, as of its most recent fiscal year-end, in the Compliance Report.[55] Rule 17a-5 presently requires that independent public accountants include any instances of material inadequacies in their reports based on the Study.[56] The term "material inadequacies," however, is not defined in existing auditing literature. The Commission is proposing to remove the reference to "material inadequacies" in Rule 17a-5 and replace it, for purposes of reporting on the broker-dealer's compliance, with a reference to "material non-compliance." Further, the Commission is proposing to define an instance of material non-compliance, in new paragraph (d)(3)(ii) of Rule 17a-5, as a failure by the broker-dealer to comply with any of the requirements of the Financial Responsibility Rules in all material respects. The Commission preliminarily believes that any failure by the broker-dealer to perform any of the procedures enumerated in the Financial Responsibility Rules would be an instance of non-compliance; therefore, the broker-dealer should evaluate any such failure to determine whether it is material.

When determining whether an instance of non-compliance is material, the Commission preliminarily believes that the broker-dealer should consider all relevant factors including but not limited to: (1) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms; (2) the nature and frequency of non-compliance identified; and (3) qualitative considerations.[57] The Commission also preliminarily believes that some deficiencies would necessarily constitute instances of material non-compliance. For example, failing to maintain the

[54] See proposed paragraph (d)(3)(ii) of Rule 17a-5. The Commission notes that reporting on material non-compliance is discussed, for example, in AT § 601 of the PCAOB's Interim Attestation Standards; see PCAOB Attestation Standard § 601.

[55] See proposed paragraph (d)(3)(ii) of Rule 17a-5.

[56] See Rule 17a-5(g).

[57] See, e.g., paragraph 36 of PCAOB Attestation Standard § 601.

required minimum amount of net capital as required under Rule 15c3-1, or failing to maintain the minimum deposit requirement in a special reserve bank account for the exclusive benefit of customers under Rule 15c3-3,[58] would be instances of material non-compliance. These two instances of material non-compliance would not, however, represent all possible instances of material non-compliance with respect to Rules 15c3-1 and 15c3-3.

The Commission is proposing several conforming amendments to Rule 17a-5 to incorporate the proposed use of the term "material non-compliance." The Commission proposes to amend paragraph (c)(5) of Rule 17a-5, which requires broker-dealers to send Statements of Financial Condition to customers twice per year. Paragraph (c) of Rule 17a-5 provides that a broker-dealer can make these statements available through its Internet website in lieu of sending the statements to the customers in paper form.[59] However, paragraph (c)(5)(vi) of Rule 17a-5 prohibits broker-dealers from making the statements available online, in lieu of sending statements to customers in paper form, if the broker-dealer was required by paragraph (e) of Rule 17a-11 to give notice of a material inadequacy. The Commission is proposing to delete the reference to the term "material inadequacy" and amend paragraph (c)(5)(vi) of Rule 17a-5 to provide that the broker-dealer may make the customer statements available online, in lieu of sending statements to customers in paper form, provided its financial statements receive an unqualified opinion from the independent public accountant and neither the broker-dealer nor the

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58 See Section 15(c)(3) of the Exchange Act, which provides that no 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 or attempt to induce the purchase or sale of, any security "in contravention of such rules and regulations as the Commission shall prescribe … to provide safeguards with respect to the financial responsibility and related practices of the brokers and dealers including, but not limited to the acceptable custody and use of customers' securities and the carrying and use of customers' deposits or credit balances." 15 U.S.C. 78o(c)(3)(A).

59 Rule 17a-5 requires that the statements be sent to its customers, except if the activities of the broker-dealer are limited to certain enumerated activities or except as provided in paragraph (c)(5), which permits the broker-dealer to instead make the statements available online if certain requirements are met. See Rule 17a-5(c)(1) and (c)(5).

independent public accountant identifies a material weakness or an instance of material non-compliance pursuant to proposed new paragraph (g) of Rule 17a-5, described below.

The proposed amendments to Rule 17a-5 also would provide that a broker-dealer could not assert that its internal control over compliance with the Financial Responsibility Rules during the fiscal year was effective if one or more material weaknesses exist with respect to internal control over compliance.[60] The Commission preliminarily believes that a broker-dealer's internal control over compliance with the Financial Responsibility Rules would not be effective if a material weakness exists, given the meaning of the term "material weakness" as described below. Consequently, if one or more material weaknesses exist, the broker-dealer would need to describe in the Compliance Report each material weakness identified during the fiscal year.[61] This would provide the Commission with notice of the nature of any weakness and allow the Commission and DEA examination staff to ascertain how the broker-dealer addressed each weakness.

The Commission is proposing to define the term "material weakness" in paragraph (d)(3)(iii) of Rule 17a-5 as a deficiency, or a combination of deficiencies, in internal control over compliance with the Financial Responsibility Rules, such that there is a reasonable possibility that material non-compliance with those provisions will not be prevented or detected on a timely basis. For purposes of this paragraph, a deficiency in internal control over compliance would exist when the design or operation of a control does not allow the broker-dealer, in the normal course of performing its assigned functions, to prevent or detect non-compliance with the

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60 See proposed paragraph (d)(3)(iii) of Rule 17a-5.

61 See proposed paragraph (d)(3)(i)(C) of Rule 17a-5.

Financial Responsibility Rules on a timely basis.[62] The Commission proposes these definitions, in part, because they are based on previous Commission action.[63]

The Commission preliminarily believes that, for purposes of the proposed definition of the term "material weakness," there is a reasonable possibility of an event occurring if it is "probable" or "reasonably possible." An event is "probable" if the future event or events are likely to occur.[64] An event is "reasonably possible" if the chance of the future event or events occurring is more than remote, but less than likely.[65]

The Commission preliminarily believes that an instance of non-compliance that the broker-dealer has determined does not constitute material non-compliance may nonetheless be indicative of a control deficiency that constitutes a material weakness. The broker-dealer's evaluation of whether an instance of non-compliance is material would be based upon the consideration of the specifically identified instance of non-compliance; whereas the broker-dealer's conclusions with respect to whether the related control deficiency or deficiencies are material weaknesses would relate to whether it is reasonably possible that the control deficiency or deficiencies could result in material non-compliance. This evaluation would require the broker-dealer to consider not only the specifically identified instance of non-compliance but also any additional possible effect that the control deficiency or deficiencies could have on compliance.

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62 See proposed paragraph (d)(3)(iii) of Rule 17a-5.

63 See Amendments to Rules Regarding Management's Report on Internal Control Over Financial Reporting, Exchange Act Release No. 55928 (Jun. 27, 2007), 72 FR 35310 (Jun. 27, 2007). See also Exchange Act Rule 12b-2 (17 CFR 240.12b-2) and Rule 1-02 of Regulation S-X (17 CFR 210.1-02), which state that a "material weakness is a deficiency, or a combination of deficiencies, in internal controls over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis."

64 See Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934, Securities Act of 1933 Release No. 8810 (Jun. 20, 2007), 72 FR 35324 (Jun. 27, 2007), at note 47 and corresponding text.

65 Id.

The Commission generally requests comment on the proposed amendments associated with the proposed Compliance Report. In addition, the Commission requests comment on the following questions:

- Should other rules be included in the scope of the Compliance Report, in addition to, or as an alternative to, the Financial Responsibility Rules? If so, which rules? Commenters should explain their choices.
- Should the proposed Compliance Report cover Regulation T?
- Are the proposed assertions appropriate? Are there other assertions that the broker-dealer should make regarding either compliance or internal control over compliance? Why would any additional assertions result in improved reporting to the Commission?
- Would all of the proposed assertions achieve the Commission's goals to, among other things, strengthen broker-dealers' compliance with the Financial Responsibility Rules, and, in turn, improve the financial and operational condition of broker-dealers and the safeguarding of investor assets?
- What additional steps would a broker-dealer likely have to take in order to comply with the proposed requirements and make each additional proposed assertion?
- Are there any practical issues the Commission should consider with respect to the proposal to assert compliance with the Financial Responsibility Rules?
- Is the proposed definition of the term "material non-compliance" understandable in the context of broker-dealer audits? What alternative definition could be used? Why would any alternative definition be more appropriate?

- Are the examples of material non-compliance described above appropriate? What other examples of material non-compliance should be specifically identified, if any? Should the Commission include examples of material non-compliance in the text of the rule?
- Is the proposed definition of the term "material weakness" understandable in the context of Rule 17a-5? What alternative definition could be used? Why would any alternative definition be more appropriate?
- Is the proposed definition of "deficiency in internal control over compliance" understandable in the context of Rule 17a-5? What alternative definition could be used? Why would any alternative definition be more appropriate?

2. Compliance Examination and Examination Report

The Commission proposes to require each carrying broker-dealer to engage an independent public accountant to examine the broker-dealer's assertions in the Compliance Report ("Compliance Examination") and issue an Examination Report. Under the proposal, following the Compliance Examination, carrying broker-dealers would be required to file the resulting Examination Report of the independent public accountant with the Commission. This Compliance Examination and Examination Report would replace the existing practice that results in the independent public accountant issuing a report based on a Study.

The Commission proposes to amend paragraph (g) of Rule 17a-5 and rename it "Engagement of independent public accountant." As proposed, paragraph (g) would provide that a broker-dealer subject to the requirement to file annual reports pursuant to paragraph (d) would need to engage an independent public accountant to examine or review, as applicable, the reports that are required under that provision. Each carrying broker-dealer would be required to engage its independent public accountant to prepare the Examination Report based on an examination of the assertions contained in the Compliance Report required to be filed pursuant to paragraph (d)(3) of Rule 17a-5.[66] The Examination Report would be required to be prepared in accordance with PCAOB standards.[67]

The proposed changes would not affect existing obligations of broker-dealers or their accountants with respect to financial reporting.[68] Further, the assertions in the Compliance Report would not cover the effectiveness of internal control over financial reporting. Therefore, the independent public accountant would not be required in the Examination Report to opine on the effectiveness of the broker-dealer's internal control over financial reporting. However, the accountant's existing obligation to gain an understanding and perform appropriate procedures relative to the broker-dealer's internal control over financial reporting, as a necessary part of the independent public accountant's financial statement audit, would remain unchanged.[69] Further, the Examination Report would pertain solely to the assertions in the Compliance Report and not to the broker-dealer's process for arriving at the assertions. Because the report of the independent public accountant required by proposed paragraph (g) of Rule 17a-5 would require the accountant to perform its own independent examination of the related controls and procedures, the Commission preliminarily does not believe that it is necessary for the

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66 See proposed paragraph (g)(2)(i) of Rule 17a-5.

67 Id. The Commission preliminarily believes that the independent public accountant's examination would be conducted pursuant to existing PCAOB Attestation Standards or other standards established by the PCAOB for such purposes.

68 The Commission is not proposing to change existing requirements with regard to the broker-dealer's audited financial statements, the computation of required and actual net capital under Rule 15c3-1, or, for carrying broker-dealers, the computation of the customer reserve requirement under Rule 15c3-3. The computation of net capital and the computation of the customer reserve requirement would continue to be subject to audit procedures by the accountant.

69 See PCAOB Auditing Standard No. 12, Identifying and Assessing Risks of Material Misstatements for audits of fiscal years beginning on or after December 15, 2010.

independent public accountant to provide an opinion with regard to the process that the broker-dealer used to arrive at its conclusions.

The Commission preliminarily intends that the proposed amendments and requirements pertaining to the Examination Report would result in the following fundamental changes to broker-dealer audits. First, broker-dealer examinations would be performed in accordance with PCAOB standards, rather than GAAS, consistent with the Dodd-Frank Act.[70] Second, in connection with their engagement, independent public accountants would be required to provide an opinion concerning the broker-dealer's compliance, and internal control over compliance, with key regulatory requirements. Further, the independent public accountant's report, as it applies to internal control over compliance, would cover the full fiscal year instead of relating to the effectiveness of controls only at year-end. Compliance with the Account Statement Rules would be included as part of the review. These changes are intended to encourage, in connection with broker-dealer audits, greater focus by the auditor on internal control over compliance as it pertains to key regulatory requirements, including, in particular, greater focus on broker-dealer custody practices under the Financial Responsibility Rules. In addition, the Commission intends that the amendments, as they pertain to custody of customer funds and securities, will better align the broker-dealer custody requirements with certain requirements in the IA Custody Rule.[71]

The Commission generally requests comment on the proposed amendments and, in particular, the Compliance Examination and Examination Report provisions. In addition, the Commission requests comment on the following questions:

- Should the Compliance Examination also cover a broker-dealer's statement in the Compliance Report as to whether the broker-dealer has established and

[70] See Section 982 of the Dodd-Frank Act.

[71] See Rule 206(4)-2(a)(6)(ii)(A).

maintained a system of internal control to provide the broker-dealer with reasonable assurance that any instances of material non-compliance with the Financial Responsibility Rules will be prevented or detected on a timely basis? If so, why? If not, why not?

- Should the independent public accountant provide an opinion with regard to the process that the broker-dealer used to arrive at its assertions?

3. Notification Requirements

The proposed amendments would require that the independent public accountant notify the Commission within one business day if the accountant determines that an instance of "material non-compliance" exists with respect to any of the Financial Responsibility Rules during the course of the examination.[72] This notice requirement would be triggered at the time that the independent public accountant determines that material non-compliance exists, not at the time of completion of the examination. Alerting the Commission to a broker-dealer's material non-compliance with the Financial Responsibility Rules on an expedited basis could enable the Commission to react to the non-compliance more quickly for the protection of investors and others. Currently, Rule 17a-5 requires notification in the event the independent public accountant determines the existence of a "material inadequacy."[73] Specifically, the independent public accountant must call the material inadequacy to the attention of the broker-dealer's chief financial officer, who is then obligated to notify the Commission and the broker-dealer's DEA.

The Commission proposes modifying the notification requirement to replace the term "material inadequacy" with "material non-compliance" and to require the independent public accountant to notify the Commission directly. Specifically, the Commission proposes to amend

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72 See proposed paragraph (h) of Rule 17a-5.

73 See Rule 17a-5(h)(2). "Material inadequacy" is not a defined term in existing auditing literature.

paragraph (h) of Rule 17a-5 to provide that upon determining the existence of any material non-compliance during the course of preparing the independent public accountant's reports, the independent public accountant must notify the Commission within one business day of the determination by means of a facsimile transmission or electronic mail, followed by first class mail, and must provide a copy of the notification in the same manner to the principal office of the DEA for the broker-dealer. The Commission preliminarily believes that this change would provide more effective and timely notice of broker-dealer compliance deficiencies, and, as noted above, enable the Commission to react more quickly to protect customers and others adversely affected by those deficiencies. It also would be consistent with current notification requirements applicable to independent public accountants examining investment advisers pursuant to the IA Custody Rule.[74]

The Commission is proposing a conforming amendment to paragraph (e) of Rule 17a-11, which now requires that broker-dealers provide notice to the Commission of the existence of any material inadequacy. The Commission also is proposing two technical amendments to correct certain references to Rule 17a-12 in paragraph (e) of Rule 17a-11.[75] Further, the Commission is proposing to delete paragraph (h)(1) of Rule 17a-5, which relates to the extent and timing of broker-dealer audits, and which would now be superseded by paragraphs (d) and (g).[76] Finally, the Commission is proposing to delete paragraph (j) of Rule 17a-5, which currently requires the filing of an independent public accountant's report describing any material inadequacies

74 See Rule 206(4)-2(a)(4)(ii).

75 Specifically, the Commission proposes to amend the references for Rule 17a-12(f)(2) and Rule 17a-12(e)(2) to be Rule 17a-12(i)(2) and Rule 17a-12(h)(2), respectively.

76 As discussed above, the broker-dealer must assert that it is in compliance in all material respects with the Financial Responsibility Rules as of the fiscal year-end and that its internal controls over compliance were effective throughout the fiscal year. See proposed paragraph (d)(3) of Rule 17a-5.

concurrent with the annual audit report. This requirement likewise would be superseded by the proposed amendments.

The Commission generally requests comment on the proposed amendments and the notification provisions. In addition, the Commission requests comment on the following questions:

- Would an alternative means to notify the Commission of an instance of material non-compliance be appropriate? If so, what alternative and why?

4. Comparison to the IA Custody Rule

The IA Custody Rule provides that a registered investment adviser is prohibited from having custody of client funds or securities unless a qualified custodian maintains those funds and securities: (1) in a separate account for each client under that client's name; or (2) in accounts that contain only the investment adviser's clients' funds and securities, under the investment adviser's name as agent or trustee for the clients.[77] Under the IA Custody Rule, only banks, certain savings associations, registered broker-dealers, registered futures commission merchants ("FCMs"),[78] and certain foreign financial institutions may act as qualified custodians.[79]

In addition, when an investment adviser or its related person maintains client funds and securities as qualified custodian in connection with advisory services provided to clients, the adviser annually must obtain, or receive from its related person, a written internal control report prepared by an independent public accountant registered with, and subject to regular inspection

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77 See Rule 206(4)-2(a)(1)(i)-(ii).

78 FCMs are individuals, associations, partnerships, corporations, and trusts that solicit or accept orders for the purchase or sale of any commodity for future delivery on or subject to the rules of any exchange and that accept payment from or extend credit to those whose orders are accepted. See the Commodity Futures Trading Commission Glossary available at www.cftc.gov.

79 For the complete definition of the term "qualified custodian," see infra note 154.

by, the PCAOB. This report must be supported by the independent public accountant's examination of the qualified custodian's custody controls.[80] The Commission has issued guidance identifying the control objectives that would need to be included in the scope of the examination.[81]

The control objectives identified in the Commission's guidance on the IA Custody Rule are more general than the specific operational requirements in the Financial Responsibility Rules. These general control objectives are appropriate for purposes of the IA Custody Rule, since this approach allows the different types of qualified custodians (banks, certain savings associations, registered broker-dealers, registered FCMs, and certain foreign financial institutions) to establish controls and procedures that meet the identified control objectives in a manner that reflects differences in business models, regulatory requirements, and other factors. For example, the manner in which an FCM maintains custody of assets[82] differs from that of a

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80 The IA Custody Rule provides that the internal control report must include an opinion of an independent public accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and are operating effectively to meet control objectives relating to custodial services, including the safeguarding of funds and securities held by either the adviser or its related person on behalf of advisory clients, during the year. The rule also requires that the accountant "verify that the funds and securities are reconciled to a custodian other than [the adviser or its] related person." The required controls are not enumerated in the rule, however.

81 See Commission Guidance Regarding Independent Public Accountant Engagements Performed Pursuant to Rule 206(4)-2 Under the Investment Advisers Act of 1940, Advisers Act Release No. 2969 (Dec. 30, 2009), 75 FR 1942 (Jan. 11, 2010). The Commission guidance on the IA Custody Rule provided the following specified objectives: (1) documentation for the opening and modification of client accounts is received, authenticated, and established completely, accurately, and timely on the applicable system; (2) client transactions, including contributions and withdrawals, are authorized and processed in a complete, accurate, and timely manner; (3) trades are properly authorized, settled, and recorded completely, accurately, and timely in the client account; (4) new securities and changes to securities are authorized and established in a complete, accurate and timely manner; (5) securities income and corporate action transactions are processed to client accounts in a complete, accurate, and timely manner; (6) physical securities are safeguarded from loss or misappropriation; (7) cash and security positions are reconciled completely, accurately and on a timely basis between the custodian and depositories; and (8) account statements reflecting cash and security positions are provided to clients in a complete, accurate and timely manner.

82 See section 4d(a) and (b) of the Commodity Exchange Act (7 U.S.C. 4d); see also 17 CFR 1.20 to 1.30.

bank, and the different entities are subject to different regulations governing their custodial functions.

Broker-dealers that maintain custody of customer funds and securities are subject to specific operational requirements in the Financial Responsibility Rules with respect to handling and accounting for customer assets.[83] The Commission preliminarily believes that the operational requirements of those rules are consistent with the control objectives outlined in the Commission's guidance on the IA Custody Rule. Consequently, the Commission has preliminarily determined that, if the proposed rule amendments are adopted, a broker-dealer subject to the proposed Compliance Examination that also acts as a qualified custodian for itself as an investment adviser or for its related investment advisers under the IA Custody Rule would be able to use the Examination Report to satisfy the reporting requirements under Rule 17a-5 and the IA Custody Rule's internal control report requirement.

The Commission generally requests comment on the comparability of the scope of the internal control report under the IA Custody Rule and the scope of the proposed Compliance Examination under the proposed amendments to Rule 17a-5. In addition, the Commission requests comment on the following question:

- Should the Commission add additional elements to the scope of the proposed Examination Report? Commenters should identify any such elements and discuss the feasibility, benefits and costs of including them as elements in the scope of the proposed Compliance Examination.

[83] While Rule 15c3-1 prescribes broker-dealer net capital requirements, it also contains provisions relating to custody. For example, a broker-dealer must take net capital charges for short security differences unresolved after specifically enumerated timeframes. See Rule 15c3-1(c)(2)(v)(A).

5. Proposed Exemption Report

As discussed above, broker-dealers claiming an exemption from Rule 15c3-3 (i.e., non-carrying broker-dealers) are required to have their independent public accountants "ascertain that the conditions of the exemption were being complied with as of the examination date and that no facts came to the [independent public accountant's] attention to indicate that the exemption had not been complied with during the period since [the independent public accountant's] last examination."[84] The Commission proposes to amend this requirement by requiring a non-carrying broker-dealer claiming an exemption from Rule 15c3-3 to file a new Exemption Report.[85] This Exemption Report would replace the existing requirement described above.

Specifically, under new paragraph (d)(4) of Rule 17a-5, the Exemption Report would require an assertion by a broker-dealer that it is exempt from the provisions of Rule 15c3-3 because it meets one or more of the conditions set forth in paragraph (k) of Rule 15c3-3 with respect to all of its business activities.[86] In addition, the non-carrying broker-dealer would be required to engage an independent public accountant to review the assertion in the Exemption Report and prepare a report based on that review and in accordance with standards of the PCAOB.[87] If the independent public accountant is aware of any material modifications[88] that should be made to the assertion contained in the Exemption Report, the independent public accountant would be required to disclose them in its report. The Commission preliminarily

84 See Rule 17a-5(g)(2).

85 A non-carrying broker-dealer would file the Exemption Report and corresponding report prepared by its independent public accountant in lieu of the Compliance Report and Examination Report. The Commission notes, however, that under the IA Custody Rule, a non-carrying or "introducing" broker-dealer may be a "qualified custodian." In this case, in order to receive an internal control report that would satisfy the IA Custody Rule, the non-carrying broker-dealer would have to be separately examined by an independent public accountant for that purpose.

86 See Rule 15c3-3(k), which sets forth the exemptions to Rule 15c3-3.

87 See proposed paragraph (g)(2)(ii) of Rule 17a-5.

88 See paragraph 90 of PCAOB Attestation Standard § 101.

believes that an example of a discovery that would necessitate a material modification would be a discovery that the broker-dealer failed to promptly forward any customer securities it received.[89]

The Commission preliminarily believes that the independent public accountant would be able to obtain the moderate level of assurance contemplated by the required review[90] through a combination of procedures that the accountant would perform in connection with the financial audit currently required under Rule 17a-5[91] and certain inquiries and other procedures targeted specifically to the exemption asserted by the broker-dealer.

The Commission generally requests comment on the proposed Exemption Report. In addition, the Commission requests comment on the following questions:

- Are there other types of broker-dealers that would not qualify to file an Exemption Report, but, based on the limited scope of their businesses, should be allowed to file a more limited report than the Compliance Report? If so, please identify the types of broker-dealers and indicate why they should not be required to file Compliance Reports.
- What additional processes and controls might a broker-dealer put in place in order to comply with the new requirements relating to the Exemption Report and to accommodate a review of the report by an independent public accountant?

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89 See Rule 15c3-3(k)(2)(ii), which provides that an introducing broker-dealer is exempt from the requirements of Rule 15c3-3 if the introducing broker-dealer "promptly transmits all customer funds and securities to the clearing broker or dealer which carries all of the accounts of such customers ..."

90 See paragraph 55 of PCAOB Attestation Standard § 101.

91 See Rule 17a-5(d). As noted previously, the Commission is not proposing to change the requirement that broker-dealers file annual audited financial statements. Therefore, the Commission preliminarily believes that the independent public accountant can leverage the work related to the financial audit in the course of undertaking its review of the broker-dealer's assertion with respect to the claimed exemption from Rule 15c3-3.

- Should the Commission require that the assertion made by the broker-dealer with respect to the exemption from Rule 15c3-3 be examined by the accountant (i.e., the independent public accountant issues an opinion based on obtaining reasonable assurance) as opposed to being reviewed (i.e., the independent public accountant issues a report based on obtaining a moderate level of assurance)? Commenters should discuss the feasibility, benefits and costs of such a requirement.
- What additional costs and burdens would a non-carrying broker-dealer incur under the proposal requiring an independent public accountant to review the broker-dealer's claim that it qualifies for an exemption from Rule 15c3-3?

6. Change in Applicable Audit Standards

The Commission is proposing to require that the audit of the Financial Report, the examination of the Compliance Report, and the review of the Exemption Report be performed pursuant to standards established by the PCAOB. The Dodd-Frank Act provided authority to the PCAOB to establish, subject to Commission approval, 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 pursuant to Section 17(e) of the Exchange Act.[92] To enable the PCAOB to effectively implement the authority provided to it by the Dodd-Frank Act, the Commission is proposing to amend paragraph (g) of Rule 17a-5 to provide that the independent public

[92] See Section II.A. of this release for a discussion of the PCAOB's new oversight authority under the Dodd-Frank Act.

accountants' reports required under the rule must be prepared in accordance with the standards of the PCAOB.[93]

In September 2010, the Commission issued interpretive guidance concerning the auditing standards that should be applied by broker-dealer accountants with respect to the current requirements in Rule 17a-5.[94] That guidance stated that references in Commission rules, staff guidance, and in the federal securities laws to GAAS or to specific standards under GAAS, as they relate to non-issuer broker-dealers, should continue to be understood to mean auditing and attestation standards generally accepted in the U.S., in addition to any applicable rules of the Commission.[95]

Because PCAOB auditing standards differ from existing standards governing broker-dealer audits, the proposed change to paragraph (g) would result in a change in the procedures accountants would have to undertake as part of their engagement for audits of broker-dealers. For example, certain audit documentation requirements contained in PCAOB Auditing Standard 3 (Audit Documentation) and the engagement quality review requirement in PCAOB Auditing Standard 7 (Engagement Quality Review) are not required by GAAS.

The Commission generally requests comment on the proposed change to applicable auditing standards. In addition, the Commission requests comment on the following questions:

- Are there implications to the differences that were identified that the Commission should consider? Are there other differences that exist that would have significant implications to the audits of broker-dealers?

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93 See proposed paragraph (g)(1) of Rule 17a-5.

94 See Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers, Exchange Act Release No. 62991 (Sep. 24, 2010), 75 FR 60616 (Oct. 1, 2010). The Commission also noted in its guidance that it intended to revisit this interpretation in connection with this rulemaking.

95 Id. at 60617.

- Should the requirement to be audited in accordance with PCAOB standards be phased in for non-carrying broker-dealers? Why or why not? If so, what time-table should the Commission adopt?

7. Compliance Date and Transition Period

The Commission is proposing to make the Annual Reporting Amendments effective for annual reports filed with the Commission for fiscal years ending on or after December 15, 2011. The Commission is proposing this date to include fiscal years that end on or after December 31, 2011. The Commission preliminarily intends to implement a transition period for carrying broker-dealers required to file Compliance Reports with the Commission with fiscal years ending on or after December 15, 2011 but before September 15, 2012. During this transition period, a carrying broker-dealer's assertion in its Compliance Report as to whether internal control over compliance with the Financial Responsibility Rules was effective would be a point-in-time assertion as of the date of the Compliance Report, rather than covering the broker-dealer's entire fiscal year. The Commission preliminarily believes that the compliance date and transition period set forth above will provide adequate time for broker-dealers to prepare the additional required reports and for independent public accountants to plan and perform the Compliance Examination procedures.

The Commission generally requests comment on the proposed compliance date and transition period. In addition, the Commission requests comment on the following questions:

- Will the proposed compliance date and transition period for the Annual Reporting Amendments provide sufficient time for broker-dealers to prepare the additional reports and for independent public accountants to comply with PCAOB standards? Will it provide sufficient time to plan and perform Compliance

Examination procedures? If not, what are the impediments and what would be a more appropriate time frame for implementation?

8. General Solicitation of Comments

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following questions related to the proposal:

- Certain broker-dealers conducting a limited and specific type of business are not presently required to file an annual audit report.[96] Should the Commission require all broker-dealers to file an annual audit of their financial statements and supporting schedules? Should any of the proposed amendments to Rule 17a-5 applicable to carrying firms be applied to other specific types of broker-dealers? If so, which types of firms and why? What impact would extension of the audit requirement or the proposed amendments relating to non-carrying firms have on small businesses?

C. Proposed Amendment to the Filing of SIPC Reports

1. Existing Requirement

SIPC is a non-profit, membership corporation created under the Securities Investor Protection Act of 1970 ("SIPA").[97] SIPC is designed to protect the custodial function of a broker-dealer in the event it fails financially. For example, SIPC can fund the liquidation of a

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96 See Rule 17a-5(e)(1)(A) and (B), which provide limited exemptions to broker-dealers from having their financial statements and supporting statements audited by an independent public accountant, so long as specified factors are met (e.g., if the securities business of the broker-dealer has been limited to acting as a broker for an issuer in soliciting subscriptions for securities of such issuer and the broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and the broker has not otherwise held funds or securities for or owed money or securities to customers, then the broker-dealer does not have to have the financial statements audited by an independent public accountant). See Rule 17a-5(e)(1)(A).

97 15 U.S.C. 78 et seq.

broker-dealer that cannot wind itself down in an orderly self-liquidation.[98] As part of the liquidation, SIPC can advance up to $500,000 per customer to satisfy claims for securities and cash.[99] However, of the $500,000, only $250,000 can be used to satisfy claims for cash.[100] In order to pay for these liquidations and advances, SIPC maintains the SIPC Fund.[101] The SIPC Fund is established and maintained by collecting assessments from broker-dealers that are required to be members of SIPC.[102] Generally all broker-dealers registered with the Commission under Section 15(b) of the Exchange Act[103] are required to be members of SIPC.[104] However, broker-dealers engaged exclusively in the distribution of mutual fund shares, the sale of variable annuities, the insurance business, the furnishing of investment advice to investment companies or insurance company separate accounts, or whose principal business is conducted outside the U.S. are not required to be members of SIPC.[105]

Under SIPA, SIPC may assess each of its member broker-dealers a fee determined as a percentage of the firm's revenues.[106] There are required percentage assessments that must be made when the SIPC Fund falls below deposited amounts or such other amount as the Commission may determine in the public interest ("the SIPC Fund Target Level").[107] SIPC can

98 15 U.S.C. 78eee(a)(3).

99 15 U.S.C. 78fff-3(a).

100 15 U.S.C. 78fff-3(d).

101 15 U.S.C. 78ddd.

102 15 U.S.C. 78ddd(c).

103 15 U.S.C. 78o(b).

104 15 U.S.C. 78ccc(a)(2).

105 15 U.S.C. 78ccc(a)(2)(A)(i)-(iii).

106 See 15 U.S.C. 78ddd(c)(2). See also SIPC Bylaws, Article 6.

107 Prior to the Lehman Brothers Inc. and Bernard L. Madoff Investment Securities LLC SIPA liquidations, the SIPC Fund was maintained at a target level of not less than $1 billion. Currently, the SIPC Fund Target Level is $2.5 billion. See SIPC Bylaws, Article 6, Section 1(a)(1)(A) (specifying the $2.5 billion SIPC Fund Target Level). See also Securities Investor Protection Corporation Modernization Task Force,

assess broker-dealers a fee based on a greater percentage of their revenues when the SIPC Fund falls below the SIPC Fund Target Level.[108]

In order to assist in the collection of these assessments, SIPC has promulgated two forms that broker-dealers must file with SIPC, as applicable: Form SIPC-3 and Form SIPC-7. Form SIPC-3 is required when a broker-dealer is claiming an exemption from SIPC membership (i.e., when the broker-dealer does not have to pay an assessment). Such a broker-dealer must file Form SIPC-3 each year certifying that the broker-dealer remained qualified for the exemption during the prior year. Form SIPC-7 elicits information from a broker-dealer that is a SIPC member about the broker-dealer's sources of revenue attributable to its securities business. Every broker-dealer that is a member of SIPC must file this form annually.

When SIPC raises SIPC Fund assessments above the minimum assessment provided for in Section 4(d)(1)(c) of SIPA,[109] Rule 17a-5(e)(4) requires a broker-dealer that files Form SIPC-3 or Form SIPC-7 to also file with the Commission, the broker-dealer's DEA, and SIPC a supplemental report ("Supplemental Report") covered by an opinion of the broker-dealer's independent public accountant that covers the information in the respective form. Among other things, the Supplemental Report also is required to: (1) include a statement that the broker-dealer qualified for an exclusion from SIPC membership under SIPA during the prior year if exclusion from membership is claimed; and (2) include an independent public accountant's report stating that "in the accountant's opinion…[the broker-dealer's] claim for exclusion from

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Adequacy of the SIPC Fund (Jun. 2010), at 5 (describing the increase in the SIPC Fund Target Level from $1 billion to $2.5 billion).

108 SIPC Bylaws, Article 6, Section 1(a).

109 15 U.S.C. 78ddd(d)(1)(c).

membership was consistent with income reported" or "the assessments were determined fairly in accordance with applicable instructions and forms" (as applicable).[110]

2. Proposed Amendment

Because Forms SIPC-3 and SIPC-7 are used solely by SIPC for purposes of levying its assessments, the Commission preliminarily believes that Supplemental Reports relating to these forms would be more appropriately filed with SIPC and that SIPC, rather than the Commission, should, by rule, prescribe the form of the Supplemental Reports. This would provide SIPC with the discretion to determine the need for and form of a Supplemental Report and the nature and extent of the review by an independent public accountant, if any. The Commission would continue to have a role in establishing the requirements for a Supplemental Report because the Commission must approve SIPC rule proposals.

The Commission proposes to amend Rule 17a-5 to require that broker-dealers continue to file a Supplemental Report with the Commission, the broker-dealer's DEA, and SIPC until the Commission considers and determines to approve any such rule adopted by SIPC. Because, for an interim period, broker-dealers would be required to continue to file their Supplemental Reports with the Commission, the Commission is proposing to update the rule text to conform it to existing professional standards and industry practices. Specifically, the Commission is proposing to amend Rule 17a-5(e)(4) to eliminate the ambiguity that stems from the differing auditing terms used therein by removing all references to "review" and "opinion" where those terms are used in Rule 17a-5(e)(4).[111] In their place, the Commission proposes to amend paragraph (e)(4) of Rule 17a-5 to provide that Supplemental Reports shall include the independent public accountant's report prepared pursuant to agreed-upon procedures based on

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110 See Rule 17a-5(e)(4).

111 See Rule 17a-5(e)(4), Rule 17a-5(e)(4)(iii), and Rule 17a-5(e)(4)(iii)(F).

the performance of the procedures outlined in current paragraph (e)(4)(iii) of Rule 17a-5, which the Commission is not proposing to change.[112]

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following questions related to the proposal:

- Should the Commission and/or a broker-dealer's DEA continue to receive SIPC Reports relating to assessments, and, if so, for what reasons?
- Should the Commission continue to require that the broker-dealer engage an independent public accountant to perform some level of work with respect to the information contained in the SIPC Reports? If so, should the Commission also specify what type of engagement the broker-dealer must have with its independent public accountant with respect to the information contained in the SIPC Reports? For example, should the Commission require a broker-dealer to engage its independent public accountant to perform a review of the information in the SIPC Reports pursuant to PCAOB standards? Commenters should discuss the feasibility, benefits, and costs of such requirements.
- Should the Commission impose any requirements or limitations on SIPC with respect to its ability to propose rules to have SIPC Reports filed solely with SIPC? If so, what requirements and/or limitations?

112 See Rule 17a-5(e)(4)(iii). The Commission notes that as part of the proposed amendments to this paragraph, the procedures outlined in current paragraph (e)(4)(iii) of Rule 17a-5 would remain, but would be renumbered to be included in paragraph (e)(4)(ii)(C).

III. THE PROPOSED ACCESS TO AUDIT DOCUMENTATION AMENDMENTS

Pursuant to Section 17(b) of the Exchange Act, broker-dealers are subject to routine inspection and examination by Commission and DEA staff. To facilitate the examination of a broker-dealer that clears transactions or carries customer accounts (a "clearing broker-dealer"), the Commission is proposing that each clearing broker-dealer be required to consent to permitting its independent public accountant to make available to Commission and DEA examination staff the audit documentation associated with its annual audit reports required under Rule 17a-5 and to discuss findings relating to the audit reports with Commission and DEA examination staff.[113] The Commission preliminarily believes that it is appropriate to limit these requirements to broker-dealers that maintain customer funds and securities or self-custody their proprietary securities because these firms generally have more complex business operations than other broker-dealers. Consequently, having access to audit documentation and the independent public accountants that audit these broker-dealers would be of greater assistance to examiners in performing examinations of these firms, as compared to firms with simpler business models.

The Commission is not proposing that the Commission or DEA staff would use any audit documentation they may request, or discuss findings related to the audit reports, for purposes of examining independent public accountants; the PCAOB carries out that function. Rather, the Commission preliminarily intends that any such requests would be made exclusively in connection with conducting a regulatory examination of the clearing broker-dealer.

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113 The sole obligation of the broker-dealer under this proposed requirement would be to provide the proposed consent in the manner discussed below. The Commission is not addressing in this release any rights, obligations, or responsibilities of a broker-dealer's independent public accountant with respect to its work papers.

The Commission preliminarily intends that examiners generally would use any information obtained from audit documentation and discussions with the independent public accountants to establish the scope and focus of a pending examination of a clearing broker-dealer. The Commission preliminarily believes that, in cases in which such information is obtained, it would enhance and improve the efficiency and effectiveness of Commission and DEA examinations of clearing broker-dealers by providing examiners with access to additional relevant information to plan their examinations. This additional relevant information would enable representatives of the Commission and a clearing broker-dealer's DEA to better focus and tailor their examination efforts relating to asset verification and other matters pertinent to customer protection. For example, where an independent public accountant has performed extensive testing of a carrying broker-dealer's custody of funds and securities by confirming holdings at sub-custodians, examiners could focus their efforts on other matters that had not been the subject of prior testing and review.

In connection with these proposals, the Commission is proposing to amend paragraph (f)(2) of Rule 17a-5, which contains the requirement for broker-dealers to file notices with the Commission and their DEAs to designate their independent public accountants, to require that the broker-dealer represent that the engagement of the independent public accountant by the broker-dealer meets the required undertakings of amended paragraph (g).[114] Currently, paragraph (f)(2) of Rule 17a-5 provides that a broker-dealer required to file an annual audit report must file a statement with the Commission and its DEA that it has designated an independent public accountant responsible for performing the annual audit of the broker-dealer,

[114] See proposed paragraph (f)(2)(ii)(E) of Rule 17a-5.

which is called "Notice pursuant to Rule 17a-5(f)(2)" ("Notice").[115] Paragraph (f)(2)(iii) of Rule 17a-5 prescribes the items that are required to be included in the Notice: the name, address, telephone number and registration number of the broker-dealer; the name, address and telephone number of the accounting firm; and the audit date of the broker-dealer for the year covered by the agreement.[116]

The proposed amendments to Rule 17a-5 would require: (1) that the Notice include a statement as to whether the broker-dealer's engagement letter with its independent public accountant is for a single year or is of a continuing nature;[117] (2) a representation that the engagement of the independent public accountant by the broker-dealer meets the required undertakings of paragraph (g);[118] (3) in the case of a clearing broker-dealer, a representation that the broker-dealer agrees to allow representatives of the Commission or the DEA, if requested for purposes of an examination of the broker-dealer, to review the audit documentation associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of Rule 17a-5;[119] and (4) in the case of a clearing broker-dealer, a representation that the broker-dealer agrees to permit the independent public accountant to discuss with representatives of the Commission and the DEA of the broker-dealer, if requested for purposes of an examination of the broker-dealer, the findings associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of Rule 17a-5.[120] Subparagraph (f)(2)(iii) of Rule 17a-5

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115 See Rule 17a-5(f)(2).

116 See Rule 17a-5(f)(2)(iii)(A) through (C).

117 See proposed paragraph (f)(2)(ii)(D) of Rule 17a-5. The Commission notes that FINRA currently provides its members with a template for the Rule 17a-5(f)(2) Notice that includes a provision as to whether the engagement is continuing in nature, which is available at http://www.finra.org/web/groups/industry/@ip/@comp/@regis/documents/industry/p009841.pdf.

118 See proposed paragraph (f)(2)(ii)(E) of Rule 17a-5.

119 See proposed paragraph (f)(2)(ii)(F) of Rule 17a-5.

120 See proposed paragraph (f)(2)(ii)(G) of Rule 17a-5.

would provide that a non-clearing broker-dealer is not required to include the third and fourth representations above.[121]

The Commission also is proposing several technical changes to paragraph (f)(2) of Rule 17a-5. Specifically, the Commission proposes to amend the language in the preamble of paragraph (f)(2) to streamline the paragraph and to add a reference to the requirements of the Notice. The Commission proposes to delete paragraph (f)(2)(ii), which provides that the agreement can be continuing in nature, because the amended preamble to paragraph (f)(2) captures this concept.

If the Access to Audit Documentation Amendments described above were adopted, Notices on file with the Commission at the time of the effectiveness of the amendment would not be in compliance with the new rules. Accordingly, broker-dealers subject to paragraph (f)(2) would have to file new Notices if the proposals were adopted. However, if the engagement covered by the new Notice was of a continuing nature, no subsequent filing would be required unless the broker-dealer changed independent public accountants.[122]

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following questions:

- Should the proposed Access to Audit Documentation Amendments apply to all broker-dealers, or additional broker-dealers rather than just clearing broker-dealers?

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121 See proposed paragraph (f)(2)(iii) of Rule 17a-5, which would provide that a "broker or dealer who does not carry nor clear transactions nor carry customer accounts is not required to include the representations in paragraph (e)(ii)(F)."

122 See Rule 17a-5(f)(2)(ii).

- Would applying the proposed Access to Audit Documentation Amendments to non-clearing broker-dealers provide any advantages in terms of enhancing the examination of the broker-dealers or gaining efficiencies?
- Are there any other types of broker-dealers whose conduct may pose risks to the investing public that should be subject to the proposed Access to Audit Documentation Amendments?
- Are there additional reasons why examiners should obtain documentation from independent public accountants other than those described above (i.e., to establish the scope and focus of a pending examination of a clearing broker-dealer)? If so, please explain the reasons and the objectives behind the reasons and how the information could be used to achieve those objectives.
- Would any limitations on the ability of examiners to have access to audit documentation or to discuss the findings of the independent public accountant be appropriate? If so, what are those restrictions, why would they be appropriate, and what effect would they have on broker-dealer examinations?
- Should examiners be required to request access to the audit documentation in writing?
- Should the Commission require a broker-dealer to submit a statement consenting to provide access to its independent public accountant and the audit documentation ("statement of consent") only when it files the "Notice pursuant to Rule 17a-5(f)(2)"?
- How often should the statement of consent be filed (e.g., on an annual or more frequent basis)?

- Are the proposed representations in the Notice sufficient to provide effective access to the independent public accountant's audit documentation? If not, what additional representations, or what other measures, would be more effective?
- Will the terms of engagement between clearing broker-dealers and their independent public accountants, including compensation terms, be affected by the proposed amendments? What additional costs might this place on clearing broker-dealers? In this respect, would there be a disproportionate impact on smaller clearing broker-dealers?
- What is the risk, if any, that clearing broker-dealers and their current independent public accountants will not be able to agree on mutually-agreeable terms in order to compensate them for additional burdens they may incur as a result of the proposed amendments?

IV. THE PROPOSED FORM CUSTODY AMENDMENTS

The Commission has brought numerous enforcement actions against investment advisers and broker-dealers alleging fraudulent conduct that includes misappropriation or other misuse of customer assets.[123] Consequently, the Commission recently took steps to enhance oversight of

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[123] See, e.g., SEC v. Donald Anthony Walker Young, et al., Litigation Release No. 21006 (Apr. 20, 2009) (complaint alleges registered investment adviser and its principal misappropriated in excess of $23 million, provided false account statements to investors in limited partnership, and provided false custodial statements to limited partnership's introducing broker); SEC v. Isaac I. Ovid, et al, Litigation Release No. 20998 (Apr. 14, 2009) (complaint alleges that defendants, including registered investment adviser and manager of purported hedge funds, misappropriated in excess of $12 million); SEC v. The Nutmeg Group, LLC, et al., Litigation Release No. 20972 (Mar. 25, 2009) (complaint alleges that registered investment adviser misappropriated in excess of $4 million of client assets, failed to maintain client assets with a qualified custodian, and failed to obtain a surprise examination); SEC v. WG Trading Investors, L.P., et al., Litigation Release No. 20912 (Feb. 25, 2009) (complaint alleges that registered broker-dealer and affiliated registered adviser orchestrated fraudulent investment scheme, including misappropriating as much as $554 million of the $667 million invested by clients and sending clients misleading account information); SEC v. Stanford International Bank, et al., Litigation Release No. 20901 (Feb. 17, 2009) (complaint alleges that affiliated bank, broker-dealer, and advisers colluded with each other in carrying out an $8 billion fraud); SEC v. Bernard L. Madoff, et al., Litigation Release No. 20889 (Feb. 9, 2009) (complaint alleges that

the custody function of investment advisers,[124] and is now proposing enhancements to the oversight of the custody function of broker-dealers. The Commission is proposing amendments to Rule 17a-5 that are designed to provide greater information regarding the custody function at broker-dealers and their compliance with requirements relating to custody of customer and non-customer assets. Specifically, the Commission is proposing a new form to be filed by broker-dealers – Form Custody – which is designed to elicit information concerning whether a broker-dealer maintains custody of customer and non-customer assets, and, if so, how such assets are maintained.[125] As discussed below, the Commission proposes to require that a broker-dealer file proposed Form Custody with its quarterly FOCUS Report.[126]

Currently, a broker-dealer's FOCUS Report provides the Commission and other regulators (e.g., a broker-dealer's DEA) with information relating to the broker-dealer's financial and operational condition.[127] A broker-dealer's FOCUS Report does not, however, solicit detailed information on how a broker-dealer maintains custody of assets. The proposed new form is intended to provide additional information about a broker-dealer's custodial activities.

Madoff and Bernard L. Madoff Investment Securities LLC – a registered investment adviser and registered broker-dealer – committed a $50 billion fraud).

124 See, e.g., Custody of Funds or Securities by Investment Advisers, Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456 (Jan. 11, 2010).

125 For purposes of Form Custody, the term "customer" means a person that is a "customer" for purposes of Rule 15c3-3(a), and a "non-customer" means a person other than a "customer" as that term is defined in Rule 15c3-3(a). See Rule 15c3-3(a) and FINRA's Interpretations of Financial and Operational Rules, Rule 15c3-3, Rule 15c3-3(a)(1)/01, available on FINRA's Internet website at http://www.finra.org/Industry/Regulation/Guidance/FOR/.

126 See Rule 17a-5(a). FOCUS Reports, filed with the Commission and SROs by broker-dealers, are one of the primary means of monitoring the financial and operational condition of broker-dealers and enforcing the broker-dealer financial responsibility rules. The completed forms are also used to determine which firms are engaged in various securities-related activities, and how economic events and government policies might affect various segments of the securities industry. The FOCUS Report was designed to eliminate overlapping regulatory reports required by various SROs and the Commission and to reduce reporting burdens as much as possible. See supra note 20. The Commission notes that FOCUS Reports are, and proposed Form Custody would be, deemed to be confidential pursuant to paragraph (a)(3) of Rule 17a-5.

127 See Form X-17A-5 Schedule I, Part II, Part IIa, Part IIb, and Part III.

The Commission preliminarily believes that proposed Form Custody could make it easier for examiners to determine whether broker-dealers are in compliance with laws and regulations concerning the custody of assets. If, upon reviewing Form Custody, regulatory authorities became aware of inconsistencies or other red flags in information contained in the form, they could initiate a more detailed and focused analysis of the broker-dealer's custodial activities. Such an analysis may, in turn, identify potential abuses related to customer assets. Moreover, proposed Form Custody could expedite the examination of a broker-dealer's custodial activities and reduce examination costs, as examiners would no longer need to request basic custody-related information already disclosed on the form.

The Commission is proposing that broker-dealers file Form Custody with their quarterly FOCUS Reports. The Commission preliminarily believes that Form Custody would help provide applicable regulators with current information about a broker-dealer's custodial activities and, as described below, would promote compliance with applicable laws and rules. The Commission is proposing that Form Custody be filed on a quarterly basis to ensure that the information disclosed on the form is current and to enable examiners to identify significant recent changes in a broker-dealer's custody practices. For example, examiners could more promptly investigate instances in which a broker-dealer frequently changes the locations where customer securities are held. While a broker-dealer may have valid and lawful reasons for changes in the custody arrangements for its customers' securities, such actions also could suggest improper activity and could cause examiners to make further inquiries.

Proposed Form Custody is comprised of nine line items (each, an "Item") that elicit information about a broker-dealer's custodial activities. Several Items contain multiple questions, and a few Items require completion of charts and disclosure of custody-related information specific to the broker-dealer completing the form. Each Item and its subparts are discussed below.

A. Item 1 - Accounts Introduced on a Fully Disclosed Basis

Item 1.A of Form Custody would elicit information concerning whether the broker-dealer introduces customer accounts to another broker-dealer on a fully disclosed basis by requiring the broker-dealer to check the appropriate "Yes" or "No" box. Many broker-dealers enter into agreements ("carrying agreements") with another broker-dealer in which the two firms allocate certain responsibilities with respect to the handling of accounts.[128] These carrying agreements are governed by applicable self-regulatory organization ("SRO") rules, which require broker-dealers entering into a carrying agreement to allocate certain responsibilities associated with introduced accounts.[129]

Typically, under a carrying agreement, one broker-dealer (the "introducing broker-dealer") agrees to act as the customer's account representative (e.g., by providing the customer with account opening documents, ascertaining the customer's investment objectives, and making investment recommendations). The carrying broker-dealer typically agrees to receive and hold the customer's cash and securities, clear transactions, make and retain records relating to the transactions and the receipt and holding of assets, and extend credit to the customer in connection with the customer's securities transactions.

Proposed Item 1.A would elicit information concerning whether the broker-dealer introduces customer accounts to another broker-dealer on a fully disclosed basis, rather than asking whether the broker-dealer is an "introducing broker-dealer." The Commission is

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128 To be consistent with the definition of the term "customer" in Rule 15c3-3, the Commission proposes to define the term "customer" in the General Instructions to Form Custody the same. See Rule 15c3-3(a)(1).

129 See, e.g., NYSE Rule 382, NASD Rule 3230, and FINRA Rule 4311.

proposing the question in this manner because some broker-dealers operate as carrying broker-dealers (i.e., they hold cash and securities) for one group of customers but also introduce the accounts of a second group of customers on a fully disclosed basis to another broker-dealer. For example, a broker-dealer may incur the capital expense and cost of acting as a carrying broker-dealer for certain products (e.g., equities) but not for other products (e.g., options). In this case, the firm operates as a hybrid introducing/carrying broker-dealer by introducing on a fully disclosed basis to a carrying broker-dealer those customers that trade securities the broker-dealer is not equipped to maintain. Broker-dealers also may introduce customer accounts on an omnibus basis, as is discussed in detail in Section IV.B. of this release.

If the broker-dealer answers Item 1.A by checking the "Yes" box, the broker-dealer would be required under Item 1.B to identify each broker-dealer to which customer accounts are introduced. As discussed above, the carrying broker-dealer in such an arrangement maintains the cash and securities of the introduced customers. Consequently, Item 1.B would elicit the identity of each broker-dealer obligated to return cash and securities to the introduced customers. Commission and DEA examiners could use this information to confirm the existence of an introducing/carrying relationship and to confirm that the carrying broker-dealer acknowledges its obligation to return the cash and securities belonging to the introduced customers.[130]

The Commission generally requests comment on all aspects of proposed Item 1. In addition, the Commission requests comment on the following questions relating to proposed Items 1.A and 1.B:

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130 See Letter from Richard G. Ketchum, Director, Division of Market Regulation, Commission, to David Marcus, New York Stock Exchange (Jan. 14, 1985), which states that the customers of introducing broker-dealers are presumed to be customers of the clearing broker-dealer for purposes of the Commission's financial responsibility rules and SIPA.

- Should the Commission require additional information about accounts introduced to carrying broker-dealers on a fully disclosed basis? If so, what type of information?
- Should the Commission require the broker-dealer to disclose the number of accounts it introduces on a fully disclosed basis?
- Should the Commission require the broker-dealer to disclose the approximate dollar amount of assets held in fully disclosed accounts at the carrying broker-dealer?
- Should the Commission solicit information as to whether a broker-dealer other than the carrying broker-dealer clears transactions that are ultimately maintained by the carrying broker-dealer on a fully disclosed basis?
- Should the Commission require the broker-dealer to identify whether it relies on the carrying broker-dealer or another third party to maintain books and records relating to introduced accounts?

B. Item 2 – Accounts Introduced on an Omnibus Basis

Item 2.A would elicit information concerning whether the broker-dealer introduces customer accounts to another broker-dealer on an omnibus basis by requiring the broker-dealer to check the appropriate "Yes" or "No" box. An omnibus account is an account carried and cleared by another broker-dealer that contains accounts of undisclosed customers on a commingled basis and that are carried individually on the books of the broker-dealer introducing the accounts.[131] Disclosure of this information is important because a broker-dealer that introduces customer accounts to another broker-dealer on an omnibus basis is considered to be a

131 See Broker-Dealer Audit Guide, supra note 14.

carrying broker-dealer with respect to those accounts under the Commission's broker-dealer financial responsibility rules.[132] Thus, in these arrangements, the broker-dealer introducing the omnibus account to a carrying broker-dealer is obligated to return cash and securities in the account to customers.[133]

If the broker-dealer checks the "Yes" box in Item 2.A, it would be required to identify in Item 2.B each broker-dealer to which accounts are introduced on an omnibus basis. Commission and DEA examiners could use this information to confirm whether the cash and securities introduced to the carrying broker-dealer are in fact being held in an omnibus account at the carrying broker-dealer.

The Commission generally requests comment on all aspects of proposed Item 2. In addition, the Commission requests comment on the following questions relating to proposed Items 2.A and 2.B:

- Should the Commission require additional information about accounts introduced to carrying broker-dealers on an omnibus basis? For example, should the Commission require a broker-dealer to provide information about the specific types of products or customers introduced to a carrying broker-dealer on an omnibus basis? What other information about accounts introduced to carrying-broker-dealers on an omnibus basis should the Commission require to be disclosed? Why?
- Should the Commission require a broker-dealer to disclose the number of omnibus accounts it introduces to other broker-dealers? If yes, please explain why. If no, please explain why not.

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132 See Net Capital Rule, Exchange Act Release No. 31511 (Nov. 24, 1992); 57 FR 56973 (Dec. 2, 1992), n. 16.

133 Id.

- Should the Commission require a broker-dealer to disclose the approximate dollar amount of assets held in omnibus accounts at the carrying broker-dealer? If yes, please explain why. If no, please explain why not.
- Should the Commission solicit information as to whether a broker-dealer other than the carrying broker-dealer clears transactions where the securities are ultimately maintained by the carrying broker-dealer on an omnibus basis? If yes, please explain why. If no, please explain why not.

C. Item 3 – Carrying Broker-Dealers

1. Items 3.A and 3.B

Item 3 elicits information concerning how a carrying broker-dealer holds cash and securities. Item 3 is comprised of five subparts. The first question – Item 3.A – elicits information concerning whether the broker-dealer carries securities accounts for customers by requiring the broker-dealer to check the appropriate "Yes" or "No" box. As noted above, the proposed General Instructions to Form Custody would specify that the term "customer" as used in the Form means a "customer" as defined in Rule 15c3-3. The next question – Item 3.B – elicits information concerning whether the broker-dealer carries securities accounts for persons that are not "customers" under the definition in Rule 15c3-3. For example, under Rule 15c3-3, persons that are not "customers" include an accountholder that is a general partner, director, or principal officer of the carrying broker-dealer and accountholders that are themselves broker-dealers.

2. Item 3.C

Item 3.C requires the broker-dealer to identify in three charts the types of locations where it holds securities and the frequency with which it performs reconciliations between the information on its stock record and information on the records of those locations. The proposed instructions to Item 3.C provide that the broker-dealer must identify the types of locations where it holds securities. The broker-dealer would be required to identify locations that are used at any one time for maintaining customer, non-customer, and proprietary securities. The proposed instructions also require the broker-dealer to specify the locations where the broker-dealer holds securities directly in the name of the broker-dealer (i.e., the broker-dealer should not identify a type of location if the broker-dealer only holds securities at the location through an intermediary). For example, when a broker-dealer is not a member of a securities clearing organization but, instead, accesses the securities processing facilities of the organization by holding securities at an entity that is a member of the organization (e.g., a U.S. bank), the broker-dealer would be required to identify the category of location for which the broker-dealer has a direct custodial relationship (i.e., the U.S. bank), but not the securities clearing organization.

The first chart – set forth in Item 3.C.i – identifies the most common locations where broker-dealers hold securities. Many of the locations identified on the first chart, and described below, are locations deemed to be satisfactory control locations under paragraph (c) of Rule 15c3-3.

The first location identified in the chart is the broker-dealer's vault. As noted above, broker-dealers primarily hold securities in fungible bulk at other institutions. In some cases, however, broker-dealers may physically hold securities certificates (e.g., in the case of restricted securities).

The second location identified in the chart is another U.S. registered broker-dealer. For example, a broker-dealer may hold customers' foreign securities at another U.S. broker-dealer, or may hold securities in an omnibus account at another broker-dealer.

The third and fourth potential locations identified in the chart are the Depository Trust Company ("DTC") and the Options Clearing Corporation. These are two of the predominant securities clearing organizations in the U.S. and, consequently, are identified by name rather than type.

The fifth potential location identified in the chart is a U.S. bank. Broker-dealers may have arrangements with U.S. banks to receive and hold securities for the accounts of the broker-dealer's customers and non-customers, as well as for the broker-dealer's own account. Obtaining information about a broker-dealer's relationships with U.S. banks could enable examiners to test and confirm the accuracy of the broker-dealer's representations on proposed Form Custody (i.e., that a U.S. bank holds securities for the broker-dealer), and in addition facilitate the collection of information regarding the relationship between the broker-dealer and the bank. For instance, customer fully paid and excess margin securities cannot be pledged as collateral for a loan to the broker-dealer, and customer margin securities may not be commingled with proprietary securities that are pledged as collateral for a bank loan. Form Custody could, for example, lead examiners to seek account statements and documentation governing the broker-dealer's relationship with the U.S. bank to ensure customer fully paid and excess margin securities are not pledged as collateral.

The sixth potential location identified in the chart is the transfer agent of an open-end investment management company registered under the Investment Company Act of 1940 (i.e., a mutual fund). Generally, mutual funds issue securities only in book entry form. This means that the ownership of securities is not reflected on a certificate that can be transferred but rather through a journal entry on the books of the issuer maintained by the issuer's transfer agent. A broker-dealer that holds mutual funds for customers would hold them in the broker-dealer's name on the books of the mutual fund.

The second chart – set forth in Item 3.C.ii – is intended to capture all other types of U.S. locations where a broker-dealer may hold securities that are not specified in the chart included in Item 3.C.i. This could include securities held in book-entry form by the issuer of the securities or the issuer's transfer agent. A broker-dealer that holds securities in such locations would be required to list the types of locations in the spaces provided in the chart and indicate the frequency with which the broker-dealer performs asset reconciliations with those locations.

The third chart – set forth in Item 3.C.iii – pertains to foreign locations where the broker-dealer maintains securities. The Commission is not proposing to list categories of foreign locations because terminology used to identify certain locations may differ by jurisdiction. For example, in some foreign jurisdictions, banks may operate a securities business, making it difficult to classify whether securities are held at a bank or a broker-dealer. A broker-dealer that holds securities in a foreign location would be required to list the types of foreign locations where it maintains securities in the spaces provided in the chart and indicate the frequency with which reconciliations are performed with the location.

3. Items 3.D and 3.E

Items 3.D and 3.E of proposed Form Custody each have three identical subparts that elicit information about the types and amounts of securities and cash the broker-dealer holds, whether those securities are recorded on the broker-dealer's stock record and, if not, why they are not recorded, and where the broker-dealer holds free credit balances. The General Instructions to proposed Form Custody would define "free credit balances" as liabilities of a broker-dealer to customers or non-customers which are subject to immediate cash payment to customers or non-customers on demand, whether resulting from sales of securities, dividends, interest, deposits, or otherwise.[134]

The difference between Item 3.D and Item 3.E is that the former would elicit information with respect to securities and free credit balances held for the accounts of customers, whereas the latter would elicit information with respect to securities and free credit balances held for the accounts of persons that are not customers.[135] Accordingly, the form would ask two sets of identical questions to elicit information about each category of accountholder – customer and non-customer.

Proposed Items 3.D.i and 3.E.i would elicit information about the types and dollar amounts of the securities the broker-dealer carries for the accounts of customers and non-customers, respectively. Specifically, for each Item, the broker-dealer would be required to complete information on a chart to the extent applicable. The charts have twelve rows, with each row representing a category of security. The categories are: (1) U.S. Equity Securities; (2) Foreign Equity Securities; (3) U.S. Listed Options; (4) Foreign Listed Options; (5) Domestic Corporate Debt; (6) Foreign Corporate Debt; (7) U.S. Public Finance Debt; (8) Foreign Public Finance Debt; (9) U.S. Government Debt; (10) Foreign Sovereign Debt; (11) U.S. Structured Debt; and (12) Foreign Structured Debt. A thirteenth row is included in each chart to identify any securities not specifically listed in the first twelve rows. The types of securities are categorized this way because the various categories ordinarily are associated with certain types of locations. Thus, as examiners review the form, they could assess whether the types of

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134 This definition is similar to the definition of the term "free credit balance" in Rule 15c3-3, except that the definition in the rule is limited to liabilities to "customers" whereas the definition in the proposed Form contemplates liabilities to customers and non-customers. See Rule 15c3-3(a)(8).

135 As discussed above, the term "customer" on proposed Form Custody would mean a "customer" as defined in Rule 15c3-3(a)(1). Broker-dealers may carry securities accounts for "customers" as defined in Rule 15c3-3 and for persons that are not customers (such as insiders and other broker-dealers).

securities held by the broker-dealer are maintained at locations generally known to hold such securities. If the form indicates that some types of securities are held at a location that is atypical for such securities, the examiner can refine the focus of the examination to ensure customer assets are properly safeguarded.

The charts in Items 3.D.i and 3.E.i each have eight columns. The first column contains boxes for each category of security specified in the Item. The broker-dealer would be required to check the box in each chart for every applicable category of security it holds for the accounts of customers and non-customers, respectively. The second column identifies the category of security. The third through eighth columns represent ranges of dollar values: (1) up to $50 million; (2) greater than $50 million up to $100 million; (3) greater than $100 million up to $500 million; (4) greater than $500 million up to $1 billion; (5) greater than $1 billion up to $5 billion; and (6) greater than $5 billion. The broker-dealer would be required to check the box in each chart reflecting the approximate dollar value for every category of security the broker-dealer carries for the accounts of customers and non-customers, respectively.

The Commission is proposing dollar ranges for the values of the securities, as opposed to actual values, to ease compliance burdens. The intent is to elicit information about the relative dollar value of securities the broker-dealer holds for customers and non-customers in each category of security. Values would be reported as of the date specified in the broker-dealer's accompanying quarterly FOCUS Report.

Proposed Items 3.D.ii and 3.E.ii would elicit information concerning whether the broker-dealer has recorded all the securities it carries for the accounts of customers and non-customers, respectively, on its stock record by requiring the broker-dealer to check the appropriate "Yes" or "No" box. If the broker-dealer checks "No," it would be required to explain in the space provided why it has not recorded such securities on its stock record and indicate the type of securities and approximate U.S. dollar market value of such unrecorded securities.

The Commission anticipates that a broker-dealer would answer "Yes" in response to Items 3.D.ii and 3.E.ii because the stock record – which a broker-dealer is required to create pursuant to Rule 17a-3 – is a record of custody and movements of securities. A long position in the stock record indicates ownership of the security or a right to the possession of the security. Thus, the "long side" of the stock record indicates the person to whom the broker-dealer owes the securities. Common examples of "long side" positions are securities received from customers (e.g., fully paid or excess margin securities), securities owned by the firm (i.e., securities held in the broker-dealer's inventory for its own account), securities borrowed, and fails-to-deliver (i.e., securities sold to or through another broker-dealer but not delivered).

A short position in the stock record indicates either the location of the securities or the responsibility of other parties to deliver the securities to the broker-dealer. Every security owned or held by the broker-dealer must be accounted for by its location. Since securities are fungible, the short side of the stock record does not in fact designate where particular securities are located. Rather, it indicates the total amount of securities, on a security-by-security basis, held at each location, which could include, for example, securities depositories. Common short-side stock record locations also include banks (e.g., when a broker-dealer pledges securities to a bank as collateral for a loan), stock loan counterparties (e.g., when a broker-dealer lends securities to another firm as part of a securities lending transaction), and counterparties failing to deliver securities to the broker-dealer (e.g., when the broker-dealer has purchased securities that have not yet been received from the counterparty).

The Commission's goals in proposing this question are twofold. First, the question could elicit the disclosure of the unusual circumstance in which a broker-dealer carries securities for the account of a customer or non-customer but does not reflect them on its stock record. The Commission and other securities regulators could use this information to assess whether the broker-dealer is properly accounting for securities. Second, this question could prompt a broker-dealer to identify, and self-correct, circumstances in which it did not include securities on its stock record as required by Rule 17a-3.

Proposed Items 3.D.iii and 3.E.iii would elicit information as to how the broker-dealer treats free credit balances in securities accounts of customers and non-customers, respectively. The information is elicited through a chart the broker-dealer would be required to complete. The chart in Item 3.D.iii has five rows with each row representing a different process for treating free credit balances. The treatment options (referred to as "processes" on the form) would be that free credit balances are: (1) included in a computation under Rule 15c3-3(e); (2) held in a bank account under Rule 15c3-3(k)(2)(i); (3) swept to a U.S. bank; (4) swept to a U.S. money market fund; and (5) "other," with a space to describe such other treatment. The options are not intended to be mutually exclusive in that a broker-dealer may treat free credit balances in several different ways (e.g., a broker-dealer may be instructed by certain customers to sweep their free credit balances to a bank, and by other customers to sweep their free credit balances to a U.S. money market fund).

A broker-dealer would be required to check the box in the first column of the chart for every process that applies to the broker-dealer's treatment of free credit balances in customer and non-customer accounts, respectively. The first process identified on each chart is that the broker-dealer treats customer and non-customer free credit balances in accordance with the customer reserve computation required under Rule 15c3-3(e). Rule 15c3-3(e) requires a broker-dealer to maintain a special reserve bank account for the exclusive benefit of its customers and maintain deposits in that account (to the extent a deposit is required) in amounts computed in accordance with Exhibit A to Rule 15c3-3.[136] Rule 15c3-3 requires a broker-dealer to comply with these reserve account provisions only with respect to customer-related credit balances. The Commission has, however, proposed amendments to Rule 15c3-3 that would require a broker-dealer to maintain a reserve account and perform a reserve computation for non-customer accountholders that are domestic and foreign broker-dealers.[137]

The second process identified on the chart is that the broker-dealer handles free credit balances by placing funds in a "bank account under Rule 15c3-3(k)(2)(i)." Rule 15c3-3(k)(2)(i) prescribes a process by which a broker-dealer can qualify for an exemption from the requirements of Rule 15c3-3. Specifically, the exemption applies to a broker-dealer that does not carry margin accounts, promptly transmits all customer funds and delivers all securities received in connection with its activities, does not otherwise hold funds or securities for, or owe money or securities to, customers and effectuates all financial transactions between the broker-dealer and its customers through one or more bank accounts that are each designated as a "Special Account for the Exclusive Benefit of Customers of (the name of broker or dealer)."[138]

The third process identified in the chart – "swept to a U.S. bank" – is included because some broker-dealers engage in "Bank Sweep Programs." Rather than hold customer funds in securities accounts, some broker-dealers require or offer the option to transfer free credit

136 See Rule 15c3-3(e) and Rule 15c3-3a.

137 See Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007). See also Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Raymond J. Hennessy, Vice President, NYSE, and Thomas Cassella, Vice President, NASD Regulation, Inc. (Nov. 10, 1998).

138 See Rule 15c3-3(k)(2)(i).

balances in securities accounts to a specific money market fund or interest bearing bank account ("Sweep Programs"). The customer earns dividends on the money market fund or interest on the bank account until such time as the customer chooses to liquidate the position in order to use the cash, for example, to purchase securities.[139] Customers must make a request to the broker-dealer for the return of funds swept from their securities accounts to the bank.

The fourth option identified in the chart is that the broker-dealer sweeps free credit balances into a money market fund as part of a Sweep Program. In most cases when a broker-dealer sweeps free credit balances into a money market fund, the broker-dealer purchases shares in the money market fund, which is registered in the name of the broker-dealer. The money market fund understands that these shares are not proprietary positions of the broker-dealer, and any interest earned on the shares from the money market fund are payable to the customers.

Finally, the fifth option in the chart would cover any other process that is not described in the other options.

The Commission generally requests comment on all aspects of proposed Item 3. In addition, the Commission requests comment on the following questions relating to proposed Item 3:

- Should the Commission identify additional U.S. locations in Item 3.C.i relating to where broker-dealers maintain custody of securities held in the U.S.?
- Should the Commission include separate charts to identify locations where customer, non-customer, and proprietary securities are held?
- Should the charts in Item 3.C solicit information from broker-dealers other than the location where securities are held and reconciliation frequency?

139 See Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007) at 12866.

- Should the broker-dealer be required to identify only the types of locations in Items 3.C.i, ii and iii where un-hypothecated securities are located? For example, should the broker-dealer not be required to identify locations where securities are hypothecated in transactions such as stock loans, bank loans and repurchase agreements?
- Should the Commission identify additional categories of securities in the charts specified under Item 3.D and 3.E? For example, are the securities listed on those charts sufficiently comprehensive to cover most, if not all, types of securities carried by broker-dealers?
- Should the Commission require the broker-dealer to provide the identities of all custodians, as opposed to, or in addition to, describing the types of custodians?
- Should the Commission use different dollar ranges in the charts specified in Items 3.D.i and 3.E.i? If so, what ranges?
- Should the Commission require broker-dealers to provide specific dollar amounts, rather than indicating ranges, in Items 3.D.i and 3.E.i?
- Should the Commission require broker-dealers to identify in Items 3.D.iii and 3.E.iii the specific locations where free credit balances are held (e.g., the names of banks and money market funds)?

D. Item 4 – Carrying for Other Broker-Dealers

Item 4 of proposed Form Custody requires a broker-dealer to disclose whether it acts as a carrying broker-dealer for other broker-dealers. There are two sets of questions in Item 4 – Item 4.A.i, ii, and iii and Item 4.B.i, ii, and iii. The first set of questions would elicit information from a broker-dealer as to whether it carries transactions for other broker-dealers on a fully disclosed basis. The second set of questions would elicit information from a broker-dealer as to whether it carries transactions for other broker-dealers on an omnibus basis.

Proposed Items 4.A.i and 4.B.i require a broker-dealer to indicate by checking the appropriate "Yes" or "No" box whether it carries customer accounts for another broker-dealer on a fully disclosed basis and on an omnibus basis, respectively. Items 4.A.ii and 4.B.ii require a broker-dealer, if applicable, to indicate the number of broker-dealers with which it has an arrangement to carry accounts on a fully disclosed basis and on an omnibus basis, respectively. Items 4.A.iii and 4.B.iii require a broker-dealer, if applicable, to identify any affiliated broker-dealers that introduce accounts to the broker-dealer on a fully disclosed basis and on an omnibus basis, respectively.

The Commission has stated that related person custody arrangements can present higher risks to "advisory clients" than maintaining assets with an independent custodian,[140] and the Commission believes the same to be true for broker-dealer clients. Consistent with the definition of the term in other contexts applicable to broker-dealers, including Form BD,[141] the General Instructions for proposed Form Custody would define the term "affiliate" as any person who directly or indirectly controls the broker-dealer or any person who is directly or indirectly controlled by or under common control with the broker-dealer. The definition also would specify that ownership of 25% or more of the common stock of the broker-dealer introducing

140 See Custody of Funds or Securities by Investment Advisers, Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456 at 1462 (Jan. 11, 2010).

141 Form BD is the uniform application for broker-dealer registration with the Commission. Form BD states that a person is presumed to control a company if, among other things, that person has directly or indirectly the right to vote 25% or more of a class of a voting security or has the power to sell or direct the sale of 25% or more of a class of voting securities, or, in the case of a partnership, the right to receive upon dissolution, or has contributed, 25% or more of the firm's capital.

accounts to the broker-dealer submitting the Form Custody is deemed prima facie evidence of control; this definition is consistent with the definition used in Form BD.[142]

Item 4 in proposed Form Custody would elicit information about broker-dealers' custodial responsibilities with respect to accounts held for the benefit of other broker-dealers, and would require broker-dealers to identify such broker-dealers that are affiliates of the broker-dealer.[143] The Commission believes that this information will be useful for examination purposes and will provide the Commission with an enhanced understanding of, and useful and readily available information relating to, the scope of broker-dealer introducing/carrying relationships and activities, and the custodial practices of broker-dealers involved in such relationships.

The Commission generally requests comment on all aspects of proposed Item 4. In addition, the Commission requests comment on the following questions relating to proposed Item 4:

- The Commission is proposing to require that broker-dealers carrying accounts of other broker-dealers specify on proposed Form Custody the identities of only affiliated broker-dealers that introduce accounts to the carrying broker-dealer. Should the Commission require that broker-dealers carrying accounts of other,

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142 This definition of the term "affiliate" is the same as the definition in Form BD, including the specification that ownership of 25% or more of the common stock is deemed prima facie evidence of control.

143 Form Custody would not require a broker-dealer to identify unaffiliated broker-dealers for which it carries accounts, though, as discussed above, it would need to indicate that it carries accounts for such broker-dealers. The Commission preliminarily believes that this approach provides the Commission and DEA examiners with access to useful information involving a broker-dealer's custody practices while alleviating potential time and cost burdens associated with completing proposed Form Custody given that some broker-dealers carry accounts for hundreds of unaffiliated broker-dealers. The Commission notes that information about these broker-dealers would be part of the books and records of the carrying broker-dealer. Therefore, an affirmative answer to Item 4 could prompt the Commission and DEA examiners to request information about the identities of the unaffiliated broker-dealers.

unaffiliated, broker-dealers specify on proposed Form Custody the identities of all broker-dealers that introduce accounts to the carrying broker-dealer?

- For purposes of defining the term "affiliate" in Item 4, should the Commission use the Form BD definition of the term "affiliate"? Is there a more appropriate definition? If so, which definition? For example, should ownership by a carrying broker-dealer of 10% or more of the common stock of the introducing broker-dealer qualify such entities as affiliates?

E. Item 5 – Trade Confirmations

Item 5 of proposed Form Custody would require broker-dealers to disclose whether they send transaction confirmations to customers and other accountholders by checking the appropriate "Yes" or "No" box. Confirmations are important safeguards that enable customers to monitor transactions that occur in their securities accounts. Timely confirmations would alert customers of unauthorized transactions and would provide customers with an opportunity to object to the transactions.

Exchange Act Rule 10b-10 specifies the information a broker-dealer must disclose to customers on a trade confirmation at or before completion of a securities transaction.[144] Generally, Rule 10b-10 requires a confirmation to include, among other things: (1) the date and time of the transaction and the identity, price, and number of shares or units (or principal amount) of such security purchased or sold by such customer; (2) the broker-dealer's capacity (agent or principal) and its compensation; (3) the source and amount of any third party remuneration it has received or will receive; and (4) other information, both general (e.g., that

[144] 17 CFR 240.10b-10.

the broker-dealer is not a SIPC member, if such is the case) and transaction-specific (e.g., certain yield information in most transactions involving debt securities).

The information contained on a trade confirmation should reconcile with customer statements and the broker-dealer's journal entries.[145] In this regard, there is a direct link between trade confirmations sent by a broker-dealer and the broker-dealer's custody of customer assets.[146] How a broker-dealer answers Item 5 of proposed Form Custody could assist examiners in focusing their inspection. For example, if a broker-dealer claims that a third-party is responsible for sending trade confirmations, the examiners can confirm with that third-party that it is sending them on behalf of the broker-dealer.

The Commission generally requests comment on all aspects of proposed Item 5. In addition, the Commission requests comment on the following questions relating to proposed Item 5:

- If the broker-dealer answers "No" to Item 5.A, what information in addition to the identity of the broker-dealer that sends the confirmations would be useful to elicit in the form? For example, if the broker-dealer is a party to a carrying agreement pursuant to which a carrying broker-dealer agrees to issue trade confirmations for the broker-dealer, should the Commission require the broker-dealer to identify the

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[145] See 17 CFR 240.17a-3(a)(1), which requires the broker-dealer to make "blotters" "(or other records of original entry) containing an itemized daily record of all purchases and sales of securities, all receipts and deliveries of securities (including certificate numbers), all receipts and disbursements of cash and all other debits and credits. Such records shall show the account for which each such transaction was effected, the name and amount of securities, the unit and aggregate purchase or sale price (if any), the trade date, and the name or other designation of the person from whom purchased or received or to whom sold or delivered."

[146] Although broker-dealers may allocate the function of sending confirmations to other broker-dealers or to service providers, the broker-dealer retains the responsibility for sending confirmations. See New York Stock Exchange, Inc.; Order Approving Proposed Rule Change, Exchange Act Release No. 18497 (Feb. 19, 1982), 47 FR 8284 (Feb. 25, 1982) at note 2 ("... no contractual arrangement for the allocation of functions between an introducing and carrying organization can operate to relieve either organization from their respective responsibilities under the federal securities laws and applicable SRO rules").

date the agreement was made with the carrying broker-dealer and/or which SRO approved the carrying agreement?

- If the broker-dealer answers "Yes" to Item 5.A, and the broker-dealer has hired a third party service provider to prepare and send trade confirmations on the broker-dealer's behalf, should the broker-dealer be required to disclose the name of the third party service provider?
- Is there any additional information related to trade confirmations that the Commission should request in Item 5?

F. Item 6 – Account Statements

Item 6 of proposed Form Custody would require broker-dealers to disclose whether they send account statements directly to customers and other accountholders by checking the appropriate "Yes" or "No" box. Account statements generally are sent to customers and other accountholders on a monthly or quarterly basis and typically set forth the assets held in the investor's securities account as of a specific date and the transactions that occurred in the account during the relevant period. SROs impose requirements on broker-dealers with respect to the statements they must send to their customers.[147] For example, FINRA generally requires any member that conducts a general securities business and also carries customer accounts or holds customer funds or securities, at least once each calendar quarter, to send an account statement to each customer whose account had a security position, money balance, or account activity since the last statement was sent.[148] The account statement must contain a description of any securities

[147] See NASD Rule 2340 (Customer Account Statements) and NYSE Rule 409 (Statements of Accounts to Customers).

[148] See NASD Rule 2340, which defines a "general securities member" as any member that conducts a general securities business and is required to calculate its net capital pursuant to Rule 15c3-1. Additionally, NASD Rule 2340 defines "account activity" broadly so that it includes, but is not limited to, purchases, sales, interest credits or debits, charges or credits, dividend payments, transfer activity, securities receipts or

positions, money balances, or account activity in the account. In addition, the account statement must include a statement that advises the customer to report promptly any inaccuracy or discrepancy in that person's account to the brokerage firm.[149] The statement also is required to advise the customer that any oral communications made to the broker-dealer regarding inaccuracies or discrepancies should be re-confirmed in writing to further protect the customer's rights, including rights under SIPA.[150]

Like trade confirmations, account statements are important investor safeguards to monitor transactions that occur in an investor's securities account. As noted above, an introducing broker-dealer and clearing broker-dealer that are parties to a carrying agreement may allocate the sending of account statements to the clearing broker-dealer.[151] If the allocation has been made to a broker-dealer other than the broker-dealer completing Form Custody, this would be disclosed on the Form in Item 6.B. Item 6.C would elicit whether the broker-dealer sends account statements to anyone other than the beneficial owner of the account.[152]

The Commission is proposing to require broker-dealers to answer the questions in Item 6 to enhance its understanding of a broker-dealer's relationship with customers, particularly in the context of the broker-dealer's custodial responsibilities. The Commission notes that broker-dealers do not currently disclose to the Commission whether they send account statements

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deliveries and/or journal entries relating to securities or funds in the possession or control of the member. See also Exchange Act Release No. 54411 (Sept. 7, 2006), 71 FR 54105 (Sept. 13, 2006) (order granting approval of a proposed rule change relating to Rule 2340 concerning customer account statements).

149 If the customer's account is serviced by both an introducing broker-dealer and a clearing broker-dealer, the statement must inform customers that such reports must be made to both firms. See NASD Rule 2340(a).

150 Id.

151 As with trade confirmations, broker-dealers can allocate the function but not the responsibility; see supra note 146.

152 Generally, the beneficial owner of an account represents the person entitled to the economic benefits of ownership. With respect to securities, the term beneficial owner is defined in Rule 13d-3 under the Exchange Act (17 CFR 240.13d-3).

directly to customers. Collecting this information on proposed Form Custody would provide examiners with additional background information that could be used to refine the focus of their inspections. Further, the Commission anticipates that examiners would make further inquiries to the extent the Form reveals answers that are inconsistent with industry practice.

A review of Item 6 also may facilitate an examiner's preparation for an inspection. For example, if a broker-dealer indicates on Form Custody that it holds customer accounts and sends account statements to customers, the examiner could prepare a more targeted document request to the broker-dealer. In this regard, an examiner could request customer account statements from the broker-dealer, as well as statements from the custodian(s) of the broker-dealer's customer assets, which would be disclosed in response to Item 3.C. of Form Custody. Examiners could then review and reconcile these documents to verify whether customer assets are held at the custodian(s) identified by the broker-dealer.

The Commission generally requests comment on all aspects of proposed Item 6. In addition, the Commission requests comment on the following questions relating to proposed Item 6:

- If the broker-dealer answers "No" to Item 6.A, what information in addition to the identity of the broker-dealer that sends the account statements would be useful to elicit in the form?
- If a broker-dealer sends account statements to persons other than the beneficial owner of the account, should the Commission require the broker-dealer to explain why those persons receive account statements from the broker-dealer?

G. Item 7 – Electronic Access to Account Information

Item 7 of proposed Form Custody would require broker-dealers to indicate whether they provide customers and other accountholders with electronic access to information about the securities and cash positions in their accounts by checking the appropriate "Yes" or "No" box. Electronic access to account information can provide investors with an efficient means of monitoring transactions that occur in their securities accounts. This inquiry would inform the Commission as to how readily customers are able to access and review their account information.

The Commission preliminarily believes that electronic access to account information is beneficial to customers, who can more easily monitor the performance of their accounts and perhaps more quickly identify any discrepancies or inaccuracies. The Commission proposes to include this item in proposed Form Custody because it would help to inform examiners as to how readily customers can access and review account information.

The Commission generally requests comment on all aspects of Item 7 to Form Custody. In addition, the Commission requests comment on the following questions related to Item 7:

- If a broker-dealer checks "Yes" in response to Item 7, should the Commission require additional disclosure on Form Custody relating to the types of electronic access the broker-dealer provides to customers and other accountholders?
- If a broker-dealer checks "Yes" in response to Item 7, should the Commission require broker-dealers to indicate on Form Custody if customers that elect to receive certain account-related communications (e.g., trade confirmations) electronically also are sent copies of those documents via mail or whether they are limited to accessing those documents electronically?

H. Item 8 – Broker-Dealers Registered as Investment Advisers

Item 8 of proposed Form Custody would elicit information, if applicable, about whether and how the broker-dealer operates as an investment adviser. The first question in proposed Item 8.A would require the broker-dealer to indicate whether it is registered as an investment adviser with the Commission under the Advisers Act or with one or more states pursuant to the laws of a state.[153] If the broker-dealer indicates that it is registered with the Commission under the Advisers Act or pursuant to state law (or both), then it would be required to respond to the remaining questions under proposed Item 8.

Proposed Item 8.B. would require the broker-dealer to disclose the number of clients it has as an investment adviser. This would provide the Commission with information about the scale of the broker-dealer's investment adviser activities.

Proposed Items 8.C would require the broker-dealer to complete a chart, which would consist of six columns, in which the broker-dealer would provide information about the custodians where the assets of the investment adviser clients are held.[154]

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153 Section 203A of the Advisers Act prohibits certain investment advisers from registering with the Commission, based on the advisers' assets under management, among other factors.

154 Under the IA Custody Rule, it is a "fraudulent, deceptive, or manipulative act, practice or course of business" for an investment adviser registered or required to be registered under Section 203 of the Advisers Act to have custody of client funds or securities unless, among other things, a qualified custodian maintains those funds or securities. See Rule 206(4)-2. The Commission defines a qualified custodian as: (1) a bank as defined in Section 202(a)(2) of the Advisers Act or savings association as defined in Section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)) that has deposits insured by the Federal Deposit Insurance Corporation under the Federal Deposit Insurance Act (2 U.S.C. 1811); (2) a broker-dealer registered under Section 15(b)(1) of the Exchange Act holding the client assets in customer accounts; (3) an FCM registered under Section 4f(a) of the Commodity Exchange Act (7 U.S.C. 6f(a)), holding the client assets in customer accounts, but only with respect to clients' funds and security futures, or other securities incidental to transactions in contracts for the purchase or sale of a commodity for future delivery and options thereon; and (4) a foreign financial institution that customarily holds financial assets for its customers, provided that the foreign financial institution keeps the advisory clients' assets in customer accounts segregated from its proprietary assets. See Rule 206(4)-2(d)(6). The Commission requires that the qualified custodian maintain client funds and securities: (1) in a separate account for each client under that client's name; or (2) in accounts that contain only the clients' funds and securities, under the investment adviser's name as agent or trustee for the clients. See Rule 206(4)-2(a)(1).

In the first column, the broker-dealer would be required to disclose the name of the custodian, and in the second column, the broker-dealer would be required to identify the custodian by either SEC file number or CRD number, as applicable.

The third and fourth columns of the chart would elicit information about the scope of the broker-dealer/investment adviser's authority over the accounts held at the custodian by requiring the broker-dealer/investment adviser to check the appropriate "Yes" or "No" box. Specifically, in the third column, the broker-dealer/investment adviser would indicate whether it has the authority to effect transactions in the advisory client accounts at the custodian. In the fourth column, the broker-dealer/investment adviser would indicate whether it has the authority to withdraw funds and securities out of the accounts at the custodian.

In the fifth column, the broker-dealer/investment adviser would indicate whether the custodian sends account statements directly to the investment adviser clients. The Commission recently adopted amendments to the IA Custody Rule to require that investment advisers have a reasonable basis, after due inquiry, for believing that qualified custodians of advisory client assets send account statements to the investment advisers' clients. As stated in the release adopting that requirement, the Commission believes that the direct delivery of account statements by qualified custodians will provide greater assurance of the integrity of account statements received by clients.[155]

In the sixth column, the broker-dealer/investment adviser would indicate whether investment adviser client assets are recorded on the broker-dealer's stock record. If the broker-dealer is acting as custodian for such assets, the Commission anticipates that those assets would be recorded on the stock record.

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[155] See, e.g., Custody of Funds or Securities by Investment Advisers, Advisers Act Release No. 2876 (May 20, 2009), 74 FR 25354 (May 27, 2009) (proposing release); Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456 (Jan. 11, 2010) (adopting release).

The information solicited in Item 8 differs from the information that would be elicited in Item 3, because Item 3 requires a broker-dealer to provide detailed information about its custodial functions. In contrast, the goal of the information elicited in Item 8 is to assist the Commission and DEA examiners in developing a profile of the firm with respect to its functions as an investment adviser, and not as a custodian.

The Commission generally requests comment on all aspects of proposed Item 8. In addition, the Commission requests comment on the following questions:

- Should the Commission request additional information from dually-registered broker-dealer/investment advisers in the chart located in Item 8.C? If so, what information should the Commission request?
- Should the Commission require broker-dealer/investment advisers to disclose the type of client assets held by custodians (e.g., fixed income securities or equity securities, etc.)?
- Should the Commission amend the charts in Item 8 to require broker-dealer/investment advisers to disclose the dollar amount of assets held at the custodian in ranges?

I. Item 9 – Broker-Dealers Affiliated with Investment Advisers

Item 9 of Form Custody would elicit information concerning whether the broker-dealer is an affiliate of an investment adviser. For these purposes, an affiliate is any person who directly or indirectly controls the broker-dealer or any person who is directly or indirectly controlled by or under common control with the broker-dealer. Ownership of 25% or more of the common stock of the investment adviser is deemed prima facie evidence of control.[156] If the broker-dealer

[156] See supra note 141 and corresponding text which specifies the same ownership percentage on Form BD.

is such an affiliate, Item 9 would also elicit information concerning whether the broker-dealer has custody of client assets of an affiliated investment advisor and, if so, the approximate U.S. dollar market value of the assets.

The Commission generally requests comment on all aspects of proposed Item 9. In addition, the Commission requests comment on the following question related to Item 9:

- Should the Commission define affiliate differently? Should the Commission use a different percentage of ownership for prima facie evidence of control?

J. Proposed Text Amendments to Require the Filing of Form Custody

The Commission is proposing to add a new paragraph (a)(5) to Rule 17a-5 to implement the Form Custody filing requirement. Specifically, proposed paragraph (a)(5) would provide that "[e]very broker or dealer subject to this paragraph (a) shall file Form Custody with its designated examining authority within 17 business days after the end of each calendar quarter and within 17 business days after the date selected for the annual reports where said date is other than the end of a calendar quarter. The designated examining authority shall maintain the information obtained through the filing of the Form Custody and transmit such information to the Commission."[157] The proposed language, including filing proposed Form Custody within 17 business days after the end of each calendar quarter, is the same as the existing requirements under Rule 17a-5 pertaining to the time frame for broker-dealers to file their FOCUS Reports,[158] and the maintenance of the FOCUS Reports filed with the DEAs.[159]

157 See proposed paragraph (a)(5) of Rule 17a-5. The Commission proposes to amend the numbering of the remaining subparagraphs – for example, current paragraph (a)(5) of Rule 17a-5 would be renumbered as paragraph (a)(6) and current paragraph (a)(6) would be renumbered as paragraph (a)(7).

158 See Rule 17a-5(a)(2)(ii).

159 See Rule 17a-5(a)(4).

The Commission generally requests comment on all aspects of proposed new paragraph (a)(5) of Rule 17a-5. In addition, the Commission requests comment on the following question related to proposed new paragraph (a)(5):

- Should the Commission require the proposed Form Custody be filed on a different schedule? If so, what schedule?

K. General Solicitation of Comments on Form Custody

In addition to the questions above with respect to the specific Items of Form Custody, the Commission requests comment more generally on the overall approach of the proposal. In addition, the Commission requests comment on the following questions:

- Should the Commission require that the broker-dealer engage an independent public accountant with respect to Form Custody? If so, what level of engagement should be required? For example, should the Form Custody be audited by the independent public accountant?

V. ADDITIONAL AMENDMENTS TO RULE 17a-5

In addition to the proposed amendments discussed above and their corresponding technical amendments, the Commission proposes several "clean up" amendments to Rule 17a-5 that would modernize the rule and delete unnecessary or outdated provisions.

A. Requirement to File Annual Reports

The Commission proposes to amend paragraph (d)(6) of Rule 17a-5 to provide that copies of the annual reports shall be provided to all SROs of which the broker-dealer is a member "unless the self-regulatory organization by rule waives this requirement." The Commission proposes this addition because in some cases SROs do not believe it is necessary to receive copies of broker-dealer annual reports, particularly when they are not the broker-dealer's DEA.

The Commission also proposes to amend paragraph (d)(6) of Rule 17a-5 to require broker-dealers to file copies of their annual reports with SIPC. As discussed above, SIPC may be required to fund the liquidation of a broker-dealer that cannot wind itself down in an orderly fashion. As part of the liquidation process, SIPC may be required to advance up to $500,000 per customer to satisfy claims for cash and securities of which $250,000 can be used to satisfy claims for cash.[160] In order to pay for these liquidations and advances, SIPC maintains the SIPC Fund. This SIPC Fund is established and maintained by collecting assessments from broker-dealers that are required to be members of SIPC.[161]

In some cases where SIPC has used the SIPC Fund to liquidate failed broker-dealers and make advances to customers, SIPC has not been able to recover the money advanced because the estate of the failed broker-dealer had insufficient assets.[162] SIPC has sought to recover money damages from auditing firms, but at least one court has held under New York law that SIPC could not maintain a claim because it was not a recipient of the annual audit filing and could not have relied on it.[163] Therefore, if SIPC had received a copy of the annual reports as contemplated under this proposed amendment, SIPC could have brought a claim against the auditing firm. In addition, the filing of annual reports with SIPC could allow it to better monitor industry trends and enhance its knowledge of particular firms.

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160 15 U.S.C. 78fff-3(a), (d).

161 15 U.S.C. 78ddd.

162 The most recent example of a SIPA liquidation in which SIPC does not expect to recover money advanced to a trustee is the liquidation of Bernard L. Madoff Investment Securities LLC. SIPC 2010 Annual Report, p.18, available at http://www.sipc.org/pdf/2010%20Annual%20Report.pdf.

163 See SIPC v. BDO Seidman, LLP, 746 N.E.2d 1042 (N.Y. 2001).

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following question related to the proposal:

- Rather than filing the annual reports directly with SIPC, should the Commission propose that the broker-dealers make the reports available to SIPC upon request? If so, why? If no, why not?

B. Confidentiality of Annual Reports

The Commission also proposes to update the method in which broker-dealers request that their annual reports be filed with the Commission on a confidential basis. Currently, under paragraph (e)(3) of Rule 17a-5, in order for a broker-dealer to receive confidential treatment for the financial statements it files with the Commission, other than the Statement of Financial Condition, the broker-dealer must bind the Statement of Financial Condition separately from the remaining financial statements and denote the Statement of Financial Condition as "Public" and the separate document as "Confidential."[164] The wording of this provision has led to confusion, resulting in inquiries to the Commission staff on how broker-dealers can receive confidential treatment for financial statements filed with the Commission under paragraph (e)(3) of Rule 17a-5, and, on occasion, broker-dealers inadvertently making publicly available financial statements intended to be confidential. The Commission proposes that broker-dealers continue to bind separately the Statement of Financial Condition from the remaining pages of the annual reports. In order to provide better clarity as to which part of the annual report is public and which part

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164 The Commission's website provides guidance that the public and non-public portions of the financial statements must be clearly segregated and the Facing Page must be appropriately marked. For example, the Facing Page attached to the Statement of Financial Condition should not be marked "Confidential." Further, if the Statement of Financial Condition is not bound separately or placed in a separate package, then, in accordance with Rule 17a-5(e)(3), none of the statements will be accorded confidential treatment. See "Broker-Dealer Notices and Reports" at http://www.sec.gov/divisions/marketreg/bdnotices.htm.

should be kept confidential, the Commission proposes to require that the broker-dealer stamp each page of the separately bound confidential portion of its annual reports as "Confidential."

Paragraph (e)(3) of Rule 17a-5 currently provides that the annual reports, including the confidential portions, shall be available, for example, for official use by any official or employee of the U.S., and national securities exchanges and registered national securities associations of which the person filing is a member. The Commission proposes to amend paragraph (e)(3) of Rule 17a-5 to include the PCAOB as a permitted recipient. The Commission further proposes to amend paragraph (e)(3) of Rule 17a-5 by updating references to the revised rule and reflecting the proposed Annual Audit Reports.

The Commission generally requests comment on all aspects of this proposed amendment. In addition, the Commission requests comment on the following question related to the proposal:

- Would this proposed amendment be the simplest method to request confidentiality treatment, or is there a better alternative?

C. Removing Obsolete Provisions

The Commission proposes to delete paragraph (e)(5) of Rule 17a-5 in its entirety because the provisions are now moot. Paragraph (e)(5) of Rule 17a-5 discusses the requirement for broker-dealers to file Form BD-Y2K. Form BD-Y2K elicited information with respect to the broker-dealer's readiness for the year 2000 and any potential problems that could arise with the advent of the new millennium.[165] Form BD-Y2K was required to be filed in April of 1999 and only then.

165 See Reports to be Made by Certain Brokers and Dealers, Exchange Act Release No. 40608 (Oct. 28, 1998), 63 FR 59208 (Nov. 3,1998).

D. Classification of Qualified Accountant

The Commission proposes to amend paragraph (f)(1) of Rule 17a-5, which determines how the Commission classifies a qualified independent public accountant, by adding a sentence to the paragraph stating that the "accountant must be registered with the Public Company Accounting Oversight Board if required by the Sarbanes-Oxley Act of 2002." This is a technical, non-substantive amendment because broker-dealer accountants are already required to be registered with the PCAOB.

E. Technical Amendments

The Commission proposes to delete paragraph (b)(6) of Rule 17a-5, which currently provides that a "copy of the annual audit report shall be filed at the regional office of the Commission for the region in which the broker or dealer has its principal place of business and the principal office of the designated examining authority for said broker or dealer. Two copies of said report shall be filed at the Commission's principal office in Washington, D.C. Copies thereof shall be provided to all self-regulatory organizations of which said broker or dealer is a member." The Commission proposes to delete this paragraph because it is redundant to the requirement in paragraph (d)(6) of the rule.[166]

For consistency purposes, the Commission proposes to delete references to "balance sheet" and replace them with references to "Statement of Financial Condition."[167]

166 As previously discussed, the Commission proposes to amend paragraph (d)(6) of Rule 17a-5 to require that a copy of the annual report be filed with SIPC. Specifically, the Commission proposes that paragraph (d)(6) provide that the annual reports shall "be filed at the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the Commission's principal office in Washington, D.C., and the principal office of the designated examining authority for said broker or dealer and with the Securities Investor Protection Corporation. Copies thereof shall be provided to all self-regulatory organizations of which said broker or dealer is a member, unless the self-regulatory organization by rule waives this requirement."

167 See, e.g., Rule 17a-5(c)(2)(i).

The Commission also proposes technical amendments to paragraph (e)(1)(i) of Rule 17a-5. Paragraph (e)(1)(i) provides the exemption for broker-dealers that are not required to engage an independent public accountant to audit their financial statements. The technical amendments that the Commission is proposing include updating references and clarifying the existing language.[168] The Commission also proposes technical amendments to paragraph (e)(1)(ii) of Rule 17a-5, which requires a broker-dealer to include an oath or affirmation related to the claimed exemption from the annual audit requirement. Specifically, the Commission proposes to update references and other non-substantive changes to the text of the paragraph.

Further, the Commission is proposing to amend paragraph (e)(4)(iii)(F) of Rule 17a-5 to correct an inaccurate reference to a form filed in connection with the SIPC Reports. Currently, paragraph (e)(4)(iii)(F) refers to the "Certificate of Exclusion from Membership" as Form SIPC-7. The proposed amendments would change the reference in proposed paragraph (e)(4)(iii)(F) from Form SIPC-7 to Form SIPC-3 in proposed paragraph (e)(4)(ii)(C).

In addition, the Commission is proposing to amend paragraphs (f)(1) and (f)(3) of Rule 17a-5. Currently, paragraph (f)(1) of Rule 17a-5 contains the "Qualification of accountants." Specifically, paragraph (f)(1) states that the "Commission will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of his place of residence or principal office."[169] Paragraph (f)(3) of Rule 17a-5 contains the requirement for independence: "[a]n accountant shall be independent in accordance with the provisions of § 210.2-01(b) and (c) of this chapter." The Commission proposes to delete

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168 See, e.g., proposed Rule 17a-5(e)(1).

169 See Rule 17a-5(f)(1).

paragraph (f)(3) and amend (f)(1) to state that "the independent public accountant must be qualified and independent in accordance with § 210.2-01 of this chapter. In addition, the accountant must be registered with the Public Company Accounting Oversight Board if required by the Sarbanes-Oxley Act of 2002." The Commission is proposing this technical amendment to update the definition of an independent public accountant to be consistent with other Commission rules. Furthermore, by citing to § 210.2-01 in its entirety, rather than the provisions of (b) and (c), the text of (f)(1) becomes unnecessary. The Commission is also proposing a conforming amendment to paragraph (f)(4), which contains a notice provision concerning the replacement of the broker-dealer's independent public accountant. Paragraph (f)(4) would be renumbered as (f)(3).

The Commission is proposing to delete paragraph (i)(5) of Rule 17a-5, which provides that the terms "audit," "accountant's report," and "certified" "shall have the meanings given in § 210.1-02 of this chapter." The Commission is proposing to delete this paragraph because the terms are defined under existing auditing standards promulgated by the PCAOB.

The Commission is proposing additional technical amendments throughout Rule 17a-5, including changes to consistently use the defined term "independent public accountant"[170] and to make the rule gender neutral.[171]

- The Commission generally requests comment on all aspects of the amendments proposed in this Section V.

VI. PAPERWORK REDUCTION ACT

The proposed amendments to Rule 17a-5 contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission is submitting the

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170 See, e.g., proposed paragraph (f)(4) of Rule 17a-5.

171 Id.

proposed amendments and the proposed new collection to the Office of Management and Budget ("OMB") for review in accordance with the PRA. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:

(1) Rule 17a-5, Reports to be made by certain brokers and dealers (OMB Control Number 3235-0123);

(2) Rule 17a-11, Notification provisions for brokers and dealers (OMB Control Number 3235-0085); and

(3) Form Custody (a proposed new collection of information).

A. Collections of Information under the Proposed Rule Amendments

As discussed above, the Commission is proposing three sets of amendments to Rule 17a-5. The first set of proposed amendments, the Annual Reporting Amendments, would: (1) update the existing requirements of the rule; (2) facilitate the PCAOB with its inspection and oversight authority over broker-dealer independent public accountants; and (3) enable a broker-dealer to use a single report to satisfy the proposed requirements under Rule 17a-5 and the IA Custody Rule's internal control report requirement.

The second set of proposed amendments, the Access to Audit Documentation Amendments, applies only to clearing broker-dealers. The Access to Audit Documentation Amendments are designed to facilitate the communication between a clearing broker-dealer's independent public accountant and representatives of Commission and the DEA. Additionally, the Access to Audit Documentation Amendments are designed to enable representatives of the Commission and the DEA of the clearing broker-dealer, in the scope of their examination of the firm, to have access to the audit documentation related to the examination of the broker-dealer.

The third set of proposed amendments, the Form Custody Amendments, would enhance the information received by the Commission and DEAs with respect to the custody practices of broker-dealers by requiring broker-dealers to file on a quarterly basis a new Form Custody. Proposed Form Custody would elicit information as to whether and how a broker-dealer maintains custody of cash and securities of customers and others.

Each set of proposed amendments has a corresponding paperwork burden, which is addressed below.

B. Proposed Use of Information

As discussed above, the Commission is proposing three sets of amendments to Rule 17a-5. The first set of proposed amendments, the Annual Reporting Amendments, would require a broker-dealer to either file a Compliance Report or an Exemption Report as part of its annual audit requirements under Rule 17a-5. The Compliance Report would be filed by a carrying broker-dealer and contain assertions by the broker-dealer with respect to the Financial Responsibility Rules. The Exemption Report would be filed by a broker-dealer that claims an exemption from Rule 15c3-3 because it does not operate as a carrying broker-dealer and would contain an assertion as to the basis for the claimed exemption. In addition, the broker-dealer would be required to engage an independent public accountant to provide a report addressing the accuracy of the assertions in either the Compliance Report or Exemption Report, as applicable.

The Commission preliminarily believes that the information gathered from the proposed Annual Reporting Amendments would assist the PCAOB in establishing an effective oversight and inspection program over the independent public accountants of broker-dealers, and it would enable broker-dealers that are jointly registered as investment advisers to use a single report to satisfy the proposed requirements under Rule 17a-5 and the IA Custody Rule's internal control report requirement.

The second set of proposed amendments, the Access to Audit Documentation Amendments, would provide the Commission and DEA examiners with access to clearing broker-dealer independent public accountants to discuss the independent public accountants' findings with respect to broker-dealer annual audit reports and to review audit documentation associated with those reports. Specifically, the amendments would require a representation from the clearing broker-dealer that it agrees to permit its independent public accountant to discuss with representatives of the Commission the findings with respect to annual audit reports of broker-dealers and review the related audit documentation. These proposed amendments would provide another tool to Commission and DEA examiners of broker-dealers by providing access to additional relevant information.

The third set of proposed amendments, the Form Custody Amendments, would establish a new Form Custody that the broker-dealer would need to include when filing its quarterly FOCUS Reports. Form Custody would elicit information as to whether and how a broker-dealer maintains custody of cash and securities of customers and others. The Commission preliminarily believes that proposed Form Custody would provide more detailed information about a broker-dealer's custodial activities. Moreover, proposed Form Custody could assist in expediting the Commission's or DEA's examination of a broker-dealer's custodial activities as examiners would no longer need to request basic custody-related information already disclosed on the form.

C. Respondents

The applicability of the proposed amendments discussed in this release depends on how a broker-dealer conducts its business. There are 5,063 broker-dealers registered with the

Commission as of year-end 2009. Of the 5,063 registered broker-dealers, 305 broker-dealers are carrying broker-dealers – i.e., broker-dealers that maintain custody of customer funds and/or securities and are required to comply with the customer protection provisions of Rule 15c3-3. The type of report a broker-dealer would be required to file under the proposed Annual Reporting Amendments would be based on whether a broker-dealer is a carrying broker-dealer subject to Rule 15c3-3, or is exempt from Rule 15c3-3. Carrying broker-dealers would be required to file Compliance Reports under the proposed Annual Reporting Amendments. Broker-dealers exempt from Rule 15c3-3 would be required to file Exemption Reports. There are 4,752 broker-dealers that claim exemptions to Rule 15c3-3.[172] The Commission estimates 305 carrying broker-dealer respondents would file the proposed Compliance Report and 4,752 non-carrying broker-dealer respondents would file the proposed Exemption Report under the Annual Reporting Amendments.[173]

The Access to Audit Documentation Amendments would apply to clearing broker-dealers, which, as defined above, includes broker-dealers that clear transactions or carry customer accounts. There are 528 clearing broker-dealers based on year-end 2009 FOCUS Report data, and, accordingly, the Commission estimates that there would be 528 broker-dealer respondents with respect to the Access to Audit Documentation Amendments.[174]

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172 These numbers are based on FOCUS Report data as of year-end 2009. See supra note 126 for a description of the FOCUS Report. As discussed in note 126, FOCUS Reports are deemed to be confidential pursuant to paragraph (a)(3) of Rule 17a-5.

173 There are 4,752 broker-dealers that claim an exemption to Rule 15c3-3.

174 The clearing broker-dealers would be required to respond to the paperwork burdens associated with the Access to Audit Documentation Amendments, and 528 broker-dealers represent the number of Part II FOCUS filers.

The Commission estimates that there would be approximately 5,057 broker-dealer respondents with respect to the Form Custody Amendments.[175]

Additionally, the Commission estimates that there could be approximately 550 independent public accountants affected by the amendments. This number represents the number of independent public accountants registered with the PCAOB that are engaged to perform broker-dealer audits.

The Commission generally requests comment on all aspects of these estimates. In addition, the Commission requests specific comment on the following items related to these estimates:

- Should the Commission use different estimates for the number of respondents for the Annual Reporting Amendments? If so, what estimates should the Commission use and why? What are the sources of these estimates?
- Should the Commission use different estimates for the number of broker-dealer respondents for the Access to Audit Documentation Amendments? If so, what estimates should the Commission use and why? What are the sources of these estimates?
- Should the Commission use a different estimate of the number of independent public accountants that would be affected by the amendments? If so, what estimate should the Commission use and why? What is the source of this estimate?

Commenters should provide specific data and analysis to support any comments they submit with respect to these estimates with respect to the number of respondents.

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175 Carrying broker-dealers and non-carrying broker-dealers would be required to file Form Custody; 305 + 4,752 = 5,057.

D. Total Annual Recordkeeping and Reporting Burden

As discussed below, the Commission estimates the total recordkeeping burden resulting from the proposed Rule 17a-5 amendments would be approximately 287,325 hours on an annual basis[176] and 10,214 hours on a one-time basis.[177] The Commission notes that, given the significant variance between the largest broker-dealer and the smallest broker-dealer, the total annual and one-time hour burden estimates described below are averages across all types of broker-dealers expected to be affected by the proposed amendments.

1. Annual Reporting Amendments

a. Financial Reports filed with the Commission

Currently, broker-dealers are required to file their annual audit report, which, as discussed previously, the Commission proposes to rename as the broker-dealer's "Financial report" in Rule 17a-5. The Commission is not proposing any substantive changes to the financial audit; therefore the Commission believes the hour burden for broker-dealers with respect to financial reports would remain the same.[178] As is discussed in Section V.E. of this release, the Commission is proposing to delete paragraph (b)(6) of Rule 17a-5, which currently provides that two copies of a broker-dealer's annual audit report be filed at the Commission's principal office in Washington, D.C., because it is redundant with paragraph (d)(6) of Rule 17a-5, which requires that only one copy of a broker-dealer's annual audit report be filed at the Commission's principal office in Washington, D.C. By deleting paragraph (b)(6) of Rule 17a-5, only one copy

[176] The total annual hour burden is estimated to be 287,325 hours (18,300 hours for the Compliance Report + 23,760 hours for the Exemption Report + 2,529 hours for copies of the Annual Reports to be filed with SIPC + 242,736 hours for Form Custody).

[177] The total one-time burden is estimated to be 10,114 hours for the revised Notice Designating Accountant (required for the proposed Access to Audit Documentation Amendments) + 100 hours for SIPC forms to be filed with respect to the SIPC proposal.

[178] The Commission notes that the financial audit would be subject to standards promulgated by the PCAOB; however, this would not change the Commission's prescribed reporting burden associated with the financial audit.

of the annual audit report would need to be filed with the Commission, rather than two, which will result in a slight reduction in broker-dealers' hour burden in providing related papers to the Commission.[179]

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

b. Compliance Report and Examination Report

The Commission proposes to require carrying broker-dealers to file two new reports: (1) the proposed Compliance Report, which is prepared by the carrying broker-dealer; and (2) the Examination Report, which is prepared by the broker-dealer's independent public accountant as a result of its examination of the Compliance Report.[180] Included in the Compliance Report would be a statement that the carrying broker-dealer is responsible for establishing and maintaining a system of internal control to provide the broker-dealer's management with reasonable assurance that there are no instances of material non-compliance with the Financial Responsibility Rules and three assertions. The three assertions would be whether the broker-dealer: (1) was in compliance with Financial Responsibility Rules as of its most recent fiscal year-end; (2) used information derived, in all periods during the fiscal year, from the broker-dealer's books and records; and (3) had a system of internal control over compliance with these rules that was effective during the most recent fiscal year such that there were no instances of material weakness.

179 As is discussed above in Section V.A. of this release, broker-dealers would be required to file a copy of their annual audit reports with SIPC under proposed paragraph (d)(6) of Rule 17a-5, which would impose an annual hour burden on broker-dealers. This burden is discussed below in Section VI.D.1.d of this release.

180 The Compliance Report and Examination Report are discussed in Section II.B.2 of this release.

The Commission preliminarily believes that broker-dealers would validate, gather, and review records to enable them to make the assertions in the proposed Compliance Report. The Commission estimates, on average, that broker-dealers would spend an additional 60 hours to perform the validation and evidence gathering.[181] For all carrying broker-dealers, we estimate the annual hour burden to be 18,300 hours.[182]

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

c. Exemption Report

For a non-carrying broker-dealer claiming an exemption from Rule 15c3-3, the proposed Exemption Report would require the broker-dealer to assert that it is exempt from Rule 15c3-3 and identify the provision of the rule that it is relying on to qualify for the exemption. The non-carrying broker-dealer would be required to include this assertion in its Exemption Report to be filed with the Commission. The Commission does not anticipate that this requirement will result in a significant hourly burden because the broker-dealer has been operating under the claimed exemption and is aware of what exemption it will claim on the Exemption Report. Therefore, the hour burden associated with this proposed amendment should be administrative and encompass the drafting and filing of the report. Based on staff experience with broker-dealers filing similar types of reports, the Commission estimates it should take a non-carrying broker-dealer five hours to prepare the Exemption Report and file the Exemption Report and copy of the

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181 The Commission's preliminary estimate of 60 hours is an average based on the varying sizes of carrying broker-dealers and is based on staff experience.

182 60 hours x 305 carrying broker-dealers = 18,300. See infra Economic Analysis Section for a discussion of the external cost estimates associated with the independent public accountant preparing the Examination Report based on an examination of the Compliance Report.

associated independent public accountant's report with the Commission and applicable securities regulators. Thus, we estimate the annual hour burden for broker-dealers required to file the Exemption Report and associated independent public accountant's report would be 23,760 hours.[183]

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

d. Copies of Annual Reports Filed with SIPC

The Commission is proposing that copies of broker-dealer annual reports (including the Financial Report and either the Compliance Report and corresponding independent public accountant's report based on the Compliance Examination, or the Exemption Report and corresponding independent public accountant's report based on the review of the Exemption Report) be filed with SIPC. The Commission estimates that broker-dealers would incur an administrative cost associated with the additional filing. The Commission estimates that it would take 30 minutes to prepare the additional copies and mail them to SIPC. Therefore, the Commission estimates that there is an annual hour burden of 2,529 with respect to this requirement.[184]

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

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183 5 hours x 4,752 non-carrying broker-dealers = 23,760 hours. See infra Economic Analysis Section for a discussion of the external costs associated with engaging an independent public accountant to prepare its report based on the review of the broker-dealer's Exemption Report.

184 1/2 hour x 5,057 broker-dealers = 2,528.50 hours, which is rounded up to 2,529 hours.

e. Notice of Designated Accountant

The Commission proposes amending Rule 17a-5(f)(2) and the Notice of Designated Accountant. As discussed above, the Commission proposes to require broker-dealers to state in their Notice that they have engaged an independent public accountant pursuant to proposed paragraph (g) of Rule 17a-5. Broker-dealers are currently required to file a Notice with the Commission designating the independent public accountant who will be conducting the broker-dealer's annual audit.

The Commission proposes to require that broker-dealers file a revised Notice designating their independent public accountant and containing the proposed new provisions in subparagraphs (D) through (G) to Rule 17a-5(f)(2)(ii), as applicable. As previously discussed, proposed new subparagraph (D) requires the broker-dealer to indicate whether the engagement is for a single year or not. Proposed subparagraph (E) requires the broker-dealer to make a representation that the engagement of the independent public accountant by the broker or dealer meets the required undertakings of paragraph (g).[185] Each clearing broker-dealer is required to make the following representations: (1) that it agrees to allow representatives of the Commission or its DEA, if requested for purposes of an examination of the broker-dealer, to review the audit documentation associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of Rule 17a-5;[186] and (2) to permit the independent public accountant to discuss with representatives of the Commission and the DEA of the broker-dealer, if requested for purposes of an examination of the broker-dealer, the findings associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of Rule 17a-5.[187]

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[185] See proposed paragraph (f)(2)(ii)(E) of Rule 17a-5.

[186] See proposed paragraph (f)(2)(ii)(F) of Rule 17a-5.

[187] See proposed paragraph (f)(2)(ii)(G) of Rule 17a-5.

The Commission notes that broker-dealers have previous versions of the Notice containing the current required information that could be used and revised to include the proposed new information. Therefore, the Commission estimates that it would take a broker-dealer approximately two hours to amend its existing Notice and file its new Notice pursuant to the proposed amendments. This estimate includes the time it would take a compliance officer and potentially other personnel to review the revised Notice to ensure that it complies with the proposed requirements. The Commission notes that the Notice can be continuing in nature and therefore the designation of an independent public accountant can apply to successive audits. Thus, the Commission estimates that the filing of the proposed new Notice would result in a one-time burden for broker-dealers. The Commission further estimates that this would be a one-time hour burden associated with revising and filing the new Notice, which would total 10,114 hours for all broker-dealers.[188]

The Commission requests comment on all aspects of these proposed burden estimates. If possible, commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates.

f. SIPC Forms

As previously discussed, the Commission proposes to amend Rule 17a-5 to provide that broker-dealers continue to file their required SIPC Forms with the Commission and SIPC unless the Commission takes final action to approve any proposed rule change SIPC may file for Commission consideration to require the filing of the forms solely with SIPC. Because broker-dealers are currently required to file the forms with both the Commission and SIPC, the

188 2 hours x 5,057 broker-dealers = 10,114.

Commission does not believe there is any change in the hour burden for broker-dealers to comply with this requirement.

However, the Commission notes that SIPC would have to file a proposed and final rule with the Commission, to, as discussed above, require broker-dealers to file the SIPC Forms with SIPC. Based on staff experience with filings related to SRO rule changes, the Commission estimates that it would take, conservatively, 100 hours for SIPC to prepare the filings necessary to require broker-dealers to file the SIPC Forms solely with SIPC. Therefore, the one-time hour burden associated with this requirement is 100 hours. Additionally, the Commission notes that subsequent to the adoption of SIPC's rule, that broker-dealers would benefit from only having to file the reports with one entity.

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

2. Access to Audit Documentation Amendment

The Commission proposes to amend Rule 17a-5 to require broker-dealers to consent to allow representatives of the Commission and DEA to speak with, and review the audit documentation of, their independent public accountants, if requested in connection with a regulatory examination. As previously discussed, the rule proposal would require broker-dealers to amend and file a new Notice. As described above, the Commission calculated the hour burden associated with amending the Notice with respect to the proposed Annual Reporting. The Commission believes the estimated hour burden includes, if applicable, the needed representations associated with the Access to Audit Documentation.

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

3. Proposed Form Custody

The Commission is proposing a new form – Form Custody – that is designed to elicit information about whether and how a broker-dealer maintains custody of customer assets and handles customer cash. As discussed below, a broker-dealer would be required to file Form Custody quarterly and with its annual audit reports. The goal is to create a report that provides information about the custodial activities of broker-dealers that can serve as a starting point for securities regulators to undertake more in depth reviews as they deem appropriate.

As discussed above, the proposed form is comprised of nine line items that elicit information about the broker-dealer's custodial responsibilities and operations. Some of the items contain multiple questions and also require the completion of charts or the disclosure of additional data points in designated spaces on the form.

The Commission preliminarily believes that the hour burden associated with the FOCUS Report provides an appropriate baseline for estimating the hour burden associated with the proposed Form Custody because the FOCUS Report is a broker-dealer report that requires the broker-dealer to provide financial and operational information.[189] Specifically, the Commission believes that the information the broker-dealer uses to compute the required computation related to Rule 15c3-3 in the FOCUS Report can be used in answering the questions contained in the proposed Form Custody. Thus, the Commission bases this estimate on the current hour burden estimate for broker-dealers to complete their FOCUS Reports, and that on average, each broker-

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189 See supra note 126.

dealer would require 12 hours to complete Form Custody.[190] This results in an estimated annual burden of 242,736 hours.[191]

The Commission requests comment on all aspects of these proposed burden estimates. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates, if possible.

4. Technical Amendments to Rule 17a-5 and to Rule 17a-11

The Commission believes that the proposed technical amendments to Rule 17a-5 (e.g., making the rule gender-neutral)[192] would not impose any additional time burden on broker-dealers. Additionally, the Commission's proposed conforming amendment to paragraph (e) of Rule 17a-11 (eliminating a reference to current paragraph (h) of Rule 17a-5 and correcting references) is also technical in nature and should not result in an additional hour burden.

E. Collection of Information Is Mandatory

The collection of information obligations imposed by the proposed rule amendments and the proposed new rule would be mandatory for broker-dealers that are registered with the Commission.

F. Confidentiality

The Commission notes that a broker-dealer can seek confidential treatment for information filed with the Commission under existing laws and rules governing confidential

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190 The Commission notes that the current PRA hour burden estimate for the FOCUS Report filing is 12 hours. See SEC File No. 270-155, 75 FR 8759 (Feb. 25, 2010).

191 5,057 x 4 = 20,228 annual responses × 12 hours = 242,736.

192 See supra discussion in Section V.E. for specified technical amendments.

treatment.[193] The Commission will accord this information confidential treatment to the extent permitted by law.[194]

G. Request for Comment

Pursuant to 44 U.S.C. 3306(c)(2)(B), the Commission requests comment on the proposed collections of information in order to: (1) 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; (2) evaluate the accuracy of the Commission's estimates of the burden of the proposed collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) 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; and (5) evaluate whether the proposed rule amendments would have any effects on any other collection of information not previously identified in this section.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-23-11. OMB is required to make a decision concerning the collections of information

[193] 15 U.S.C. 78o-7(k). A broker-dealer can request that the Commission keep this information confidential. See Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80 and 17 CFR 200.83.

[194] 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. 5 U.S.C. 552.

between 30 and 60 days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. 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. S7-23-11, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549.

VII. ECONOMIC ANALYSIS

The Commission recognizes that there are costs associated with the adoption of the proposed amendments to Rule 17a-5 and proposed Form Custody that are separate from the hour burdens discussed in the Paperwork Reduction Act. Thus, the Commission has identified certain costs and benefits of the proposed rule amendments and requests comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[195] The Commission preliminarily believes that potential costs incurred by a broker-dealer to comply with the proposed rule amendments would depend on its size and the complexity of its business activities. The size and complexity of broker-dealers vary significantly. Therefore, their costs could vary significantly. The Commission is providing estimates on the average cost per broker-dealer taking into consideration the variance in size and complexity of the business activities of broker-dealers. Any costs incurred would also vary

195 For the purposes of this cost/benefit analysis, the Commission is using salary data from the Securities Industry and Financial Markets Association ("SIFMA") Report on Management and Professional Earnings in the Securities Industry 2009, which provides base salary and bonus information for middle-management and professional positions within the securities industry. The salary costs derived from the report and referenced in this cost benefit section are modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Hereinafter, references to data derived from the report as modified in the manner described above will be cited as <u>SIFMA's Management & Professional Earnings in the Securities Industry 2009</u>.

depending on whether the broker-dealers carry customer accounts or not. For these reasons, the cost estimates represent the average cost across all broker-dealers.

The Commission seeks comment and data on the benefits identified. The Commission also seeks comment on the accuracy of its cost estimates in each section of this cost-benefit analysis, and requests those commenters to provide data, including identification of statistics relied on by commenters to reach conclusions on cost estimates. Finally, the Commission seeks estimates and views regarding these costs and benefits for particular types of market participants (e.g., broker-dealers, customers of broker-dealers and independent public accountants), as well as any other costs or benefits that may result from these proposed rule amendments and the new proposed Form.

Under Section 3(f) of the Exchange Act,[196] the Commission shall, when engaging in rulemaking that requires the Commission to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act[197] requires the Commission to consider the anticompetitive effects of any rules the Commission adopts under the 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. The Commission has considered the effects of each of the proposed amendments in this release on competition, efficiency and capital formation. The Commission's preliminary view, as discussed in greater detail with respect to each proposed amendment below, is that the proposed rule amendments may promote efficiency, competition, and capital formation and any burden on competition is justified by the benefits.

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196 15 U.S.C. 78c(f).

197 15 U.S.C. 78w(a)(2).

In considering the effect of the proposed amendments on capital formation, the Commission notes that broker-dealers that lack appropriate custody procedures or internal controls may expose investors to unnecessary risks. For example, if losses are incurred by investors as a result of a broker-dealer's failure to properly safeguard customer assets, investors may lose confidence in broker-dealers, which, in turn, could negatively impact the ability of companies to raise capital through securities issuances underwritten by broker-dealers. A perceived lack of such procedures should be expected to reduce investors' willingness to invest through broker-dealers, and measures, such as these proposed amendments, should thereby enhance capital formation by strengthening the operational controls of broker-dealers with respect to safeguarding customer assets. At the same time, the Commission acknowledges that additional requirements designed to safeguard investor assets could impose a burden on competition by raising compliance costs for broker-dealers.

The Commission generally requests comment on all aspects of this analysis of the burden on competition and promotion of efficiency, competition, and capital formation. Commenters should provide specific data and analysis to support their views.

A. Annual Reporting Amendments

1. Benefits

The Commission preliminarily believes that the Annual Reporting Amendments will have a number of benefits. First, the Annual Reporting Amendments would update the existing requirements of Rule 17a-5, which is used by the Commission to monitor the financial condition of broker-dealers. This will align the text of Rule 17a-5 with current auditing literature. Second, the amendments would facilitate PCAOB inspection and oversight authority over broker-dealer independent public accountants by providing an improved foundation for the PCAOB to establish new broker-dealer audit standards. Third, the Commission preliminarily believes that the Annual Reporting Amendments proposed in this release, if adopted, would create an efficient process for broker-dealers by enabling them to satisfy the proposed requirements under Rule 17a-5 and the IA Custody Rule's internal control report requirement.

Additionally, the Commission preliminarily believes that the proposed Annual Reporting Amendments would strengthen and improve compliance with the Financial Responsibility Rules because it would increase the focus of independent public accountants on the custody practices of broker-dealers. This could help identify broker-dealers that have weak controls for safeguarding investor assets.

The Commission preliminarily believes that the proposed Annual Reporting Amendments, by updating the existing requirements of Rule 17a-5 and requiring reports prepared by independent public accountants that make custody a greater focus of the audit, would strengthen broker-dealer compliance with the Financial Responsibility Rules and, in turn, improve the financial and operational condition of broker-dealers and the safeguarding of investor assets. . These improvements could enhance investor trust in the financial markets and thereby potentially have a positive impact on capital formation.

Additionally, the Commission preliminarily believes that the proposed Annual Reporting amendments create regulatory efficiencies for broker-dealers that are also registered as investment advisers because the proposals would potentially eliminate regulatory redundancy by enabling entities subject to the IA Custody Audit Rule and the Compliance Examination to submit a single report with the Commission.

2. Costs

As discussed above, the Commission estimates that there are 305 carrying broker-dealers that would be subject to the Compliance Examination and Report based on data included in FOCUS Reports. The Commission recognizes that the proposed amendments associated with the Compliance Examination would create additional costs incurred by the broker-dealers related to their annual audits. As stated previously, the proposed requirements with respect to the Compliance Examination are based on existing requirements in Rule 17a-5. The Commission is also proposing new requirements for the Compliance Examination that are not currently in Rule 17a-5.[198]

The Commission preliminarily believes that the costs associated with the Compliance Examination would be incremental to the current annual audit costs, because the proposed amendments are based on existing requirements. Consequently, the Commission preliminarily believes that the independent public accountants would be able to build upon existing work to satisfy the new requirements. For example, as discussed above, under existing requirements, the independent public accountant, among other things, must review the accounting system, internal accounting control and procedures for safeguarding securities, including appropriate tests therefore for the period since the prior examination date.[199] The Commission preliminarily estimates that the additional costs incurred by carrying broker-dealers associated with paying their independent public accountants would average $150,000 per firm, per year. The

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198 See supra discussion in Section II.B.2; the proposed Compliance Examination would result in the following four changes to existing audit work: (1) use of PCAOB standards; (2) revised reporting requirements for the examination of the broker-dealer's assertions regarding compliance and internal controls over compliance (i.e., expression of an opinion); (3) period of time of reporting on internal controls over compliance (i.e., controls over compliance effective through the year instead of only at year-end); and (4) including the Account Statement Rule as part of the examination.

199 See Section II.A. of this release.

Commission derived this cost estimate from its estimates of the costs associated with the IA Custody Rule.

The Commission estimated that the IA Custody Rule would impose costs of $250,000 per investment adviser.[200] The Commission noted that the cost to prepare an internal control report relating to custody would vary based on the size and services offered by a qualified custodian, but that the average cost for an internal control report was approximately $250,000.[201] The Commission notes that the IA Custody Rule imposed new requirements on investment advisers, and was not based on existing obligations. The Commission preliminarily believes that the costs associated with the Compliance Examination would be incremental to broker-dealers because of the existing work done by the independent public accountants. The Commission preliminarily estimates that the additional costs associated with the Compliance Examination and Examination Report to be, on average, $150,000 per year per broker-dealer. As noted above, the Commission derived this cost estimate from its estimates of the costs associated with the IA Custody Rule.

Therefore the Commission estimates an annual cost associated with this proposal to be $45,750,000 per year.[202]

The Commission estimates that 4,752 non-carrying broker-dealers would be required to file the proposed Exemption Report. As discussed above, this number is based on the number of non-carrying broker-dealers that claim exemptions from Rule 15c3-3.[203] These non-carrying broker-dealers would be required to have an independent public accountant review the claimed assertion (exemption) and prepare a corresponding report that also would be filed with the

200 See IA Custody Adopting Release at 1478.

201 See IA Custody Adopting Release at note 291 and corresponding text at 1479.

202 $150,000 x 305 broker-dealers = $45,750,000.

203 These numbers are based on FOCUS Report data as of year-end 2009. See supra notes 172-173.

Commission. The Commission preliminarily believes that an independent public accountant's review of the exemption assertion would add an incremental cost to that incurred by the annual financial audit. As discussed above, independent public accountants engaged by broker-dealers must "ascertain that the conditions of the exemption were being complied with as of the examination date and that no facts came to [the independent public accountant's] attention to indicate that the exemption had not been complied with during the period since [the independent public accountant's] last examination."[204] The Commission therefore estimates that the submission of the Exemption Report and any additional work done by the independent public accountant to conduct the review would result in an incremental increase to the current audit cost of the non-carrying broker-dealer.

The cost for paying the independent public accountant to perform a financial audit of a non-carrying broker-dealer varies depending on the size and amount of net revenues. The Commission's preliminary estimates of these costs as set forth below are based on staff experience, including communications with broker-dealers, broker-dealer auditors, and auditor industry groups. The Commission preliminarily estimates that the cost for an annual audit for a non-carrying broker-dealer with net revenue of less than \$1 million to be \$15,000. The Commission preliminarily estimates the average cost for an audit of a non-carrying broker-dealer with net revenue of \$1 million to \$10 million to be \$20,000. The Commission preliminarily estimates the average cost of an audit of a non-carrying broker-dealer with net revenue greater than \$10 million and less than \$100 million to be \$60,000. Finally, the Commission preliminarily estimates the average cost of an audit of a non-carrying broker-dealer with net

204 See Rule 17a-5(g)(2). As noted previously, the independent public accountants currently satisfy this requirement by including a statement in the study providing that they have ascertained that the broker-dealer was complying with the conditions of the exemption; see Broker Dealer Audit Guide supra note 14 at Section 3.32.

revenue greater than $100 million to be $300,000. Therefore, the Commission preliminarily estimates the average cost for the financial audit for non-carrying broker-dealers is approximately $30,000.[205] As noted, the Commission believes that the cost of the proposed review would be incremental to costs currently incurred for the financial audit. The Commission estimates that, on average, the additional average cost would be approximately $3,000 for each non-carrying broker-dealer.[206] Therefore, the total annual cost for all non-carrying broker-dealers required to submit Exemption Reports is estimated to be $14,256,000.[207]

The Commission preliminarily believes that the proposed amendments may impose a burden on competition for smaller broker-dealers to the extent that they impose relatively fixed costs, which would represent a higher percentage of net income for smaller broker-dealers. However, the Commission preliminary believes that the incremental costs resulting from the proposed amendments would not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

B. Access to Audit Documentation Amendments

1. Benefits

The Commission preliminarily believes that the proposed Access to Audit Documentation Amendments would have a number of benefits. These proposed rules would make it easier for the Commission and DEAs to access information about a clearing broker-dealer's independent public accountant's work and the steps taken by the independent public

205 The average is derived from applying the number of broker-dealers with the given net revenue ranges and multiplying it by the estimated audit costs; for example there are over 2,000 non-carrying broker-dealers with net revenues under $1 million; however there are over 1500 firms with net revenue between $1 million and $10 million and so forth. The Commission preliminarily estimates the average audit cost to be $30,000.

206 Based on staff experience the Commission believes that the incremental work done to conduct the review represents 10% of the current work done. Therefore the Commission estimates an average additional cost of around $3,000 (10% * $30,000).

207 $3,000 x 4,752 = $14,256,000.

accountant to audit the broker-dealer's financial statements. In turn, this information would enable the Commission and DEA examiners to more efficiently deploy examination resources.[208] The Commission preliminarily believes that examiners reviewing the audit documentation may tailor the scope of their examinations by identifying areas where extensive audit work was performed by the independent public accountant and focusing their examinations on other areas. Enabling Commission and DEA examination staff to conduct more focused examinations of broker-dealers could, in turn, provide investors with greater protection, as examination resources could be allocated more strategically for their benefit.

2. Costs

The Commission notes that clearing broker-dealers would incur additional costs from the proposed Access to Audit Documentation Amendments by permitting representatives of the Commission and its DEA to discuss with the independent public accountants the findings in their audit reports and to review the audit documentation associated with the audit reports. While the Commission does not anticipate that its representatives would need to discuss findings and review audit documentation with respect to each clearing broker-dealer annually, the Commission's estimate is nevertheless based on the total number of clearing broker-dealers. Further, the Commission assumes that independent public accountants would charge their clearing broker-dealer clients for any time spent with the Commission and DEA representatives discussing the findings associated with the annual audit reports and providing access to the

208 As discussed previously, the Commission preliminarily believes that where an independent public accountant has performed extensive testing of a carrying broker-dealer's custody of securities and cash by confirming holdings at subcustodians, examiners could focus their efforts on matters that had not been the subject of prior testing and review

documentation associated with the annual audit reports. The Commission estimates clearing broker-dealers would incur an additional $660,000 per year in annual costs.[209]

The Commission preliminarily believes that the proposed amendments may impose a burden on competition for smaller broker-dealers to the extent that they impose relatively fixed costs, which would represent a higher percentage of net income for smaller broker-dealers. However, the Commission preliminarily believes that the incremental costs resulting from the proposed amendments would not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, given the investor protection objectives of the proposed amendments.

C. Proposed Form Custody and Related Requirements

1. Benefits

The Commission frequently brings enforcement actions against investment advisers and broker-dealers alleging fraudulent conduct, including misappropriation or other misuse of investor assets.[210] The Commission also has brought an enforcement action against the accountant responsible for auditing one of these broker-dealers.[211] In order to enhance protection, the Commission has taken steps to enhance oversight of the custody function of investment advisers[212] and preliminarily believes that the proposal to adopt Form Custody will provide information related to custodial practices of broker-dealers that, in turn, will better protect investors who entrust funds and securities to broker-dealers. Proposed Form Custody would be filed with a broker-dealer's quarterly FOCUS Reports and would elicit information

209 Based on industry sources, the Commission estimates that the hourly cost of an independent public accountant to be $250. With an additional 5 hours per year, the annual hour burden would be 2,640 (528 clearing broker-dealers x 5 hours) for a yearly cost estimate of $660,000 (2,640 hours x $250 per hour).

210 See supra note 123.

211 SEC v. David G. Friehling, C.P.A., et al., Litigation Release No. 20959 (Mar. 18, 2009).

212 See supra note 124.

about whether and how the broker-dealer maintains custody of assets. This form would consolidate information about the broker-dealer's custodial responsibility and relationships with other custodians in one report so that the Commission and other securities regulators can have a more comprehensive understanding of the broker-dealer's custody practices and arrangements. Further, the Commission believes that the additional information made available on the proposed form would aid in the examination of broker-dealers, because the examination staff could use the form as another tool for purposes of prioritizing and planning examinations.

The Commission believes that the proposed Form Custody amendments also could enhance investor confidence. By establishing a discipline under which broker-dealers are required to report to the Commission greater detail as to their custodial functions, investor perception as to the safety of their funds and securities at broker-dealers could improve. This, in turn, could increase the willingness of investors to provide capital for investment through broker-dealers.

2. Costs

The proposed form is comprised of nine line items that elicit information about the broker-dealer's custodial responsibilities and operations. Some of the Items contain multiple questions and also elicit information by requiring charts to be filled out or additional information to be provided in spaces provided.[213]

The cost of compliance will vary given the variation in the size and complexity of the businesses of the brokers and dealers subject to Rule 17a-5. The Commission estimates that, on average, each report would require approximately 12 hours for a broker-dealer to complete.[214]

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213 See supra Section IV for discussion of each proposed item of Form Custody.

214 See supra note 190; the Commission's current hour burden associated with a broker-dealer filing a FOCUS Report is 12 hours.

As noted above, the Commission proposes to require that firms file proposed Form Custody on a quarterly basis. Therefore, the Commission estimates that there would 20,228 annual responses[215] and therefore a total annual hour burden of 242,736 hours.[216] Thus, the Commission anticipates that the annual cost to the industry will be $69,179,760.[217]

The Commission preliminarily believes that the proposed amendments could have a burden on competition because they could increase compliance costs for broker-dealers. However, the Commission preliminarily believes that this proposed amendment would not have a disproportionate effect on smaller broker-dealers. The Commission expects that smaller firms in completing proposed Form Custody will incur fewer associated costs because the information required to be disclosed is less. For example, broker-dealers that introduce customers on a fully disclosed basis and do not have custody of customer funds or assets would leave much of the Form blank.

C. 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 amendments and form.

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:

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215 5,057 firms x 4 times a year = 20,228 total responses.

216 20,228 total responses x 12 hours per Form Custody = 242,736.

217 The Commission anticipates that one or more Financial Reporting Managers, at an average cost of $285 per hour, would be responsible for completion of Form Custody. This $285 per hour figure for a Financial Reporting Manager is based upon information obtained from SIFMA's Management & Professional Earnings in the Securities Industry 2009 publication, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Thus, the annual cost burden is estimated to be $69,179,760 (242,736 total hours x $285 per hour)

- With respect to the costs estimates for the proposed Compliance Examination and corresponding Examination Report, is the cost associated with the IA Custody Rule comparable? Is the Commission's estimated cost for the proposed Compliance Examination and Examination Report conservative or too low?
- With respect to the costs estimates for the proposed Compliance Examination, do commenters believe that there could be some cost savings because some respondents would no longer have to engage an independent public accountant to perform the internal control examination required by the IA Custody Rule? If so, how much savings could be generated?
- With respect to the cost estimates for the proposed Exemption Report and review by the independent public accountant, would the amount of additional work for the review by the independent public accountant be greater than estimated by the Commission?
- Are there any additional costs associated with the proposed Access to Audit Documentation Amendments that are not currently contemplated in the Economic Analysis section? Will independent public accountants allocate the costs associated with the proposed Access to Audit Documentation Amendments to broker-dealers?
- With respect to the cost estimates for proposed Form Custody, do commenters believe that broker-dealers will need more than the estimated 12 hours to complete the form? If so, why? Also, please provide an alternative estimate.
- Are there any additional economic effects related to efficiency, capital formation or competition that the Commission has not identified?

The Commission generally requests comment on the competitive or anticompetitive effects as well as efficiency and capital formation effects, of the proposed amendments and form on any market participants if the proposals are adopted. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed amendments and form.

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[218] the Commission must advise OMB whether a proposed regulation constitutes a major rule. Under SBREFA, a rule is "major" if it has resulted in, 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
- A significant adverse effect on competition, investment, or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. The Commission requests comment on the potential impact of the proposed rule amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA"), in accordance with the provisions of the Regulatory Flexibility Act,[219] regarding the proposed rule amendments to Rule 17a-5 under the Exchange Act.

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[218] 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).

[219] 5 U.S.C. 603.

A. Reasons for the Proposed Action

The proposed Annual Reporting Amendments are designed to, among other things: (1) update the existing requirements of Rule 17a-5; (2) facilitate the ability of the PCAOB to implement oversight of independent public accountants of broker-dealers as required by the Dodd-Frank Act; and (3) eliminate potentially redundant requirements for certain broker-dealers affiliated with, or dually-registered as, investment advisers.

The Commission preliminarily believes the Access to Audit Documentation Amendments would enhance Commission and DEA examinations of broker-dealers by providing examiners with access to additional relevant information, which could improve the efficiency and effectiveness of the examination process. The Commission preliminarily believes that Commission and DEA examiners could use the Access to Audit Documentation Amendments to develop the scope for their examinations of clearing broker-dealers.

Currently, limited information is elicited about the scope of the broker-dealer's custodial function and the manner in which it handles assets of customers and other persons. The Commission, therefore, is proposing Form Custody, which it preliminarily believes would be useful because it provides information about the custodial activities of the broker-dealer that can serve as a starting point for examiners to undertake more in-depth reviews as they deem appropriate.

B. Objectives

The objectives of the proposed Form Custody Amendments are to enhance the Commission's oversight of broker-dealers, especially with respect to broker-dealers' custody of assets. As stated previously, the Commission preliminarily believes that proposed Form Custody would provide useful information that is currently not routinely made available to the

Commission. In addition, the proposed Access to Audit Documentation Amendments would assist the examination of broker-dealers. Another objective of the proposed Annual Reporting Amendments is, among other things, to update the existing provisions of Rule 17a-5 to align the text of the rule with current auditing literature.

C. Legal Basis

Pursuant to the Exchange Act[220] and, particularly, Sections 15(c), 17(a), 17(E) and 23 of the Exchange Act, the Commission is proposing amendments to Rule 17a-5 and new Form Custody.[221]

D. Small Entities Subject to the Rule

Paragraph (a) of Rule 0-10 provides that for purposes of the Regulatory Flexibility Act, a small entity "[w]hen used with reference to a broker or dealer, the Commission has defined the term "small entity" to mean a broker or dealer ("small broker-dealer" that: (1) had total capital (net worth plus subordinated liabilities of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements, were prepared pursuant to Rule 17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated debt) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this release."[222] Currently, based on FOCUS Report data, there are 871 broker-dealers that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[223]

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220 15 U.S.C. 78a et seq.

221 15 U.S.C. 78o.

222 17 CFR 240.0-10(c).

223 See 17 CFR 240.0-10(a).

E. Reporting, Recordkeeping, and Other Compliance Requirements

The Commission proposes three amendments to Rule 17a-5: the (1) Annual Reporting Amendments; (2) Access to Audit Documentation Amendments; and (3) Form Custody Amendments.

The Commission preliminarily believes that the potential impact of the proposals on small broker-dealers would be substantially less than on larger firms. With respect to the Annual Reporting Amendments, small broker-dealers would be subject to the Exemption Report, and not the proposed Compliance Report and Examination.[224] Therefore, small broker-dealers would engage their independent public accountant to review their Exemption Reports and would be subject to the additional costs associated with that review. Additionally, these firms could be required to pay additional fees to their independent public accountant, should the Commission or DEA examiners decide to interview them.

F. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap, or conflict with the proposed rule amendments.

G. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[225] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design

224 There are no broker-dealers that are carrying firms that satisfy the definition of a "small" broker-dealer.

225 5 U.S.C. 603(c).

standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission considered whether it is necessary or appropriate to establish different compliance or reporting requirements or timetables; or clarify, consolidate, or simplify compliance and reporting requirements under the rule for small entities. Because the proposed rule amendments would enhance the Commission's oversight, the Commission preliminarily believes that small entities should be covered by the rule. The Commission also preliminarily believes that it would not be necessary to establish different compliance requirements for small broker-dealers, in that, as discussed previously, the proposed amendments are based in large part on existing compliance requirements in Rule 17a-5. Similarly, the Commission does not believe it would be necessary to establish different compliance requirements for small broker-dealers with respect to Form Custody. The information that would be elicited on the form is designed to allow examiners to obtain an understanding of the custody practices of all types of broker-dealers. Therefore, the Commission preliminarily believes that having inconsistent requirements could undermine the objectives of the proposed requirement.

H. Request for Comments

The Commission encourages written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed rule amendments and whether the effect on small entities would be economically significant. Commenters are asked to describe the nature of any effect and to provide empirical data to support their views.

X. STATUTORY AUTHORITY AND TEXT OF THE PROPOSED AMENDMENTS

The Commission is proposing amendments to Rule 17a-5 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 15, 17, 23(a) and 36.[226]

List of Subjects in 17 CFR Parts 240 and 249

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

TEXT OF THE PROPOSED AMENDMENTS

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

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

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78l, 78m, 78n, 78n–1, 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.

* * * * *

2. Section 240.17a-5 is amended by:

a. in paragraph (a)(2)(ii), in the first sentence, removing the phrase "annual audit of financial statements where said date is other than a calendar quarter" and adding in its place "annual reports where said date is other than the end of a calendar quarter.";

[226] 15 U.S.C. 78o, 78q, 78w(a) and 78mm.

b. in paragraph (a)(2)(iii), removing the phrase "the annual audit of financial statements where said date is other than the end of the calendar quarter." and adding in its place "the annual reports where said date is other than the end of a calendar quarter.";

c. in paragraph (a)(2)(iv), adding the phrase "("designated examining authority")" after the phrase "section 17(d) of the Act";

d. redesignating paragraphs (a)(5) and (a)(6) as paragraphs (a)(6) and (a)(7);

e. in newly redesignated paragraph (a)(6)(ii)(A), removing the phrase "(a)(5)(i)" and adding in its place "(a)(6)(i)";

f. adding new paragraph (a)(5);

g. in paragraph (b)(4), removing the word "he" and adding in its place the phrase "the broker or dealer".

h. removing paragraph (b)(6);

i. in paragraph (c)(1)(i), removing the phrase "his customers" and adding in its place the phrase "customers of the introducing broker or dealer";

j. in paragraph (c)(1)(iii), removing the phrase "in the manner contemplated by the $2,500 minimum net capital requirement of § 240.15c3-1" and adding in its place "and otherwise qualified to maintain net capital of no less than what is required pursuant to § 240.15c3-1(a)(2)(iv)";

k. in paragraph (c)(2), in the first sentence, removing the phrase "audited financial statements" and adding in its place "financial report";

l. in paragraph (c)(2)(i) removing the phrase "balance sheet with appropriate notes prepared in accordance with" and adding in its place "Statement of Financial Condition with appropriate notes prepared in accordance with U.S.";

m. removing paragraph (c)(2)(iii);

n. redesignating paragraph (c)(2)(iv) as (c)(2)(iii);

o. in newly redesignated paragraph (c)(2)(iii), removing the phrase "annual audit report" and adding in its place "financial report";

p. adding new paragraph (c)(2)(iv);

q. in paragraph (c)(4) removing the word "'customer'" and adding in its place the word "customer";

r. in paragraphs (c)(5)(ii)(A) and (c)(5)(iii), removing the phrase "Web site" and adding in its place "website";

s. in paragraph (c)(5)(vi), removing the phrase "was not required by paragraph (e) of § 240.17a-11 to give notice and transmit a report to the Commission" and replacing it with "received an unqualified financial statement audit report pursuant to paragraph (g) of this section and neither the broker or dealer, pursuant to paragraph (d) of this section, or the independent public accountant, pursuant to paragraph (g) of this section, identified a material weakness or instance of material non-compliance";

t. revising paragraph (d);

u. in paragraph (e) introductory text, removing the phrase "financial statements" and adding in its place "annual reports";

v. revising paragraph (e)(1);

w. in paragraph (e)(2), in the first sentence, adding the word "financial" before "report";

x. revising paragraphs (e)(3) and (e)(4);

y. removing paragraph (e)(5);

z. revising paragraphs (f), (g), (h), and (i); and aa. removing and reserving paragraph (j).

The revisions and additions read as follows:

§ 240.17a-5 Reports to be made by certain brokers and dealers.

(a) * * *

(5) Every broker or dealer subject to this paragraph (a) shall file Form Custody (§ 249.1900 of this chapter) with its designated examining authority within 17 business days after the end of each calendar quarter and within 17 business days after the date selected for the annual reports where said date is other than the end of a calendar quarter. The designated examining authority shall maintain the information obtained through the filing of Form Custody and transmit such information to the Commission, at such time as it transmits the applicable part of Form X-17A-5 (§ 249.617 of this chapter) as required in paragraph (a)(4) of this section.

* * * * *

(c) * * *

(2) * * *

(iv) If in connection with the most recent annual report the independent public accountant provided notice to the Commission pursuant to paragraph (h) of this section, there shall be a statement by the broker or dealer that a copy of such notice is currently available for the customer's inspection at the principal office of the Commission in Washington, DC.

* * * * *

(d) Annual reports. (1)(i) Every broker or dealer registered pursuant to section 15 of the Act shall file annually, on a calendar or fiscal year basis:

(A) A financial report as described in paragraph (d)(2) of this section;

(B)(1) A compliance report as described in paragraph (d)(3) of this section unless the broker or dealer is exempt from the provisions of § 240.15c3-3; or

(2) An exemption report described in paragraph (d)(4) of this section if the broker or dealer is exempt from the provisions of § 240.15c3-3; and

(C) For each report filed pursuant to this paragraph (d), a report prepared by an independent public accountant pursuant to the engagement provisions set forth in paragraph (g)(1) of this section, except as provided in paragraphs (d)(1) and (e)(1) of this section.

(ii) The reports required to be filed under this paragraph (d) shall be as of the same fixed or determinable date each year, unless a change is approved in writing by the designated examining authority for the broker or dealer. A copy of such written approval should be sent to the regional office of the Commission for the region in which the broker or dealer has its principal place of business.

(iii) A broker or dealer succeeding to and continuing the business of another broker or dealer need not file the reports under this paragraph (d) as of a date in the fiscal or calendar year in which the succession occurs if the predecessor broker or dealer has filed a report in compliance with this paragraph (d) as of a date in such fiscal or calendar year.

(iv) A broker or dealer that is a member of a national securities exchange and has transacted a business in securities solely with or for other members of a national securities exchange, and has not carried any margin account, credit balance or security for any person who is defined as a customer in paragraph (c)(4) of this section, shall not be required to file the reports under this paragraph.

(2) Financial report. The financial report shall contain:

(i) A Statement of Financial Condition (in a format and on a basis that is consistent with the total reported on the Statement of Financial Condition contained in Form X-17A-5 (§ 249.617 of this chapter) Part II or IIA), a Statement of Income, a Statement of Cash Flows, a

Statement of Changes in Stockholders' or Partners' or Sole Proprietor's Equity, and Statement of Changes in Liabilities Subordinated to Claims of General Creditors. Such statements shall be in a format that is consistent with such statements as contained in Form X-17A-5 Part II or Part IIA. If the Statement of Financial Condition filed in accordance with instructions to Form X-17A-5, Part II or Part IIA, is not consolidated, a summary of financial data, including the assets, liabilities, and net worth or stockholders' equity, for subsidiaries not consolidated in the Part II or Part IIA Statement of Financial Condition as filed by the broker or dealer should be included in the notes to the consolidated statement of financial condition reported on by the independent public accountant.

(ii) Supporting schedules shall include, from Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) a Computation of Net Capital Under § 240.15c3-1, a Computation for Determination of the Reserve Requirements under Exhibit A of § 240.15c3-3 and Information Relating to the Possession or Control Requirements Under § 240.15c3-3 and shall be filed with said report.

(iii) If either the Computation of Net Capital under § 240.15c3-1 or the Computation for Determination of the Reserve Requirements Under Exhibit A of § 240.15c3-3 in the financial report is materially different from the corresponding computation in the most recent Part II or Part IIA of Form X-17A-5 (§ 249.617 of this chapter) filed by the broker or dealer pursuant to paragraph (a) of this section, then the broker or dealer shall include in the financial report a reconciliation, including appropriate explanations, between the computation in the financial report and the computation in the most recent Part II or Part IIA of Form X-17A-5 filed by the broker or dealer. If no material differences exist, a statement so indicating shall be included in the financial report.

(3) Compliance report. (i) The compliance report shall contain:

(A) A statement as to whether the broker or dealer has established and maintained a system of internal control to provide the broker or dealer with reasonable assurance that any instances of material non-compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and any rule of the designated examining authority of the broker or dealer that requires account statements to be sent to the customers of the broker or dealer ("Account Statement Rule") will be prevented or detected on a timely basis;

(B) Assertions by the broker or dealer that include:

(1) Whether it was in compliance in all material respects with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule as of the fiscal year-end;

(2) Whether the information used to assert compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule was derived from the books and records of the broker or dealer; and

(3) Whether the internal control over compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule was effective during the most recent fiscal year such that there were no instances of material weakness; and

(C) A description of each identified instance of material non-compliance and each identified material weakness in internal control over compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule.

(ii) The broker or dealer is not permitted to conclude that it is in compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13 and the Account Statement Rule if it identifies one or more instances of material non-compliance. For purposes of this paragraph material non-compliance would be a failure by the broker or dealer to comply with the requirements of §§ 240.15c3-1, 240.15c3-3, and 240.17a-13 or the Account Statement Rule in all material respects.

(iii) The broker or dealer is not permitted to conclude that the internal control over compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule were effective if there were one or more instances of material weakness in the internal control over compliance. For purposes of this paragraph, an instance of material weakness is defined as a deficiency, or a combination of deficiencies, in internal control over compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, and the Account Statement Rule, such that there is a reasonable possibility that material non-compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, or the Account Statement Rule will not be prevented or detected on a timely basis. For purposes of this paragraph a deficiency in internal control over compliance exists when the design or operation of a control does not allow the broker or dealer, in the normal course of performing their assigned functions, to prevent or detect non-compliance with §§ 240.15c3-1, 240.15c3-3, and 240.17a-13, or the Account Statement Rule on a timely basis.

(4) Exemption report. The exemption report shall contain an assertion by the broker or dealer that it is exempt from the provisions of § 240.15c3-3 because it meets conditions set forth in § 240.15c3-3(k) and should identify the specific conditions.

(5) The annual reports shall be filed not more than sixty (60) days after the date of the financial statements.

(6) The annual reports shall be filed at the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the Commission's principal office in Washington, DC, and the principal office of the designated examining authority for said broker or dealer and with the Securities Investor Protection Corporation.

Copies thereof shall be provided to all self-regulatory organizations of which said broker or dealer is a member, unless the self-regulatory organization by rule waives this requirement.

(e) * * *

(1)(i) The broker or dealer need not engage an independent public accountant to provide the reports required pursuant to paragraph (d) of this section if, since the date of the registration of the broker or dealer pursuant to Section 15 of the Act (15 U.S.C. 78o) or of the previous annual reports filed pursuant to paragraph (d) of this section:

(A) The securities business of such broker or dealer has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or

(B) Its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed or trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance or security for any securities customer.

* * * * *

(3) The annual reports filed pursuant to paragraph (d) of this section shall be public, except that, if the Statement of Financial Condition in a format that is consistent with Form X-17A-5 (§ 249.617 of this chapter), Part II or Part IIA, is bound separately from the balance of the annual report filed pursuant to paragraph (d)(2) of this section, and each page of the balance of the annual report is stamped confidential, then the balance of the annual report shall be deemed confidential. However, the annual reports, including the confidential portions, shall be available

for official use by any official or employee of the U.S. or any State, by national securities exchanges and registered national securities associations of which the person filing such a report is a member, by the PCAOB and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any registered national securities association or national securities exchange that give to customers of a member broker or dealer the right, upon request to such member broker or dealer, to obtain information relative to its financial condition.

(4)(i) The broker or dealer shall file with the Securities Investor Protection Corporation ("SIPC") a report on the SIPC annual general assessment reconciliation or exclusion from membership forms that contains such information and is in such format as determined by SIPC by rule and approved by the Commission.

(ii) Until the earlier of two years after the date paragraph (e)(4)(i) of this section is effective or SIPC adopts a rule pursuant to paragraph (e)(4)(i) of this section and the rule is approved by the Commission, the broker or dealer shall file a supplemental report on the status of the membership of the broker or dealer in SIPC if, pursuant to paragraph (d)(1)(i)(C) of this section, the broker or dealer is required to file reports prepared by an independent public accountant. The supplemental report shall include the independent public accountant's report on applying agreed-upon procedures based on the performance of the procedures outlined in paragraph (e)(4)(ii)(C). The supplemental report shall cover the SIPC annual general assessment reconciliation or exclusion from membership forms not previously reported on under this paragraph (e)(4) that were required to be filed on or prior to the date of the reports required by paragraph (d) of this section: Provided, that the broker or dealer need not file the supplemental report on the SIPC annual general assessment reconciliation or exclusion from membership form for any period during which the SIPC assessment is a specified dollar value as provided for in section 4(d)(1)(c) of the Securities Investor Protection Act of 1970, as amended. The supplemental report shall be filed with the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the Commission's principal office in Washington, DC, the principal office of the designated examining authority for the broker or dealer, and the principal office of SIPC. The supplemental report shall include the following:

(A) A schedule of assessment payments showing any overpayments applied and overpayments carried forward including: payment dates, amounts, and name of SIPC collection agent to whom mailed, or

(B) If exclusion from membership was claimed, a statement that the broker or dealer qualified for exclusion from membership under the Securities Investor Protection Act of 1970, and

(C) An accountant's report. The accountant shall be engaged to perform the following procedures:

(1) Comparison of listed assessment payments with respective cash disbursements record entries;

(2) For all or any portion of a fiscal year ending, comparison of amounts reflected in the annual report as required by paragraph (d) of this section, with amounts reported in the Annual General Assessment Reconciliation (Form SIPC-7);

(3) Comparison of adjustments reported in Form SIPC-7 with supporting schedules and working papers supporting adjustments;

(4) Proof of the arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the schedules and working papers supporting adjustments; and

(5) Comparison of the amount of any overpayment applied with the Form SIPC-7 on which it was computed; or

(6) If exclusion from membership is claimed, a comparison of the income or loss reported in the financial report required by paragraph (d) of this section to the Certification of Exclusion from Membership (Form SIPC-3).

(f)(1) Qualification of accountants. The independent public accountant must be qualified and independent in accordance with § 210.2-01 of this chapter and, in addition, the independent public accountant must be registered with the Public Company Accounting Oversight Board if required by the Sarbanes-Oxley Act of 2002.

(2) Designation of accountant. (i) Every broker or dealer that is required by paragraph (d) of this section to file annual reports shall file no later than December 10 of each year (or 30 calendar days after the effective date of its registration as a broker or dealer, if earlier) a statement as prescribed in paragraph (f)(2)(ii) of this section designating an independent public accountant with the Commission's principal office in Washington, DC, the regional office of the Commission for the region in which its principal place of business is located, and the principal office of the designated examining authority for the broker or dealer. The statement must be dated no later than December 1. If the engagement of the independent public accountant is of a continuing nature, providing for successive engagements, no further filing is required. If the engagement is for a single year, or if the most recent engagement has been terminated or amended, a new statement must be filed by the required date.

(ii) The statement must be headed "Notice pursuant to Rule 17a-5(f)(2)" and must contain the following information and representations:

(A) Name, address, telephone number, and registration number of the broker or dealer;

(B) Name, address, and telephone number of the independent public accountant;

(C) The date of the annual reports of the broker or dealer covered by the engagement;

(D) Whether the engagement is for a single year or is of a continuing nature;

(E) A representation that the engagement of the independent public accountant by the broker or dealer meets the required undertakings of paragraph (g) of this section; and

(F) A representation that the broker or dealer agrees to allow representatives of the Commission or its designating examining authority, if requested for purposes of an examination of the broker or dealer, to review the documentation associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of this section.

(G) A representation that the broker or dealer agrees to permit the independent public accountant to discuss with representatives of the Commission and its designated examining authority, if requested for purposes of an of an examination of the broker or dealer, the findings associated with the reports of the independent public accountant prepared pursuant to paragraph (g) of this section.

(iii) A broker or dealer that does not carry nor clear transactions nor carry customer accounts is not required to include the representations in paragraphs (e)(2)(ii)(F) and (e)(2)(ii)(G) of this section.

(iv) Any broker or dealer that is exempted from the requirement to file an annual audited report of financial statements shall nevertheless file the notice specified herein indicating the date as of which the unaudited report will be prepared.

(v) Notwithstanding the date of filing specified in paragraph (f)(2)(i) of this section, every broker or dealer shall file the notice provided for in paragraph (f)(2) of this section within 30 days following the effective date of registration as a broker or dealer.

(3) Replacement of accountant. A broker or dealer must file a notice that must be received by the Commission's principal office in Washington, DC, the regional office of the Commission for the region in which its principal place of business is located, and the principal office of the designated examining authority for such broker or dealer, not more than 15 business days after:

(i) The broker or dealer has notified the independent public accountant whose reports covered the most recent annual reports filed under paragraph (d) of this section that the independent public accountant's services will not be utilized in future engagements; or

(ii) The broker or dealer has notified an independent public accountant who was engaged to provide reports covering the annual reports to be filed under paragraph (d) of this section that the engagement has been terminated; or

(iii) An independent public accountant has notified the broker or dealer that the independent public accountant would not continue under an engagement to provide reports covering the annual reports to be filed under paragraph (d) of this section; or

(iv) A new independent public accountant has been engaged to provide reports covering the annual reports to be filed under paragraph (d) of this section without any notice of termination having been given to or by the previously engaged independent public accountant.

(v) Such notice must provide:

(A) The date of notification of the termination of the engagement or of the engagement of the new independent public accountant as applicable; and

(B) The details of any issues arising during the 24 months (or the period of the engagement, if less) preceding such termination or new engagement relating to any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure, or compliance with applicable rules of the Commission, which issues, if not resolved to the satisfaction of the former independent public accountant, would have caused the independent public accountant to make reference to them in the report of the independent public accountant. The issues required to be reported include both those resolved to the former independent public accountant's satisfaction and those not resolved to the former accountant's satisfaction. Issues contemplated by this section are those that occur at the decision-making level -- i.e., between principal financial officers of the broker or dealer and personnel of the accounting firm responsible for rendering its report. The notice must also state whether the accountant's report covering the annual reports filed under paragraph (d) of this section for any of the past two years contained an adverse opinion or a disclaimer of opinion or was qualified as to uncertainties, audit scope, or accounting principles, and must describe the nature of each such adverse opinion, disclaimer of opinion, or qualification. The broker or dealer must also request the former independent public accountant to furnish the broker or dealer with a letter addressed to the Commission stating whether the independent public accountant agrees with the statements contained in the notice of the broker or dealer and, if not, stating the respects in which independent public accountant does not agree. The broker or dealer must file three copies of the notice and the accountant's letter, one copy of which must be manually signed by the sole proprietor, or a general partner or a duly authorized corporate officer, as appropriate, and by the independent public accountant, respectively.

(g) Engagement of independent public accountant. Every broker or dealer required to file the annual reports pursuant to paragraph (d) of this section shall engage an independent public accountant, unless the broker or dealer is subject to the exclusions in paragraphs (d)(1) and (e)(1)(i) of this section. The independent public accountant as part of the engagement must undertake the following, as applicable:

(1) To prepare an independent public accountant's report based on an examination of the financial report required to be filed by the broker or dealer under paragraph (d)(2) of this section in accordance with standards of the Public Company Accounting Oversight Board; and

(2)(i) To prepare an independent public accountant's report based on an examination of the compliance report required to be filed by the broker or dealer under paragraph (d)(3) of this section in accordance with standards of the Public Company Accounting Oversight Board. This examination and the related report would apply to the assertions of the broker or dealer required under paragraph (d)(3) of this section; or

(ii) To prepare an independent public accountant's report based on a review of the exemption report required to be filed by the broker or dealer under paragraph (d)(4) of this section in accordance with standards of the Public Company Accounting Oversight Board.

(h) Notification of material non-compliance. Upon determining any material non-compliance exists during the course of preparing the independent public accountant's reports, the independent public accountant must notify the Commission within one business day of the determination by means of a facsimile transmission or electronic mail, followed by first class mail, directed to the attention of the Director of the Office of Compliance Inspections and Examinations and provide a copy of such notification in the same manner to the principal office of the designated examining authority for the broker or dealer within one business day of the finding.

(i) <u>Reports prepared by the independent public accountant</u>.

(1) <u>Technical requirements</u>. The independent public accountant's reports shall:

(i) Be dated;

(ii) Be signed manually;

(iii) Indicate the city and state where issued; and

(iv) Identify without detailed enumeration the items covered by the reports.

(2) <u>Representations as to the examinations and review</u>. The accountant's report shall:

(i) State whether the examination or review was made in accordance with standards of the Public Company Accounting Oversight Board;

(ii) Designate any examination and, if applicable, review procedures deemed necessary by the independent public accountant under the circumstances of the particular case that have been omitted, and the reason for their omission.

(iii) Nothing in this section shall be construed to imply authority for the omission of any procedure that independent public accountants would ordinarily employ in the course of an examination or review made for the purpose of expressing the opinions or statement required under this section.

(3) <u>Opinion to be expressed</u>. The independent public accountant's reports shall state clearly the opinion of the independent public accountant:

(i) With respect to the financial report and the accounting principles and practices reflected therein and the compliance report; and

(ii) With respect to the financial report, as to the consistency of the application of the accounting principles, or as to any changes in such principles that have a material effect on the financial statements.

(4) Exceptions. Any matters to which the independent public accountant takes exception shall be clearly identified, the exception thereto specifically and clearly stated, and, to the extent practicable, the effect of each such exception on any related items contained in the annual reports.

3. Section 240.17a-11 is amended by revising paragraph (e) introductory text to read as follows:

§ 240.17a-11 Notification provision for brokers and dealers.

* * * * *

(e) Whenever any broker or dealer discovers, or is notified by an independent public accountant pursuant to § 240.17a-12(i)(2), of the existence of any material inadequacy as defined in § 240.17a-12(h)(2), the broker or dealer shall:

* * * * *

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. Add Subpart T and Form Custody (referenced in § 249.1900) to Part 249 to read as follows:

Subpart T—Form for Broker-Dealers

§ 249.1900 FORM CUSTODY

This form shall be used for reports of information required by § 240.17a-5 of this chapter.

Note: The text of Form Custody 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 CUSTODY
For Broker-Dealers

(Please read instructions before preparing Form.)

Name of Broker/Dealer ______________________ As of (Month/Day/Year) ______________

8-______________________
SEC File No. CRD No.

Address of Principal Place of Business

(No. and Street) (City) (State) (Zip Code)

INSTRUCTIONS

GENERAL INSTRUCTIONS

A. Definitions: for purposes of this Form:

1. "Affiliate" means any person who directly or indirectly controls the broker-dealer or any person who is directly or indirectly controlled by or under common control with the broker-dealer. Ownership of 25% or more of the common stock of an entity is deemed prima facie evidence of control.

2. "Bank" has the same meaning as in 15 U.S.C. 78c(a)(6).

3. "Broker" has the same meaning as in 15 U.S.C. 78c(a)(4).

4. "Dealer" has the same meaning as in 15 U.S.C. 78c(a)(5).

5. "Carrying broker-dealer" means a broker-dealer that holds customer accounts.

6. "Clearing broker-dealer" means a broker-dealer that clears transactions for itself or accounts of other broker-dealers either on a fully disclosed or omnibus basis.

7. "Customer" has the same meaning as in 17 CFR 240.15c3-3(a)(1).

8. "Free credit balance" means any liabilities of a broker-dealer to customers and non customers that are subject to immediate cash payment to customers and non-customers on demand, whether resulting from sales of securities, dividends, interest, deposits, or otherwise, excluding, however, funds in commodity accounts that are segregated in accordance with the Commodity Exchange Act or in a similar manner.

9. "Money Market Fund" means any security issued by an investment company registered under section 8 of the Investment Company Act of 1940 that is considered a money market fund under Investment Company Act Rule 2a-7.

10. "Omnibus account" means an account carried and cleared by another broker-dealer and containing accounts of undisclosed customers on a commingled basis that are carried individually on the books of the broker-dealer introducing the accounts.

11. "Structured debt" means any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. Structured debt is a broad category of financial instrument and includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities ("RMBS") and other types of structured debt instruments such as collateralized debt obligations ("CDOs"), including synthetic and hybrid CDOs, or collateralized loan obligations ("CLOs").

INSTRUCTIONS FOR SPECIFIC LINE ITEMS

Item 1.A Answer the question by checking the appropriate box. A broker-dealer must check "Yes" if it introduces any customer accounts to another broker-dealer on a fully disclosed basis. A broker-dealer that carries customer accounts and/or introduces customer accounts on an omnibus basis must check "Yes" if it also introduces one or more customer accounts to another broker-dealer on a fully disclosed basis.

Item 1.B Item 1.B applies to broker-dealers that introduce customer accounts on a fully disclosed basis to one or more other broker-dealers. If Item 1.B applies, identify each broker-dealer to which customer accounts are introduced on a fully disclosed basis.

Item 2.A Answer the question by checking the appropriate box. A broker-dealer must check "Yes" if it introduces any customer accounts to another broker-dealer on an omnibus basis. A broker-dealer that carries customer accounts (other than those introduced on an omnibus basis) and/or introduces customer accounts on a fully disclosed basis must check "Yes" if it also introduces one or more customer accounts to another broker-dealer on an omnibus basis.

Item 2.B Item 2.B applies to broker-dealers that introduce accounts on an omnibus basis to one or more other broker-dealers. If Item 2.B applies, identify each broker-dealer to which customer accounts are introduced on an omnibus basis.

Item 3.A Answer the question by checking the appropriate box. A broker-dealer that introduces customer accounts to another broker-dealer on an omnibus basis is a carrying broker-dealer with respect to those accounts under the Commission's broker-dealer financial responsibility rules. If those accounts are the only accounts carried by the broker-dealer, check "No" in Item 3.A, as those accounts are addressed in Items 2.A and 2.B.

Item 3.B Answer the question by checking the appropriate box. Answer "Yes" if accounts are carried by the broker-dealer for persons that are not "customers" as that term is defined in Rule 15c3-3 under the Securities Exchange Act of 1934. Examples of persons that are not customers of a broker-dealer include general partners, directors, or principal officers – such as the president, executive vice presidents, treasurer, secretary or any person performing similar functions – of the broker-dealer and accountholders that are themselves broker-dealers (unless such broker-dealer accountholders are required to be treated as customers under Rule 15c3-3).

Item 3.C Identify the types of locations where the broker-dealer holds securities. Only identify types of locations where the broker-dealer holds securities directly in the name of the broker-dealer (*i.e.*, do not identify a type of location if the broker-dealer only holds securities at the location through an intermediary). The information required by Items 3.C.i-iii is intended to identify all locations used by the broker-dealer to hold securities listed on the broker-dealer's stock record, and to elicit information concerning the frequency with which the broker-dealer performs reconciliations between the information on its stock record and information about the securities provided by the location. In Item 3.C.i, check all applicable boxes, and in Items 3.C.i-iii provide all applicable information as specified for each Item.

Item 3.D	Answer the questions in Items 3.D.i-iii by checking appropriate boxes and entering appropriate financial information, where applicable, and by providing explanations as requested. In Item 3.D.i, check "Other" if a type of security carried by the broker-dealer for customers is not listed on the chart, and for each category of security, indicate by checking the approximate box the approximate U.S. dollar market value of the securities.
Item 3.E	Answer the questions in Items 3.E.i-iii by checking appropriate boxes and entering appropriate financial information, where applicable, and providing explanations as requested. In Item 3.E.i, check "Other" if a type of security carried by the broker-dealer for persons that are not customers is not listed on the chart, and for each category of security, indicate by checking the appropriate box the approximate U.S. dollar market value of the securities.
Item 4	Answer the questions in Items 4.A.i-iii and 4.B.i-iii by checking appropriate boxes and, if applicable, providing requested information.
Item 5	Answer the questions in Items 5.A. and 5.B. by checking the appropriate box and, if applicable, providing requested information.
Item 6	Answer the questions by checking the appropriate boxes and, if applicable, providing requested information.
Item 7	Answer the question by checking the appropriate box.
Item 8	Answer the questions in Item 8 by checking appropriate boxes and, if applicable, providing requested information.
Item 9	Answer the questions in Item 9 by checking appropriate boxes and, if applicable, providing requested information.

Item 1. **A.** Does the broker-dealer introduce customer accounts on a fully disclosed basis to another broker-dealer? Yes ☐ No ☐

B. If the answer to question 1.A is "yes," identify below the broker-dealer(s) (by name and SEC No. and CRD No.) to which the customer accounts are introduced on a fully disclosed basis:

____

____

____

Item 2. **A.** Does the broker-dealer introduce customer accounts to another broker-dealer on an omnibus basis? Yes ☐ No ☐

B. If the answer to question 2.A is "yes," identify below the broker-dealer(s) (by name and SEC No. and CRD No.) to which the accounts are introduced on an omnibus basis:

____

____

____

Item 3. **A.** Does the broker-dealer carry securities accounts (*i.e.*, accounts that are not introduced on a fully disclosed basis to another broker-dealer) for customers?
Yes ☐ No ☐

B. Does the broker-dealer carry securities accounts (*i.e.*, accounts that are not introduced on a fully disclosed basis to any other broker-dealer) for non-customers? Yes ☐ No ☐

C. Location of Securities

i. Indicate in the chart below the types of U.S. locations used by the broker-dealer to hold securities that it carries by checking each box in the first column that applies. For each type of location selected, indicate in the third column the frequency (*e.g.*, daily, weekly, monthly, quarterly, semi-annually, annually) with which the broker-dealer performs a reconciliation between the information on its stock record and information about the securities provided by the location:

	Location	Reconciliation Frequency
☐	**The broker-dealer's vault**	
☐	**U.S. broker-dealer(s)**	
☐	**The Depository Trust Company**	
☐	**The Options Clearing Corporation**	
☐	**U.S. bank(s)**	
☐	**Transfer Agents of Mutual fund(s) under the Investment Company Act**	

ii. Indicate in the chart below the types of U.S. locations not identified in Item 3.C.i used by the broker-dealer to hold securities that it carries by describing the type of entity in the first column. For each type of location, indicate in the second column the frequency (*e.g.*, daily, weekly, monthly, quarterly, semi-annually, annually) with which the broker-dealer performs a reconciliation between the information on its stock record and information about the securities provided by location:

Other Types of U.S. Locations	Reconciliation Frequency

iii. Indicate in the chart below the types of foreign locations used by the broker-dealer to hold securities that it carries by describing the type of location in the first column. For each type of location indicate in the second column the frequency (*e.g.*, daily, weekly, monthly, quarterly, semi-annually, annually) with which the broker-dealer performs a reconciliation between the information on its stock record and information about the securities provided by the location:

Non-U.S. Locations	Reconciliation Frequency

D. Securities and Cash Carried for the Accounts of Customers

i. Indicate by checking the appropriate boxes on the chart below the types of securities and provide the approximate U.S. dollar market value of such securities carried by the broker-dealer for the accounts of customers:

	Type of Securities	Up to $50 million	Greater than $50 million up to $100 million	Greater than $100 million up to $500 million	Greater than $500 million up to $1 billion	Greater than $1 billion up to $5 billion	Greater than $5 billion
☐	U.S. Equity Securities						
☐	Foreign Equity Securities						
☐	U.S. Listed Options						
☐	Foreign Listed Options						
☐	Domestic Corporate Debt						
☐	Foreign Corporate Debt						
☐	U.S. Public Finance Debt						
☐	Foreign Public Finance Debt						
☐	U.S. Government Debt						
☐	Foreign Sovereign Debt						
☐	U.S. Structured Debt						
☐	Foreign Structured Debt						
☐	Other						

ii. Has the broker-dealer recorded all securities it carries for the accounts of customers on its stock record? Yes ☐ No ☐

If the answer is "no," explain in the space provided why the broker-dealer has not recorded such securities on its stock record and provide the approximate U.S. dollar market value of such unrecorded securities:

____
____
____

iii. Indicate in the chart below each process used by the broker-dealer with respect to free credit balances in accounts it carries for customers by checking all the boxes that apply and providing applicable information:

	Process
☐	Included in a computation under Rule 15c3-3(e)
☐	Held in a bank account under Rule 15c3-3(k)(2)(i)
☐	Swept to a U.S. bank
☐	Swept to a U.S. money market fund
☐	Other (Briefly describe in the space provided below)

E. Securities and Cash Carried for the Accounts of Non-customers

i. Indicate by checking the appropriate boxes on the chart below the types of securities and provide the approximate U.S. dollar market value of such securities carried by the broker-dealer for the accounts of non-customers:

	Type of Securities	Up to $50 million	Greater than $50 million up to $100 million	Greater than $100 million up to $500 million	Greater than $500 million up to $1 billion	Greater than $1 billion up to $5 billion	Greater than $5 billion
☐	U.S. Equity Securities						
☐	Foreign Equity Securities						
☐	U.S. Listed Options						
☐	Foreign Listed Options						
☐	Domestic Corporate Debt						
☐	Foreign Corporate Debt						
☐	U.S. Public Finance Debt						
☐	Foreign Public Finance Debt						
☐	U.S. Government Debt						
☐	Foreign Sovereign Debt						
☐	U.S. Structured Debt						
☐	Foreign Structured Debt						
☐	Other						

ii. Has the broker-dealer recorded all securities it carries for the accounts of non-customers on its stock record? Yes ☐ No ☐

If the answer is "no," explain in the space provided why the broker-dealer has not recorded such securities on its stock record and provide the approximate total U.S. dollar market value of such unrecorded securities:

iii. Indicate in the chart below each process used by the broker-dealer with respect to free credit balances in the securities accounts of non-customers by checking all the boxes that apply and providing applicable information:

	Process
☐	Included in a reserve computation
☐	Swept to a U.S. bank
☐	Swept to a U.S. money market fund
☐	Other (Briefly describe in space provided below) ______________________________ ______________________________ ______________________________ ______________________________ ______________________________ ______________________________

Item 4. Acting as a Carrying Broker-Dealer for Other Broker-Dealers

A. On a fully disclosed basis

i. Does the broker-dealer carry customer accounts for another broker-dealer(s) on a fully disclosed basis? Yes ☐ No ☐

ii. If the answer to question 4.A.i is "yes," indicate the number of broker-dealers:

____

iii. If the answer to question 4.A is "yes," identify any of these broker-dealers that are affiliates of the broker-dealer by name and "SEC File No.":

____
____
____

B. On an omnibus basis

i. Does the broker-dealer carry customer accounts for another broker-dealer(s) on an omnibus basis? Yes ☐ No ☐

ii. If the answer to question 4.B.i is "yes," indicate the number of broker-dealers:

____

iii. If the answer to question 4.B.i is "yes," identify any of these broker-dealers that are affiliates of the broker-dealer by name and "SEC File No.":

____
____
____

Item 5. A. Does the broker-dealer send trade confirmations directly to customers and other accountholders? Yes ☐ No ☐

B. If the answer to question 5.A is "no," who sends the trade confirmations to customers and other accountholders? :________________

Item 6. **A.** Does the broker-dealer send account statements directly to customers and other accountholders? Yes ☐ No ☐

B. If the answer to question 6.A is "no," who sends the account statements to customers and other accountholders? :________________

C. Does the broker-dealer send account statements to anyone other than the beneficial owner of the account? Yes ☐ No ☐

Item 7. Does the broker-dealer provide customers and other accountholders with electronic access to information about the securities and cash positions in their accounts? Yes ☐ No ☐

Item 8. **A.** Is the broker-dealer also registered as an investment adviser:

i. With the SEC under the Investment Advisers Act of 1940? Yes ☐ No ☐

ii. With one or more U.S. states under the laws of the state? Yes ☐ No ☐

If the answer to question 8.A.i or 8.A.ii is "yes," answer each of the following items:

B. Provide the number of investment adviser clients:________________

C. Complete the following chart concerning the custodians if any (including, if applicable, the broker-dealer):

Column 1: The name of the custodian
Column 2: The identity of the custodian by SEC File No. or CRD No.
Column 3: Whether the broker-dealer/investment adviser has the authority to effect transactions in these advisory client accounts at the custodian
Column 4: Whether the broker-dealer/investment adviser has the authority to withdraw funds and securities out of any accounts at the custodian
Column 5: Whether the custodian sends account statements directly to the investment adviser clients
Column 6: Whether the investment adviser client assets are recorded on the broker-dealer's stock record

1	2	3	4	5	6
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐	Yes ☐	Yes ☐	Yes ☐

		No ☐	No ☐	No ☐	No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐
		Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐	Yes ☐ No ☐

Item 9. **A.** Is the broker-dealer an affiliate of an investment adviser? Yes ☐ No ☐

B.i. If the answer to Item 9.A. is "yes," does the broker-dealer have custody of client assets of the adviser? Yes ☐ No ☐

B.ii. If the answer to Item 9.B.i is "yes" indicate the approximate U.S. dollar market value of the adviser client assets of which the broker-dealer has custody: ___

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

June 15, 2011

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-64678; File No. S7-24-11]

Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps.

AGENCY: Securities and Exchange Commission

ACTION: Exemptive order.

SUMMARY: The Securities and Exchange Commission ("Commission") is issuing an exemptive order granting temporary exemptive relief and other temporary relief from compliance with certain provisions of the Securities Exchange Act of 1934 ("Exchange Act") concerning security-based swaps. The Commission also is providing guidance regarding compliance with other provisions of the Exchange Act concerning security-based swaps that were amended or added by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") and requesting comments on such guidance and the temporary relief granted.

DATES: Comments must be received on or before July 6, 2011.

ADDRESSES: Comments may be submitted, identified by File Number S7-24-11, by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/interp.shtml); or
- Send an email to rule-comments@sec.gov. Please include File Number S7-24-11 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 S7-24-11. 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 charge; the Commission does not edit personal identifying information from submissions. You should only submit information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Jack Habert, Attorney Fellow, at (202) 551-5063; Leah Drennan, Attorney-Adviser, at (202) 551-5507; or Ann McKeehan, Attorney-Adviser, at (202) 551-5797, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

TABLE OF CONTENTS

I. Introduction and Background.

On July 21, 2010, President Barack Obama signed the Dodd-Frank Act into law.[1] The Dodd-Frank Act was enacted, among other reasons, to promote the financial stability of the United States by improving accountability and transparency in the financial system.[2] The recent financial crisis demonstrated the need for enhanced regulation of the over-the-counter ("OTC")

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[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] Id. at preamble.

derivatives markets, which have experienced dramatic growth in recent years[3] and are capable of affecting significant sectors of the U.S. economy.[4] Title VII of the Dodd-Frank Act ("Title VII") establishes a regulatory regime applicable to the OTC derivatives markets by providing the Commission and the Commodity Futures Trading Commission ("CFTC") with the tools to oversee these heretofore largely unregulated markets. 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."[5]

Title VII amends the Exchange Act[6] to substantially expand the regulation of the security-based swap ("SB swap") markets, establishing a new regulatory framework within which such markets can continue to evolve in a more transparent, efficient, fair, accessible, and competitive manner.[7] The Dodd-Frank Act amendments to the Exchange Act impose, among other requirements, the following: (1) registration and comprehensive oversight of SB swap dealers ("SBSDs") and major SB swap participants ("MSBSPs" and, collectively with SBSDs,

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3 From their beginnings in the early 1980s, the notional value of these markets has grown to almost $600 trillion globally. See Monetary and Econ. Dep't, Bank for Int'l Settlements, Triennial and Semiannual Surveys - Positions in Global Over-the-Counter (OTC) Derivatives Markets at End-June 2010 (Nov. 2010), available at http://www.bis.org/publ/otc_hy1011.pdf.

4 See 156 Cong. Rec. S5878 (daily ed. July 15, 2010) (statement of Sen. Dodd).

5 Section 712(d) of the Dodd-Frank Act provides that the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System, shall further define the terms "swap," "security-based swap," "swap dealer," "security-based swap dealer," "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 the Commission and the CFTC have proposed to further define these terms in proposed joint rulemaking. See Further Definition of ''Swap,'' ''Security-Based Swap,'' and ''Security-Based Swap Agreement''; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 76 FR 29818 (May 23, 2011); Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," 75 FR 80174 (Dec. 21, 2010) ("Entity Definitions Release").

6 15 U.S.C. 78a et seq.

7 See generally subtitle B of Title VII. Citations to provisions of the Exchange Act in this Order refer to the numbering of those provisions after the amendments made by the Dodd-Frank Act, except as otherwise provided.

"SBS Entities");[8] (2) reporting of SB swaps to a registered SB swap data repository ("SDR"), to the Commission, and to the public;[9] (3) clearing of SB swaps through a registered clearing agency or through a clearing agency that is exempt from registration[10] if such SB swaps are of a type that the Commission determines is required to be cleared, unless an exemption or exception from such mandatory clearing applies;[11] and (4) if an SB swap is subject to the clearing requirement,[12] execution of the SB swap transaction on an exchange, on an SB swap execution facility ("SB SEF") registered under section 3D of the Exchange Act,[13] or on an SB SEF that has been exempted from registration by the Commission under section 3D(e) of the Exchange Act,[14] unless no SB SEF or exchange makes such SB swap available for trading.[15] Title VII also

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8 As required by the Dodd-Frank Act, the Commission will propose rules regarding the registration of SBS Entities and a process for revocation of such registration. See section 15F of the Exchange Act, 15 U.S.C. 78o-10.

9 See section 3(a)(75) of the Exchange Act, 15 U.S.C. 78c(a)(75) (defining the term "security-based swap data repository"). The registration of an SDR and the reporting of SB swaps are the subject of separate Commission rulemakings. See Security-Based Swap Data Repository Registration, Duties, and Core Principles, 75 FR 77305 (Dec. 10, 2010), corrected at 75 FR 79320 (Dec. 20, 2010) and 76 FR 2287 (Jan. 13, 2011); Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information, 75 FR 75207 (Dec. 2, 2010).

10 See Clearing Agency Standards for Operation and Governance, 76 FR 14472 (Mar. 16, 2011). The Commission has proposed rules regarding registration of clearing agencies and standards for the operation and governance of clearing agencies, including rules that would exempt certain SBSDs and SB SEFs from the definition of a clearing agency.

11 See section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1). The Commission has proposed rules regarding the manner in which clearing agencies provide information to the Commission about SB swaps that the clearing agency plans to accept for clearing and that would, in turn, be used by the Commission in determining whether such SB swaps are required to be cleared. See 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, 75 FR 82489 (Dec. 30, 2010).

12 See section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g) (providing an exception to the clearing requirement for certain persons).

13 15 U.S.C. 78c-4.

14 15 U.S.C. 78c-4(e).

15 See section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g). See section 3C(h) of the Exchange Act, 15 U.S.C. 78c-3(h). See also section 3(a)(77) of the Exchange Act, 15 U.S.C. 78c(77) (defining the term "security-based swap execution facility"). The Commission has proposed an interpretation of

amends the Exchange Act and the Securities Act of 1933[16] ("Securities Act") to include "security-based swaps" in the definition of "security" for purposes of those statutes.[17] As a result, "security-based swaps" will be subject to the provisions of the Securities Act and the Exchange Act and the rules thereunder applicable to "securities."[18] The Commission has proposed exemptions[19] under the Securities Act, the Exchange Act, and the Trust Indenture Act of 1939[20] ("Trust Indenture Act") for SB swaps issued by certain clearing agencies satisfying certain conditions.[21] In addition, the Commission will take other actions to address certain SB swaps, such as providing guidance regarding – and where appropriate, temporary relief from – the various pre-Dodd Frank Act provisions that would otherwise apply to SB swaps on July 16, 2011, as well as extending existing temporary rules under the Securities Act, the Exchange Act, and the Trust Indenture Act for certain SB swaps.[22]

The provisions of Title VII generally are effective on July 16, 2011 (360 days after enactment of the Dodd-Frank Act, referred to herein as the "Effective Date"), unless a provision

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the definition of "security-based swap execution facility" and has proposed rules to implement registration requirements, duties, and core principles for SB SEFs. See Registration and Regulation of Security-Based Swap Execution Facilities, 76 FR 10946 (Feb. 28, 2011).

16 15 U.S.C. 77a et seq.

17 See sections 761(a)(2) and 768(a)(1) of the Dodd-Frank Act (amending sections 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), and 2(a)(1) of the Securities Act, 15 U.S.C. 77b(a)(1), respectively).

18 The Commission has considered similar issues raised by the treatment of credit default swaps as securities in connection with taking action in the past to facilitate clearing of certain credit default swaps ("CDS") by clearing agencies functioning as central counterparties ("CCPs"). See infra notes 222 and 223.

19 See Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies, Securities Act Release No. 9222, Exchange Act Release No. 64639, Trust Indenture Act Release No. 2474 (June 9, 2011) ("Proposed Cleared SB Swap Exemptions").

20 15 U.S.C. 77aaa et seq.

21 See discussion infra note 223.

22 See SEC Announces Steps to Address One-Year Effective Date of Title VII of Dodd-Frank Act, available at http://www.sec.gov/news/press/2011/2011-125.htm (June 10, 2011).

requires a rulemaking. Specifically, if a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later.[23] A substantial number of Title VII provisions require a rulemaking and thus will not go into effect on the Effective Date. A number of Title VII provisions also expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions.[24] Other provisions of Title VII impose requirements that require compliance by market participants as a result of, or in response to, Commission action other than rulemaking and thus do not impose a compliance obligation upon market participants in the absence of such Commission action.

In addition, Title VII provides the Commission with flexibility to establish effective dates beyond the minimum 60 days specified therein for Title VII provisions that require a rulemaking.[25] Furthermore, as with other rulemakings under the Exchange Act, the Commission may set compliance dates (which may be later than the effective dates) for rulemakings under the Title VII amendments to the Exchange Act. Together, this provides the Commission with the ability to sequence the implementation of the various Title VII requirements in a way that effectuates the policy goals of Title VII while minimizing unnecessary disruption or costs.

Title VII also includes certain provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market

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23 See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

24 See, e.g., sections 15F(e)(1) of the Exchange Act, 15 U.S.C. 78o-10(e)(1) (capital and margin requirements); 15F(f)(1) (reporting and recordkeeping); 15F(h)(1) (business conduct standards).

25 See id. (specifying that the effective date for a provision requiring a rulemaking is "not less than 60 days after publication of the final rule or regulation implementing such provision").

participants.[26] These provisions will become effective on the Effective Date, but, by their plain language, pertain to Commission action. Accordingly, these provisions do not require compliance by market participants on the Effective Date unless the relevant Commission action already has been undertaken. The Commission does not expect to complete all of the rulemaking it is directed to carry out pursuant to these provisions prior to the Effective Date.

In furtherance of the Dodd-Frank Act's stated objective of promoting financial stability in the U.S. financial system, the Commission intends to move forward expeditiously with the implementation of the new SB swap requirements in an efficient manner, while minimizing unnecessary disruption and costs to the markets. The Commission recognizes that many market participants will find compliance with Title VII to be a substantial undertaking. SB swap markets already exist, are global in scope, and have generally grown in the absence of regulation in the United States and elsewhere. In addition, the SB swap markets are interconnected with other financial markets, including the traditional securities markets. In order to comply with Title VII provisions and related rules, the Commission recognizes that market participants will need additional time to acquire and configure necessary systems or to modify existing practices and systems, engage and train necessary staff, and develop and implement necessary policies and procedures.[27] Furthermore, some of these changes cannot be finalized until certain rules are effective. Accordingly, it is necessary or appropriate to defer some of these tasks until certain rules are effective, as more fully described below.

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26 See, e.g., section 3D(f) of the Exchange Act, 15 U.S.C. 78c-4(f) (requiring the Commission to prescribe rules governing the regulation of SB SEFs). Certain of these provisions relate to the CFTC or another government agency in addition to, or instead of, the Commission.

27 The Commission expects that it will not, by July 16, 2011, have completed implementing Title VII. As a result, the Commission believes it would not be reasonable to require market participants to put systems in place or hire personnel based on a regulatory scheme that is not fully in place. To require otherwise, depending on the content of the final rules, might require these entities to incur costs to change their systems again in a relatively short period of time.

In order to effectuate the purposes of Title VII, and in response to comments received from market participants,[28] the Commission is providing guidance as to the provisions of the Exchange Act added by Title VII with which industry compliance will be required as of the Effective Date.[29]

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[28] The Commission has received comments from a wide range of commenters inquiring as to the effective dates and related compliance dates of certain provisions and requesting that the Commission propose a compliance schedule for the statutory provisions of subtitle B of Title VII and the rules being promulgated thereunder. See, e.g., letter from American Bankers Association, Financial Services Roundtable, Futures Industry Association, Institute of International Bankers, International Swaps and Derivatives Association, Investment Company Institute, Securities Industry and Financial Markets Association, U.S. Chamber of Commerce (June 10, 2011) ("Trade Association Letter"); letter from Stephen Merkel, Chairman, Wholesale Markets Brokers' Association Americas (June 3, 2010) ("WMBA Letter"); letter from Richard M. Whiting, Executive Director and General Counsel, Financial Services Roundtable (May 12, 2011); letter from Andrew Downes, Managing Director, and James B. Fuqua, Managing Director, UBS Securities LLC (Feb. 7, 2011); letter from Craig S. Donohue, CME Group Inc. (Jan. 18, 2011); letter from R. Glenn Hubbard, Co-Chair, John L. Thornton, Co-Chair, and Hal S. Scott, Director, the Committee on Capital Markets Regulation (Jan. 18, 2011) ("Committee on Capital Markets Regulation Letter"); letter from Larry E. Thompson, General Counsel, the Depository Trust & Clearing Corporation (Jan 18, 2011) ("DTCC Letter"); letter from Mr. James Hill, Managing Director, Morgan Stanley (Nov. 1, 2010) ("Morgan Stanley Letter").

In addition, many letters from market participants have advocated for a phased-in approach to compliance with the requirements of Title VII. See, e.g., WMBA Letter (suggesting a "progression" of finalization of specific Title VII rules); Committee on Capital Markets Regulation Letter (stating that "the reporting and recordkeeping requirements should be implemented gradually over time"); letter from Financial Services Forum, Futures Industry Association, International Swaps and Derivatives Association, and Securities Industry and Financial Markets Association (May 4, 2011) (stating that "[t]he Commissions should phase in requirements based on the state of readiness of each particular asset class"); letter from G14 Member dealers and others (Mar. 31, 2011) (suggesting a "phased-in implementation schedule"); letter from Richard H. Baker, President & Chief Executive Officer, Managed Funds Association (Mar. 24, 2011) (recommending "milestones for clearing access and voluntary clearing with a phase-in period before clearing becomes mandatory"); DTCC Letter (recommending a "phased-in" approach to implementation of reporting requirements under Regulation SBSR); Morgan Stanley Letter (urging the Commission and the CFTC "to phase in the clearing, execution and other requirements product-by-product over time").

Some of the commenters cited above addressed issues regarding effective dates, compliance, and implementation that will be addressed by other action to be taken the Commission. See supra note 22 and accompanying text.

[29] While this release provides guidance with respect to the provisions of the Exchange Act added by Title VII, as indicated above, the Commission will take other actions to address SB swaps under various provisions of the federal securities laws. See supra note 22 and accompanying text. In addition, after proposing all of the key rules under Title VII, the Commission intends to consider publishing a detailed implementation plan in order to enable the Commission to move forward

In addition, and for the reasons discussed in this Order, the Commission is granting temporary exemptive and other relief that is necessary or appropriate in the public interest, and consistent with the protection of investors, from compliance with certain of those provisions of the Exchange Act with which compliance would otherwise be required as of the Effective Date. Generally, section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt, by rule, regulation, or order, any person, security, or transaction (or any class or classes of persons, securities, or transactions) from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.[30] This exemptive authority is not available for certain specified provisions of the Exchange Act that relate to SB swaps.[31] Where such exemptive authority is not provided, the Commission is using other available authority to provide appropriate temporary relief.

II. Discussion.

A. Clearing for Security-Based Swaps.

Section 3C of the Exchange Act, added by section 763(a) of the Dodd-Frank Act, generally provides that, if an SB swap is required to be cleared, it is unlawful for any person to engage in such SB swap unless that person submits such SB swap for clearing to a clearing agency that is registered under the Exchange Act or to a clearing agency that is exempt from

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expeditiously with the roll-out of the new SB swap requirements in an efficient manner, while minimizing unnecessary disruption and costs to the markets. Id.

30 15 U.S.C. 78mm.

31 See section 36(c) of the Exchange Act, 15 U.S.C. 78mm(c) (limiting the Commission's exemptive authority with respect to certain provisions of the Exchange Act added by Title VII, such as sections 13A, 15F, and 17A(g) through (l) of the Exchange Act, 15 U.S.C. 78m-1, 78o-10, and 78q-1(g) through (l)). The Commission notes that the Securities Act provides for exemptive authority to be exercised through rulemaking and, as a result, this Order does not provide for any exemptive action with respect to the Securities Act.

registration under the Exchange Act.[32] Table A below lists each provision of section 3C of the Exchange Act and identifies those with which compliance will be required on the Effective Date and those with which compliance will be triggered by registration of a person as a clearing agency, adoption of final rules, or other action by the Commission.[33] For the provisions with which compliance will be required on the Effective Date, Table A notes whether temporary relief from compliance is granted. The rationale and duration for such relief is explained in the text following the table. The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants.[34] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date.

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[32] 15 U.S.C. 78c-3.

[33] Id.

[34] See supra note 26 and accompanying text.

Table A: Clearing for Security-Based Swaps – Compliance Dates.

Exchange Act Section[35]	Compliance Date		Authorizes/ Directs Commission Action[36]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[37]		
3C(a)(1): In general – standard for clearing		✓		N/A[38]
3C(a)(2): In general – open access		✓		N/A[39]

35 References to section 3C of the Exchange Act in this table are to15 U.S.C. 78c-3.

36 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

37 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

38 Section 3C(b)(5) of the Exchange Act, 15 U.S.C. 78c-3(b)(5), requires the Commission to "adopt rules for a clearing agency's submission for review . . . of a security-based swap, or a group, category, type, or class of [SB swaps], that it seeks to accept for clearing."

39 Section 3C(a)(2) of the Exchange Act, 15 U.S.C. 78c-3(a)(2), is applicable to "rules of a clearing agency described in [section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1)]." The clearing agencies described in section 3C(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(a)(1), are required to be registered, or exempt from registration, and clearing SB swaps subject to the clearing requirement. As result, the requirements of section 3C(a)(2) of the Exchange Act, 15 U.S.C. 78c-3, will not be triggered until a clearing agency is registered or exempt from registration and also is clearing SB swaps that are subject to the clearing requirement. Three entities will be deemed registered on the Effective Date. See discussion infra part II.H. However, no SB swaps will be subject to the clearing requirement on the Effective Date.

Exchange Act Section[35]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[37]	Authorizes/ Directs Commission Action[36]	Relief Granted
3C(b)(1): Commission review – Commission-initiated review			✓	N/A
3C(b)(2)(A) and (B): Commission review – swap submission		✓		N/A[40]
3C(b)(2)(C): Commission review – swap submission			✓	N/A
3C(b)(3): Commission review – deadline			✓	N/A
3C(b)(4): Commission review – determination			✓	N/A

40 Section 3C(b)(2)(B) of the Exchange Act, 15 U.S.C. 78c-3(b)(2)(B), states in part that SB swaps "listed for clearing by a clearing agency as of the date of enactment of [section 3C(b) of the Exchange Act, 15 U.S.C. 78c-3(b),] shall be considered submitted to the Commission." However, pursuant to section 3C(b)(3) of the Exchange Act, 15 U.S.C. 78c-3(b)(3), a clearing agency may agree to extend the time for action required under the section. The relevant clearing agencies have agreed to an extension of the deadline for a determination by the Commission "until 90 days after the Commission has published final rules governing the process by which SB swaps shall be submitted to the Commission for a clearing determination." Until the rulemaking is completed, therefore, no SB swaps will be considered submitted. See letter from Lisa Dunsky, Chicago Mercantile Exchange Inc., to Robert Cook, Director, Division of Trading and Markets, Commission (Aug. 26, 2010); letter from Thomas Book, Eurex Clearing AG, to Robert Cook, Director, Division of Trading and Markets, Commission (Aug. 19, 2010); and letter from Trabue Bland, regarding ICE Trust U.S. LLC and ICE Clear Europe Limited, to Robert Cook, Director, Division of Trading and Markets, Commission (Sept. 2, 2010).

Exchange Act Section[35]	Compliance Date		Authorizes/ Directs Commission Action[36]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[37]		
3C(b)(5): Commission review – rules			✓	N/A
3C(c): Stay of clearing requirement			✓	N/A
3C(d): Prevention of evasion			✓	N/A
3C(e)(1): Reporting transition rules – pre-enactment SB swaps			✓	Yes[41]
3C(e)(2): Reporting transition rules – post-enactment SB swaps			✓	N/A[42]
3C(f)(1): Clearing transition rules		✓		N/A[43]

41 The Commission has proposed rules pursuant to this provision. See infra note 172.

42 The Commission has proposed rules pursuant to this provision. See Regulation SBSR - Reporting and Dissemination of Security-Based Swap Information, supra note 9 (providing by rule a deadline by which post-enactment SB swaps must be reported).

43 Because the exemption from the clearing requirement in this provision requires the reporting of SB swaps pursuant to section 3C(e)(1) of the Exchange Act, 15 U.S.C. 78c-3(e)(1), market participants cannot comply with this provision until final rules have been adopted pursuant to such section 3C(e)(1).

Exchange Act Section[35]	Compliance Date		Authorizes/ Directs Commission Action[36]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[37]		
3C(f)(2): Clearing transition rules		✓		N/A[44]
3C(g)(1)-(2), (4): Exceptions – in general; option to clear; treatment of affiliates		✓		N/A[45]
3C(g)(3)(A): Exceptions – financial entity definition – in general		✓		N/A[46]
3C(g)(3)(B): Exceptions – financial entity definition – exclusion			✓	N/A

44 Because the exemption from the clearing requirement in this provision requires the reporting of SB swaps pursuant to section 3C(e)(2) of the Exchange Act, 15 U.S.C. 78c-3(e)(2), market participants cannot comply with this provision until final rules have been adopted pursuant to such section 3C(e)(2).

45 Because the mandatory clearing requirement is a predicate requirement for the end-user clearing exception set forth in section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g), end users will not need to rely upon that exception until such time as an SB swap is determined by the Commission to be required to be cleared. Accordingly, the provisions of sections 3C(g)(1), (2) and (4) of the Exchange Act, 15 U.S.C. 78c-3(g)(1), (2) and (4), will not be triggered until that time.

46 Since the mandatory clearing requirement is a predicate requirement for the end-user clearing exception set forth in section 3C(g) of the Exchange Act, 15 U.S.C. 78c-3(g), end users will not need to rely upon that exception until such time as a SB swap is determined by the Commission to be required to be cleared.

Exchange Act Section[35]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[37]	Authorizes/ Directs Commission Action[36]	Relief Granted
3C(g)(5)(A): Exceptions – election of counterparty – SB swaps required to be cleared		✓		N/A
3C(g)(5)(B): Exceptions – election of counterparty – SB swaps not required to be cleared	✓			Yes
3C(g)(6): Exceptions – abuse of exception			✓	N/A
3C(h): Trade execution		✓		N/A
3C(i): Board approval		✓		N/A[47]

47 Since the mandatory clearing requirement is a predicate requirement for any exemptions to it, this provision will not be trigged until such time as a SB swap is determined by the Commission to be required to be cleared.

Exchange Act Section[35]	Compliance Date		Authorizes/ Directs Commission Action[36]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[37]		
3C(j)(1) – (2): Designation of chief compliance officer – in general; duties		✓		Yes[48]
3C(j)(3): Designation of chief compliance officer – annual reports		✓		N/A

As indicated in Table A, the Commission is providing temporary exemptive relief from compliance with section 3C(e)(1) of the Exchange Act[49] for market participants with reporting obligations under section 13A of the Exchange Act.[50]

Section 3C(e)(1) of the Exchange Act requires the Commission to adopt rules that provide that "[s]ecurity-based swaps entered into before the date of enactment of this section [('pre-enactment SB swaps')] shall be reported to a registered security-based swap data repository or the Commission no later than 180 days after the effective date of [section 3C of the

[48] Section 3C(j) of the Exchange Act, 15 U.S.C. 78c-3(j), applies only to registered clearing agencies, including clearing agencies that provide clearance and settlement services for securities other than SB swaps. Accordingly, compliance with such requirements will be required on the later of the Effective Date and registration of the clearing agency. As noted above, three clearing agencies will be deemed registered on the Effective Date, in addition to clearing agencies already registered with the Commission. See discussion infra part II.H.

[49] 15 U.S.C. 78c-3(e)(1).

[50] 15 U.S.C. 78m-1.

Exchange Act]."[51] Section 3C of the Exchange Act becomes effective on July 16, 2011, and 180 days after that date is January 12, 2012.

The Commission is exercising its authority under section 36 of the Exchange Act[52] to exempt any person from having to report any pre-enactment SB swaps as set forth in the rules adopted by the Commission pursuant to section 3C(e)(1) of the Exchange Act[53] until six (6) months after an SDR that is capable of accepting the asset class of the pre-enactment SB swaps is registered by the Commission. The Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors, because, even after an SDR is registered, market participants will need additional time to establish connectivity and develop appropriate policies and procedures to be able to deliver information to the registered SDR. Therefore, under this exemption, no person will be required to report a pre-enactment SB swap in an asset class until six (6) months after an SDR that is capable of accepting SB swaps in that asset class has registered with the Commission.[54]

The Commission also is exercising its authority pursuant to section 36 of the Exchange Act to grant a temporary exemption from section 3C(g)(5)(B) of the Exchange Act.[55] Section 3C(g)(5)(B) of the Exchange Act[56] permits a counterparty to an SB swap that is not subject to the

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51 15 U.S.C. 78c-3(e)(1).

52 15 U.S.C. 78mm.

53 15 U.S.C. 78c-3(e)(1).

54 Similarly, we proposed – in rule 910 of Regulation SBSR – that no transaction reports for any SB swap executed on or after July 21, 2010 would have to be submitted to a registered SDR until six months after the date that an SDR registers with the Commission. See Regulation SBSR - Reporting and Dissemination of Security-Based Swap Information, supra note 9. As we stated in the Regulation SBSR proposing release, before reporting to a registered SDR could commence, persons with a duty to report would have to know the policies and procedures of the SDR and have time to implement necessary systems changes. Id.

55 15 U.S.C. 78c-3(g)(5)(B).

56 Id.

mandatory clearing requirement to elect to clear its SB swap with an SBS Entity. The Commission finds that it is necessary or appropriate in the public interest, and consistent with the protection of investors to grant a temporary exemption to SBS Entities from section 3C(g)(5)(B) of the Exchange Act [57] because the Commission understands that there are currently no CCPs offering customer clearing of SB swaps and additional action by the Commission will be necessary to address segregation and other customer protection issues. Therefore, under this exemption, section 3C(g)(5)(B) of the Exchange Act[58] will not apply until the earliest compliance date set forth in any of the final rules regarding section 3C(b) of the Exchange Act.[59]

In addition, the Commission is exercising its authority pursuant to section 36 of the Exchange Act to grant temporary exemptions from sections 3C(j)(1) and (2) of the Exchange Act.[60] Section 3C(j)(1) of the Exchange Act[61] requires that each registered clearing agency designate an individual to serve as a chief compliance officer. The chief compliance officer will be required to comply with the duties specified in section 3C(j)(2) of the Exchange Act,[62] as well as, following rulemaking, the reporting provisions of section 3C(j)(3) of the Exchange Act.[63] The Commission finds that it is necessary or appropriate in the public interest, and consistent with the protection of investors to grant temporary exemptions from sections 3C(j)(1) and (2) of the Exchange Act [64] because there is potential uncertainty regarding the duties of a chief

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57 Id.

58 Id.

59 15 U.S.C. 78c-3(b).

60 15 U.S.C. 78c-3(j)(1) and (2).

61 15 U.S.C. 78c-3(j)(1).

62 15 U.S.C. 78c-3(j)(2).

63 15 U.S.C. 78c-3(j)(2).

64 15 U.S.C. 78c-3(j)(1) and (2).

compliance officer as required by section 3C(j)(2).[65] Therefore, under this exemption, no person will be required to comply with section 3C(j)(1) or (2) of the Exchange Act[66] until the earliest compliance date set forth in any of the final rules regarding section 3C(j)(2) of the Exchange Act.[67]

With respect to the remaining provisions of section 3C of the Exchange Act, unless and until the Commission makes a determination that an SB swap is required to be cleared, section 3C of the Exchange Act, by its terms, does not require any SB swap to be cleared through a registered clearing agency or a clearing agency that is exempt from registration.[68] The Commission is required to adopt rules for clearing agencies' submissions to the Commission for review of SB swaps that clearing agencies seek to accept for clearing.[69] Thus, no SB swaps will be required to be submitted to the Commission for review until the compliance date set forth in such rules.

Request for Comment:

- Are there other provisions of section 3C of the Exchange Act for which the Commission should grant temporary exemptive relief? Please specify which provisions and

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65 See Letter from DTCC (April 29, 2011) (stating that "[w]hile DTCC fully supports the principle of a clearing agency designating a CCO, DTCC believes that some of the duties of the CCO specified in Proposed Rule 3Cj-1 require clarification in order to avoid an overly broad reading of those duties. DTCC believes that some of the duties of the CCO specified in the Proposed Rule go beyond those duties traditionally understood to be part of the compliance function.").

66 15 U.S.C. 78c-3(j)(1) or (2).

67 15 U.S.C. 78c-3(j)(2).

68 See supra note 45.

69 See section 3C(b)(5) of the Exchange Act, 15 U.S.C. 78c-3(b)(5). The Commission published proposed rules regarding the submission process. See 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, supra note 11.

provide a detailed explanation of why granting such exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

B. Security-Based Swap Execution Facilities.

Section 3D of the Exchange Act, added by section 763(c) of the Dodd-Frank Act, contains the provisions regarding the registration of SB SEFs and the core principles with which registered SB SEFs must comply.[70] Table B below lists each provision of section 3D of the Exchange Act and identifies those with which compliance will be required on the Effective Date and those with which compliance will be triggered by registration of a person as a SB SEF, adoption of final rules, or other action by the Commission.[71] For the provisions with which compliance will be required on the Effective Date, Table B notes whether temporary relief from compliance is granted. The rationale and duration for such relief is explained in the text following the table. The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants. Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date.

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70 15 U.S.C. 78c-4.

71 Id.

Table B – Security-Based Swap Execution Facilities – Compliance Dates.

Exchange Act Section[72]	Compliance Date		Authorizes/ Directs Commission Action[73]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[74]		
3D(a)(1): Registration – in general		✓		Yes[75]
3D(a)(2): Registration – dual registration		✓		N/A
3D(b): Trading and trade processing		✓		N/A
3D(c): Identification of facility used to trade SB swaps by national securities exchanges	✓			Yes

[72] References to section 3D of the Exchange Act in this table are to 15 U.S.C. 78c-4.

[73] These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

[74] A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

[75] Rulemaking is necessary to establish the form and manner of registration.

Exchange Act Section[72]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[74]	Authorizes/ Directs Commission Action[73]	Relief Granted
3D(d): Core principles for SB SEFs – compliance with core principles – in general and Commission rules and information requests		✓		N/A[76]
3D(e): Exemptions			✓	N/A
3D(f): Rules			✓	N/A

As indicated in Table B, the Commission finds, pursuant to section 36 of the Exchange Act,[77] that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant temporary exemptions from sections 3D(a)(1) and 3D(c) of the Exchange Act.[78] Section 3D(a)(1) of the Exchange Act states that no person may operate a facility for the trading or processing of SB swaps unless the facility is registered as a SB SEF or

76 Section 3D(d)(1) of the Exchange Act, 15 U.S.C. 78c-4(d)(1), states in part that "[t]o be registered, and to maintain registration, as a security-based swap execution facility, the security-based swap execution facility shall comply with . . . any requirement that the Commission may impose by rule or regulation." Accordingly, compliance with such requirements will be required on the later of the registration of the SB SEF and the compliance date of any Commission rule establishing such requirements under section 3D of the Exchange Act, 15 U.S.C. 78c-4.

77 15 U.S.C. 78mm.

78 15 U.S.C. 78c-4(a)(1) and 78c-4(c).

as a national securities exchange under section 3D of the Exchange Act.[79] The temporary exemption from section 3D(a)(1) would allow an entity that trades SB swaps and is not currently registered as a national securities exchange, or that cannot yet register as a SB SEF because final rules for such registration have not yet been adopted,[80] to continue trading SB swaps during this temporary period without registering as a national securities exchange or SB SEF.[81] The Commission finds that such action is necessary or appropriate in the public interest, and consistent with the protection of investors, to facilitate the operation of entities that trade SB swaps so that these instruments can continue to be traded without the need for entities that trade such instruments to register as national securities exchanges before the Commission has put in place a registration regime for SB SEFs, at which time the entities that operate these facilities would be able to choose between registration as a national securities exchange and a SB SEF.

Section 3D(c) of the Exchange Act requires that a national securities exchange (to the extent that it also operates an SB SEF and uses the same electronic trade execution system for listing and executing trades of SB swaps on or through the exchange and the facility) identify whether electronic trading of such SB swaps is taking place on or through the national securities exchange or the SB SEF.[82] The temporary exemption from section 3D(c) of the Exchange Act[83] would avoid legal uncertainty regarding whether a national securities exchange is operating as a SB SEF until further guidance is available.

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79 15 U.S.C. 78c-4(a)(1).

80 Such an entity could, for example, be an alternative trading system or a trading platform that is currently not registered with the Commission in any capacity. The Commission notes that, if such an entity were doing business as an alternative trading system, it would continue to be subject to the requirements of Regulation ATS (17 CFR 242.300 et seq.) during this temporary period.

81 The Commission intends to separately consider temporary relief from the exchange registration requirements of Sections 5 and 6 of the Exchange Act, 15 U.S.C. 78f.

82 15 U.S.C. 78c-4(c).

83 Id.

The temporary exemptions from sections 3D(a)(1) and 3D(c) of the Exchange Act[84] will expire on the earliest compliance date set forth in any of the final rules regarding registration of SB SEFs.

Request for Comment:

- Are there other provisions of section 3D of the Exchange Act for which the Commission should grant temporary exemptive relief? Please provide a detailed explanation of why granting such an exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

C. Segregation of Collateral in Security-Based Swaps.

Section 3E of the Exchange Act, added by section 763(d) of the Dodd-Frank Act, regulates the collection and handling of collateral that counterparties to SB swaps deliver to secure their obligations arising from such SB swaps and sets out certain rights of the counterparties who deliver such collateral.[85] Certain of these provisions require rulemaking by the Commission and thus will not require compliance on the Effective Date because the Commission will not have adopted a segregation rule by that date. Table C below lists each provision of section 3E of the Exchange Act and identifies those provisions that will require compliance on the Effective Date and those with which compliance will be triggered by the adoption of final rules or other action by the Commission.[86] For the provisions with which compliance will be required on the Effective Date, Table C notes whether temporary relief from

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84 15 U.S.C. 78c-4(a)(1) and (c).

85 15 U.S.C. 78c-5.

86 Section 3E of the Exchange Act, 15 U.S.C. 78c-5, contains no provisions that expressly apply only to registered SBSDs.

compliance is granted. The rationale and duration for such relief is explained in the text following the table.

Table C: Segregation of Collateral in Security-Based Swaps– Compliance Dates.

Exchange Act Section[87]	Compliance Date		Authorizes/ Directs Commission Action[88]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[89]		
3E(a): Registration requirement	✓			No[90]
3E(b): Cleared SB swaps – segregation required; commingling prohibited	✓			No[91]
3E(c)(1): Exceptions – use of funds	✓			N/A

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87 References to section 3E of the Exchange Act in this table are to 15 U.S.C. 78c-5.

88 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

89 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

90 As explained below, the Commission will consider requests for relief from compliance with this provision by CCPs on behalf of participants.

91 As explained below, the Commission will consider requests for relief from compliance with this provision by CCPs on behalf of participants.

Exchange Act Section[87]	Compliance Date		Authorizes/ Directs Commission Action[88]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[89]		
3E(c)(2): Exceptions – Commission action	✓			N/A[92]
3E(d): Permitted investments	✓			N/A
3E(d): Permitted investments – specified as permitted investments by the Commission		✓		N/A
3E(e): Prohibition	✓			No[93]
3E(f): Segregation requirements for uncleared SB swaps	✓			Yes
3E(g): Bankruptcy	✓			N/A[94]

92 As explained below, the Commission will consider requests for relief from CCPs on behalf of participants.

93 As explained below, the Commission will consider requests for relief from CCPs on behalf of participants.

94 This section incorporates "security-based swap" into certain provisions of the Bankruptcy Code, 11 U.S.C. 1 et seq.

As indicated in Table C, the Commission is granting temporary exemptions from compliance with section 3E(f) of the Exchange Act for SBS Entities.[95] Section 3E(f) of the Exchange Act requires SBS Entities to segregate initial margin amounts delivered by their counterparties in uncleared SB swap transactions if requested to do so by such counterparties.[96] Such segregation would require the establishment of accounts in which to segregate collateral with independent third-party custodians.[97] The establishment of these accounts and the adoption of policies and procedures setting forth the proper collection and maintenance of collateral will require expenditures of resources and time.[98]

The Commission finds that temporary exemption from section 3E(f) of the Exchange Act for SBS Entities is necessary or appropriate in the public interest, and is consistent with the protection of investors, because it would allow persons to register as an SBS Entity in accordance with the applicable registration requirements, once established, prior to expending resources to comply with the provisions of section 3E(f) of the Exchange Act as discussed above.[99] In addition, the Commission believes the exemption will give SBS Entities additional time to establish the necessary accounts and adopt the policies and procedures required by section 3E(f) of the Exchange Act.[100] Accordingly, the Commission is providing a temporary exemption pursuant to section 36 of the Exchange Act[101] from section 3E(f) of the Exchange

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95 15 U.S.C. 78c-5(f).

96 Id.

97 15 U.S.C. 78c-5(f)(1)(B) and (3).

98 Notwithstanding the exemption granted, market participants in uncleared SB swaps may continue to voluntarily negotiate for and receive similar protections to those provided in section 3E(f) of the Exchange Act, 15 U.S.C. 78c-5(f), until compliance with such section 3E(f) is required.

99 15 U.S.C. 78c-5(f).

100 Id.

101 15 U.S.C. 78mm.

Act[102] for SBS Entities. The temporary exemption will expire on the date upon which the rules adopted by the Commission to register SBSDs and MSBSPs become effective.

Section 3E(a) of the Exchange Act prohibits a person not registered as a broker, dealer, or SBSD from undertaking specified actions pertaining to the collection of margin associated with clearing an SB swap for an SB swap customer through a clearing agency.[103] Section 3E(a) of the Exchange Act requires that a person register with the Commission as a broker, dealer, or SBSD in order to comply with the provision.[104] Section 3E(b) of the Exchange Act obligates such persons to segregate initial margin amounts delivered by their counterparties in cleared SB swaps.[105] Sections 3E(c), (d), and (e) of the Exchange Act,[106] respectively, contain exceptions to section 3E(b) of the Exchange Act[107] permitting the commingling of funds for convenience in certain circumstances, prescribe certain obligations of the United States government in which margin collected may be invested, and contain other prohibitions on the use of margin.

The Commission is not granting exemptions from the requirements of sections 3E(a), (b), (c) or (e) of the Exchange Act.[108] Based on the Commission's experience in granting, and representations made by recipients of, previous exemptive orders for CCPs, the Commission understands that there are currently no CCPs offering customer clearing of SB swaps.[109]

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102 15 U.S.C. 78c-5(f)(1), (f)(3), and (f)(4).

103 15 U.S.C. 78c-5(a).

104 Id.

105 15 U.S.C. 78c-5(b).

106 15 U.S.C. 78c-5(c), (d), and (e).

107 15 U.S.C. 78c-5(b).

108 15 U.S.C. 78c-5(a), (b), (c) or (e).

109 The Commission has granted temporary conditional exemptions to facilitate CDS clearing in connection with requests on behalf of ICE Clear Europe Limited; Eurex Clearing AG; Chicago Mercantile Exchange Inc.; ICE Trust US LLC: and LIFFE Administration and Management and LCH.Clearnet Ltd. See infra note 222 and accompanying text.

However, for CCPs that are planning to offer customer clearing of SB swaps before the compliance date for any of the final rules regarding registration of SBS Entities, the Commission will consider requests for relief from such CCPs on behalf of their participants from sections 3E(a), (b), and (e) of the Exchange Act, as appropriate, based on the applicable facts and circumstances.[110]

Request for Comment:

- Under the stock-broker bankruptcy provisions of the Bankruptcy Code,[111] the description of which persons have the status as a customer of a broker-dealer with respect to their posted margin includes persons whose margin is required to be segregated. Given that reference to a segregation requirement, is any temporary exemption from section 3E(f) of the Exchange Act appropriate?

- Please explain the steps that must be taken for an SBSD to segregate initial margin for uncleared SB swap transactions. How long would it take to put in place such an arrangement with an independent third-party custodian? Would any existing documentation between the parties need to be amended?

- Are there other provisions of section 3E of the Exchange Act for which the Commission should consider granting a temporary exemption? Please specify the provision or provisions for which exemptions should be granted and provide a detailed explanation of why granting such exemptions would be necessary or appropriate in the public interest, and consistent with the protection of investors.

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110 15 U.S.C. 78c-5(a), (b), and (e).

111 See generally 11 U.S.C. 741 et seq.

D. Security-Based Swap Antifraud Provisions.

Section 9(j) of the Exchange Act,[112] added by 763(g) of the Dodd-Frank Act, includes a provision regarding the prevention of fraud, manipulation, and deception in connection with SB swaps. As indicated in Table D below, section 9(j) of the Exchange Act requires rulemaking.[113]

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[112] 15 U.S.C. 78i(j).

[113] Id. In the context of Section 774 of the Dodd-Frank Act, which addresses provisions that require rulemaking, we believe Section 9(j) requires rulemaking.

Table D: Security-Based Swap Antifraud Provisions – Compliance Dates.

Exchange Act Section[114]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[116]	Authorizes/ Directs Commission Action[115]	Relief Granted
9(j): Amends Exchange Act to make unlawful fraud, manipulation and deception in connection with SB swaps directs the Commission to engage in rulemaking to define and prescribe means reasonably designed to prevent, such fraud, manipulation and deception.		✓		N/A

The Commission notes that, as of the Effective Date, SB swaps will be securities.[117]

Thus, once the relevant provisions of the Dodd-Frank Act take effect,[118] persons effecting

[114] References to section 9 of the Exchange Act in this table are to 15 U.S.C. 78i.

[115] These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

[116] A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

[117] See discussion infra. Section 761(a)(2) of the Dodd-Frank Act amends the definition of "security" in section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10), to include SB swaps. Section 768(a)(1) of the Dodd-Frank Act amends the Securities Act to include SB swaps in the definition of "security" in section 2(a)(1) thereof, 15 U.S.C. 77b(a)(1).

transactions in, or engaged in acts, practices, and courses of business involving, SB swaps will be subject to the Commission's rules and regulations that define and prescribe acts and practices involving securities that are manipulative, deceptive, fraudulent, or otherwise unlawful for purposes of the general antifraud and anti-manipulation provisions of the federal securities laws, including sections 9(a) and 10(b)[119] of the Exchange Act, rule 10b–5 thereunder[120] (and the prohibitions against insider trading), section 15(c) of the Exchange Act,[121] and section 17(a) of the Securities Act,[122] among others.

E. Position Limits for Security-Based Swaps.

Section 10B of the Exchange Act, added by section 763(h) of the Dodd-Frank Act, provides that the Commission "shall, by rule or regulation, as necessary or appropriate in the public interest or for the protection of investors" establish limits on the size of positions in any SB swap that may be held by any person.[123] As indicated in Table E below, the provisions of section 10B authorize and direct the Commission to undertake certain actions pertaining to position limits.[124] These provisions will become effective on the Effective Date, but, by their plain language, pertain to Commission action. Accordingly, these provisions do not require compliance by market participants on the Effective Date.

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118 See section 774 of the Dodd-Frank Act.

119 15 U.S.C. 78i(a) and 78j(b).

120 17 CFR 240.10b-5.

121 15 U.S.C. 78o(c).

122 15 U.S.C. 77q(a).

123 15 U.S.C. 78j-2.

124 Id.

Table E: Position Limits for Security-Based Swaps– Compliance Dates.

Exchange Act Section[125]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action	Authorizes/ Directs Commission Action[126]	Relief Granted
10B(a): Position limits			✓	N/A
10B(b): Exemptions			✓	N/A
10B(c): SRO rules			✓	N/A
10B(d): Large trader reporting			✓	N/A

F. Reporting of Security-Based Swaps.

i. Public Availability of Security-Based Swap Data.

Section 13(m) of the Exchange Act, added by section 763(i) of the Dodd-Frank Act, includes provisions regarding the reporting of SB swap transactions and the public dissemination of such reported information.[127] As set forth in Table F-1 below, certain of the statutory provisions of section 13(m) of the Exchange Act require Commission rulemaking or other action or are only applicable once there are registered SDRs to accept SB swap transaction data.[128] The table also includes provisions that authorize or direct the Commission to take specified action

[125] References to section 10B of the Exchange Act in this table are to 15 U.S.C. 78j-2.

[126] These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

[127] 15 U.S.C. 78m(m).

[128] Id.

that, once undertaken, may impose compliance obligations upon market participants.[129] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date. The remaining provisions of section 13(m) of the Exchange Act will require compliance on the Effective Date but do not impose any self-executing duties or requirements upon market participants.[130] Accordingly, the Commission is not granting temporary relief from compliance with any provisions of section 13(m) of the Exchange Act.

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[129] See supra note 26 and accompanying text.

[130] Id.

Table F-1: Public Availability of Security-Based Swap Data – Compliance Dates.

Exchange Act Section[131]	Compliance Date		Authorizes/ Directs Commission Action[132]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[133]		
13(m)(1)(A): In general – definition of real-time public reporting	✓			N/A[134]
13(m)(1)(B): In general – purpose	✓			N/A[135]
13(m)(1)(C): In general – general rule			✓	N/A

[131] References to section 13(m) of the Exchange Act in this table are to 15 U.S.C. 78m(m).

[132] These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

[133] A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

[134] This section defines "real-time public reporting" for the purposes of section 13(m) of the Exchange Act, 15 U.S.C. 78m(m).

[135] This section sets forth the purpose of section 13(m) of the Exchange Act, 15 U.S.C. 78m(m).

Exchange Act Section[131]	Compliance Date		Authorizes/ Directs Commission Action[132]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[133]		
13(m)(1)(D): In general – registered entities and public reporting			✓	N/A
13(m)(1)(E): In general – rulemaking required			✓	N/A
13(m)(1)(F): In general – timeliness of reporting		✓		N/A
13(m)(1)(G): In general – reporting of swaps to registered SDRs		✓		N/A
13(m)(1)(H): In general – registration of clearing agencies		✓		N/A
13(m)(2): Semiannual and annual public reporting of aggregate SB swap data			✓	N/A

ii. Security-Based Swap Data Repositories.

Section 13(n) of the Exchange Act, added by section 763(i) of the Dodd-Frank Act, provides for the registration, operation, and governance of SDRs.[136] Certain of the statutory provisions in section 13(n) of the Exchange Act either require a rulemaking or other Commission action or apply only to SDRs once registered, rather than to SDRs generally.[137] Compliance with those provisions will not be required on the Effective Date because the Commission will not have adopted final rules (including rules regarding the manner and form of registration) by that date. The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants.[138] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date. Table F-2 below lists each provision of section 13(n) of the Exchange Act and identifies those provisions with which compliance will be required on the Effective Date and those with which compliance will be triggered by registration of a person as an SDR or by adoption of final rules by the Commission.[139] For the provisions with which compliance will be required on the Effective Date, Table F-2 notes whether temporary relief from compliance is granted. The rationale and duration for such relief is explained in the text following the table.

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[136] 15 U.S.C. 78m(n).

[137] Id.

[138] See supra note 26 and accompanying text.

[139] Id.

Table F-2: Security-Based Swap Data Repositories – Compliance Dates.

Exchange Act Section[140]	Compliance Date		Authorizes/ Directs Commission Action[141]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[142]		
13(n)(1): Registration requirement		✓		N/A[143]
13(n)(2): Inspection and examination		✓		N/A
13(n)(3)(A): Compliance with core principles		✓		N/A

140 References to section 13(n) of the Exchange Act in this table are to 15 U.S.C. 78m(n).

141 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

142 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

143 In order to provide for orderly registration of SDRs, the Commission will need to propose rules regarding the form and manner of registration with the Commission as an SDR.

Exchange Act Section[140]	Compliance Date		Authorizes/ Directs Commission Action[141]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[142]		
13(n)(3)(B): Compliance with core principles – reasonable discretion of SDR		✓		N/A
13(n)(4)(A): Standard setting – data identification			✓	N/A
13(n)(4)(B): Standard setting – data collection and maintenance			✓	N/A
13(n)(4)(C): Standard setting – comparability			✓	N/A
13(n)(5)(A), (B),[144] (C), (D)(ii), and (E): Duties		✓		N/A
13(n)(5)(D)(i), (F), (G), and (H): Duties	✓			Yes

[144] The data for which an SDR needs to confirm the accuracy first needs to be prescribed by the Commission pursuant to section 13(n)(5)(A).

Exchange Act Section[140]	Compliance Date		Authorizes/ Directs Commission Action[141]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[142]		
13(n)(6)(A) – (B): Designation of chief compliance officer – in general; duties		✓		N/A[145]
13(n)(6)(C): Designation of chief compliance officer – annual reports		✓		N/A
13(n)(7)(A): Core principles applicable to SDRs – market access to services and data	✓			Yes
13(n)(7)(B): Core principles applicable to SDRs – governance arrangements	✓			Yes

[145] Section 13(n)(6) of the Exchange Act, 15 U.S.C. 78m(n)(6), requires each SDR to designate a chief compliance officer who shall perform certain specified duties and prepare annual reports. Although the provision does not explicitly limit its application to registered SDRs, within the context of Title VII and section 13(n) of the Exchange Act, 15 U.S.C. 78m(n), which addresses registered SDRs, the Commission believes that Congress intended these requirements to apply only to SDRs that are registered or are required to register with the Commission.

Exchange Act Section[140]	Compliance Date		Authorizes/ Directs Commission Action[141]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[142]		
13(n)(7)(C): Core principles applicable to SDRs – Conflicts of interest	✓			Yes
13(n)(7)(D): Core principles applicable to SDRs – additional duties developed by Commission			✓	N/A
13(n)(8): Required registration for SDRs		✓		N/A
13(n)(9): Rules			✓	N/A

As indicated in Table F-2, the Commission finds, pursuant to section 36 of the Exchange Act,[146] that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant temporary exemptions from the provisions of sections 13(n)(5)(D)(i), 13(n)(5)(F), 13(n)(5)(G), 13(n)(5)(H), and 13(n)(7)(A) through (C) of the Exchange Act[147] that would otherwise impose obligations on SDRs as of the Effective Date. These temporary exemptions will allow SDRs additional time to develop the policies,

[146] 15 U.S.C. 78mm.

[147] 15 U.S.C. 78m(n)(5)(D)(i), (n)(5)(F), (n)(5)(G), (n)(5)(H), and (n)(7)(A) through (C).

procedures, and systems necessary to comply with the requirements of section 13(n) of the Exchange Act.[148]

The Commission finds that granting a temporary exemption from compliance with the requirements of section 13(n)(5)(D)(i) of the Exchange Act[149] is necessary or appropriate in the public interest, and is consistent with the protection of investors. Section 13(n)(5)(D)(i) of the Exchange Act requires an SDR to provide direct electronic access to the Commission or any designee of the Commission.[150] The Commission believes that this provision will require investment of significant time and resources by an SDR to implement the technology to be used to enable this direct electronic access and to coordinate with the Commission to establish its direct electronic access to data maintained by the SDR. The form and manner in which an SDR will provide direct electronic access may vary, depending in part on the amount of data stored at the SDR and how the SDR maintains that data. In addition, this requirement would obligate SDRs to make changes to existing systems and practices, or develop entirely new systems and practices, all of which would require significant investment of time and resources. The Commission believes it would be inefficient for an SDR to expend time and resources to develop the technological systems necessary to provide the direct electronic access required by section 13(n)(5)(D)(i) of the Exchange Act prior to knowing the capabilities the Commission rules will require these systems to have.[151]

Section 13(n)(5)(F) of the Exchange Act requires and SDR to maintain the privacy of any and all SB swap transaction information that the SDR receives from an SBSD, counterparty, or

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148 15 U.S.C. 78m(n).

149 15 U.S.C. 78m(n)(5)(D)(i).

150 Id.

151 Id.

other registered entity.[152] The Commission finds that granting a temporary exemption from compliance with section 13(n)(5)(F) of the Exchange Act[153] is necessary or appropriate in the public interest because it will provide SDRs additional time to establish and implement robust policies and procedures to protect the privacy of data reported to them.

Section 13(n)(5)(G) of the Exchange Act requires that SDRs, on a confidential basis, and after notifying the Commission of the request, make available all data obtained by the SDR, including individual counterparty trade and position data, to certain enumerated entities.[154] Section 13(n)(5)(H) of the Exchange Act[155] requires that an SDR, before sharing information with any of the entities listed in section 13(n)(5)(G) of the Exchange Act,[156] (i) receive a written agreement from such entity that the entity will abide by certain confidentiality provisions relating to the information on SB swap transactions that is provided and (ii) each such entity shall agree to indemnify the SDR and the Commission for any expenses arising from litigation relating to the information provided. The Commission finds that granting a temporary exemption from compliance with the notification and indemnification requirements of sections 13(n)(5)(G) and 13(n)(5)(H) of the Exchange Act,[157] is necessary or appropriate in the public interest, and is consistent with the protection of investors, because it would enable relevant authorities to continue to have access to data maintained by SDRs necessary to fulfill their respective mandates while the Commission considers various issues related to these requirements.

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[152] 15 U.S.C. 78m(n)(5)(G).

[153] Id.

[154] Id.

[155] 15 U.S.C. 78m(n)(5)(G).

[156] 15 U.S.C. 78m(n)(5)(H).

[157] 15 U.S.C. 78m(n)(5)(G) and 78m(n)(5)(H).

The Commission also finds that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant temporary exemptions from section 13(n)(7)(B) of the Exchange Act's[158] requirement that SDRs establish transparent governance arrangements for certain enumerated reasons. Delaying compliance with this requirement until the Commission's final rules setting forth the full panoply of duties applicable to SDRs have been adopted would avoid possible complications and unnecessary expenditures of time and resources by an SDR. It also would avoid unnecessary disruption of an SDR's governance structure, which could adversely impact the SDR's operations and could result in unnecessary expenditures of time and resources by the SDR. In addition, the Commission finds that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant temporary relief from compliance with (i) section 13(n)(7)(A) of the Exchange Act,[159] which prohibits an SDR from adopting any rule or taking any action that results in any unreasonable restraint of trade or impose any material anticompetitive burden on the trading, clearing, or reporting of transactions and (ii) section 13(n)(7)(C) of the Exchange Act,[160] which requires that SDRs establish rules to minimize conflicts of interest and establish a process for resolving conflicts of interest. The Commission believes that, until SDRs can register with the Commission, they should be given additional time to establish and implement the policies and procedures required by these provisions. In addition, providing additional time through a temporary exemption for SDRs to examine current business practices and any past issues they may have dealt with will likely result in more robust policies and procedures that will better protect market participants.

158 15 U.S.C. 78m(n)(7)(B).

159 15 U.S.C. 78m(n)(7)(A).

160 15 U.S.C. 78m(n)(7)(C).

The temporary exemption granted by the Commission from compliance with the requirements of sections 13(n)(5)(D)(i), 13(n)(5)(F), 13(n)(5)(G), 13(n)(5)(H), 13(n)(7)(A), 13(n)(7)(B), and 13(n)(7)(C) of the Exchange Act[161] will expire on the earlier of (1) the date the Commission grants registration to the SDR and (2) the earliest compliance date set forth in any of the final rules regarding the registration of SDRs.

Request for Comment:

- Are there other provisions in addition to those identified above for which compliance is required as of the Effective Date but exemptive relief is or is not appropriate? If so, please specify those provisions and provide a detailed explanation of why granting such an exemption is or is not necessary or appropriate in the public interest, or consistent with the protection of investors.

iii. Reporting and Recordkeeping for Security-Based Swaps.

Section 13A of the Exchange Act, added by section 766(a) of the Dodd-Frank Act, generally sets forth reporting requirements for SB swaps that are not cleared.[162] As set forth in Table F-3 below, certain of the statutory provisions of section 13A of the Exchange Act require Commission rulemaking or other action or are only applicable if a registered SDR will accept reports.[163] The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants.[164] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date. The remaining provisions of section

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161 15 U.S.C. 78m(n)(5)(D)(i), (n)(5)(G), (n)(5)(H)(ii), (n)(7)(A), (n)(7)(B), and (n)(7)(C).

162 15 U.S.C. 78m-1.

163 Id.

164 See supra note 26 and accompanying text.

13A of the Exchange Act will become effective on the Effective Date but do not impose any duties or requirements upon market participants.[165] Accordingly, the Commission is not granting temporary relief from compliance with any provisions of section 13A of the Exchange Act.[166]

[165] Id.

[166] Id.

Table F-3: Reporting and Recordkeeping for Security-Based Swaps – Compliance Dates.

Exchange Act Section[167]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[169]	Authorizes/ Directs Commission Action[168]	Relief Granted
13A(a)(1)(A): Required reporting of SB swaps not accepted by a clearing agency or derivatives clearing organization – in general – reporting to SDRs		✓		N/A[170]

167 References to section 13A of the Exchange Act in this table are to 15 U.S.C. 78m-1.

168 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

169 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

170 Section 13A(a)(1) of the Exchange Act, 15 U.S.C. 78m-1(a)(1), states in part that "[e]ach security-based swap that is not accepted for clearing by any clearing agency or derivatives clearing organization shall be reported to (A) a security-based swap data repository described in section 13(n) [of the Exchange Act, 15 U.S.C. 78m(n)]." Because the SDRs described in section 13(n) of the Exchange Act, 15 U.S.C. 78m(n), are required by section 13(n)(1) of the Exchange Act, 15 U.S.C. 78m(n)(1), to be registered, the Commission believes this requirement is not triggered until an SDR is registered.

Exchange Act Section[167]	Compliance Date		Authorizes/ Directs Commission Action[168]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[169]		
13A(a)(1)(B): Required reporting of SB swaps not accepted by a clearing agency or derivatives clearing organization – in general – reporting to the Commission		✓		N/A[171]

[171] Section 13A(a)(1)(B) of the Exchange Act, 15 U.S.C. 78m-1(a)(1)(B), provides for an alternative method of reporting if there is no SDR that will accept a report; however, the time frame for that reporting requirement must be established by Commission rule.

Exchange Act Section[167]	Compliance Date		Authorizes/ Directs Commission Action[168]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[169]		
13A(a)(2)(A): Required reporting of SB swaps not accepted by a clearing agency or derivatives clearing organization – transition rule pre-enactment SB swaps		✓		N/A[172]

[172] Section 13A(a)(2) of the Exchange Act, 15 U.S.C. 78m-1(a)(2), required the Commission to promulgate an interim final rule regarding reporting of pre-enactment SB swaps and states in part that each such pre-enactment SB swap, the terms of which have not expired as of such date, "shall be reported to a registered security-based swap data repository or the Commission by a date that is not later than (i) 30 days after issuance of the interim final rule; or (ii) such other period as the Commission determines to be appropriate." The effective date of the interim final rule was October 20, 2010. However, pursuant to the interim final temporary rule issued by the Commission on reporting of pre-enactment SB swap data, specified counterparties to such pre-enactment SB swaps are required to (1) report certain information to a registered SDR or the Commission by the compliance date established in the reporting rules required under sections 3C(e) and 13A(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(e) and 78m-1(a)(1), or within 60 days after a registered SDR commences operations to receive and maintain data concerning such SB swap, whichever occurs first, and (2) report to the Commission any information relating to such pre-enactment SB swaps upon request of the Commission. No SDR is registered yet to accept SB swap data and the reporting rules under section 3C(e) have not yet been adopted. In addition, the Commission stated, in an interpretative note to the interim final rule, its belief that it is necessary for a counterparty, that may be required to report transactions under the interim final rule, to retain all information relating to the terms of pre-enactment security-based swaps in order for that counterparty to be able to comply with the reporting requirements of the interim final rule. See Reporting of Security-Based Swap Transaction Data, 75 FR 64643 (Oct. 20, 2010). The reporting rules under sections 3C(e) and 13A(a)(1) of the Exchange Act, 15 U.S.C. 78c-3(e) and 78m-1(a)(1), are included in a separate release. See Regulation SBSR - Reporting and Dissemination of Security-Based Swap Information, supra note 9.

Exchange Act Section[167]	Compliance Date		Authorizes/ Directs Commission Action[168]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[169]		
13A(a)(2)(B): Required reporting of SB swaps not accepted by a clearing agency or derivatives clearing organization – rulemaking for transition rule pre-enactment SB swaps			✓	N/A
13A(a)(2)(C): Required reporting of SB swaps not accepted by a clearing agency or derivatives clearing organization – effective date	✓			N/A[173]
13A(a)(3): Reporting obligations[174]		✓		N/A

[173] This section provides that the effective date of section 13A of the Exchange Act, 15 U.S.C. 78m-1, is the date of enactment of section 13A of the Exchange Act, 15 U.S.C. 78m-1. However, compliance will not be required until applicable rules and regulations regarding registered SDRs are in place.

[174] See supra note 170.

Exchange Act Section[167]	Compliance Date		Authorizes/ Directs Commission Action[168]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[169]		
13A(b): Duties of certain individuals		✓		N/A[175]
13A(c)(1): Requirements – provision of reports on SB swaps to the Commission		✓		N/A
13A(c)(2): Requirements – recordkeeping requirement		✓		N/A
13A(d): Identical data			✓	N/A

Request for Comment:

- Are there provisions of section 13A of the Exchange Act for which the Commission should grant temporary exemptive relief? Please specify which provisions and provide a detailed explanation of why granting such exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

175 This section defines the individuals and entities to which the requirements of section 13A(c) of the Exchange Act, 15 U.S.C. 78m-1(c), apply.

G. Registration and Regulation of Security-Based Swap Dealers and Major Security-Based Swap Participants.

Section 15F of the Exchange Act, added by section 764(a) of the Dodd-Frank Act, establishes requirements for registration and comprehensive oversight of SBS Entities.[176] Many of the provisions of section 15F of the Exchange Act either require rulemaking or other action by the Commission[177] or apply only to SBS Entities once registered, rather than to SBS Entities generally.[178] Those provisions that either require rulemaking or other action by the Commission or apply only to registered SBS Entities will not require compliance on the Effective Date because the Commission will not have adopted final rules (including rules regarding the manner and form of registration) or taken other required action by that date. Table G below lists each provision of section 15F of the Exchange Act[179] and identifies those provisions with which compliance will be required on the Effective Date and those with which compliance will be triggered by registration of SBS Entities or by the adoption of final rules or other action by the Commission. The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants.[180] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date. For the provisions with which

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176 15 U.S.C. 78o-10.

177 See, e.g., section 15F(b)(2) of the Exchange Act, 15 U.S.C. 78o-10(b)(2) (providing that the registration application of SBS Entities "shall be made in such form and manner as prescribed by the Commission").

178 See, e.g., section 15F(h)(1) of the Exchange Act, 15 U.S.C. 78o-10(h)(1) (providing that registered SBS Entities shall conform to certain prescribed business conduct standards); section 15F(h)(6) of the Exchange Act, 15 U.S.C. 78o-10(h)(6) (directing the Commission to prescribe rules to implement the business conduct requirements of subsection (h) of such section 15F applicable to registered SBS Entities).

179 15 U.S.C. 78o-10.

180 See supra note 26 and accompanying text.

compliance will be required on the Effective Date, Table G notes whether the Commission is providing temporary relief from compliance. The rationale and duration for such relief is explained in the text following the table.

Table G: Registration and Regulation of Security-Based Swap Dealers and Major Security-Based Swap Participants – Compliance Dates.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(a): Registration of SBSDs and MSBSPs		✓		N/A[184]
15F(b)(1) – (3): Requirements – in general; contents; expiration		✓		N/A
15F(b)(4): Requirements – rules			✓	N/A

181 References to section 15F of the Exchange Act in this table are to 15 U.S.C. 78o-10.

182 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

183 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

184 Section 15F(b)(2)(A) of the Exchange Act, 15 U.S.C. 78o-10(b)(2)(A), requires SBS Entities to register as such "in such form and manner as prescribed by the Commission . . . ."

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(b)(5): Requirements – transition			✓	N/A
15F(b)(6): Requirements – statutory disqualification	✓			Yes
15F(c): Dual registration – SBS Entities		✓		N/A
15F(d): Rulemaking			✓	N/A
15F(e)(1): Capital and margin requirements – in general		✓		N/A[185]
15F(e)(2): Capital and margin requirements – rules			✓	N/A[186]
15F(e)(3)(A): Capital and margin requirements			✓	N/A

185 Section 15F(e)(1) of the Exchange Act, 15 U.S.C. 78o-10(e)(1), states in part that registered SBS Entities for which there is not a prudential regulator "shall meet such minimum capital requirements and minimum initial and variation and margin requirements as the Commission shall by rule or regulation prescribe . . . ." Accordingly, compliance with such requirements will be required on the later of the registration of a person as an SBS Entity and the compliance date of any Commission rule establishing these capital and margin requirements.

186 For SBS Entities for which there is a prudential regulator, the prudential regulator shall consult with the Commission and the CFTC in establishing capital and margin requirements.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(e)(3)(B)(i): Capital and margin requirements – rule of construction; in general			✓[187]	N/A
15F(e)(3)(B)(ii): Capital and margin requirements – rule of construction; futures commission merchants and other dealers	✓			N/A[188]

[187] Section 15F(e)(3)(B)(i) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(B)(i), provides that nothing in section 15F of the Exchange Act, 15 U.S.C. 78o-10, shall limit the authority of the Commission or the CFTC to set financial responsibility rules for SBS Entities over which they have jurisdiction, respectively.

[188] Section 15F(e)(3)(B)(ii) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(B)(ii), provides that a futures commission merchant, introducing broker, broker, or dealer shall maintain sufficient capital to comply with the stricter of any applicable capital requirements to which such futures commission merchant, introducing broker, broker, or dealer is subject to under section 15(f) of the Exchange Act, 15 U.S.C. 78o-10(f), or the Commodity Exchange Act.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(e)(3)(C), (D): Capital and margin requirements – rule of construction; margin requirements and; comparability			✓	N/A[189]
15F(f)(1): Reporting and recordkeeping – in general		✓		N/A[190]
15F(f)(2): Reporting and recordkeeping – rules			✓	N/A

[189] Section 15F(e)(3)(C) of the Exchange Act, 15 U.S.C. 78o-10(e)(3)(C), provides, *inter alia*, that prudential regulators, the Commission, and the CFTC shall consult and "to the maximum extent practicable" establish and maintain comparable minimum capital and margin requirements.

[190] Section 15F(f)(1) of the Exchange Act, 15 U.S.C. 78o-10(f)(1), states in part that registered SBS Entities "shall make such reports as are required by the Commission, by rule or regulation, regarding the transactions and positions and financial condition of the registered security-based swap dealer or major security-based swap participant" and "shall keep books and records . . . in such form and manner and for such period as may be prescribed by the Commission by rule or regulation . . . ." Accordingly, compliance with such reporting and recordkeeping requirements will be required on the later of the registration of a person as an SBS Entity and the compliance date of any Commission rule establishing these reporting and recordkeeping requirements.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(g)(1) – (4): Daily trading records – in general; information requirements; counterparty records; audit trail		✓		N/A[191]
15F(g)(5): Daily trading records – rules			✓	N/A
15F(h)(1): Business conduct standards		✓		N/A[192]
15F(h)(2): Business conduct standards – responsibilities with respect to special entities		✓		N/A[193]

191 Section 15F(g)(1) of the Exchange Act, 15 U.S.C. 78o-10(g)(1), states in part that each registered SBS Entity shall maintain daily trading records and recorded communications "for such period as may be required by the Commission by rule or regulation." In addition, section 15F(g)(2) of the Exchange Act, 15 U.S.C. 78o-10(g)(2) provides that the daily trading records shall include "such information as the Commission shall require by rule or regulation." Accordingly, compliance with such recordkeeping requirements will be required on the later of the registration of a person as an SBS Entity and the compliance date of the Commission rule establishing these recordkeeping requirements.

192 Section 15F(h)(6) of the Exchange Act, 15 U.S.C. 78o-10(h)(6), directs the Commission to "prescribe rules under this subsection [(h) of the Exchange Act, 15 U.S.C. 78o-10(h),] governing business conduct standards." Accordingly, business conduct standards pursuant to section 15F(h) of the Exchange Act, 15 U.S.C. 78o-10(h), will be established by rule and compliance will be required on the compliance date of the Commission rule establishing these business conduct standards. See also infra note 195.

193 Id.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(h)(3): Business conduct standards – business conduct requirements			✓	N/A[194]
15F(h)(4): Business conduct standards – special requirements for SBSDs acting as advisors		✓		N/A[195]
15F(h)(5)(A): Business conduct standards – special requirements for SBSDs as counterparties to special entities		✓		N/A[196]
15F(h)(5)(B): Business conduct standards – Commission authority			✓	N/A

[194] Id.

[195] Id. The Commission notes, however, that, as of the Effective Date, SB swaps will be securities and will be subject to the Commission's authority under sections 9(a) and 10(b) of the Exchange Act, 15 U.S.C. 78i(a) and 78j(b), including rule 10b-5 thereunder, 17 CFR 240.10b-5, section 15(c) of the Exchange Act, 15 U.S.C. 78o(c), and section 17(a) of the Securities Act, 15 U.S.C. 77q(a), among others. See discussion supra note 117 and accompanying text.

[196] See supra note 192.

Exchange Act Section[181]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[183]	Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
15F(h)(6): Business conduct standards – rules			✓	N/A
15F(h)(7): Business conduct standards – applicability	✓			N/A[197]
15F(i)(1): Documentation standards – in general		✓		N/A[198]
15F(i)(2): Documentation standards –rules			✓	N/A

[197] This section limits the applicability of section 15F(h) of the Exchange Act, 15 U.S.C. 78o-10(h).

[198] Section 15F(i) of the Exchange Act, 15 U.S.C. 78o-10(i), states in part that each registered SBS Entity "shall conform with such standards as may be prescribed by the Commission, by rule or regulation, that relate to timely and accurate confirmation, processing, netting, documentation, and valuation of all security-based swaps." Accordingly, compliance with such requirements will be required on the later of the registration of a person as an SBS Entity and the compliance date of the Commission rule establishing these documentation standards.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(j)(1) – (6): Duties – monitoring of trading; risk management procedures; disclosure of general information; ability to obtain information; conflicts of interest; antitrust considerations		✓		N/A
15F(j)(7): Duties – rules			✓	N/A
15F(k)(1) – (2): Designation of chief compliance officer – in general; duties		✓		N/A[199]
15F(k)(3): Designation of chief compliance officer – annual reports		✓		N/A

[199] Section 15F(k) of the Exchange Act, 15 U.S.C. 78o-10(k), requires each SBS Entity to designate a chief compliance officer who shall perform certain specified duties and prepare annual reports. Although the provision does not explicitly limit its application to a registered SBS Entity, within the context of Title VII and section 15F of the Exchange Act, 15 U.S.C. 78o-10, which regulates registered SBS Entities, the Commission believes that Congress intended these requirements to apply only to SBS Entities that are registered or are required to register with the Commission.

Exchange Act Section[181]	Compliance Date		Authorizes/ Directs / Limits Commission Action[182]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[183]		
15F(l): Enforcement and administrative proceeding authority[200]			✓[201]	N/A

As indicated in Table G, the Commission is providing a temporary exception for SBS Entities from compliance with section 15F(b)(6) of the Exchange Act.[202] Section 15F(b)(6) of the Exchange Act prohibits an SBS Entity from permitting an associated person who is subject to a statutory disqualification, as defined in section 3(a)(39) of the Exchange Act,[203] to effect or be involved in effecting SB swaps on its behalf if the SBS Entity knew or should have known of the statutory disqualification.[204] Section 15F(b)(6) expressly authorizes the Commission to establish exceptions to this provision by rule, regulation, or order.[205] This authority is similar to authority provided to the Commission with respect to the "traditional" securities industry, i.e., the industry regulated under the Exchange Act prior to the Dodd-Frank Act amendments. This existing

200 As discussed above, provisions in this column that require Commission action will be effective on the Effective Date. In particular, if (after the Effective Date) the Commission has issued an order pursuant to section 15F(l)(3) of the Exchange Act, 15 U.S.C. 78o-10(l)(3), then, section 15F(l)(4) of the Exchange Act, 15 U.S.C. 78o-10(l)(4), will be applicable and will require Commission consent for persons subject to such an order to be associated with a SBS Entity.

201 In addition to Commission authority, section 15F(l) of the Exchange Act, 15 U.S.C. 78o-10(l), also provides enforcement authority to prudential regulators for SBS Entities for which they are the prudential regulator.

202 15 U.S.C. 78o-10(b)(6).

203 15 U.S.C. 78c(a)(39).

204 15 U.S.C. 78o-10(b)(6).

205 Id.

Exchange Act authority permits self-regulatory organizations ("SROs"), subject to Commission review, to allow, among other things, a person subject to a statutory disqualification to associate with a broker-dealer.[206]

Similarly, Commission rule 193 (Applications by Barred Individuals for Consent to Associate) provides a process by which persons that are not regulated by a SRO (e.g., an investment adviser, an investment company, or a transfer agent) can seek to reenter the securities industry despite previously being barred by the Commission.[207]

The Commission intends to separately consider issues relating to how an associated person of an SBS Entity subject to a statutory disqualification may be involved in the SB swap business of the SBS Entity. The Commission believes that existing business relationships and market activity may be unnecessarily disrupted if market participants were required to comply with section 15F(b)(6) of the Exchange Act[208] before the Commission considered, through notice and comment rulemaking, whether to adopt a procedure for potential modifications of the effect of statutory disqualifications under Title VII for SBS Entities and what any such procedure would require. The Commission, therefore, by this Order and pursuant to the authority granted in section 15F(b)(6) of the Exchange Act, is providing a temporary and limited exception for

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206 When such a person seeks admission to or continuance in membership or association, the Commission and the SRO have the opportunity to give special review to such person and to restrict or prevent entry into, or continuance in, the business where appropriate in the public interest and for the protection of investors. See Senate Comm. on Banking, Housing, and Urban Affairs, The Securities Act Amendments of 1989, S. Rep. No. 101-105, at 39 (1989); Provision for Notices by Self-Regulatory Organizations of Stays of Such Actions; Appeals; and Admissions to Membership or Association of Disqualified Persons, 42 FR 36409 (Jul. 14, 1977) (adopting rule 19h-1 under the Exchange Act, 17 CFR 240.19h-1, and providing rules for process of filing notices, content of notices, and Commission determination).

207 17 CFR 201.193.

208 15 U.S.C. 78o-10(b)(6).

SBS Entities from the application of the prohibition in section 15F(b)(6) of the Exchange Act.[209] Specifically, persons subject to a statutory disqualification (as defined in section 3(a)(39) of the Exchange Act[210]) who are, as of the Effective Date, currently associated with an SBS Entity and who effect or are involved in effecting SB swaps on behalf of such SBS Entity may continue to be associated with any SBS Entity until the date upon which rules adopted by the Commission to register SBS Entities become effective.

Request for Comment:

- Are there certain persons subject to statutory disqualification who should not be permitted to remain associated with an SBS Entity during the time period of the exception, for example, based upon the nature of the underlying conduct or sanction that resulted in the disqualification?

- Should there be any differentiation in relief from section 15F(b)(6) of the Exchange Act based upon the nature of the person, e.g., a natural person or an entity? If so, how and why?

- Are there persons who are not currently associated with an SBS Entity but who should be able to associate with such entities notwithstanding their statutory disqualification until such time as a procedural rule defining the application of section 15F(b)(6) of the Exchange Act is in place?

H. Registration of Clearing Agencies for Security-Based Swaps.

Section 17A of the Exchange Act, amended by section 763(b) of the Dodd-Frank Act,[211] requires registration of persons performing the functions of a clearing agency with respect to SB

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[209] Id.

[210] 15 U.S.C. 78c(a)(39).

[211] 15 U.S.C. 78q-1.

swaps. Many of the provisions of section 17A of the Exchange Act either require rulemaking or other action by the Commission or apply only to clearing agencies once registered. Those provisions that either require rulemaking or other action by the Commission or apply only to registered clearing agencies will not require compliance on the Effective Date. Table H below lists each provision of section 17A of the Exchange Act[212] that was added by the Dodd-Frank Act and identifies those provisions with which compliance will be required on the Effective Date and those with which compliance will be triggered by registration of clearing agencies or by the adoption of final rules or other action by the Commission. The table also includes provisions that authorize or direct the Commission to take specified action that, once undertaken, may impose compliance obligations upon market participants.[213] Unless otherwise noted in the table below, these provisions do not require compliance by market participants on the Effective Date. For the provisions with which compliance will be required on the Effective Date, Table H notes whether temporary relief from compliance is granted.

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212 Id.

213 See supra note 26 and accompanying text.

Table H: Registration of Clearing Agencies for Security-Based Swaps– Compliance Dates.

Exchange Act Section[214]	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[216]	Authorizes/ Directs Commission Action[215]	Relief Granted
17A(g): Registration requirement		✓		N/A[217]

214 References to section 17A of the Exchange Act in this table are to 15 U.S.C. 78q-1.

215 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

216 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

217 Section 17A(g) of the Exchange Act, 15 U.S.C. 78q-1(g), will not require compliance as of the Effective Date because sections 17A(i) and (j) of the Exchange Act, 15 U.S.C. 78q-1(i) and (j), require rulemaking regarding registration of clearing agencies that clear SB swap transactions. The Commission notes that the general clearing agency registration requirement under section 17A(b) of the Exchange Act, 15 U.S.C. 78q-1(b), also will apply to SB swap clearing agencies when the provisions amending the definitions of "security" to include SB swaps become effective on the Effective Date. See supra note 17. As noted above, however, the Commission intends to provide temporary relief from certain provisions of the Exchange Act that would otherwise be applicable to SB swaps. See supra note 22 and accompanying text. This includes temporary relief from the clearing agency registration requirement to certain persons with respect to SB swaps. Specifically, persons that currently provide important post-trade, non-CCP clearance and settlement processing services for SB swaps may be required to register as a clearing agency as of the Effective Date (including trade matching, collateral management, and tear-up/compression services). Temporary relief for such persons would provide time for the Commission to consider comments from industry on the issue of registration of these non-CCP clearance and settlement service providers, and to consider possible alternatives to full registration as clearing agencies. See infra note 223 and accompanying text.

Exchange Act Section[214]	Compliance Date		Authorizes/ Directs Commission Action[215]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[216]		
17A(h): Voluntary registration	✓			No[218]
17A(i): Standards for clearing agencies clearing SB swap transactions		✓		N/A[219]
17A(j): Rules			✓	N/A
17A(k): Exceptions			✓	N/A
17A(l)(1) – (2): Existing depository institutions and derivative clearing organizations – in general; conversion of depository institutions	✓			No[220]

218 Section 17A(h) provides that a person that clears trades that are not required to be cleared may nevertheless register as a clearing agency with the Commission. It is a voluntary provision.

219 Rules adopted under section 17A(i) of the Exchange Act, 15 U.S.C. 78q-1(i), apply only to registered clearing agencies. Accordingly, compliance with such requirements will be required on the later of the registration of the clearing agency and the compliance date of the Commission rule establishing these clearing agency standards.

220 Section 17A(l)(1)-(2) provides for the deemed registration of certain clearing agencies. See infra note 223.

Exchange Act Section[214]	Compliance Date		Authorizes/ Directs Commission Action[215]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[216]		
17A(l)(3): Existing depository institutions and derivative clearing organizations – sharing of information			✓	N/A [221]
17A(m): Modification of core principles			✓	N/A

As of July 16, 2011, ICE Trust U.S. LLC, ICE Clear Europe Limited and the Chicago Mercantile Exchange Inc., which are operating pursuant to exemptive authority granted by the Commission to clear CDS,[222] will be deemed registered with the Commission solely for the purpose of clearing SB swaps pursuant to the Dodd-Frank Act.[223]

221 Section 17A(l)(3) of the Exchange Act, 15 U.S.C. 78q-l(3), provides that the CFTC shall share certain information with the Commission regarding derivatives clearing organizations deemed to be registered.

222 The Commission has authorized five entities to clear credit default swaps. See Exchange Act Release Nos. 60372 (July 23, 2009), 74 FR 37748 (July 29, 2009), 61973 (Apr. 23, 2010), 75 FR 22656 (Apr. 29, 2010) and 63389 (Nov. 29, 2010), 75 FR 75520 (Dec. 3, 2010) (CDS clearing by ICE Clear Europe Limited); 60373 (July 23, 2009), 74 FR 37740 (July 29, 2009), 61975 (Apr. 23, 2010), 75 FR 22641 (Apr. 29, 2010) and 63390 (Nov. 29, 2010), 75 FR 75518 (Dec. 3, 2010), (CDS clearing by Eurex Clearing AG); 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) and 63388 (Nov. 29, 2010). 75 FR 75522 (Dec. 3, 2010) (CDS clearing by Chicago Mercantile Exchange Inc.); 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009), 61119 (Dec. 4, 2009), 74 FR 65554 (Dec. 10, 2009). 61662 (Mar. 5, 2010), 75 FR 11589 (Mar. 11, 2010) and 63387 (Nov. 29, 2010) 75 FR 75502 (Dec. 3, 2010) (CDS clearing by ICE Trust US LLC); 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009)

By virtue of the broad definition of the term "clearing agency" in section 3(a)(23)(A) of the Exchange Act,[224] certain entities that provide non-CCP clearing agency services with respect to SB swaps would be required to register as a clearing agency under section 17A(b) of the Exchange Act as of the Effective Date.[225] This issue arises for these entities as of the Effective

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(temporary CDS clearing by LIFFE Administration and Management and LCH.Clearnet Ltd.) (collectively, "CDS Clearing Exemption Orders"). LIFFE Administration and Management and LCH.Clearnet Ltd. allowed their order to lapse without seeking renewal.

There are currently four clearing agencies authorized to provide CCP services for SB swap transactions pursuant to these orders. Eurex Clearing AG will not be deemed registered as a clearing agency.

[223] See section 17A(l) of the Exchange Act, 15 U.S.C. 78q-1(1). To be deemed registered, a clearing agency must be a depository institution that cleared swaps as a multilateral clearing organization or a derivative clearing organization that cleared swaps pursuant to an exemption from registration as a clearing agency. Id. Section 17A(l) of the Exchange Act, 15 U.S.C. 78q-1(l), provides that certain SB swap clearing agencies will be deemed registered for the purpose of clearing SB swaps ("Deemed Registered Provision"). Under this Deemed Registered Provision, a deemed registered clearing agency will be required to comply with all requirements of the Exchange Act, and the rules thereunder, applicable to registered clearing agencies, including, for example, the obligation to file proposed rule changes under section 19(b) of the Exchange Act, 15 U.S.C. 78s(b). After the Deemed Registered Provision becomes effective on the Effective Date, see supra Table H, certain clearing agencies will no longer need an exemption from registration as a clearing agency under section 17A of the Exchange Act, 15 U.S.C. 78q-1, in order to clear SB swaps. As noted above, ICE Trust U.S. LLC, ICE Clear Europe Limited, and the Chicago Mercantile Exchange Inc., are eligible for the Deemed Registered Provision based on the specified criteria in section 17A(l) of the Exchange Act, 15 U.S.C. 78q-1(l). In addition, to facilitate the operation of clearing agencies as CCPs for eligible CDS, the Commission also adopted interim temporary exemptions ("Temporary Exemptions") from certain provisions of the Securities Act, the Exchange Act and the Trust Indenture Act, 15 U.S.C. 77aaa et seq., subject to certain conditions. See Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, 74 FR 3967 (Jan. 22, 2009). The Commission extended the expiration date of the final temporary rules until July 16, 2011. See Extension of Temporary Exemptions for Eligible Credit Default Swaps to Facilitate Operation of Central Counterparties to Clear and Settle Credit Default Swaps, 75 FR 72660 (Nov. 26, 2010). The Commission is considering extending the Temporary Exemptions. Once extended, the Temporary Exemptions would continue to be available to those clearing agencies that are deemed registered. The Commission also has proposed exemptions that would allow clearing agencies in their function as CCPs to offer or sell SB swaps subject to certain conditions. These proposed exemptions, if adopted, would replace the Temporary Exemptions and would extend to all SB swaps. See Proposed Cleared SB Swap Exemptions, supra note 19.

[224] 15 U.S.C. 78c(a)(23)(A).

[225] 15 U.S.C. 78q-1(b). As discussed above, the new registration requirement for SB swap clearing agencies in section 17A(g) of the Exchange Act, 15 U.S.C. 78q-1(g), will not apply until at least 60 days after rulemaking is completed.

Date, and not before, because prior to such time SB swaps (other than in limited circumstances) were not deemed to be securities. Non-CCP clearing agency services include such services such as trade matching,[226] collateral management,[227] and tear-up/compression services,[228] which are important post-trade processing services for the SB swap markets ("non-CCP clearing agency services"). On March 2, 2011, the Commission proposed exempting certain market participants from the definition of clearing agency as part of its clearing agency standards release.[229] As noted above, the Commission also intends to separately consider temporary relief from section 17A(b) of the Exchange Act[230] for persons that provide non-CCP clearing agency services in connection with SB swaps so that those persons are not required to be registered as a clearing agency on the Effective Date.[231]

Request for Comment:

- Are there any provisions of section 17A of the Exchange Act for which the Commission should grant temporary exemptive relief? Please specify which provisions and provide a detailed explanation of why granting such exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

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226 See Clearing Agency Standards for Operation and Governance, supra note 10 (discussing trade matching services).

227 Id. (discussing collateral management activities).

228 Id. (discussing tear-up and compression services).

229 Id. at 14494-96 (proposing, under section 36 of the Exchange Act, 15 U.S.C. 78mm, an exemption to certain persons from the definition of clearing agency in section 3(a)(23) of the Exchange Act, 15 U.S.C. 78c(a)(23), and asking questions regarding whether there are other persons for whom the Commission should grant a similar exemption).

230 15 U.S.C. 78q-1(b).

231 See supra note 217.

I. Other Amendments to the Federal Securities Laws Relating to Security-Based Swaps.

Table I lists the remaining statutory provisions of Title VII of the Dodd-Frank Act that have not been addressed above.

Table I: Other Amendments to Federal Securities Laws Relating to Security-Based Swaps– Compliance Dates.

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
761(a): Amendments to section 3(a) of the Exchange Act[234] – Definitions (other than the definition of substantial position in section 3(a)(67)(B))[235]	✓			No[236]

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232 These provisions do not require compliance by market participants on the Effective Date, unless the relevant Commission action already has been undertaken. See supra note 26 and accompanying text.

233 A number of Title VII provisions expressly (or implicitly) apply only to "registered" persons. Until the related registration processes for such persons have been established by final Commission rules, and such persons have become registered pursuant to such rules, they will not be required to comply with these Title VII provisions. If a Title VII provision requires a rulemaking, such provision will not necessarily go into effect on the Effective Date, but instead will go into effect "not less than" 60 days after publication of the related final rule or on July16, 2011, whichever is later. See section 774 of the Dodd-Frank Act, 15 U.S.C. 77b note.

234 15 U.S.C. 78c(a).

235 15 U.S.C. 78c(a)(67)(B).

236 See supra note 22 and accompanying text.

Exchange Act Section	Compliance Date: Upon Effective Date (July 16, 2011)	Compliance Date: Upon Registration, Publication of Final Rules, or Other Commission Action[233]	Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
761(a): Amendments to section 3(a) of the Exchange Act[237] – Definition of substantial position in section 3(a)(67)(B)[238]			✓	N/A
761(b): Authority to further define terms			✓	N/A
762(a): Repeals section 206B and 206C of the Gramm-Leach-Bliley Act ("GLBA")[239]	✓			No
762(b): Section 206A of GLBA: conforming amendment[240]	✓			No

[237] 15 U.S.C. 78c(a).

[238] 15 U.S.C. 78c(a)(67)(B).

[239] 15 U.S.C. 78c note. This amendment, along with the amendments in sections 762(b), (c), and (d) of the Dodd-Frank Act, repeals GLBA, Securities Act, and Exchange Act provisions (as added by the Commodity Futures Modernization Act of 2000) limiting the Commission's authority over security-based swap agreements (as defined in section 206B of the GLBA, 15 U.S.C. 78c note).

[240] Id.

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
762(c): Sections 2A and 17 of the Securities Act: conforming amendments[241]	✓			No
762(d): Sections 3A, 9, 10, 15, 16, 20, and 21A of the Exchange Act: conforming amendments[242]	✓			No
763(e): Section 6(l) of the Exchange Act: trading in SB swaps[243]	✓			Yes
763(f): Amends sections 9(b)(1) – (3) of the Exchange Act to add "security-based swaps"[244]	✓			No

241 15 U.S.C. 77b-1 and 77q.

242 15 U.S.C. 78c-1, 78i, 78j, 78o, 78p, 78t, and 78u-1. See supra note 224.

243 15 U.S.C. 78f(l).

244 15 U.S.C. 78i(b)(1) - (3). Section 763(f) makes conforming amendments to the Exchange Act.

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
764(b): Savings clause regarding Federal banking agency authority			✓[245]	N/A
765: Rulemaking on conflicts of interest			✓	N/A
766(b): Sections 13(d)(1) and (g)(1) of the Exchange Act: beneficial ownership reporting[246]	✓			No
766(c): Section 13(f)(1) of the Exchange Act: reports by institutional investment managers[247]	✓			No

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245 Section 764(b) provides that no appropriate Federal banking agency shall be divested of any authority for any entity over which it has authority.

246 15 U.S.C. 78m(d)(1) and (g)(1).

247 15 U.S.C. 78m(f)(1).

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
766(d): Sections 15(b)(4)(C) and (b)(4)(F) of the Exchange Act: administrative proceeding authority[248]	✓			No
766(e): Section 13(o) of the Exchange Act: SB swap beneficial ownership[249]		✓[250]		No
767: Section 28(a) of the Exchange Act: state gaming and bucket shop laws[251]	✓			N/A[252]

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248 15 U.S.C. 78o(b)(4)(C) and (b)(4)(F).

249 15 U.S.C. 78m(o).

250 See Beneficial Ownership Reporting Requirements and Security-Based Swaps, Exchange Act Release No. 64628 (June 8, 2011), available at http://www.sec.gov/rules/final/2011/34-64628.pdf.

251 15 U.S.C. 78bb(a).

252 This section limits the scope of applicability of certain provisions of the Exchange Act and addresses certain state law issues.

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
768: Sections 2(a) and 5(d) of the Securities Act: amendments to the Securities Act; treatment of SB swaps[253]	✓			No[254]
769: Conforming definition in section 2(a)(54) of the Investment Company Act of 1940[255]	✓			No
770: Conforming definition in section 202(a)(29) of the Investment Advisers Act of 1940[256]	✓			No

253 15 U.S.C. 77b(a) and 77e(d).

254 The Commission has proposed exemptions from the registration requirements of the Securities Act for offers or sales of SB swaps issued by certain clearing agencies satisfying certain conditions. See Proposed Cleared SB Swap Exemptions, supra note 19.

255 15 U.S.C. 80a-2(a)(54). Section 769 of the Dodd-Frank Act makes conforming amendments to section 2(a)(54) the Investment Company Act of 1940.

256 15 U.S.C. 80b-2(a)(29). Section 770 of the Dodd-Frank Act makes conforming amendments to section 202(a)(2) of the Investment Advisers Act of 1940.

Exchange Act Section	Compliance Date		Authorizes/ Directs / Limits Commission Action[232]	Relief Granted
	Upon Effective Date (July 16, 2011)	Upon Registration, Publication of Final Rules, or Other Commission Action[233]		
771: Other authority of other agencies	✓			N/A
772(a): Section 36(c) of the Exchange Act: jurisdiction – in general[257]	✓			N/A
772(b): Section 30(c) of the Securities Act: jurisdiction – rule of construction[258]	✓			N/A
773: Section 21B(f) of the Exchange Act: civil penalties[259]	✓			N/A
774: Effective date	✓			N/A

As indicated in Table I, the Commission finds, pursuant to section 36 of the Exchange Act,[260] that it is necessary or appropriate in the public interest, and is consistent with the protection of investors, to grant a temporary conditional exemption from section 6(l) of the

[257] 15 U.S.C. 78mm(c).

[258] 15 U.S.C. 78dd(c).

[259] 15 U.S.C. 78u-2(f).

[260] 15 U.S.C. 78mm.

Exchange Act to certain persons.[261] Section 6(l) of the Exchange Act[262] would make it unlawful, as of the Effective Date, for any person to effect a transaction in an SB swap with or for a person that is not an eligible contract participant,[263] unless such transaction is effected on a national securities exchange registered pursuant to section 6(b) of the Exchange Act.[264]

Title VII amended the definition of eligible contract participant in the Commodity Exchange Act.[265] A number of commenters have raised concerns about potential uncertainty regarding the definition of "eligible contract participant" as a result of the Title VII amendments to that definition.[266] They have suggested, among other things, that market participants may cease or limit their business with counterparties that could potentially be considered non-eligible contract participants when the Dodd-Frank Act amendments to the definition of eligible contract participant go into effect.[267]

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261 15 U.S.C. 78f(l).

262 Id.

263 See section 1a(18) of the Commodity Exchange Act, 7 U.S.C. 1a(18).

264 15 U.S.C. 78f(b).

265 Section 721(a) of the Dodd-Frank Act amended section 1a(18) of the Commodity Exchange Act, 7 U.S.C. 1a(18), to include a new definition of the term "eligible contract participant."

266 See, e.g., Trade Association Letter, supra note 28 ("The definition of [eligible contract participant] was amended by [the Dodd-Frank Act], and the [Commission and the CFTC] have sought comments in [the Entity Definitions Release] on how to further define such term, including how to interpret the phrase "discretionary basis." Until the term [eligible contract participant] is further defined in a final rulemaking, market participants will not know whether they are dealing with an [eligible contract participant], and where the line is between their institutional and retail businesses. As a result, they will not know . . . whether certain transactions are subject to the new requirement for [non-eligible contract participant] transactions to be executed on an exchange . . . . As a result, market participants may cease or severely limit their business with counterparties that could potentially be considered [non-eligible contract participants] under the Dodd-Frank statutory definition of [eligible contract participant].").

267 Id.

The Commission finds that temporary exemption from section 6(l) of the Exchange Act[268] for persons that meet the definition of eligible contract participant as set forth in section 1a(12) of the Commodity Exchange Act (as in effect on July 20, 2010)[269] is necessary or appropriate in the public interest, and is consistent with the protection of investors, because it would allow persons currently participating in the SB swap markets that could potentially be considered non-eligible contract participants under the definition of eligible contract participant as amended by Title VII of the Dodd-Frank Act, to continue to do so until the term eligible contract participant is further defined in final rulemaking. Accordingly, the Commission is providing a temporary conditional exemption pursuant to section 36 of the Exchange Act[270] from section 6(l) of the Exchange Act[271] for eligible contract participants under current law. The temporary exemption will expire on the effective date for the final rules further defining the term eligible contract participant.

In addition, the Commission has received comments[272] expressing concern regarding the implication of the incorporation of SB swaps into the definition of "security."[273] Commenters have indicated that they are still analyzing the full implication of such expansion of the definition

[268] 15 U.S.C. 78(f)(l).

[269] 7 U.S.C. 1a(12) (as in effect on July 20, 2010).

[270] 15 U.S.C. 78mm.

[271] 15 U.S.C. 78f(l).

[272] See supra note 28.

[273] The Commission notes however that it has not received any comments regarding the definition of "security future" or the possibility that SB swaps may be characterized as security futures. Section 3(a)(55) of the Exchange Act, 15 U.S.C. 78c(a)(55), excludes from the definition of security future "any agreement, contract, or transaction excluded from the Commodity Exchange Act under section 2(c), 2(d), 2(f), or 2(g) of the Commodity Exchange Act (as in effect on the date of enactment of the Commodity Futures Modernization Act of 2000) or title IV of the Commodity Futures Modernization Act of 2000." Although the Dodd-Frank Act repealed certain provisions of the Commodity Exchange Act added by the CFMA. Title VII did not affect this exclusion or otherwise affect the legal certainty provided by section 3(a)(55) of the Exchange Act regarding the potential scope of the definition of security future.

of security, but that it will take time.[274] Market participants therefore have requested temporary relief from certain provisions of the Exchange Act that will impose new obligations on counterparties to SB swaps so that they may complete their analysis and submit requests for more targeted relief.[275] The Commission intends to separately address relief in this area.[276]

Moreover, the Commission has proposed exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for SB swaps issued by certain clearing agencies satisfying certain conditions.[277] The proposed exemptive rules would exempt transactions by clearing agencies in these SB swaps from all provisions of the Securities Act, other than the section 17(a)[278] antifraud provisions, as well as exempt these SB swaps from Exchange Act registration requirements and from the provisions of the Trust Indenture Act, provided certain conditions are met.[279]

Request for Comment:

- Is the temporary exemption from section 6(l) of the Exchange Act appropriate? If not, why not? Is the condition that transactions be limited to eligible contract participants as defined under current law sufficient to protect SB swap market participants that would otherwise receive the protection of the exchange-trading requirement of section 6(l) of the Exchange Act?

- Are there any provisions set out in Table I above, other than those for which the Commission has indicated that it will be providing guidance, and where appropriate, temporary relief, for which the Commission should grant temporary exemptive relief? Please specify which

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274 See supra note 28 and note 275

275 See Trade Association Letter, supra note 28.

276 See supra note 22 and accompanying text.

277 See Proposed Cleared SB Swap Exemptions, supra note 19 and discussion supra note 223.

278 15 U.S.C. 77q(a).

279 See Proposed Cleared SB Swap Exemptions, supra note 19.

provisions and provide a detailed explanation of why granting such exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

J. Section 29(b) of the Exchange Act.

Section 29(b) of the Exchange Act generally provides that contracts made in violation of any provision of the Exchange Act, or the rules thereunder, shall be void "(1) as regards the rights of any person who, in violation of any such provision, . . . shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contracts, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contracts in violation of any such provision . . . ."[280] As discussed above, the Commission does not believe that provisions of Title VII for which the Commission has taken the view that compliance will either be triggered by registration of a person or by adoption of final rules by the Commission, or for which the Commission has provided an exception or exemptive relief herein, require compliance as of the Effective Date. The Commission thus does not believe that section 29(b) of the Exchange Act[281] would apply to such provisions. For the avoidance of doubt, however, and to avoid possible legal uncertainty or market disruption, the Commission is granting temporary exemptive relief from section 29(b) of the Exchange Act.[282]

The Commission is exercising its authority under section 36 of the Exchange Act[283] to temporarily exempt any SB swap contract entered into on or after the Effective Date from being

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[280] 15 U.S.C. 78cc(b).

[281] Id.

[282] Id.

[283] 15 U.S.C. 78mm.

void or considered voidable by reason of section 29 of the Exchange Act[284] because any person that is a party to the SB swap contract violated a provision of the Exchange Act that was amended or added by subtitle B of Title VII of the Dodd Frank Act and for which the Commission has taken the view that compliance will be triggered by registration of a person or by adoption of final rules by the Commission, or for which the Commission has provided an exception or exemptive relief herein, until such date as the Commission specifies.

The Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors, because the legal uncertainty that could result if contracts entered into after the Effective Date were void or voidable under section 29(b) of the Exchange Act[285] could be disruptive to the financial markets, create confusion for both financial institutions and their customers, or result in unnecessary and wasteful litigation.

As previously discussed, once the relevant provisions of the Dodd-Frank Act take effect,[286] persons effecting transactions in SB swaps, or engaged in acts, practices, and courses of business involving SB swaps, will be subject to the general antifraud and anti-manipulation provisions of the federal securities laws that were in place before the enactment of the Dodd-Frank Act, including sections 9(a) and 10(b) of the Exchange Act,[287] rule 10b–5 thereunder[288] (and the prohibitions against insider trading), section 15(c) of the Exchange Act,[289] and section

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284 15 U.S.C. 78cc(b).

285 Id.

286 See section 774 of the Dodd-Frank Act.

287 15 U.S.C. 78i(a) and 78j(b).

288 17 CFR 240.10b-5.

289 15 U.S.C. 78o(c).

17(a) of the Securities Act,[290] among others. Persons would retain all available rights as a result of any violation of these general antifraud and anti-manipulation provisions.

III. Solicitation of Comments.

The Commission intends to monitor closely the transition of the derivatives markets to regulated markets and to determine to what extent, if any, additional regulatory action may be necessary. The Commission is soliciting public comment on all aspects of these exemptions and the guidance it provided regarding compliance dates, including:

1. Is the guidance provided in this section useful, appropriate, and sufficient for persons to determine which amendments to the Exchange Act by Title VII require compliance on July 16, 2011? If not, please explain and provide examples of which provisions require additional guidance.

2. Are there other provisions of the Exchange Act as amended by the Dodd-Frank Act for which temporary exemptive relief should be granted? Please provide section references and provide a detailed explanation of why granting such an exemption would be necessary or appropriate in the public interest, and consistent with the protection of investors.

3. Is the duration of the temporary exemptions granted in this Order appropriate? If not, for which exemptions are the duration not appropriate and what should be the appropriate duration?

4. Should any conditions be placed on any of these exemptions? If so, which exemptions? Please explain and provide specific examples.

Interest persons are invited to submit written data, views, and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

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[290] 15 U.S.C. 77q(a).

IV. Temporary Exemptions and Other Temporary Relief

For the reasons discussed above in Part II, the Commission is granting the following temporary relief:

IT IS HEREBY ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that no reporting party (as defined in 17 CFR 242.900) shall be required to report any pre-enactment security-based swap (as defined in 17 CFR 242.900) under section 3C(e)(1) of the Securities Exchange Act of 1934 until the date six (6) months after the date a security-based swap data repository that is capable of accepting the asset class (as defined in 17 CFR 242.900) of such security-based swap is registered by the Commission.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that security-based swap dealers and major security-based swap participants are exempt from the requirements of section 3C(g)(5)(B) of the of the Securities Exchange Act of 1934 until the earliest compliance date set forth in any of the final rules regarding section 3C(b) of the Securities Exchange Act of 1934.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that registered clearing agencies under section 17A of the Securities Exchange Act of 1934 are exempt from the requirements of sections 3C(j)(1) and (2) of the of the Securities Exchange Act of 1934 until the earliest compliance date set forth in any of the final rules regarding section 3C(j)(2) of the Securities Exchange Act of 1934.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that persons that operate a facility for the trading or processing of security-based swaps that is not currently registered as a national securities exchange or that cannot yet register as a security-based swap execution facility because final rules for such registration have not yet been adopted are exempt from the requirements of section 3D(a)(1) of the Securities Exchange Act of 1934 until the earliest compliance date set forth in any of the final rules regarding registration of security-based swap execution facilities.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that registered clearing agencies under section 17A of the Securities Exchange Act of 1934 are exempt from the requirements of section 3D(c) of the Securities Exchange Act of 1934 until the earliest compliance date set forth in any of the final rules regarding registration of security-based swap execution facilities.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that security-based swap dealers and major security-based swap participants are exempt from the requirements of section 3E(f) of the Securities Exchange Act of 1934 until the date upon which the rules adopted by the Commission to register security-based swap dealers and major security-based swap participants become effective.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that entities that meet the definition of security-based swap data repository as set forth in section 3(a)(75) of the Securities Exchange Act of 1934 are exempt from requirements of sections 13(n)(5)(D)(i), 13(n)(5)(F), 13(n)(5)(G), 13(n)(5)(H), and 13(n)(7)(A) through (C) of the Securities Exchange Act of 1934 until the earlier of (1) the date the Commission grants registration to the security-based swap data repository and (2) the earliest compliance date for any of the final rules regarding the registration of security-based swap data repositories.

IT IS HEREBY FURTHER ORDERED, pursuant to section 15F(b)(6) of the Securities Exchange Act of 1934, that security-based swap dealers and major security-based swap participants are temporarily excepted from the prohibition of section 15F(b)(6) of the Securities Exchange Act of 1934 with respect to persons subject to a statutory disqualification (as defined in section 3(a)(39) of the Securities Exchange Act of 1934) who are currently associated with a security-based swap dealer or major security-based swap participant and who effect or are involved in effecting security-based swaps on behalf of such security-based swap dealer or major security-based swap participant until the date upon which rules adopted by the Commission to register security-based swap dealers and major security-based swap participants become effective.

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that any person that meets the definition of eligible contract participant as set forth in section 1a(12) of the Commodity Exchange Act (as in effect on July 20, 2010) is exempt from the requirements of section 6(l) of the Securities Exchange Act of 1934 with respect to a transaction in a security-based swap until the effective date for the final rules further defining the term eligible contract participant, provided that such person effects such transaction with or for a person that also meets the definition of eligible contract participant as set forth in section 1a(12) of the Commodity Exchange Act (as in effect on July 20, 2010).

IT IS HEREBY FURTHER ORDERED, pursuant to section 36 of the Securities Exchange Act of 1934, that no contract entered into on or after July 16, 2011 shall be void or considered voidable by reason of section 29(b) of the Securities and Exchange Act of 1934 because any person that is a party to the contract violated a provision of the Securities Exchange Act of 1934 that was amended or added by subtitle B of the Wall Street Transparency and

Accountability Act of 2010 and for which the Commission has taken the view that compliance will be triggered by registration of a person or by adoption of final rules by the Commission, or for which the Commission has provided an exception or exemptive relief herein, until such date as the Commission specifies.

By the Commission,

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: June 15, 2011

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64694 / June 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14256

In the Matter of **GLOBAL SENTRY EQUITY TRANSFER, INC.,** **Respondent.**	**AMENDED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 17A(c)(3) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 17A(c)(3) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Global Sentry Equity Transfer, Inc. ("Respondent" or "Global Sentry").

II.

After an investigation, the Division of Enforcement alleges that:

A. **RESPONDENT**

1. **Global Sentry Equity Transfer, Inc. ("Global Sentry")** is a Nevada corporation with its principal place of business in Ontario, Canada. Global Sentry has been registered with the Commission as a transfer agent since July 30, 2007, pursuant to Section 17A of the Exchange Act. During 2008, Global Sentry was the transfer agent of record for, among other entities, Infinity Medical Group, Inc. ("Infinity"), Cannon Exploration Inc. ("Cannon"), and China Jiangsu Golden Horse Steel Ball Inc. ("China Jiangsu").

B. OTHER RELEVANT PERSON AND ENTITIES

1. Christopher Wheeler, age 43, is a resident of Victor, New York. He is the owner of OTCStockExchange.com, a stock promotion website. Wheeler does not hold any securities licenses, and is not associated with any entity that is registered with the Commission.

2. Infinity was incorporated in Nevada in 1989 as D.V. Holdings, Inc. Between June 1999 and August 2007, the company operated at various times under the names Iceberg Corporation of America, Royal Alliance Entertainment, Inc., and Infinity. Infinity purports to be a specialty healthcare company and initially listed its principal place of business as Ontario, Canada. During the relevant period, Infinity did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act of 1933 ("Securities Act"). During the relevant period, Infinity's shares were quoted on the Pink Sheets operated by Pink OTC Markets Inc. ("Pink Sheets").

3. Cannon was incorporated in Delaware in 1983 as Citisource, Inc. ("Citisource"). In June 2006, the company changed its name from Citisource to China Shuangji Cement Corporation, but changed it back to Citisource in October 2007. In April 2008, the company changed its name to Cannon. Cannon purports to be a mining and exploration company and listed its principal place of business as Ontario, Canada. During the relevant period, Cannon did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, Cannon's shares were quoted on the Pink Sheets.

4. China Jiangsu was incorporated in Nevada in 1999 as Puppettown.com, Inc. The company changed its name to Business Translation Services, Inc. in December 2001, to Muller Media, Inc. in February 2002, and to China Jiangsu in October 2007. Since late 2008, the company has operated as Santana Mining, Inc. During the relevant period, the company's principal place of business was China, and it purported to be a manufacturer and supplier of ball bearings. During the relevant period, China Jiangsu did not have a class of securities registered under the Exchange Act and did not register any offering of securities under the Securities Act. During the relevant period, China Jiangsu's shares were quoted on the Pink Sheets.

C. GLOBAL SENTRY'S FAILURE TO COMPLY WITH EXCHANGE ACT PROVISIONS CONCERNING TRANSFER AGENTS

1. In at least 2008, Infinity, Cannon, and China Jiangsu issued a total of approximately 3.5 million purportedly unrestricted shares to Wheeler. Global Sentry, acting in its capacity as transfer agent, issued stock certificates in Wheeler's name, which Wheeler's brokerage firm credited to Wheeler's account and from which Wheeler subsequently sold the shares. Specifically, Global Sentry failed to comply with the Exchange Act and related rule provisions as follows:

a. Section 17(a)(1) of the Exchange Act requires, in relevant part, that "[e]very . . . registered transfer agent . . . 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 this [Act]." Section 17A(d)(1) of the Exchange Act provides, in relevant part, that "[n]o . . . registered transfer agent shall, directly or indirectly, engage in any activity as . . . [a] transfer agent in contravention of such rules and regulations [] as the Commission may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Act]. . . . " Pursuant to this authority, the Commission adopted Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19 and 17Ac2-2.

b. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-6(c) thereunder require that, "every registered transfer agent which, under the terms of its agency, maintains securityholder records for an issue shall, with respect to such issue, retain each cancelled registered bond, debenture, share, warrant or right, other registered evidence of indebtedness, or other certificate of ownership and all accompanying documentation, except legal papers returned to the presentor." Under these provisions, Global Sentry was required to maintain cancelled stock certificates. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-6.

c. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-7(d) thereunder require that "the records required under Rule 17Ad-6(c) shall be maintained for a period of not less than six years . . . ." Under this Rule, to the extent that Global Sentry failed to maintain documents as required under 17Ad-6(c) identified in paragraph b. above, Global Sentry was required to maintain cancelled Infinity, Cannon, and China Jiangsu stock certificates that it issued to Wheeler for not less than six years. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain cancelled stock certificates relating to the sale of Infinity, Cannon, and China Jiangsu shares issued to Wheeler as required under Rule 17Ad-7.

d. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-10(a)(1) thereunder require that "[e]very recordkeeping transfer agent shall promptly and accurately post to the master securityholder file debits and credits containing minimum and appropriate certificate detail representing every security transferred, purchased, redeemed or issued; *Provided, however,* That if a security transferred or redeemed contains certificate detail different from that currently posted to the master securityholder file, the credit shall be posted to the master securityholder file and the debit and related certificate detail shall be maintained in a subsidiary file until resolved." Rule 17Ad-10(b) requires that "every recordkeeping transfer agent shall maintain and keep current an accurate master securityholder file. . . ." Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain accurate "master securityholder files" as required under Rule 17Ad-10.

e. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Rule 17Ad-19(b) thereunder require registered transfer agents "involved in the handling, processing, or storage of securities certificates [to]establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates." Rule 17Ad-19(d) provides that a transfer agent "shall maintain records that demonstrate compliance with the requirements set forth" under Rule 17Ad-19. Global Sentry admitted that it is "not in possession of any documentation concerning Wheeler . . . ." Global Sentry failed to maintain records as required under Rule 17Ad-19, in particular the stock certificates relating to the transfer of Infinity, Cannon, and China Jiangsu shares issued to Wheeler.

f. Exchange Act Section 17(b)(1) requires that registered transfer agents "are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission and the appropriate regulatory agency for such persons as the Commission and the appropriate regulatory agency for such persons deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this title." Global Sentry violated Section 17(b)(1) of the Exchange Act by refusing to allow an on-site examination of its transfer agent records on February 7, 2011, by the staff of the Commission's Office of Compliance Inspections and Examinations.

g. Exchange Act Sections 17(a)(1) and 17A(d)(1) and Exchange Act Rule 17Ac2-2(a) require every transfer agent registered on December 31 to file a report covering the reporting period on Form TA-2 by March 31 following the end of the reporting period. Global Sentry has failed to make timely filings for the years ended December 31, 2008, and December 31, 2009, as required.

D. <u>VIOLATIONS</u>

1. As a result of the conduct described above, Global Sentry willfully violated Sections 17(a)(1), 17(b)(1), and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Global Sentry pursuant to Section 17A(c)(3) of the Exchange Act including, but not limited to, disgorgement, if any, and civil penalties pursuant to Section 21B of the Exchange Act;

C. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of, and any future violations of, Sections 17(a)(1), 17(b)(1), and 17A(d)(1) of the Exchange Act and Rules 17Ad-6, 17Ad-7, 17Ad-10, 17Ad-19, and 17Ac2-2 thereunder.

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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. 64680 / June 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14426

In the Matter of **SHC Corp. (f/k/a Victormaxx Technologies, Inc.),** **Shells Seafood Restaurants, Inc.,** **SI Restructuring, Inc. (f/k/a Schlotzsky's, Inc.),** **SLS Industries, Inc.,** **Softlock.com, Inc. (n/k/a The Cap One Group, Inc.),** **Solar Satellite Communication, Inc., and** **Sonoran Energy, 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 SHC Corp. (f/k/a Victormaxx Technologies, Inc.), Shells Seafood Restaurants, Inc., SI Restructuring, Inc. (f/k/a Schlotzsky's, Inc.), SLS Industries, Inc., Softlock.com, Inc. (n/k/a The Cap One Group, Inc.), Solar Satellite Communication, Inc., and Sonoran Energy, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. SHC Corp. (f/k/a Victormaxx Technologies, Inc.) (CIK Nos. 1092481 and 931198) is a dissolved Illinois corporation located in West Dundee, Illinois with a class

of securities registered with the Commission pursuant to Exchange Act Section 12(g). SHC Corp. 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 over $1.18 million for the prior six months. On June 7, 2002, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Illinois, and the case was terminated on April 28, 2008. As of June 2, 2011, the company's stock (symbol "SONM") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Shells Seafood Restaurants, Inc. (CIK No. 935066) is a void Delaware corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Shells Seafood is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 29, 2008, which reported a net loss of $667,186 for the prior thirteen weeks. As of June 2, 2011, the company's stock (symbol "SHLLQ") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. SI Restructuring, Inc. (f/k/a Schlotzsky's, Inc.) (CIK No. 1002178) is a Texas corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Schlotzsky's 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, 2004, which reported a net loss of over $87 million for the prior six months. As of June 2, 2011, the company's stock (symbol "BUNZQ") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. SLS Industries, Inc. (CIK No. 743871) is a defaulted Nevada corporation located in Hanover, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SLS 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, 1998, which reported a net loss of $685,711 for the prior twelve months. As of June 2, 2011, the company's stock (symbol "SLSI") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Softlock.com, Inc. (n/k/a The Cap One Group, Inc.) (CIK No. 870227) is a Delaware corporation located in Maynard, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Softlock.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended March 31, 2008. On April 16, 2002, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Massachusetts, and the case was terminated on October 8, 2008. As of June 2, 2011, the company's stock (symbol "DIGSQ") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Solar Satellite Communication, Inc. (CIK No. 729588) is a Colorado corporation located in Reston, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Solar Satellite is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of over $1.22 million for the prior nine months. As of June 2, 2011, the company's stock (symbol "SSCI") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Sonoran Energy, Inc. (CIK No. 1101661) is an inactive Washington corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sonoran Energy is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 2008, which reported a net loss of over $1.2 million for the prior twelve months. On June 19, 2009, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Texas, and the case was terminated on January 15, 2010. As of June 2, 2011, the company's stock (symbol "SNRNQ") was quoted on OTC Link, had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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 domestic issuers to file quarterly reports.

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 16, 2011

In the Matter of	ORDER OF SUSPENSION OF TRADING
SHC Corp. (f/k/a Victormaxx Technologies, Inc.), Shells Seafood Restaurants, Inc., SI Restructuring, Inc. (f/k/a Schlotzsky's, Inc.), SLS Industries, Inc., Softlock.com, Inc. (n/k/a The Cap One Group, Inc.), Solar Satellite Communication, Inc., and Sonoran Energy, Inc.,	
File No. 500-1	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SHC Corp. (f/k/a Victormaxx Technologies, Inc.) because it has not filed any periodic reports since the period ended June 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Shells Seafood Restaurants, Inc. because it has not filed any periodic reports since the period ended June 29, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SI Restructuring, Inc. (f/k/a Schlotzsky's, Inc.) because it has not filed any periodic reports since June 30, 2004.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SLS Industries, Inc. because it has not filed any periodic reports since the period ended January 31, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Softlock.com, Inc. (n/k/a The Cap One Group, Inc.) because it has not filed any periodic reports since the period ended March 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Solar Satellite Communication, Inc. because it has not filed any periodic reports since the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sonoran Energy, Inc. because it has not filed any periodic reports since the period ended July 31, 2008.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 16, 2011, through 11:59 p.m. EDT on June 29, 2011.

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. 64682 / June 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14427

In the Matter of **BP International, Inc.,** **CyGene Laboratories, Inc.,** **Delek Resources, Inc.,** **Flooring America, Inc.,** **International Diversified Industries, Inc.,** **Nova Biogenetics, Inc., and** **Tube Media Corp. (The),** **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 BP International, Inc., CyGene Laboratories, Inc., Delek Resources, Inc., Flooring America, Inc., International Diversified Industries, Inc., Nova Biogenetics, Inc., and Tube Media Corp. (The).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. BP International, Inc. ("BPIL") [1] (CIK No. 1082737) is a void Delaware void Delaware corporation located in DeLand, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BPIL is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended February 28, 2006, which reported a net loss of $2,078,628 for the prior nine months. As of June 9, 2011, the common stock of BPIL

[1] The short form of each issuer's name is also its stock symbol.

was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. CyGene Laboratories, Inc. ("CYGE") (CIK No. 810691) is a void Delaware corporation located in Coral Springs, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CYGE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended March 31, 2005, which reported a net loss of $3,702,208 for the prior year. As of June 9, 2011, the common stock of CYGE was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Delek Resources, Inc. ("DLKR") (CIK No. 1049660) is a dissolved Florida corporation located in Miami Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). DLKR 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, 2007, which reported a net loss of $4,456,670 for the prior nine months. As of June 9, 2011, the common stock of DLKR was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Flooring America, Inc. ("FRAE") (CIK No. 910468) is a delinquent Delaware corporation located in Kennesaw, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FRAE 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 February 5, 2000, which reported a net loss of $70,546,000 for the prior year. On June 15, 2000, FRAE filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Georgia, which was still pending as of June 8, 2011. As of June 9, 2011, the common stock of FRAE was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. International Diversified Industries, Inc. ("IDII") (CIK No. 934006) is a forfeited Delaware corporation located in Clearwater, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IDII 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, 1998, which reported a net loss of $2,301,003 for the prior nine months. As of June 9, 2011, the common stock of IDII was quoted on OTC Link, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Nova Biogenetics, Inc. ("NVBG") (CIK No. 1160078) is a void Delaware corporation located in Sandy Springs, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NVBG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2006, which reported a net loss of $1,669,353 for the prior year. As of June 9, 2011, the common stock of NVBG was

quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Tube Media Corp. (The) ("TUBM") (CIK No. 1168932) is a void Delaware corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TUBM 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 $12,155,512 for the prior nine months. As of June 9, 2011, the common stock of TUBM was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. As described 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 domestic issuers to file quarterly reports

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

Commissioner Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3216 / June 16, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14428

In the Matter of ADAM SMITH, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2, and III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, 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. Smith, age 39, resides in New York, New York. From 2002 until 2009, Smith was employed by Galleon Management, LP ("Galleon"), a Delaware limited partnership founded in 1997 as a hedge fund investment adviser based in New York, New York. During the relevant time period, Galleon served as the investment adviser for several hedge funds. From 2002 until 2006, Smith was an analyst at Galleon. In 2006, Smith became the portfolio manager with respect to the Galleon Emerging Technology Funds (f/k/a Galleon Communications Funds), hedge funds advised by Galleon. Smith held a Series 7 securities license.

2. On January 26, 2011, the Commission filed a civil action against Smith in SEC v. Adam Smith, Civil Action No. 1:11-CV-0535. On May 31, 2011, the Court entered an order permanently enjoining Smith, by consent, from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleges that, in connection with the purchase, offer or sale of securities, Smith knew, recklessly disregarded, or should have known, that material non-public information he received from a tipper was disclosed or misappropriated in breach of a fiduciary duty, or similar relationship of trust and confidence, and Smith is liable for trading that occurred at Galleon because he effectuated trades on behalf of Galleon funds he managed and/or unlawfully tipped inside information to the funds he managed.

4. On January 26, 2011, Smith pled guilty to one count of securities fraud and one count of conspiracy to commit securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff and 18 U.S.C. § 371 before the United States District Court for the Southern District of New York in United States v. Adam Smith, 11-CR-00079.

5. The counts of the criminal information to which Smith pled guilty alleged, inter alia, that Smith, and others, participated in a scheme to defraud by executing securities trades based on material, nonpublic information regarding certain inside information concerning public companies that had been misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Smith be, and hereby is barred from association with any investment adviser, broker, dealer, municipal securities dealer, or transfer agent.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 16, 2011

In the Matter of **BP International, Inc.,** **CyGene Laboratories, Inc.,** **Delek Resources, Inc.,** **Flooring America, Inc.,** **International Diversified Industries, Inc.,** **Nova Biogenetics, Inc., and** **Tube Media Corp. (The),** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of BP International, Inc. because it has not filed any periodic reports since the period ended February 28, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of CyGene Laboratories, Inc. because it has not filed any periodic reports since the period ended March 31, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Delek Resources, Inc. because it has not filed any periodic reports since the period ended March 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Flooring America, Inc. because it has not filed any periodic reports since the period ended February 5, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of International Diversified Industries, Inc. because it has not filed any periodic reports since the period ended September 30, 1998.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Nova Biogenetics, Inc. because it has not filed any periodic reports since the period ended June 30, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tube Media Corp. (The) because it has not filed any periodic reports since the period ended September 30, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 16, 2011, and terminating at 11:59 p.m. EDT on June 29, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3217 / June 17, 2011

Admin. Proc. File No. 3-13908

In the Matter of

SHERWIN BROWN
and
JAMERICA FINANCIAL, INC.
5030 Champion Blvd. Suite #G6-456
Boca Raton, FL 33496-2473

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Injunction

Respondents were permanently enjoined from violations of the antifraud and recordkeeping provisions of the federal securities laws. Held, it is in the public interest to revoke the registration of Jamerica Financial, Inc. as an investment adviser and bar respondents from association with any investment adviser.

APPEARANCES:

Sherwin P. Brown, pro se, and on behalf of Jamerica Financial, Inc.

Robin Andrews, Robert Moye, and Charles J. Kerstetter, for the Division of Enforcement.

Appeal filed: January 6, 2011
Last brief received: April 29, 2011

I.

Jamerica Financial, Inc. ("Jamerica"), a registered investment adviser, and Sherwin Brown ("Brown"), Jamerica's president and 50% percent owner, appeal from an initial decision of an administrative law judge. The law judge found that respondents were enjoined from violating the antifraud and recordkeeping provisions of the securities laws. The law judge revoked Jamerica's registration as an investment adviser and barred Jamerica and Brown from associating with any investment adviser. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

A. On March 29, 2006, the Commission filed a complaint against Brown, Jamerica, and Brawta Ventures, LLC ("Brawta") in the United States District Court for the District of Minnesota. [1] The complaint alleged that the defendants had violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940, and that Jamerica, aided and abetted by Brown, had violated Advisers Act Section 204 and Advisers Act Rule 204-2. [2]

On September 30, 2008, the United States District Judge issued an order adopting the report and recommendation of a Magistrate Judge, granting the Commission's motion for summary judgment. The court findings are summarized below.

Brown controlled Jamerica and provided investment advisory services to its clients. Jamerica had approximately 250 clients across several states. Jamerica charged a fee to its clients based on the size of the client's account, but that fee was capped at 1.5% of the "size of the client's investment."

Sometime around May 2004, Brown organized Brawta, which the District Court described as a "purported private investment firm." Brown was Brawta's general managing partner. He marketed Brawta shares directly to Jamerica' clients, initially charging $10,000 per Brawta share. Between May 2004 and January 2006, approximately 53 investors invested $1.62 million in Brawta. Brown was solely responsible for selecting Brawta's investments and had sole signature authority over Brawta's bank account.

Brown did not provide investors with any written disclosure before they invested in Brawta. He told some clients that Brawta would operate like a mutual fund and invest in

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1 *SEC v. Sherwin P. Brown, et al.*, Civil Action No. 06-1213.

2 15 U.S.C. §§ 77q(a), 78j(b), 80b-6(1), 80b-6(2), 80b-4; 17 C.F.R. §§ 240.10b-5, 275.204-2.

publicly traded securities. He told other investors that Brawta would act like a venture capital fund and invest in start-up companies.

Brown also made inconsistent representations about how Brown would be compensated. He variously told investors that:

> he would not charge a separate fee for managing Brawta, but would receive his compensation from the fees clients paid to Jamerica;
>
> he would receive a percentage of Brawta profits in excess of $1 million but would not otherwise receive money from Brawta; or
>
> he would receive a percentage of Brawta's assets under Brawta's management.

None of the investors recalled being informed that funds from their Brawta accounts had been withdrawn to pay fees or management expenses before the institution of the Commission's injunctive action. However, an analysis by a Commission accountant showed that, between May 24, 2004 and February 13, 2006, approximately $869,633 was transferred from the Brawta account for non-investment purposes. These transfers typically occurred when either Brown or Jamerica was running low on funds.

Between May 2004 and August 2004, $240,406 of the $869,633 was transferred from Brawta into Brown's personal checking account. Between November 2004 and February 2006, additional Brawta funds were transferred to Jamerica, as follows:

> Between November 2004 and January 2006, $265,500 was transferred from Brawta by checks written on the Brawta account to purchase "official US Bank" checks that were deposited into a Jamerica account.
>
> Between November 2004 and February 2006, $216,050 was withdrawn from Brawta by Brawta checks made payable to Wells Fargo Bank "and by customer counter withdrawals, followed by deposits in the Jamerica account."
>
> On June 30, 2005, an additional $15,000 was withdrawn from Brawta and used to purchase an official US Bank check, which was deposited into Jamerica's account.

Following these transfers, Jamerica made thousands of dollars in payments to the Apple Store, a lawn care service, Polo/Ralph Lauren, Circuit City, Helzburg Diamonds, Netflix, and Victoria's Secret.

An additional $110,177 was withdrawn from the Brawta account between June 2004 and February 2006 and used to purchase a US Bank official bank check. The Court stated: "While the SEC accountant was unable to pinpoint the manner in which these funds were expended, he notes that these transactions were similar to those discussed above, in that checks were written to banks rather than to payees." [3]

On July 11, 2005, Brawta issued a check for $22,500 to Timothy Gullickson to repay a personal loan Gullickson had made to Brown in 2002. On March 2, 2006, after our staff had begun an investigation of Brown, Brown called Gullickson and "hinted" that, if Gullickson were asked about the check, he should represent that it was payment for "investment advice" or for helping Brown "in choosing stocks for his mutual fund." Gullickson concluded that Brown was asking Gullickson to lie and reported the conversation to his employer, which in turn reported it to the National Association of Securities Dealers.

Our examination staff began an inspection of Jamerica on February 27, 2006. Brown was unable to produce complete bank records for the Brawta account, a list of Brawta's investment, or any documentation explaining how Brawta's asset value was determined. Brown stated that no fees for management of Brawta had been taken from Brawta's funds. Rather, the fees for managing Brawta were collected as a part of Jamerica's fee.

Respondents produced books and records for Jamerica that were current only through December 31, 2004. [4] Jamerica's general ledgers reported that Brown had made capital contributions to Jamerica when in fact the deposits came from funds diverted from Brawta. Respondents did not dispute that Jamerica's account statements overstated the value of Brawta shares, whose value had dropped by approximately 50 percent from the original purchase price by December 2005.

In April 2007, the United States Attorney's office advised Brown's counsel that Brown was a target of a federal grand jury investigation. At a deposition in the Commission's proceeding, Brown asserted his Fifth Amendment privilege against self-incrimination. He further refused to testify on behalf of Jamerica or Brawta or to produce another witness who could testify on their behalf. [5] Thereafter, the District Court declined to permit Brown to submit April 2007 interrogatory responses in opposition to the Commission's motion for summary judgment.

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[3] According to an accounting filed by the defendants pursuant to court order, Brawta had made "unallocated payments" totaling $877,236.16, including $666,883 in transfers from Brawta to either Brown or Jamerica. The accounting determined that $865,389.76 of Brawta funds had been invested.

[4] The Magistrate Judge found that Brown was solely responsible for the management and control of Jamerica. The Magistrate Judge further noted that, even in opposition to the motion for summary judgment, respondents had not provided complete records.

[5] The record does not disclose the outcome of the grand jury's inquiry.

The District Court granted the Commission's motion, finding that Brown and Jamerica had violated the charged antifraud and reporting provisions. The Court found that respondents had introduced no evidence that the transfers were for legitimate purposes. The Court agreed with the Magistrate Judge that Brown and Jamerica acted with "severe recklessness." The Court found that Brown had received $1.62 million from investors for investment purposes. Instead, over half the funds were transferred to Brown or Jamerica, or could not be traced. Some of those funds were used for personal expenditures. Moreover, Brown attempted to conceal the transfers from Brawta by (1) converting Brawta funds to cash by writing checks directly to banks; (2) asking Gullickson to lie about the purpose of the $22,500 payment Gullickson had received from Brawta; and (3) falsely recording transfers to Brawta to Jamerica as Brown's capital contributions. Brown did not dispute that he overstated the value of Brawta's shares to investors after those shares dropped significantly.

On May 3, 2010, the District Court entered judgment. The court enjoined Brown and Jamerica from violations of Securities Act Section 17(a), Exchange Act Section 10(b) and Exchange Act Rule 10b-5, Adviser Act Sections 206(1), 206(2), and 204 and Advisers Act Rule 204-2. The court ordered respondents, jointly and severally, to disgorge $869,633, plus prejudgment interest of $226,380.77. It also imposed an $80,000 civil penalty on Brown and a $400,000 civil penalty on Jamerica. [6]

B. On May 21, 2010, we issued an Order Instituting Proceedings, based on the injunctive action. On November 29, 2010, the administrative law judge granted the Division of Enforcement's motion for summary disposition. [7] The law judge revoked Jamerica's investment adviser registration and barred Jamerica and Brown from association with any investment adviser. The law judge found that respondents' "conduct was egregious and recurrent." The law judge also found that the respondents had "not articulated recognition of the wrongful nature of their conduct," and noted that Brown wished to continue working in the securities industry, which would present the opportunity for future violations. This appeal followed.

III.

Under Advisers Act Section 203(e) and (f), we may impose sanctions on an investment adviser or a person associated with an investment adviser if that person has been permanently enjoined from engaging in any conduct or practice in connection with the purchase or sale of securities. [8] We find these requirements have been satisfied. Jamerica was registered as an

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[6] The District Court denied Brown's motion for a stay pending appeal on June 15, 2010. This case is currently on appeal. *SEC v. Sherwin Brown,* No. 10-2479 (8th Cir., filed July 2, 2010.).

[7] Rule of Practice 250, 17 C.F.R. § 201.250.

[8] 15 U.S.C. §§ 80b-3(e), 80b-3(f).

investment adviser, and Brown was Jamerica's president and controlled its operations. Respondents are enjoined from violations of the antifraud and recordkeeping provisions in connection with their sales of Brawta shares.

Brown, on his own and on Jamerica's behalf, has raised a series of objections to these proceedings.

A. Brown asserts that, if he had had sufficient funds for a defense and a jury trial before the District Court, he would not have been found guilty of wrong-doing. He believes that he should have rejected his attorneys' advice to invoke his FifthAmendment privilege since he "subsequently learned that by doing so that [sic] judges in Minnesota had no choice but to rubber-stamp the requests of SEC attorneys." He avers that "the first Judge was ruling [sic] motions in my favor and suddenly quit my case giving no reason." He states that he made full disclosure to Brawta clients in face-to-face meetings. He also contends that "[t]here is no actual accounting proof of the amount of money in the allegation." Rather, he and Brawta staff "deserved to be compensated at fair market levels" for their work on Brawta and "more than $500,000 of adviser fees were deposit [sic] into the Jamerica checking account."

These assertions are attempts to relitigate the District Court's findings. The doctrine of collateral estoppel precludes the Commission from reconsidering the injunction as well as factual and procedural issues that were actually litigated and necessary to the court's decision to issue the injunction. [9] Thus, we have repeatedly stated that a respondent in a follow-on administrative proceeding may not challenge the findings made by the court in the underlying proceeding. [10] To

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9 *Blinder, Robinson & Co.*, 837 F.2d 1099, 1109-11; *Demitrious Julius Shiva*, 52 S.E.C. 1247, 1249 (1997) (citations omitted). As the Supreme Court has stated, collateral estoppel "preclude[s] parties from contesting matters that they have had a full and fair opportunity to litigate" and thereby "protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions." *Montana v. United States*, 440 U.S. 147, 153-54 (1979).

10 *John Francis D'Acquisto*, 53 S.E.C. 440, 444 (1998) (finding injunction entered after summary judgment precludes relitigation of issues in follow-on proceedings); *see also David G. Ghysels*, Securities Exchange Act Rel. No. 62937 (Sept. 20, 2010), 99 SEC Docket 32610, 32616-17 (finding collateral estoppel principles preclude challenge to findings in criminal conviction); *Phillip J. Milligan,* Exchange Act Rel. No. 61790 (Mar. 26, 2010), 98 SEC Docket 26791, 26796 n.12 (granting preclusive effect to criminal plea and injunctive entered on summary judgment); *Gary M. Kornman*, Securities Exchange Act Rel. No. 59403 (Feb. 13, 2009), 95 SEC Docket 14246, 14257 (finding criminal conviction based on guilty plea has collateral estoppel effect precluding relitigation of issues in Commission proceedings), *petition denied,* 592 F.3d 173 (D.C. Cir. 2010); *James E. Franklin*, Exchange Act Rel. No. 56649 (Oct. 12, 2007), 91 SEC Docket 2708, 2711 (granting preclusive effect to injunction entered after jury

the extent respondents dispute these findings, their remedy is to challenge them on appeal from the injunctive action. As noted above, that appeal is pending. [11]

B. Respondents also argue that Division staff engaged in misconduct in the investigation and prosecution of the injunctive action. Brown states that the Commission "audited me twice in 2 years" and "could not find any problems," which "smacks of selective prosecution of the law." He also states that he was denied access to unspecified exculpatory documents. As with his challenges to the evidentiary rulings made by the District Court, this is not the appropriate forum for challenging the propriety of the Division's conduct in the injunctive action. Such a challenge should have been brought before the District Court and, if necessary, appealed. [12]

C. Brown also complains about the proceedings before the law judge. He asserts that the law judge "rubber stamp[ed] whatever pre-drawn up order/documents the SEC pushed in front of her desk."

Rule of Practice 250(b) provides that a hearing office may grant a motion for summary disposition without an in-person hearing if "there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law."[13] Once the Division showed that it had satisfied the criteria for summary disposition, respondents had the opportunity to produce documents, affidavits, or some other evidence to demonstrate that there was a genuine and material factual dispute that the law judge could not resolve without a hearing.

Here, respondents' submissions before the law judge did not create a genuine issue of fact necessitating an in-person hearing. Respondents again challenged the findings of the District Court and complained about the conduct of the Commission's staff in that proceeding. In this regard, Brown criticizes the law judge's conclusion that, "The Commission does not permit a

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trial), *petition denied,* 285 F. App'x 761 (D.C. Cir. 2008); *Shiva*, 52 S.E.C. at 1249 (granting preclusive effect to injunction entered after trial).

11 *See supra* n.6. We also have previously held that a pending judicial appeal does not affect the injunction's status as a basis for an administrative proceeding. *Franklin*, 91 SEC Docket at 2714 n.15 (collecting cases). If respondents prevail in their appeal, they can file a motion to vacate the opinion and order in this matter. *Id.* (citing *Jimmy Dale Swink*, 52 S.E.C. 379 (1995) (granting motion to vacate bar upon appellate reversal of criminal conviction that was basis for bar in administrative proceeding)).

12 *Franklin*, 91 SEC Docket at 2714; *Harold F. Harris*, Exchange Act Rel. No. 53122A (Jan. 13, 2006), 87 SEC Docket 350, 359.

13 17 C.F.R. § 201.250(b).

respondent to relitigate issues that were addressed in a previous civil proceeding against the respondent." [14] As discussed above, the law judge correctly stated Commission precedent. [15]

D. Brown asserts that the law judge exhibited bias in favor of the Division's position. Brown does not cite any evidence of bias, other than her ruling in the Division's favor, and we find none on this record. The fact that the law judge did not accept respondents' arguments does not suggest that she was biased. As we have previously observed, "[a]dverse rulings, by themselves, generally do not establish improper bias."[16]

E. Brown contends that the Commission did not turn over exculpatory documents to him although he does not identify particular documents that he was not permitted to see. The record reflects that, on May 24, 2010, the Division informed Brown by letter that documents were available for inspection in the Commission's Chicago Regional Office. On May 28, 2010, the Division informed Brown by e-mail that it was providing him by overnight UPS an encrypted DVD containing the initial document production. On June 21, 2010, before the law judge, Brown stated that he was unable to access the DVD. By e-mail dated June 22, 2010, the Division informed Brown that it would provide him with an index of the remaining materials, which was transmitted to Brown later that day. Division counsel asked Brown to inform the Division whether he wished to review the boxes of material in the Miami office. By declaration dated July 29, 2010, a Division attorney stated that, "At no point after [the first e-mail on June 22, 2010], did Respondent Brown ever contact the Division of Enforcement regarding this DVD or the paper files." We therefore reject Brown's contention.

F. Brown states that he does not have the ability pay the disgorgement or civil penalty and has submitted financial statements in support of this argument. However, these remedies were assessed in the injunctive case, not in this proceeding. These arguments should be addressed to the district court or the court of appeals.

IV.

In assessing the need for sanctions in the public interest, we consider the following factors: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against

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14 Initial Decision at p. 4.

15 *Franklin*, 91 SEC Docket at 2713 nn.13, 14.

16 *Mitchell M. Maynard,* Advisers Act Rel. No. 2875 (May 15, 2009), 95 SEC Docket 16844, 16856 (citing *Scott Epstein*, Exchange Act Rel. No. 59238 (Jan. 30, 2009), 95 SEC Docket 13833, 13860 & n.56, *aff'd,* No. 09-1550 (3rd Cir. 2010)).

future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations.[17]

We have held that antifraud injunctions merit the most stringent sanctions and that our "foremost consideration must . . . be whether [the] sanction protects the trading public from further harm."[18] Thus, "an antifraud injunction can . . . indicate the appropriateness in the public interest"[19] of a bar from participation in the securities industry and that "ordinarily, and in the absence of evidence to the contrary, it will be in the public interest to revoke the registration of, or suspend or bar from participation in the securities industry . . . a respondent who is enjoined from violating the antifraud provisions."[20] We believe that bars and revocation of Jamerica's registration are appropriate here.

Respondents' violations were egregious. Investment advisers and their associated persons have a fiduciary duty to their clients. They owe "an affirmative duty of 'utmost good faith and full and fair disclosure of all material facts,' as well as [the] affirmative obligation to employ reasonable care to avoid misleading clients." [21] Brown solicited Jamerica's advisory clients to invest in Brawta, representing that Brawta would use those funds for investment purposes. Instead, he withdrew funds from Brawta and used them for personal expenses and to replenish Jamerica's funds when they were low. During this period, he further misrepresented the value of Brawta shares to its investors, who were his advisory clients.

Brown's scienter is demonstrated by his conduct and his attempts to disguise his actions. Brown improperly withdrew funds from Brawta and purchased bank checks and converted the funds to cash. He disguised the deposits into Jamerica by falsely characterizing them as his

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17 *Scott B. Gann,* Exchange Act Rel. No. 59729 (Apr. 8, 2009), 95 SEC Docket 15818, 15823 (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979)), *aff'd*, 361 F. App'x 556 (5th Cir. 2010) (*per curiam*).

18 *James C. Dawson*, Advisers Act Rel. No. 3057 (July 23, 2010), 98 SEC Docket 30697, 30705.

19 *Michael Batterman*, 57 S.E.C. 1031, 1043 (2004) (quoting *Marshall E. Melton*, 56 S.E.C. 695, 709-10 (2003)), *aff'd*, 121 F. App'x 410 (2d Cir. 2005) (unpublished).

20 *Melton*, 56 S.E.C. at 713; *see also Steadman*, 603 F.2d at 1140 (stating that a compelling reason supporting a bar would be that "the nature of the conduct mandates permanent debarment as a deterrent to others in the industry").

21 *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); *see, e.g., Conrad P. Seghers*, Advisers Act Rel. No. 2656 (Sept. 26, 2007), 91 SEC Docket 2293 (same), 2304 n.44, *petition denied,* 548 F.3d 129 (D.C. Cir. 2008); *Michael Batterman,* 57 S.E.C. at 1043 (same).

capital contributions on Jamerica's books. He also tried to induce Gullickson to misrepresent the nature of Brawta's payment to Gullickson.

Brown states that "we all do make mistakes," but he is hard working and "obey[s] the law." He asserts that he "practiced 22 years in this industry where I have never had any complaint by any customer" and that he represented hundreds of clients. This latter assertion appears to contradict statements that Brown made in a document that he submitted to the law judge titled "The Real Truth about Sherwin Brown and Jamerica Financial, Inc." There, Brown recounts a series of customer complaints filed against him while he was at AIG/SunAmerica Securities. Brown further admitted that AIG/SunAmerica Securities settled many of these complaints although he disputes their merits.[22] However, even if Brown had no prior complaints, that would not mitigate his conduct in connection with Brawta.[23]

Brown also states that many of his clients "have stood and are continuing to, stand by me." Whether some of his clients continue to support Brown is not dispositive. "We look beyond the interests of particular investors in assessing the need for sanctions, to the protection of investors generally."[24]

Because respondents deny that they violated the antifraud and recordkeeping provisions, neither respondent has offered any assurance against future securities law violations or expressed recognition of wrong-doing. Instead, Brown blames the Commission for "trying to make their case stick by portraying its adversary in the worst possible light."

Of particular concern, Brown stated before the law judge that he continued to act as an investment adviser at "a state level." The securities industry "presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."[25] We believe that Brown's continued participation in the industry would provide opportunity for further violations.

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22 In its reply in support of its motion for summary disposition, the Division attached a print-out from FINRA's Web CRD system that reported 131 customer complaints against Brown.

23 The absence of disciplinary history is not mitigative as a securities professional should not be rewarded for complying with the securities laws. *See, e.g., Scott Epstein,* 95 SEC Docket at 13865.

24 *Dawson*, 98 SEC Docket at 30703; *see also Christopher A. Lowry*, 55 S.E.C. 1133, 1145 n.26 (2002) (finding that, while former and existing clients' testified in support of respondent, conduct established the need for bar to protect public), *aff'd*, 340 F.3d 501 (8th Cir. 2003).

25 *Seghers,* 91 SEC Docket at 2304.

Brown suggests that, because of his race, he has been a victim of selective prosecution, asserting that others have engaged in worse violations but have not been barred. No evidence supports Brown's suggestion that race motivated this proceeding. Moreover, contrary to Brown's assertions, we have brought proceedings against investment advisers who have improperly used client's assets or made misrepresentations to their clients. [26] Although we have discretion to impose a lesser sanction, the Court of Appeals for the District of Columbia has held that "[t]he Commission is not obligated to make its sanctions uniform," and the court "will not compare this sanction to those imposed in previous cases." [27]

Accordingly, having found that the public interest factors weigh heavily in favor of a bar and that there are no mitigating circumstances, we find it to be in the public interest that Jamerica's registration as an investment adviser be revoked and that Jamerica and Brown be barred from association with any investment adviser.

An appropriate order will issue.[28]

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

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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[26] *See, e.g., Dawson, 98* SEC Docket at 30701 (barring adviser who allocated unprofitable trades to clients and profitable trades to himself); *Jeffrey L. Gibson,* Exchange Act Rel. No. 57266 (Feb. 4, 2008), 92 SEC Docket 2104, 2108 (barring adviser who misappropriated funds raised in offering made to advisory clients), *petition denied,* 561 F.3d 548 (6th Cir. 2009); *Lowry,* 55 S.E.C. at 1139-41 (barring adviser who misrepresented to advisory clients use of funds raised in offering and using the funds to purchase personal residence).

[27] *Geiger v. SEC*, 363 F. 3d 481, 488 (D.C. Cir. 2004) (citing *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 186-87 (1973).

[28] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3217 / June 17, 2011

Admin. Proc. File No. 3-13908

In the Matter of

SHERWIN P. BROWN
and
JAMERICA FINANCIAL, INC.
5030 Champion Blvd. Suite #G6-456
Boca Raton, FL 33496-2473

ORDER IMPOSING REMEDIAL SANCTIONS

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

ORDERED that Sherwin P. Brown and Jamerica Financial, Inc. be, and they hereby are, barred from association with any investment adviser, and it is further.

ORDERED that the registration of Jamerica Financial, Inc. as an investment adviser be, and it hereby is, revoked.

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. 64704 / June 20, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14430

In the Matter of **JOSEPH SHERESHEVSKY,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to jurisdiction over him, the subject matter of these proceedings, and the findings contained in

Paragraphs III.2. and III.3. below, which are admitted, Respondent consents to entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

RESPONDENT

1. From in or about 2005 through in or about August 2008, Shereshevsky, age 54, was associated with Wextrust Securities, LLC, a broker-dealer formed in 2005 and registered with the Commission since March 2006. In a plea agreement dated February 3, 2011, Shereshevsky admitted that from in or about 2005 through in or about August 2008 he was "a person associated with a broker or dealer."

RESPONDENT'S CRIMINAL CONVICTION

2. On February 3, 2011, Shereshevsky pleaded guilty to one count of securities fraud in violation of Title 15, United States Code, Sections 78j(b) and 78ff; Title 17, Code of Federal Regulations, Section 240.10b-5; and Title 18, United States Code, Section 2, one count of conspiracy to commit securities fraud, mail fraud, and wire fraud in violation of Title 18, United States Code, Section 371, and one count of mail fraud in violation of Title 18, United States Code, Sections 1341 and 1342, before the United States District Court for the Southern District of New York, in *United States v. Steven Byers et al.*, No. 08-cr-1092 (DC).

3. The counts in the superseding indictment to which Shereshevsky pleaded guilty allege, *inter alia*, that Shereshevsky raised money from investors pursuant to private placement offerings, that he diverted material portions of the investor funds raised to purposes other than those specified in the private placement memoranda pursuant to which the funds were raised and failed to disclose the diversion of funds to investors, that he created or caused to be created false and fraudulent documents that falsely reflected profits earned by the investors, that he made materially false, fraudulent and misleading statements in documents distributed to investors that misstated, among other things, expenditures and income related to the investments, and that he used facilities of interstate commerce to further the fraud.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Respondent Shereshevsky be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

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.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64711 / June 21, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14432

In the Matter of Shiming U.S., Inc., Si Mei Te Food Ltd. (f/k/a China Discovery Acquisition Corp.), Sierra International Group, Inc., and SJ Electronics, 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 Shiming U.S., Inc., Si Mei Te Food Ltd. (f/k/a China Discovery Acquisition Corp.), Sierra International Group, Inc., and SJ Electronics, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Shiming U.S., Inc. (CIK No. 1091294) is a revoked Nevada corporation located in Xian, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Shiming 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, 2007. As of June 2, 2011, the company's stock (symbol "SGUS") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Si Mei Te Food Ltd. (f/k/a China Discovery Acquisition Corp.) (CIK No. 1388374) is a Cayman Islands corporation located in He Nan Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sei Mei Te Food 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, 2008, which reported a net loss of $52,865 for the prior twelve months. As of June 2, 2011, the company's securities (symbols "CADQF" (common) and "CADWF" (warrants)) were quoted on OTC Link, had seven and six market makers, respectively, and were eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Sierra International Group, Inc. (CIK No. 1204486) 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). Sierra International 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, 2010, which reported a net loss of $18,000 for the prior six months. The only other periodic report filed by the company was a Form 10-QSB for the period ended September 30, 2002. As of June 2, 2011, the company's stock (symbol "SIGR") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. SJ Electronics, Inc. (CIK No. 1376980) is a revoked Nevada corporation located in Taipei City, Taiwan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). SJ Electronics 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, 2008, which reported a net loss of $65,853 for the prior six months. As of June 2, 2011, the company's stock (symbol "SJEL") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to file 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.

7. 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

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 21, 2011

In the Matter of **Shiming U.S., Inc.,** **Si Mei Te Food Ltd. (f/k/a China Discovery Acquisition Corp.),** **Sierra International Group, Inc., and** **SJ Electronics, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Shiming U.S., Inc. because it has not filed any periodic reports since the period ended June 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Si Mei Te Food Ltd. (f/k/a China Discovery Acquisition Corp.) because it has not filed any periodic reports since the period ended December 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sierra International Group, Inc. because it has not filed any periodic reports since June 30, 2010. The only other periodic report filed by the company was a Form 10-QSB for the period ended September 30, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of SJ Electronics, Inc. because it has not filed any periodic reports since the period ended June 30, 2008.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 21, 2011, through 11:59 p.m. EDT on July 5, 2011.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 21, 2011

IN THE MATTER OF **Animal Cloning Sciences, Inc.** **(n/k/a Bancorp Energy, Inc.),** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Animal Cloning Sciences, Inc. (n/k/a Bancorp Energy, Inc.) because it has not filed any periodic reports since the period ended September 30, 2009.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on June 21, 2011, through 11:59 p.m. EDT on July 5, 2011.

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. 64709 / June 21, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14431

In the Matter of **Animal Cloning Sciences, Inc. (n/k/a Bancorp Energy, Inc.),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate 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 Respondent Animal Cloning Sciences, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Animal Cloning Sciences, Inc. (n/k/a Bancorp Energy, Inc.) (CIK No. 915337) is a Washington corporation located in La Quinta, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Animal Cloning 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, 2009, which reported a net loss of $5,625 for the prior nine months. As of June 8, 2011, the company's stock (symbol "ANML") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, Respondent is delinquent in its periodic filings with the Commission, have repeatedly failed to meet its obligations to file timely periodic reports, and failed to heed delinquency letters sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

4. As a result of the foregoing, Respondent 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 Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, 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. 64714 / June 21, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14433

In the Matter of

GAUTHAM SHANKAR,

Respondent.

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

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2, III.3 and III.5 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Shankar, age 36, resides in New Canaan, Connecticut. During the relevant time period, Shankar was a registered representative and a proprietary trader at Schottenfeld Group LLC, a New York limited liability company and registered broker-dealer based in New York, New York. At the relevant time, Shankar held Series 3, 7, 55 and 63 securities licenses.

2. On June 8, 2011, a judgment was entered by consent against Shankar, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Arthur J. Cutillo, et al., Civil Action Number 09-CV-9208, in the United States District Court for the Southern District of New York.

3. On June 8, 2011, a judgment was entered by consent against Shankar, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Galleon Management, LP, et al., Civil Action Number 09-CV-8811, in the United States District Court for the Southern District of New York.

4. The Commission's complaints alleged, inter alia, that, while working as a trader at Schottenfeld in 2007, Shankar was tipped material, nonpublic information concerning Avaya Inc. ("Avaya"), 3Com Corp. ("3Com"), Hilton Hotels Corporation ("Hilton"), Google, Inc. ("Google") and Kronos Inc. ("Kronos"), which had been conveyed in violation of a duty. The complaints further allege that Shankar traded in the securities of Avaya, 3Com, Hilton, Google and Kronos based on that material, nonpublic information, and also tipped the material, nonpublic information concerning 3Com, Hilton and Kronos to others.

5. On October 20, 2009, Shankar pled guilty to one count of conspiracy to commit securities fraud and one count of securities fraud in violation of Title 18 United States Code, Section 371 and Title 15 United States Code, Sections 78j(b) and 78ff, in the U.S. District Court for the Southern District of New York, in United States v. Gautham Shankar, 09-CR-996.

6. The counts of the criminal information to which Shankar pled guilty alleged, inter alia, that Shankar, and others, participated in a scheme to defraud by executing securities trades based on material, nonpublic information regarding certain inside information concerning public companies that had been misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Shankar be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer or transfer agent, and 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.

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64716 / June 21, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14434

In the Matter of

Alvin C. Ramsey,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Ramsey, 44 years old, is a previously registered representative who, for the period of time in which he engaged in the conduct underlying the criminal information described below, was associated with a broker-dealer and investment adviser dually registered with the Commission, located in Birmingham, Alabama and Martinez, Georgia.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On November 3, 2010, the U.S. District Court for the Southern District of Georgia entered a judgment against Ramsey after Ramsey pleaded guilty to one count of mail fraud in violation of Title 18 United States Code, Section 1341, in United States of America v. Alvin Charles Ramsey, Case No. 1:10-cr-00132. Ramsey was sentenced to fifty months in custody with three years of supervised release after incarceration and ordered to make restitution in the amount of $494,000.05.

3. The count of the criminal information to which Ramsey pleaded guilty alleged, inter alia, that from June 2005 to January 2008, Ramsey knowingly and willfully devised and intended to devise a scheme and artifice to defraud and misappropriate more than $400,000 from a customer by means of false and fraudulent pretenses, representations, promises, and omissions, by use of a commercial interstate carrier.

III.

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

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

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

IV.

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

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

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

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

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3222; File No. S7-37-10

RIN 3235-AK81

Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is adopting rules to implement new exemptions from the registration requirements of the Investment Advisers Act of 1940 for advisers to certain privately offered investment funds; these exemptions were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). As required by Title IV of the Dodd-Frank Act – the Private Fund Investment Advisers Registration Act of 2010 – the new rules define "venture capital fund" and provide an exemption from registration for advisers with less than $150 million in private fund assets under management in the United States. The new rules also clarify the meaning of certain terms included in a new exemption from registration for "foreign private advisers."

DATES: Effective Date: July 21, 2011.

FOR FURTHER INFORMATION CONTACT: Brian McLaughlin Johnson, Tram N. Nguyen or David A. Vaughan, at (202) 551-6787 or <IArules@sec.gov>, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is adopting rules 203(l)-1, 203(m)-1 and 202(a)(30)-1 (17 CFR 275.203(l)-1, 275.203(m)-1 and 275.202(a)(30)-1) under the

Investment Advisers Act of 1940 (15 U.S.C. 80b) (the "Advisers Act").[1]

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I. BACKGROUND

On July 21, 2010, President Obama signed into law the Dodd-Frank Act,[2] which, among

[1] Unless otherwise noted, all references to rules under the Advisers Act will be to Title 17, Part 275 of the Code of Federal Regulations (17 CFR 275).

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

other things, repeals section 203(b)(3) of the Advisers Act.[3] Section 203(b)(3) exempted any investment adviser from registration if the investment adviser (i) had fewer than 15 clients in the preceding 12 months, (ii) did not hold itself out to the public as an investment adviser and (iii) did not act as an investment adviser to a registered investment company or a company that has elected to be a business development company (the "private adviser exemption").[4] Advisers specifically exempt under section 203(b) are not subject to reporting or recordkeeping provisions under the Advisers Act, and are not subject to examination by our staff.[5]

The primary purpose of Congress in repealing section 203(b)(3) was to require advisers to "private funds" to register under the Advisers Act.[6] Private funds include hedge funds, private equity funds and other types of pooled investment vehicles that are excluded from the definition of "investment company" under the Investment Company Act of 1940[7] ("Investment Company

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3 In this Release, when we refer to the "Advisers Act," we refer to the Advisers Act as in effect on July 21, 2011.

4 15 U.S.C. 80b-3(b)(3) as in effect before July 21, 2011.

5 Under section 204(a) of the Advisers Act, the Commission has the authority to require an investment adviser to maintain records and provide reports, as well as the authority to examine such adviser's records, unless the adviser is "specifically exempted" from the requirement to register pursuant to section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on other sections of the Advisers Act (such as sections 203(l) or 203(m) which we discuss below) are not "specifically exempted" from the requirement to register pursuant to section 203(b), and thus the Commission has authority under section 204(a) of the Advisers Act to require those advisers to maintain records and provide reports and has authority to examine such advisers' records.

6 *See* S. Rep. No. 111-176, at 71-3 (2010) ("S. Rep. No. 111-176"); H. Rep. No. 111-517, at 866 (2010) ("H. Rep. No. 111-517"). H. Rep. No. 111-517 contains the conference report accompanying the version of H.R. 4173 that was debated in conference. While the Senate voted to exempt private equity fund advisers in addition to venture capital fund advisers from the requirement to register under the Advisers Act, the Dodd-Frank Act exempts only venture capital fund advisers. *Compare* Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 408 (2010) (as passed by the Senate) *with* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. (2009) (as passed by the House) ("H.R. 4173") *and* Dodd-Frank Act (2010), *supra* note 2.

7 15 U.S.C. 80a.

Act") by reason of section 3(c)(1) or 3(c)(7) of such Act.[8] Section 3(c)(1) is available to a fund that does not publicly offer the securities it issues[9] and has 100 or fewer beneficial owners of its outstanding securities.[10] A fund relying on section 3(c)(7) cannot publicly offer the securities it issues[11] and generally must limit the owners of its outstanding securities to "qualified purchasers."[12]

Each private fund advised by an adviser has typically qualified as a single client for purposes of the private adviser exemption.[13] As a result, investment advisers could advise up to 14 private funds, regardless of the total number of investors investing in the funds or the amount

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8 Section 202(a)(29) of the Advisers Act defines the term "private fund" as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act."

9 Interests in a private fund may be offered pursuant to an exemption from registration under the Securities Act of 1933 (15 U.S.C. 77) ("Securities Act"). Notwithstanding these exemptions, the persons who market interests in a private fund may be subject to the registration requirements of section 15(a) under the Securities Exchange Act of 1934 ("Exchange Act") (15 U.S.C. 78o(a)). The Exchange Act generally defines a "broker" as any person engaged in the business of effecting transactions in securities for the account of others. Section 3(a)(4)(A) of the Exchange Act (15 U.S.C. 78c(a)(4)(A)). *See also Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934*, Exchange Act Release No. 44291 (May 11, 2001) [66 FR 27759 (May 18, 2001)], at n.124 ("Solicitation is one of the most relevant factors in determining whether a person is effecting transactions.''); *Political Contributions by Certain Investment Advisers*, Investment Advisers Act Release No. 3043 (July 1, 2010) [75 FR 41018 (July 14, 2010)], n.326 ("Pay to Play Release").

10 *See* section 3(c)(1) of the Investment Company Act (providing an exclusion from the definition of "investment company" for any "issuer whose outstanding securities (other than short-term paper) are beneficially owned by not more than one hundred persons and which is not making and does not presently propose to make a public offering of its securities.").

11 *See supra* note 9.

12 *See* section 3(c)(7) of the Investment Company Act (providing an exclusion from the definition of "investment company" for any "issuer, the outstanding securities of which are owned exclusively by persons who, at the time of acquisition of such securities, are qualified purchasers, and which is not making and does not at that time propose to make a public offering of such securities."). The term "qualified purchaser" is defined in section 2(a)(51) of the Investment Company Act.

13 *See* rule 203(b)(3)-1(a)(2) as in effect before July 21, 2011.

of assets of the funds, without the need to register with us.[14]

In Title IV of the Dodd-Frank Act ("Title IV"), Congress generally extended Advisers Act registration to advisers to hedge funds and many other private funds by eliminating the private adviser exemption.[15] In addition to removing the broad exemption provided by section 203(b)(3), Congress amended the Advisers Act to create three more limited exemptions from registration under the Advisers Act.[16] These amendments become effective on July 21, 2011.[17] New section 203(l) of the Advisers Act provides that an investment adviser that solely advises venture capital funds is exempt from registration under the Advisers Act (the "venture capital exemption") and directs the Commission to define "venture capital fund" within one year of enactment.[18] New section 203(m) of the Advisers Act directs the Commission to provide an exemption from registration to any investment adviser that solely advises private funds if the

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14 *See* Staff Report to the United States Securities and Exchange Commission, Implications of the Growth of Hedge Funds, at 21 (2003), http://www.sec.gov/news/studies/hedgefunds0903.pdf (discussing section 203(b)(3) of the Advisers Act as in effect before July 21, 2011). Concern about this lack of Commission oversight led us to adopt a rule in 2004 extending registration to hedge fund advisers. *See Registration Under the Advisers Act of Certain Hedge Fund Advisers*, Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)] ("Hedge Fund Adviser Registration Release"). This rule was vacated by a federal court in 2006. *Goldstein v. Securities and Exchange Commission*, 451 F.3d 873 (D.C. Cir. 2006) ("Goldstein").

15 Section 403 of the Dodd-Frank Act amended section 203(b)(3) of the Advisers Act by repealing the prior private adviser exemption and inserting a "foreign private adviser exemption." *See infra* Section II.C. Unlike our 2004 rule, which sought to apply only to advisers of "hedge funds," the Dodd-Frank Act requires that, unless another exemption applies, all advisers previously eligible for the private adviser exemption register with us regardless of the type of private funds or other clients the adviser has.

16 Title IV also created exemptions and exclusions in addition to the three discussed at length in this Release. *See, e.g.*, sections 403 and 409 of the Dodd-Frank Act (exempting advisers to licensed small business investment companies from registration under the Advisers Act and excluding family offices from the definition of "investment adviser" under the Advisers Act). We are adopting a rule defining "family office" in a separate release (*Family Offices*, Investment Advisers Act Release No. 3220 (June 22, 2011)).

17 Section 419 of the Dodd-Frank Act (specifying the effective date for Title IV).

18 *See* section 407 of the Dodd-Frank Act (exempting advisers solely to "venture capital funds," as defined by the Commission).

adviser has assets under management in the United States of less than $150 million (the "private fund adviser exemption").[19] In this Release, we will refer to advisers that rely on the venture capital and private fund adviser exemptions as "exempt reporting advisers" because sections 203(l) and 203(m) provide that the Commission shall require such advisers to maintain such records and to submit such reports "as the Commission determines necessary or appropriate in the public interest or for the protection of investors."[20]

Section 203(b)(3) of the Advisers Act, as amended by the Dodd-Frank Act, provides an exemption for certain foreign private advisers (the "foreign private adviser exemption").[21] The term "foreign private adviser" is defined in new section 202(a)(30) of the Advisers Act as an investment adviser that has no place of business in the United States, has fewer than 15 clients in the United States and investors in the United States in private funds advised by the adviser,[22] and less than $25 million in aggregate assets under management from such clients and investors.[23]

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19 *See* section 408 of the Dodd-Frank Act (directing the Commission to exempt private fund advisers with less than $150 million in aggregate assets under management in the United States).

20 *See* sections 407 and 408 of the Dodd-Frank Act.

21 Advisers specifically exempt under section 203(b) are not subject to reporting or recordkeeping provisions under the Advisers Act, and are not subject to examination by our staff. *See supra* note 5.

22 Subparagraph (B) of section 202(a)(30) refers to the number of "clients and investors in the United States in private funds," while subparagraph (C) refers to the assets of "clients *in the United States* and investors in the United States in private funds" (emphasis added). We interpret these provisions consistently so that only clients *in the United States* and investors in the United States should be included for purposes of determining eligibility for the exemption under subparagraph (B).

23 The exemption is not available to an adviser that "acts as — (I) an investment adviser to any investment company registered under the [Investment Company Act]; or (II) a company that has elected to be a business development company pursuant to section 54 of [that Act], and has not withdrawn its election." Section 202(a)(30)(D)(ii). We interpret subparagraph (II) to mean that the exemption is not available to an adviser *that advises* a business development company. This exemption also is not available to an adviser that holds itself out generally to the public in the United States as an investment adviser. Section 202(a)(30)(D)(i).

These new exemptions are not mandatory.[24] Thus, an adviser that qualifies for any of the exemptions could choose to register (or remain registered) with the Commission, subject to section 203A of the Advisers Act, which generally prohibits most advisers from registering with the Commission if they do not have at least $100 million in assets under management.[25]

On November 19, 2010, the Commission proposed three rules that would implement these exemptions.[26] First, we proposed rule 203(l)-1 to define the term "venture capital fund" for purposes of the venture capital exemption. Second, we proposed rule 203(m)-1 to implement the private fund adviser exemption. Third, in order to clarify the application of the foreign private adviser exemption, we proposed new rule 202(a)(30)-1 to define several terms included in the statutory definition of a foreign private adviser as defined in section 202(a)(30) of the Advisers Act.[27] On the same day, we also proposed rules to implement other amendments made to the

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24 An adviser choosing to avail itself of an exemption under section 203(l), 203(m) or 203(b)(3), however, may be required to register as an adviser with one or more state securities authorities. *See* section 203A(b)(1) of the Advisers Act (exempting from state regulatory requirements any adviser registered with the Commission or that is not registered because such person is excepted from the definition of an investment adviser under section 202(a)(11)). *See also infra* note 488 (discussing the application of section 222 of the Advisers Act).

25 Section 203A(a)(1) of the Advisers Act generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the Commission unless it has at least $25 million of assets under management. Section 203A(b) preempts certain state laws regulating advisers that are registered with the Commission. Section 410 of the Dodd-Frank Act amended section 203A(a) to also prohibit generally an investment adviser from registering with the Commission if the adviser has assets under management between $25 million and $100 million and the adviser is required to be registered with, and if registered, would be subject to examination by, the state security authority where it maintains its principal office and place of business. *See* section 203A(a)(2) of the Advisers Act. In each of subparagraphs (1) and (2) of section 203A(a), additional conditions also may apply. *See* Implementing Adopting Release, *infra* note 32, at section II.A.

26 *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less than $150 Million in Assets under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3111 (Nov. 19, 2010) [75 FR 77190 (Dec. 10, 2010)] ("Proposing Release").

27 Proposed rule 202(a)(30)-1 included definitions for the following terms: (i) "client;" (ii) "investor;" (iii) "in the United States;" (iv) "place of business;" and (v) "assets under management." *See* discussion in section II.C of the Proposing Release, *supra* note 26. We

Advisers Act by the Dodd-Frank Act, which included reporting requirements for exempt reporting advisers.[28]

We received over 115 comment letters in response to our proposals to implement the new exemptions.[29] Most of these letters were from venture capital advisers, other types of private fund advisers, and industry associations or law firms on behalf of private fund and foreign investment advisers.[30] We also received several letters from investors and investor groups.[31] Although commenters generally supported the various proposed rules, many suggested modifications designed to expand the breadth of the exemptions or to clarify the scope of one or more elements of the proposed rules. Commenters also sought interpretative guidance on certain aspects of the scope of each of the rule proposals and related issues.

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proposed rule 202(a)(30)-1, in part, pursuant to section 211(a) of the Advisers Act, which Congress amended to explicitly provide us with the authority to define technical, trade, and other terms used in the Advisers Act. *See* section 406 of the Dodd-Frank Act.

28 *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3110 (Nov. 19, 2010) [75 FR 77052 (Dec. 10, 2010)] ("Implementing Proposing Release").

29 The comment letters on the Proposing Release (File No. S7-37-10) are available at: http://www.sec.gov/comments/s7-37-10/s73710.shtml. We also considered comments submitted in response to the Implementing Proposing Release that were germane to the rules adopted in this Release.

30 *See, e.g.*, Comment Letter of Biotechnical Industry Organization (Jan. 24, 2011) ("BIO Letter"); Comment Letter of Coalition of Private Investment Companies (Jan. 28, 2011) ("CPIC Letter"); Comment Letter of European Private Equity and Venture Capital Association (Jan. 24, 2011 ("EVCA Letter"); Comment Letter of O'Melveny & Myers LLP (Jan. 25, 2011) ("O'Melveny Letter"); Comment Letter of Norwest Venture Partners (Jan. 24, 2011) ("Norwest Letter").

31 *See, e.g.*, Comment Letter of the American Federation of Labor and Congress of Industrial Organizations (Jan. 24, 2011) ("AFL-CIO Letter"); Comment Letter of Americans for Financial Reform (Jan. 24, 2011) ("AFR Letter"); Comment Letter of The California Public Employees Retirement System (Feb. 10, 2011) ("CalPERS Letter"). *See also, e.g.*, Comment Letter of Adams Street Partners (Jan. 24, 2011); Comment Letter of Private Equity Investors, Inc. (Jan. 21, 2011) ("PEI Funds Letter") (letters from advisers of funds that invest in other venture capital and private equity funds).

II. DISCUSSION

Today, the Commission is adopting rules to implement the three new exemptions from registration under the Advisers Act. In response to comments, we have made several modifications to the proposals. In a separate companion release (the "Implementing Adopting Release") we are adopting rules to implement other amendments made to the Advisers Act by the Dodd-Frank Act, some of which also concern certain advisers that qualify for the exemptions discussed in this Release.[32]

A. Definition of Venture Capital Fund

We are adopting new rule 203(l)-1 to define "venture capital fund" for purposes of the new exemption for investment advisers that advise solely venture capital funds.[33] In summary, the rule defines a venture capital fund as a private fund that: (i) holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings) ("qualifying investments" generally consist of equity securities of "qualifying portfolio companies" that are directly acquired by the fund, which we discuss below); (ii) does not borrow or otherwise incur leverage, other than limited short-term borrowing (excluding certain guarantees of qualifying portfolio company obligations by the fund); (iii) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy to its investors and prospective investors; and (v) is not registered under the Investment Company Act and has not elected to be treated as a business development company ("BDC").[34] Consistent with the proposal, rule

32 *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011).

33 Rule 203(l)-1.

34 Rule 203(l)-1(a).

203(l)-1 also "grandfathers" any pre-existing fund as a venture capital fund if it satisfies certain criteria under the grandfathering provision.[35] An adviser is eligible to rely on the venture capital exemption only if it solely advises venture capital funds that meet all of the elements of the definition or funds that have been grandfathered.

The proposed rule defined the term venture capital fund in accordance with what we believed Congress understood venture capital funds to be, as reflected in the legislative materials, including the testimony Congress received.[36] As we discussed in the Proposing Release, the proposed definition of venture capital fund was designed to distinguish venture capital funds from other types of private funds, such as hedge funds and private equity funds, and to address concerns expressed by Congress regarding the potential for systemic risk.[37]

We received over 70 comment letters on the proposed venture capital fund definition, most of which were from venture capital advisers or related industry groups.[38] A number of commenters supported the Commission's efforts to define a venture capital fund,[39] citing the "thoughtful" approach taken and the quality of the proposed rule.[40] Commenters representing

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35 Rule 203(l)-1(b).

36 *See* Proposing Release, *supra* note 26, at n.38 and accompanying and following text.

37 *See, e.g.*, Proposing Release, *supra* note 26, discussion at section II.A. and text accompanying nn.43, 60, 61, 82, 99, 136.

38 The National Venture Capital Association submitted a comment letter, dated January 13, 2011 ("NVCA Letter") on behalf of its members, and 27 other commenters expressed their support for the comments raised in the NVCA Letter.

39 *See* BIO Letter; Comment Letter of Charles River Ventures (Jan. 21, 2011) ("Charles River Letter"); NVCA Letter.

40 *See, e.g.*, Comment Letter of Abbott Capital Management, LLC (Jan. 24, 2011) ("Abbott Capital Letter"); Comment Letter of DLA Piper LLP (Jan. 24, 2011) ("DLA Piper VC Letter"); Comment Letter of InterWest General Partners (Jan. 21, 2011) ("InterWest Letter"); NVCA Letter; Comment Letter of Oak Investment Partners (Jan. 24, 2011) ("Oak Investment Letter"); Comment Letter of Pine Brook Road Advisors, LP (Jan. 24, 2011) ("Pine Brook Letter").

investors and investor groups and others generally supported the rule as proposed,[41] one of which stated that the proposed definition "succeeds in clearly defining those private funds that will be exempt."[42] Some of these commenters expressed support for a definition that is no broader than necessary in order to ensure that only advisers to "venture capital funds, and not other types of private funds, are able to avoid the new mandatory registration requirements."[43]

Generally, however, our proposal prompted vigorous debate among commenters on the scope of the definition. For example, a number of commenters wanted us to take a different approach from the proposal and supported two alternatives. Two commenters urged us to rely on the California definition of "venture capital operating company."[44] These commenters did not, however, address our concern, discussed in the Proposing Release, that the California definition includes many types of private equity and other private funds, and thus incorporation of this definition would not appear consistent with our understanding of the intended scope of section 203(l).[45] Our concern was acknowledged in a letter we received from the current Commissioner for the California Department of Corporations, stating that "we understand the [Commission] cannot adopt verbatim the California definition of [venture capital fund]. Congressional

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41 *See* AFR Letter; AFL-CIO Letter; EVCA Letter; Comment Letter of U.S. Senator Carl Levin (Jan. 25, 2011) ("Sen. Levin Letter").

42 AFL-CIO Letter.

43 Sen. Levin Letter. Although they did not object to the approach taken by the proposed rule, several commenters cautioned us against defining venture capital fund more broadly than necessary to preclude advisers to other types of private funds from qualifying under the venture capital exemption. *See* AFR Letter; CalPERS Letter; Sen. Levin Letter ("a variety of advisers or funds are likely to try to seek refuge from the registration requirement by urging an overbroad interpretation of the term 'venture capital fund' . . . It is important for the Commission to define the term narrowly to ensure that only venture capital funds, and not other types of private funds, are able to avoid the new mandatory registration requirement.").

44 Comment Letter of Lowenstein Sandler PC (Jan. 4, 2011) ("Lowenstein Letter"); Comment Letter of Keith Bishop (Jan. 17, 2011).

45 *See* Proposing Release, *supra* note 26, at n.72 and accompanying and preceding text.

directives require the [Commission] to exclude private equity funds, or any fund that pivots its investment strategy on the use of debt or leverage, from the definition of [venture capital fund]."[46] For these reasons and the other reasons cited in the Proposing Release, we are not modifying the proposal to rely on the California definition.[47]

Several other commenters favored defining a venture capital fund by reference to investments in "small" businesses or companies, although they disagreed on the factors that would deem a business or company to be "small."[48] As discussed in the Proposing Release, we considered defining a qualifying fund as a fund that invests in small companies, but noted the lack of consensus for defining such a term.[49] We also expressed the concern in the Proposing Release that defining a "small" company in a manner that imposes a single standardized metric such as net income, the number of employees, or another single factor test could ignore the complexities of doing business in different industries or regions. This could have the potential result that even a low threshold for a size metric could inadvertently restrict venture capital funds from funding otherwise promising young small companies.[50] For these reasons, we are not

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46 Comment Letter of Preston DuFauchard, Commissioner for the California Department of Corporations (Jan. 21, 2011) ("DuFauchard Letter") (further stating that "while regulators might have an interesting discussion on whether private equity funds contributed to the recent financial crisis, in light of the Congressional directives such a dialogue would be academic.").

47 *See* Proposing Release, *supra* note 26, at n.72 and accompanying and preceding text.

48 *See* Comment Letter of National Association of Small Business Investment Companies and Small Business Investor Alliance (Jan. 24, 2011) ("NASBIC/SBIA Letter") (supported a definition of "small" company by reference to the standards set forth in the Small Business Investment Act regulations). *But cf.* Lowenstein Letter; Comment Letter of Quaker BioVentures (Jan. 24, 2011) ("Quaker BioVentures Letter"); Comment Letter of Venrock (Jan. 23, 2011) ("Venrock Letter") (each of which supported a definition of small company based on the size of its public float). *See also* Comment Letter of Georg Merkl (Jan. 25, 2011) ("Merkl Letter") (referring to "young, negative EBITDA [earnings before interest, taxes, depreciation and amortization] companies").

49 *See* Proposing Release, *supra* note 26, at section II.A.1.a. and n.69 and accompanying and following text.

50 *See* Proposing Release, *supra* note 26, at n.69 and accompanying and preceding text.

persuaded that the tests for a "small" company suggested by commenters address these concerns.

Unlike the commenters who suggested these alternative approaches, most commenters representing venture capital advisers and related groups accepted the approach of the proposed rule, and many of them acknowledged that the proposed definition would generally encompass most venture capital investing activity that typically occurs.[51] Several, however, also expressed the concern that a venture capital fund may, on occasion, deviate from its typical investing pattern with the result that the fund could not satisfy all of the definitional criteria under the proposed rule with respect to each investment all of the time.[52] Others explained that an investment fund that seeks to satisfy the definition of a venture capital fund (a "qualifying fund") would desire flexibility to invest small amounts of fund capital in investments that would not meet the criteria under the proposed rule, such as shares of other venture capital funds,[53] non-convertible debt,[54] or publicly traded securities.[55] Both groups of commenters urged us to accommodate them by broadening the definition and modifying the proposed criteria.

Commenters wanted advisers seeking to be eligible for the venture capital exemption to

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51 *See, e.g.*, Comment Letter of the Committee on Federal Regulation of Securities of the American Bar Association (Jan. 31, 2011) ("ABA Letter"); ATV Letter; BIO Letter; NVCA Letter; Comment Letter of Proskauer LLP (Jan. 23, 2011); Comment Letter of Union Square Ventures, LLC (Jan. 24, 2011) ("Union Square Letter").

52 *See, e.g.*, Comment Letter of Advanced Technology Ventures (Jan. 24, 2011) ("ATV Letter"); BIO Letter; NVCA Letter; Comment Letter of Sevin Rosen Funds (Jan. 24, 2011) ("Sevin Rosen Letter"). One commenter argued that the rule "should not bar the occasional, but also quite ordinary, financial activities" of a venture capital fund. Charles River Letter.

53 *See, e.g.*, Comment Letter of Dechert LLP (Jan. 24, 2011) ("Dechert General Letter"); Comment Letter of First Round Capital (Jan. 24, 2011) ("First Round Letter"); Sevin Rosen Letter.

54 *See, e.g.*, Comment Letter of BioVentures Investors (Jan. 24, 2011) ("BioVentures Letter"); Charles River Letter; Comment Letter of Davis Polk & Wardwell LLP (Jan. 24, 2011) ("Davis Polk Letter"); Merkl Letter.

55 *See, e.g.*, Comment Letter of Cardinal Partners (Jan. 24, 2011) ("Cardinal Letter"); Davis Polk Letter; Comment Letter of Gunderson Dettmer Stough Villeneuve Franklin & Hachigian (Jan. 24, 2011) ("Gunderson Dettmer Letter"); Merkl Letter.

have greater flexibility to operate and invest in portfolio companies and to accommodate existing (and potentially evolving) business practices that may vary from what commenters characterized as typical venture capital fund practice.[56] Some argued that a limited basket for such atypical investing activity could facilitate job creation and capital formation.[57] They were also concerned that the multiple detailed criteria of the proposed rule could result in "inadvertent" violations of the criteria under the rule.[58] Some expressed concern that a Commission rule defining a venture capital fund by reference to investing activity would have the result of reducing an adviser's investment discretion.[59]

We are sensitive to commenters' concerns that the definition not operate to foreclose investment funds from investment opportunities that would benefit investors but would not change the character of a venture capital fund.[60] On the other hand, we are troubled that the cumulative effect of revising the rule to reflect all of the modifications supported by commenters

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56 *See, e.g.*, NVCA Letter; Comment Letter of Bessemer Venture Partners (Jan. 24, 2011) ("Bessemer Letter"); Oak Investment Letter. *See also supra* note 51.

57 *See, e.g.*, NVCA Letter (stating that a low level of 15% would "allow innovation and job creation to flourish within the venture capital industry"); Sevin Rosen Letter (a 20% limit would be "flexible enough not to severely impair the operations of bona fide [venture capital funds], a critically important resource for American innovation and job creation").

58 *See, e.g.*, NVCA Letter ("Because of the consequence (*i.e.*, federal registration) of having even one inadvertent, non-qualifying investment, allowance for unintended or insignificant deviations, or differences in interpretations, is appropriate."); Comment Letter of SV Life Sciences (Jan. 21, 2011) ("SV Life Sciences Letter") (the "lack of flexibility and ambiguity in certain definitions . . . could cause our firm or other venture firms to inadvertently hold non-qualifying investments"). *See also* ATV Letter.

59 DuFauchard Letter ("Only the VC Fund advisers/managers are in a position to determine what best form 'down-round' financing should take. Whether that should be new capital, project finance, a bridge loan, or some other form of equity or debt, is neither a question for the regulators nor should it be a question of strict regulatory control."); ESP Letter ("There is no way a single regulation can determine what the appropriate level of leverage should be for every portfolio company."); Merkl Letter ("The Commission should not regulate from whom the [portfolio company] securities can be acquired or how the [company's] capital can be used.").

60 *See, e.g.*, Oak Investment Letter; Sevin Rosen Letter.

could permit reliance on the exemption by advisers to other types of private funds and thus expand the exemption beyond what we believe was the intent of Congress.[61] A number of commenters argued that defining a venture capital fund by reference to multiple detailed criteria could result in "inadvertent" violations of the definitional criteria by a qualifying fund.[62] Another commenter acknowledged that providing *de minimis* carve-outs to the multiple criteria under the proposed rule could be "cumbersome,"[63] which could lead to the result, asserted by some commenters, that an overly prescriptive rule could invite further unintentional violations of the registration provisions of the Advisers Act.[64]

To balance these competing considerations, we are adopting an approach suggested by several commenters that defines a venture capital fund to include a fund that invests a portion of its capital in investments that would not otherwise satisfy all of the elements of the rule ("non-qualifying basket").[65] Defining a venture capital fund to include funds engaged in some amount of non-qualifying investment activity provides advisers to venture capital funds with greater

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61 For example, one commenter suggested that the definition of venture capital fund include a fund that incurs leverage of up to 20% of fund capital commitments without limit on duration and invests up to 20% of fund capital commitments in publicly traded securities and an additional 20% of fund capital commitments in non-conforming investments. Charles River Letter. Under these guidelines, it would be possible to structure a fund that borrows up to 20% of the fund's "capital commitments" to acquire highly leveraged derivatives and publicly traded debt securities. If the fund only calls 20% of its capital, fund indebtedness would equal 100% of fund assets, all of which would be in derivative instruments or publicly traded debt securities.

62 *See supra* note 58.

63 First Round Letter.

64 *See, e.g., generally* NVCA Letter. *See also* Merkl Letter.

65 *See, e.g.*, Abbott Capital Letter; ATV Letter; Bessemer Letter; BioVentures Letter; Cardinal Letter; Charles River Letter; Comment Letter of CompliGlobe Ltd. (Jan. 24, 2011) ("CompliGlobe Letter"); Davis Polk Letter; First Round Letter; NVCA Letter; Comment Letter of PTV Sciences (Jan. 24, 2011) ("PTV Sciences Letter"); Quaker BioVentures; Comment Letter of Santé Ventures (Jan. 24, 2011) ("Santé Ventures Letter"); Sevin Rosen Letter; SV Life Sciences; Comment Letter of U.S. Venture Partners (Jan. 24, 2011) ("USVP Letter"); Venrock Letter.

investment flexibility, while precluding an adviser relying on the exemption from altering the character of the fund's investments to such extent that the fund could no longer be viewed as a venture capital fund within the intended scope of the exemption. To the extent an adviser uses the basket to invest in some non-qualifying investments, it will have less room to invest in others, but the choice is left to the adviser. While the definition limits the amount of non-qualifying investments, it allows the adviser to choose how to allocate those investments. Thus, one venture capital fund may take advantage of some opportunities to invest in debt whereas others may seek limited opportunities in publicly offered securities. The definition of "business development company" under the Advisers Act contains a similar basket for non-qualifying investments.[66]

Commenters suggested non-qualifying baskets ranging from 15 to 30 percent of a fund's capital commitments, although many of these same commenters wanted us to expand the other criteria of the proposed rule.[67] Several commenters in favor of a non-qualifying basket asserted that setting the level for non-qualifying investments at a sufficiently low threshold would preclude advisers to other types of private funds from relying on the venture capital exemption while providing venture capital advisers the flexibility to take advantage of investment

66 Advisers Act section 202(a)(22) (defining a "business development company" as any company that meets the definition set forth in section 2(a)(48) of, and complies with section 55 of, the Investment Company Act, except that a BDC under the Advisers Act is defined to mean a company that invests 60% of its total assets in the assets specified in section 55 of the Investment Company Act).

67 *See, e.g.*, NVCA Letter (more than 25 comment letters expressed general support for the comments raised in the NVCA Letter). Two commenters expressed support for a 30% basket for non-qualifying investments. *See* Comment Letter of Shearman & Sterling LLP (Jan. 24, 2011) ("Shearman Letter") (citing, in support of this position, the BDC definition under the Investment Company Act, which specifies a threshold of 30% for non-qualifying activity); Quaker BioVentures Letter (citing, in support of this position, the BDC definition under the Investment Company Act and the BDC definition under the Advisers Act which increased the non-qualifying activity threshold to 40%).

opportunities.[68] These commenters properly framed the question before us. We did not, however, receive specific empirical analysis regarding the venture capital industry as a whole that would help us determine the appropriate size of the basket.[69] Many of those supporting a 15 percent non-qualifying basket also supported expanding some of the other elements of the definition, and thus it is unclear whether a 15 percent non-qualifying basket alone would satisfy their needs.[70] On the other hand, those supporting a much larger basket did not, in our view, adequately address our concern that an overly expansive definition would provide room for advisers to private equity funds to remain unregistered, a consequence several commenters urged us to avoid.[71]

On balance, and after giving due consideration to the approaches suggested by commenters, we are adopting a limit of 20 percent of a qualifying fund's capital commitments for non-qualifying investments. We believe that a 20 percent limit will provide the flexibility sought by many venture capital fund commenters while appropriately limiting the scope of the

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68 Norwest Letter; Sevin Rosen Letter (noting that a 20% limit is "low enough to ensure that only true [venture capital funds] are able to qualify for the [venture capital] exemption."). *See also* NVCA Letter.

69 We did, however, receive much anecdotal evidence of particular advisers' experiences with non-qualifying investments. *See, e.g.*, Cardinal Letter ("In a very limited number of cases, it has been necessary for us to purchase securities from current shareholders of the portfolio company in order for the financing to be completed. However, in NO case have purchases from existing shareholders ever exceeded 15% of the total investment by Cardinal in a proposed financing."); Charles River Letter ("The vast majority of our investments are in the form of Convertible Preferred Stock. . . . However, very rarely - - but more often than never - - we invest in the form of a straight, non-convertible Demand Note."); Pine Brook Letter ("Our fund documents provide for investments outside of our core investing practice of up to 25% of our committed capital."). *But cf.* Mesirow Financial Private Equity Advisors, Inc. (Jan. 24, 2011) ("Mesirow Letter") (a Commission-registered adviser that advises funds that invest in other venture capital and private equity funds stated that "[s]ince the main purpose of [venture capital funds] is to invest in and help build operating companies, we believe their participation in non-qualifying activity will be rare.").

70 *See supra* note 67.

71 *See supra* note 43.

exemption. We note that several commenters recommended a non-qualifying basket limit of 20 percent.[72]

We considered adopting a 40 percent basket for non-qualifying investments by analogy to the Advisers Act definition of BDC.[73] That basket was established by Congress rather than the Commission, and it strikes us as too large in light of our task of implementing a statutory provision that does not specify a basket.[74] We find a better analogy in a rule we adopted in 2001 under the Investment Company Act. Under rule 35d-1 of that Act, commonly referred to as the "names rule," an investment company with a name suggesting that it invests in certain investments is limited to investing no more than 20 percent of its assets in other types of investments (*i.e.*, non-qualifying investments).[75] In adopting that rule, we explained that "if an investment company elects to use a name that suggests its investment policy, it is important that the level of required investments be high enough that the name will accurately reflect the

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72 *See, e.g.*, ATV Letter; Charles River Letter; Sevin Rosen Letter. At least one commenter stated that the minimum threshold limit for the non-qualifying basket should be 20%. Charles River Letter ("we believe anything less than 20% would be inadequate").

73 *See supra* note 66.

74 A larger non-qualifying basket of 40% could have the result of changing the fundamental underlying nature of the investments held by a qualifying fund, such as for example increasing the extent to which non-qualifying investments may contribute to the returns of the fund's portfolio.

75 Rule 35d-1(a)(2) under the Investment Company Act ("a materially deceptive and misleading name of a [registered investment company] includes . . . [a] name suggesting that the [registered investment company] focuses its investments in a particular type of investment or investments, or in a particular industry or group of industries, unless: (i) the [registered investment company] has adopted a policy to invest, under normal circumstances, at least 80% of the value of its [total assets] in the particular type of investments, or in investments in the particular industry or industries, suggested by the [registered investment company's] name . . ."). 17 CFR 270.35d-1(a)(2).

company's investment policy."[76] We noted that having a registered investment company hold a significant amount of investments consistent with its name is an important tool for investor protection,[77] but setting the limit at 20 percent gives the investment company management flexibility.[78] While our policy goal today in defining a "venture capital fund" is somewhat different from our goal in prescribing limitations on investment company names, the tensions we sought to reconcile are similar.[79]

1. Qualifying Investments

Under the rule, to meet the definition of venture capital fund, the fund must hold, immediately after the acquisition of any asset (other than qualifying investments or short-term holdings), no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings).[80] Thus, as discussed above, a qualifying fund could invest without restriction up to 20 percent of the fund's capital commitments in non-

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76 *Investment Company Names*, Investment Company Act Release No. 24828 (Jan. 17, 2001) [66 FR 8509, 8511 (Feb. 1, 2001), correction 66 FR 14828 (Mar. 14, 2001)] ("Names Rule Adopting Release").

77 Names Rule Adopting Release, *supra* note 76, at text accompanying n.3 and text following n.7.

78 *See* Names Rule Adopting Release, *supra* note 76, at text accompanying n.14. *See also* NVCA Letter; Sevin Rosen Letter (citing rule 35d-1 in support of recommending that the rule adopt a non-qualifying basket); Quaker BioVentures Letter (citing the approach taken by the staff generally limiting an investment company excluded by reason of section 3(c)(5)(C) of the Investment Company Act to investing no more than 20% of its assets in non-qualifying investments).

79 A number of commenters recommended that the rule specify a range for the non-qualifying basket, arguing that this approach would provide advisers to venture capital funds with better flexibility to manage their investments over time. *See, e.g.*, DLA Piper VC Letter; DuFauchard Letter; Norwest Letter; Oak Investment Letter. As we discuss in greater detail below, the non-qualifying basket is determined as of the time immediately following each investment and hence a range is not necessary.

80 Rule 203(l)-1(a)(2). The rule specifies that "immediately after the acquisition of any asset (other than qualifying investments or short-term holdings)" no more than 20% of the fund's aggregate capital contributions and uncalled committed capital may be held in assets (other than short-term holdings) that are not qualifying investments." *See infra* Section II.A.1.c. for a discussion on the operation of the 20% limit.

qualifying investments and would still fall within the venture capital fund definition.

For purposes of the rule, a "qualifying investment," which we discuss in greater detail below, generally consists of any equity security issued by a qualifying portfolio company that is directly acquired by a qualifying fund and certain equity securities exchanged for the directly acquired securities.[81]

a. Equity Securities of Portfolio Companies

Rule 203(l)-1 defines a venture capital fund as a private fund that, excluding investments in short-term holdings and non-qualifying investments, generally holds equity securities of qualifying portfolio companies.[82]

We proposed to define "equity security" by reference to the Exchange Act.[83] Commenters did not generally object to our proposal to do so, although many urged that we expand the definition of venture capital fund to include investments in other types of securities.[84] Commenters asserted that venture capital funds may invest in securities other than equity securities (including debt securities) for various business reasons, including to provide "bridge" financing to portfolio companies between equity financing rounds,[85] for working capital needs[86] or for tax or structuring reasons.[87] Many of these commenters recommended that the rule also

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[81] *See* Sections II.A.1.b.

[82] Rule 203(l)-1(a)(2) (specifying the investments of a venture capital fund); (c)(3) (defining "qualifying investment"); and (c)(6) (defining "short-term holdings").

[83] Proposed rule 203(l)-1(c)(2).

[84] Several commenters opposed any restriction on the definition of equity security. *See, e.g.*, Bessemer Letter; ESP Letter; NVCA Letter.

[85] ATV Letter; NVCA Letter.

[86] Comment Letter of Cook Children's Health Care Foundation Investment Committee (Jan. 20, 2011) ("Cook Children's Letter"); Comment Letter of Leland Fikes Foundation, Inc. (Jan. 21, 2011) ("Leland Fikes Letter").

[87] Bessemer Letter; Merkl Letter.

define a venture capital fund to include funds that invest in non-convertible bridge loans of a portfolio company,[88] interests in other pooled investment funds (including other venture capital funds)[89] and publicly offered securities.[90] Commenters argued that these types of investments facilitate access to capital for a company's expansion,[91] offer qualifying funds flexibility to structure investments in a manner that is most appropriate for the fund (and its investors), including for example to obtain favorable tax treatment, manage risks (such as bankruptcy protection), maintain the value of the fund's equity investment or satisfy the specific financing needs of a portfolio company,[92] and enable a portfolio company to seek such financing from venture capital funds if the company is unable to obtain financing from traditional lending sources.[93]

We recognize that a venture capital fund may, on occasion, make investments other than in equity securities.[94] Under the rule, as discussed above, a venture capital fund may make these investments (as well as other types of investments that commenters may not have suggested) to

88 *See, e.g.*, Comment Letter of CounselWorks LLC (Jan. 24, 2011); ESP Letter; Comment Letter of McGuireWoods LLP (Jan. 24, 2011) ("McGuireWoods Letter"); NVCA Letter; Oak Investment Letter. *See also* BioVentures Letter (supported venture capital fund investments in non-convertible debt without a time limit); Cook Children's Letter; Leland Fikes Letter (each of which expressed general support). One commenter indicated that the proposed condition limiting investments in portfolio companies to equity securities was too narrow. *See* Pine Brook Letter.

89 *See, e.g.*, Cook Children's Letter; Leland Fikes Letter; PEI Funds Letter; Comment Letter of SVB Financial Group (Jan. 24, 2011) ("SVB Letter").

90 *See, e.g.*, ATV Letter; BIO Letter (noted that investments by venture capital funds in "PIPEs" (*i.e.*, "private investments in public equity") are "common").

91 *See, e.g.*, Lowenstein Letter; Comment Letter of John G. McDonald (Jan. 21, 2011) ("McDonald Letter"); Quaker BioVentures Letter; Comment Letter of Trident Capital (Jan. 24, 2011) ("Trident Letter").

92 *See, e.g.*, Merkl Letter; Oak Investments Letter; Sevin Rosen Letter; Comment Letter of Vedanta Capital, LP (Jan. 24, 2011) ("Vedanta Letter").

93 NVCA Letter; Trident Letter.

94 *See, e.g.*, ESP Letter; Leland Fikes Letter; McGuireWoods Letter; NVCA Letter; Oak Investment Letter. *See also supra* Section II.A.

the extent there is room in the fund's non-qualifying basket. Hence, we are adopting the definition of equity security as proposed.

The final rule incorporates the definition of equity security in section 3(a)(11) of the Exchange Act and rule 3a11-1 thereunder.[95] Accordingly, equity security includes common stock as well as preferred stock, warrants and other securities convertible into common stock in addition to limited partnership interests.[96] Our definition of equity security is broad. The definition includes various securities in which venture capital funds typically invest and provides venture capital funds with flexibility to determine which equity securities in the portfolio company capital structure are appropriate for the fund. Our use of the definition of equity security under the Exchange Act acknowledges that venture capital funds typically invest in common stock and other equity instruments that may be convertible into equity common stock but does not otherwise specify the types of equity instruments that a venture capital fund could hold in deference to the business judgment of venture capital funds.

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95 Rule 203(l)-1(c)(2) (equity security "has the same meaning as in section 3(a)(11) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(11)) and § 240.3a11-1 of this chapter."). *See* 15 U.S.C. 78c(a)(11) (defining "equity security" as "any stock or similar security; or any security future on any such security; or any security convertible, with or without consideration, into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any other security which the Commission shall deem to be of similar nature and consider necessary or appropriate, by such rules and regulations as it may prescribe in the public interest or for the protection of investors, to treat as an equity security."); rule 3a11-1 under the Exchange Act (17 CFR 240.3a11-1) (defining "equity security" to include "any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.").

96 *See* rule 3a11-1 under the Exchange Act (17 CFR 240.3a11-1) (defining "equity security" to include any "limited partnership interest").

b. Capital Used for Operating and Business Purposes

Rule 203(l)-1 defines a venture capital fund as a private fund that holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings). Under the final rule, qualifying investments are generally equity securities that were acquired by the fund in one of three ways that suggest that the fund's capital is being used to finance the operations of businesses rather than for trading in secondary markets. As discussed in greater detail below, rule 203(l)-1 defines a "qualifying investment" as: (i) any equity security issued by a qualifying portfolio company that is directly acquired by the private fund from the company ("directly acquired equity"); (ii) any equity security issued by a qualifying portfolio company in exchange for directly acquired equity issued by the same qualifying portfolio company; and (iii) any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, or a predecessor, and that is acquired by the fund in exchange for directly acquired equity.[97]

In the Proposing Release we explained that one of the features of venture capital funds that distinguish them from hedge funds and private equity funds is that they invest capital directly in portfolio companies for the purpose of funding the expansion and development of the companies' business rather than buying out existing security holders.[98] Thus, we proposed that, to meet the definition, at least 80 percent of a fund's investment in each portfolio company must be acquired directly from the company, in effect limiting a venture capital fund's ability to acquire secondary market shares to 20 percent of the fund's investment in each company.[99]

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97 Rule 203(l)-1(c)(3). A security received as a dividend by virtue of the fund's holding of a qualifying investment would also be a qualifying investment. *See generally infra* note 480.

98 Proposing Release, *supra* note 26, at text accompanying n.104.

99 Proposed rule 203(l)-1(a)(2).

A few commenters objected to any limitation on secondary market purchases of a qualifying portfolio company's shares,[100] but did not address the critical role this condition played in differentiating venture capital funds from other types of private funds, such as leveraged buyout funds, which acquire controlling equity interests in operating companies through the "buyout" of existing security holders.[101] Nor did they offer an alternative method in lieu of the direct acquisition criterion to distinguish venture capital funds from the buyout funds that are considered private equity funds. We continue to believe that the limit on secondary purchases is an important element for distinguishing advisers to venture capital funds from advisers to the types of private equity funds for which Congress did not provide an exemption.[102] Therefore, we are not modifying the definition of qualifying investment to broadly include equity securities acquired in secondary transactions.

We are, however, making two changes in this provision in response to commenters. First, we have eliminated the 20 percent limit for secondary market transactions that we included in this provision in our proposal in favor of the broader 20 percent limit for assets that are not qualifying investments.[103] Most commenters addressing the limit on secondary market acquisitions supported changing the threshold from 80 percent of the fund's investment in each portfolio company to either 50 percent in each portfolio company,[104] or 80 percent of the fund's

100 *See, e.g.*, ESP Letter; Merkl Letter.

101 *See also* Proposing Release, *supra* note 26, at section II.A.1.d.

102 *See id.*, at n.112 and accompanying text.

103 *Cf.* proposed rule 203(l)-1(a)(2) and rule 203(l)-1(a)(2).

104 *See* DLA Piper VC Letter; Davis Polk Letter; Sevin Rosen Letter (each supported lowering the direct purchase requirement from 80% to 50% of each qualifying portfolio company's equity securities); Dechert General Letter (argued that the 20% allowance for secondary purchases should be increased to 45%, consistent with rules 3a-1 and 3c-5 under the Investment Company Act). *See also* ABA Letter (supported lowering the threshold from 80% to 70%); NVCA Letter; Mesirow Letter; Oak Investments Letter. Several commenters disagreed with the proposed direct

total capital commitments.[105] These commenters argued that secondary acquisitions provide liquidity to founders, angel investors and employees/former employees or align the interests of a fund with those of a portfolio company.[106]

We believe that the limit on secondary purchases remains an important element for distinguishing advisers to venture capital funds from advisers to the types of private equity funds for which Congress did not provide an exemption.[107] However, as discussed above, a venture capital fund may purchase shares in secondary markets to the extent it has room for such securities in its non-qualifying basket.

Second, the final rule defines qualifying investments as including equity securities issued by the qualifying portfolio company that are received in exchange for directly acquired equities issued by the same qualifying portfolio company.[108] This revision was suggested by a number of commenters to enable a qualifying fund to participate in the reorganization of the capital structure of a portfolio company, which may require the fund, along with other existing security holders, to accept newly issued equity securities in exchange for previously issued equity

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acquisition criterion and recommended that venture capital fund investments in portfolio company securities through secondary transactions should not be subject to any limit. *See, e.g.*, ESP Letter; Merkl Letter.

[105] ATV Letter; Bessemer Letter; Charles River Letter; Davis Polk Letter; First Round Letter; Gunderson Dettmer Letter; InterWest Letter; Mesirow Letter; Norwest Letter; NVCA Letter; Oak Investment Letter; Sevin Rosen Letter; SVB Letter; Union Square Letter; Vedanta Letter. *See also* Comment Letter of Alta Partners (Jan. 24, 2011) ("Alta Partners Letter"); USVP Letter.

[106] *See, e.g.*, Bessemer Letter; Norwest Letter; Sevin Rosen Letter.

[107] *See* Proposing Release, *supra* note 26, at n.112 and accompanying text.

[108] Under rule 203(l)-1(c)(3)(ii), "qualifying investments" include any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company that is directly acquired. *See infra* note 113.

securities.[109]

The rule similarly treats as a qualifying investment any equity security issued by another company in exchange for directly acquired equities of a qualifying portfolio company, provided that the qualifying portfolio company becomes a majority-owned subsidiary of the other company or is a predecessor company.[110] This provision enables a qualifying fund to acquire securities in connection with the acquisition (or merger) of a qualifying portfolio company by another company,[111] without jeopardizing the fund's ability to satisfy the definition of venture capital fund. A venture capital fund's acquisition of publicly offered securities in these circumstances may not present the same degree of interconnectedness with the public markets as secondary acquisitions through the open markets that are typical of other types of leveraged buyout private funds.[112] As a result of the modification to the proposed rule, a venture capital fund could hold equity securities of a company subject to reporting under the Exchange Act, if

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109 *See, e.g.*, NVCA Letter. *See also* Sevin Rosen Letter. Although we understand that the securities received in an exchange are typically newly issued, the rule would also cover exchanges for outstanding securities. *See also infra* note 113.

110 Under rule 203(l)-1(c)(3)(iii), "qualifying investments" include any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary (as defined in section 2(a)(24) of the Investment Company Act), or a predecessor company, and that is acquired by the private fund in exchange for an equity security described in paragraph (c)(3)(i) or (c)(3)(ii) of the rule. *See infra* note 113.

A "majority-owned subsidiary" is defined by reference to section 2(a)(24) of the Investment Company Act, (15 U.S.C. 80a2(a)(24), which defines a "majority-owned subsidiary" of any person as "a company 50 per centum or more of the outstanding voting securities of which are owned by such person, or by a company which, within the meaning of this paragraph, is a majority-owned subsidiary of such person."

111 *See, e.g.*, Davis Polk Letter; Comment Letter of Institutional Venture Partners (Jan. 24, 2011) ("IVP Letter"); Mesirow Letter; PTV Sciences Letter. A number of commenters argued that without this expanded definition, typical transactions enabling a venture capital fund to restructure its investment in a portfolio company, exit its investment or obtain liquidity for itself and its investors, as well as profits, would be precluded. *See, e.g.*, NVCA Letter; PTV Sciences Letter.

112 *See, e.g.*, Davis Polk Letter. *See also* Mesirow Letter.

such equity securities were issued to the fund in exchange for directly acquired equities of a qualifying portfolio company that became a majority-owned subsidiary of the reporting company.[113]

c. *Operation of the 20 Percent Limit*

Under the rule, to meet the definition of venture capital fund, a qualifying fund must hold, immediately after the acquisition of any asset (other than qualifying investments or short-term holdings), no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings).[114] Under this approach, a fund need only calculate the 20 percent limit when the fund acquires a non-qualifying investment (other than short-term holdings); after the acquisition, the fund need not dispose of a non-qualifying investment simply because of a change in the value of that investment. A qualifying fund, however, could not purchase additional non-qualifying investments until the value of its then-existing non-qualifying investments fell below 20 percent of the fund's committed capital.

As discussed above, most commenters supporting a basket for non-qualifying investments recommended a limit expressed as a percentage of fund capital commitments.[115] One commenter further suggested that the value of investments included in the non-qualifying basket be calculated at the time each investment is made to include only those non-qualifying investments that are then held by the fund (thus excluding liquidated assets); the commenter

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113 Under the rule, a qualifying fund could separately purchase additional securities pursuant to a public offering (or recapitalization) from a company after it ceases to be a "qualifying portfolio company" (because for example such company has become a reporting or foreign traded company), subject to the non-qualifying basket.

114 Rule 203(l)-1(a)(2). The calculation of the 20% limit operates in a fashion similar to the diversification and "Second Tier Security" tests of rule 2a-7 under the Investment Company Act. 17 CFR 270.2a-7(a)(24). *See Revisions to Rules Regulating Money Market Funds*, Investment Company Act Release No. 18005 (Feb. 20, 1991) [56 FR 8113, 8118 (Feb. 27, 1991)].

115 *See supra* note 67.

argued that this approach would give funds certainty that a qualifying investment would not become "non-qualifying" and simplify the test for compliance.[116]

We are persuaded that the non-qualifying basket should be based on a qualifying fund's total capital commitments, and the fund's compliance with the 20 percent limit should be calculated at the time any non-qualifying investment is made, based on the non-qualifying investments then held in the fund's portfolio.[117] We understand that using a fund's capital commitments for determining investment thresholds is generally consistent with existing venture capital fund practice,[118] and nearly all of the commenters requesting a basket specified the basket as a percentage of the fund's capital commitments.[119] We expect that calculating the size of the non-qualifying basket as a percentage of a qualifying fund's capital commitments, which will remain relatively constant during the fund's term, will provide advisers with a degree of predictability when managing the fund's portfolio and determining how much of the basket remains available for new investments.

We acknowledge that limiting non-qualifying investments to a percentage of fund capital commitments could result in a qualifying fund that invests its initial capital call in non-qualifying

116 Sevin Rosen Letter. *See also* BioVentures Letter (endorsing the NVCA Letter supporting a non-qualifying basket determined as a percentage of fund capital commitments, but also arguing in favor of determining the basket "at any point in time, rather than in the aggregate over the life of the fund").

117 Capital commitments that have been called but returned to investors and subject to a future call would be treated as uncalled capital commitments. Capital commitments that are no longer subject to a call by the fund would not be treated as uncalled capital commitments.

118 See *generally infra* notes 240-243 (discussing the use of a qualifying fund's capital commitments to determine the fund's compliance with the leverage criterion). *See also* DLA Piper VC Letter.

119 *See generally supra* note 67. For purposes of reporting its "regulatory assets under management" on Form ADV, an adviser would include uncalled capital commitments of a private fund advised by the adviser.

investments;[120] but that ability would be constrained by the adviser's need to reconcile that investment with the fund's required representation that it pursues a venture capital strategy.[121] An investment adviser that manages a fund in such a manner that renders the representation to investors and potential investors that the fund pursues a venture capital strategy an untrue statement of material fact would violate the antifraud provisions of the Advisers Act.[122] We understand that a venture capital fund is not typically required to call or fully draw down all of its capital commitments. However, only *bona fide* capital commitments may be included in the calculation under rule 203(l)-1.[123] For example, commitments made for the purpose of increasing the non-qualifying basket and with an understanding with investors that they will not be called cannot be included.[124]

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120 *See* AFL-CIO Letter; AFR Letter (discussing issues associated with specifying leverage as a percentage of fund capital commitments).

121 *See infra* Section II.A.7.

122 The Commission does not need to demonstrate that an adviser violating rule 206(4)-8 acted with *scienter*. *See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles*, Investment Advisers Act Release No. 2628 (Aug. 3, 2007) [72 FR 44756 (Aug. 9, 2007)] ("Pooled Vehicles Release").

123 *See also Investment Adviser Performance Compensation*, Investment Advisers Act Release No. 3198 (May 10, 2011) [76 FR 27959 (May 13, 2011)] at n.17 (in determining whether a person holds the requisite amount of assets under management, an investment adviser may include "assets that a client is contractually obligated to invest in private funds managed by the adviser. Only *bona fide* contractual commitments may be included, *i.e.*, those that the adviser has a reasonable belief that the investor will be able to meet.").

124 Similarly, fee waivers or reductions for the purpose of inducing investors to increase the size of their capital commitments with an understanding that they will not be called (and hence enable the adviser to increase the size of the non-qualifying basket) would indicate that the commitments are not *bona fide*. In addition, the amount of capital commitments and contributions made by investors and the investments made by the fund are indispensable to the functioning of a venture capital fund, and we understand advisers to venture capital funds typically maintain records reflecting them. *See generally supra* note 5 (describing the Commission's authority to examine the records of advisers relying on the venture capital exemption). We note that a person claiming an exemption under the federal securities laws has the burden of proving it is entitled to the exemption. *See, e.g., SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 466 (2d Cir. 1959); *Swenson v. Engelstad*, 626 F.2d 421, 425 (5th Cir. 1980); *SEC v. Wall St. Transcript Corp.*, 454 F. Supp. 559, 566 (S.D.N.Y. 1978) (stating that the

Moreover, we believe that by applying the 20 percent limit as of the time of acquisition of each non-qualifying investment, a fund is able to determine prospectively how much it can invest in the non-qualifying basket. We believe that this simpler approach to determining the non-qualifying basket would better limit a qualifying fund's non-qualifying investments and ease the burden of determining compliance with the criterion under the rule.

To determine compliance with the 20 percent limit, a venture capital fund would, immediately after the acquisition of any non-qualifying investment, excluding any short-term holdings,[125] calculate the total value of all of the fund's assets held at that time, excluding short-term holdings, that are invested in non-qualifying investments, as a percentage of the fund's total capital commitments.[126] For this purpose, the 20 percent test is determined based on the qualifying fund's non-qualifying investments after taking into account the acquisition of any newly acquired non-qualifying investment.[127]

To determine if a fund satisfies the 20 percent limit for non-qualifying investments, the fund may use either historical cost or fair value, as long as the same method is applied to all investments of a qualifying fund in a consistent manner during the term of the fund.[128] Under the rule, a venture capital fund could use either historical cost or fair value, depending, for example,

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defendant publisher "must register unless it can be shown that it is" entitled to rely on an exclusion from the definition of "investment adviser").

125 Rule 203(l)-1(c)(6) ("Short-term holdings" means cash and cash equivalents as defined in § 270.2a51-1(b)(7)(i), U.S. Treasuries with a remaining maturity of 60 days or less, and shares of an open-end management investment company registered under section 8 of the Investment Company Act of 1940 [15 U.S.C. 80a-8] that is regulated as a money market fund under § 270.2a-7 of this chapter.").

126 A qualifying investment that is acquired as a result of an exchange of equity securities provided by rule 203(l)-1(c)(3)(ii) and (iii) would not result in a requirement to calculate the 20% limit under rule 203(l)-1(a)(2).

127 Rule 203(l)-1(a)(2).

128 *Id.*

on the fund's approach to valuing investments since the fund's inception. Under the final rule, a qualifying fund using historical cost need not account for changes in the value of its portfolio due to, for example, market fluctuations in the value of a non-qualifying investment or the sale or other disposition of a qualifying investment (including the associated distribution of sale proceeds to fund investors). Requiring fair value in this particular instance could make investment planning difficult because the amount of dollars allocated to the non-qualifying basket would vary depending on changes in the value of investments already made. In addition, requiring fair value could complicate compliance for those qualifying funds that make investments frequently, because each investment would result in a requirement to value the fund's assets. Because the rule specifies that the valuation method must be consistently applied, this approach is designed to prevent a qualifying fund, or its adviser, from alternating between valuation methodologies in order to circumvent the 20 percent limit.

Our rule's approach to the valuation method, which allows the use of historical cost in determining compliance with the non-qualifying basket limit, is similar in this respect to rules under the Employee Retirement Income Security Act of 1974 ("ERISA") for funds qualifying as "venture capital operating companies," which generally specify that the value of a fund's investments is determined on a cost basis.[129] Many commenters cited the ERISA rule in connection with comments on other proposed criteria,[130] and hence we believe advisers'

129 Under U.S. Department of Labor regulations, a venture capital operating company ("VCOC") is any entity that, as of the date of the first investment (or other relevant time), has at least 50% of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, invested in venture capital investments. 29 CFR 2510.3-101(d). *See also* Proposing Release, *supra* note 26, at n.70.

130 For example, a number of commenters urged us to adopt the approach under ERISA that would determine whether or not a fund has satisfied the managerial assistance criterion. *See infra* note 225.

familiarity with the ERISA rule will facilitate compliance with our approach to the 20 percent limit and reduce the burdens associated with compliance.

2. Short-Term Holdings

A qualifying fund may also invest in cash and cash equivalents, U.S. Treasuries with a remaining maturity of 60 days or less and shares of registered money market funds.[131] A qualifying fund need not include its investments in these short-term holdings when determining whether it satisfies the 20 percent limit for non-qualifying investments.[132]

Most commenters that addressed the cash element of the proposal did not disagree with our approach to the cash element but urged us to expand it to include money market funds,[133] any U.S. Treasury without regard to maturity,[134] debt issued by foreign governments,[135] repurchase agreements,[136] and certain highly rated corporate commercial paper.[137] Many commenters did not provide a rationale, other than business practice, for expanding the cash element to include these other types of investments or discuss whether these changes would also permit other types

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131 Rule 203(l)-1(c)(6).

132 Rule 203(l)-1(a)(2). As proposed, a venture capital fund would have been defined as a fund that invested *solely* in certain investments, including specified cash instruments. Proposed rule 203(l)-1(a)(2)(ii). In the final rule, a venture capital fund is defined as a fund that holds *no more* than 20% of its committed capital in assets that are not qualifying investments, excluding for this purpose short-term holdings (which is defined to include specified cash instruments). Rule 203(l)-1(a)(2). The general focus of both the proposal and the final rule is on the types of investments in which a qualifying fund may invest. As a result of the modifications to the rule to incorporate a non-qualifying basket, we are excluding short-term holdings from the calculation of qualifying and non-qualifying investments.

133 Comment Letter of Federated Investors, Inc. (Jan. 18, 2011); IVP Letter; Merkl Letter.

134 *See, e.g.*, Dechert General Letter; IVP Letter. *See also* Shearman Letter; SVB Letter (also argued that Treasuries pose no systemic risk issues).

135 Dechert General Letter; Commenter Letter of European Fund and Asset Management Association (Jan. 24, 2011) ("EFAMA Letter"); Merkl Letter.

136 IVP Letter; NVCA Letter.

137 Sevin Rosen Letter.

of funds to meet the definition. One commenter did note, however, that short-term investments are typically held during the period between a capital call and funding by investors and invested in instruments that may provide higher returns than the cash items identified in the proposed rule.[138]

The Commission recognizes that a broader definition of short-term holdings could yield venture capital funds greater returns.[139] The exclusion of short-term holdings from a qualifying fund's assets for purposes of the 20 percent test, however, recognizes that such holdings are not ordinarily held as part of the fund's investment portfolio but as a cash management tool.[140] Advisers to venture capital funds that wish to invest in longer-term or higher yielding debt may make use of the non-qualifying basket for such investments. We are, however, modifying the definition to include as short-term holdings shares of registered money market funds that are regulated under rule 2a-7 under the Investment Company Act,[141] which we understand are commonly held for purposes of cash management.[142]

The rule defines short-term holdings to include "cash and cash equivalents" by reference to rule 2a51-1(b)(7)(i) under the Investment Company Act.[143] We did not receive any comments on this aspect of the proposal and are adopting it without modification. Rule 2a51-1, however, is

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138 NVCA Letter.

139 *See, e.g.*, NVCA Letter.

140 We do not view investing in short-term holdings as being a venture capital strategy; however, for purposes of the exemption, a qualifying fund could invest in short-term holdings as part of implementing its investment strategy. *See also infra* Section II.A.7.

141 Rule 203(l)-1(c)(6).

142 *See, e.g.*, NVCA Letter.

143 Rule 2a51-1(b)(7) under the Investment Company Act provides that cash and cash equivalents include foreign currencies "held for investment purposes" and "(i) [b]ank deposits, certificates of deposit, bankers acceptances and similar bank instruments held for investment purposes; and (ii) [t]he net cash surrender value of an insurance policy." 17 CFR 270.2a51-1(b)(7).

used to determine whether an owner of an investment company excluded by reason of section 3(c)(7) of the Investment Company Act meets the definition of a qualified purchaser by examining whether such owner holds sufficient "investments" (generally securities and other assets held for investment purposes).[144] We are not defining a venture capital fund's cash holdings by reference to whether the cash is held "for investment purposes" or to the net cash surrender value of an insurance policy. Furthermore, since rule 2a51-1 does not explicitly include short-term U.S. Treasuries, which we believe would be an appropriate form of cash equivalent for a venture capital fund to hold pending investment in a portfolio company or distribution to investors, our rule includes short-term U.S. Treasuries with a remaining maturity of 60 days or less.[145]

3. Qualifying Portfolio Company

Under the rule, qualifying investments generally consist of equity securities issued by a qualifying portfolio company. A "qualifying portfolio company" is defined as any company that: (i) is not a reporting or foreign traded company and does not have a control relationship with a reporting or foreign traded company; (ii) does not incur leverage in connection with the investment by the private fund and distribute the proceeds of any such borrowing to the private fund in exchange for the private fund investment; and (iii) is not itself a fund (*i.e.*, is an operating

144 *See generally* sections 2(a)(51) and 3(c)(7) of the Investment Company Act; 17 CFR 270.2a51-1(b) and (c).

145 We have treated debt securities with maturities of 60 days or less differently than debt securities with longer maturities under our rules. In particular, we have recognized that the potential for fluctuation in those shorter-term securities' market value has decreased sufficiently that, under certain conditions, we allow certain open-end investment companies to value them using amortized cost value rather than market value. *See Valuation of Debt Instruments by Money Market Funds and Certain Other Open-End Investment Companies*, Investment Company Act Release No. 9786 (May 31, 1977) [42 FR 28999 (June 7, 1977)]. We believe that the same consideration warrants treating U.S. Treasury securities with a remaining maturity of 60 days or less as more akin to cash equivalents than Treasuries with longer maturities for purposes of the definition of venture capital fund.

company).[146] We are adopting the rule substantially as proposed, with modifications to the leverage criterion in order to address certain concerns raised by commenters. We describe each element of a qualifying portfolio company below. We understand each of the criteria to be characteristic of issuers of portfolio securities held by venture capital funds.[147] Moreover, collectively, we believe these criteria would operate to exclude most private equity funds and hedge funds from the definition.

a. Not a Reporting Company

Under the rule, a qualifying portfolio company is defined as a company that, at the time of any investment by a qualifying fund, is not a "reporting or foreign traded" company (a "reporting company") and does not control, is not controlled by or under common control with, a reporting company.[148] Under the definition, a venture capital fund may continue to treat as a qualifying investment any previously directly acquired equity security of a portfolio company

146 Rule 203(l)-1(c)(4). In the Proposing Release, we used the defined term "publicly traded" company, but are modifying the rule to use the defined term "reporting or foreign traded" company to match more closely the defined term and to make clear that certain companies that have issued securities that are traded on a foreign exchange are covered by the definition. *See* proposed rule 203(l)-1(c)(3) and (4).

147 *See* Proposing Release, *supra* note 26, sections II.A.1.a.-II.A.1.e.

148 Rule 203(l)-1(c)(4)(i); rule 203(l)-1(c)(5) (defining a "reporting or foreign traded" company as one that is subject to the reporting requirements under section 13 or 15(d) of the Exchange Act, or has a security listed or traded on any exchange or organized market operating in a foreign jurisdiction). This definition is similar to rule 2a51-1 under the Investment Company Act (defining "public company," for purposes of the qualified purchaser standard, as "a company that files reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934"), and rule 12g3-2 under the Exchange Act (conditioning a foreign private issuer's exemption from registering securities under section 12(g) of the Exchange Act if, among other conditions, the "issuer is not required to file or furnish reports" pursuant to section 13(a) or section 15(d) of the Exchange Act). 17 CFR 270.2a51-1; 17 CFR 240.12g3-2. Under the rule, securities of a "reporting or foreign traded company" include securities of non-U.S. companies that are listed on a non-U.S. market or non-U.S. exchange. Rule 203(l)-1(c)(5).

that subsequently becomes a reporting company.[149] Moreover, after a company becomes a reporting company, a qualifying fund could acquire the company's publicly traded (or foreign traded) securities in the secondary markets, subject to the availability of the fund's non-qualifying basket.

As we discussed in the Proposing Release, venture capital funds provide operating capital to companies in the early stages of their development with the goal of eventually either selling the company or taking it public.[150] Unlike other types of private funds, venture capital funds are characterized as not trading in the public markets, but may sell portfolio company securities into the public markets once the portfolio company has matured.[151] As of year-end 2010, U.S.

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149 Rule 203(l)-1(c)(4)(i) (defining a qualifying portfolio company as any company that at the time of any investment by a venture capital fund is not a reporting or foreign traded company).

150 *See* Testimony of James Chanos, Chairman, Coalition of Private Investment Companies, July 15, 2009, at 4 ("[V]enture capital funds are an important source of funding for start-up companies or turnaround ventures."); National Venture Capital Association Yearbook 2010 ("NVCA Yearbook 2010"), at 7-8 (noting that venture capital is a "long-term investment" and the "payoff [to the venture capital firm] comes after the company is acquired or goes public."); George W. Fenn, Nellie Liang and Stephen Prowse, The Economics of the Private Equity Market, December 1995, 22, n.61 and accompanying text ("Fenn *et al.*") ("Private sales" are not normally the most important type of exit strategy as compared to IPOs, yet of the 635 successful portfolio company exits by venture capitalists between 1991-1993 "merger and acquisition transactions accounted for 191 deals and IPOs for 444 deals." Furthermore, between 1983 and 1994, of the 2,200 venture capital fund exits, 1,104 (approximately 50%) were attributed to mergers and acquisitions of venture-backed firms.). *See also* Jack S. Levin, Structuring Venture Capital, Private Equity and Entrepreneurial Transactions, 2000 ("Levin") at 1-2 to 1-7 (describing the various types of venture capital and private equity investment business but stating that "the phrase 'venture capital' is sometimes used narrowly to refer only to financing the start-up of a new business"); Anna T. Pinedo & James R. Tanenbaum, Exempt and Hybrid Securities Offerings (2009), Vol. 1 at 12-2 (discussing the role initial public offerings play in providing venture capital investors with liquidity).

151 *See* Testimony of Trevor Loy, Flywheel Ventures, before the Senate Banking Subcommittee on Securities, Insurance and Investment Hearing, July 15, 2009 ("Loy Testimony"), at 5 ("We do not trade in the public markets."). *See also* Testimony of Terry McGuire, General Partner, Polaris Venture Partners, and Chairman, National Venture Capital Association, before the U.S. House of Representatives Committee on Financial Services, October 6, 2009 ("McGuire Testimony") at 11 ("[V]enture capital funds do not typically trade in the public markets and generally limit advisory activities to the purchase and sale of securities of private operating companies in private transactions"); Levin, *supra* note 150, at 1-4 ("A *third* distinguishing feature of venture

venture capital funds managed approximately $176.7 billion in assets.[152] In comparison, as of year-end 2010, the U.S. publicly traded equity market had a market value of approximately $15.4 trillion,[153] whereas global hedge funds had approximately $1.7 trillion in assets under management.[154] The aggregate amount invested in venture capital funds is considerably smaller.[155] Congressional testimony asserted that these funds may be less connected with the public markets and may involve less potential for systemic risk.[156] This appears to be a key consideration by Congress that led to the enactment of the venture capital exemption.[157] As we discussed in the Proposing Release, the rule we proposed sought to incorporate this

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capital/private equity investing is that the securities purchased are generally privately held as opposed to publicly traded . . . a venture capital/private equity investment is normally made in a privately-held company, and in the relatively infrequent cases where the investment is into a publicly-held company, the [venture capital fund] generally holds non-public securities.") (emphasis in original).

152 National Venture Capital Association Yearbook 2011 ("NVCA Yearbook 2011") at 9, Fig. 1.0.

153 Bloomberg Terminal Database, WCAUUS <Index> (Bloomberg United States Exchange Market Capitalization).

154 Credit Suisse, *2010 Hedge Fund Industry Review*, Feb. 2011 ("Credit Suisse Report"), at 1.

155 In 2010, investors investing in newly formed funds committed approximately $12.3 billion to venture capital funds compared to approximately $85.1 billion to private equity/buyout funds. NVCA Yearbook 2011, *supra* note 152, at 20 at Fig. 2.02. In comparison, hedge funds raised approximately $22.6 billion from investors in 2010. Credit Suisse Report, *supra* note 154, at 1.

156 *See* S. Rep. No. 111-176, *supra* note 6, at 74-5 (noting that venture capital funds "do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title [IV]. Their activities are not interconnected with the global financial system, and they generally rely on equity funding, so that losses that may occur do not ripple throughout world markets but are borne by fund investors alone. Terry McGuire, Chairman of the National Venture Capital Association, wrote in congressional testimony that 'venture capital did not contribute to the implosion that occurred in the financial system in the last year, nor does it pose a future systemic risk to our world financial markets or retail investors.'"). *See also* Loy Testimony, *supra* note 151, at 7 (noting the factors by which the venture capital industry is exposed to "entrepreneurial and technological risk not systemic financial risk"); McGuire Testimony, *supra* note 151, at 6 (noting that the "venture capital industry's activities are not interwoven with U.S. financial markets"). *See also* Group of Thirty, Financial Reform: A Framework for Financial Stability, January 15, 2009, at 9 (discussing the need for registration of managers of "private pools of capital that employ substantial borrowed funds" yet recognizing the need to exempt venture capital from registration).

157 *See supra* note 156.

Congressional understanding of the nature of investments of a venture capital fund, and these principles guided our consideration of the proposed venture capital fund definition.[158] The proposed rule would have required that a qualifying fund invest primarily in equity securities of companies that are not capitalized by the public markets.[159]

Several commenters asserted that the definition should not exclude securities of reporting companies.[160] Most, however, did not object to the rule's limitation on investments in non-reporting companies, but instead sought a more flexible definition that would include some level of investments in reporting companies under certain conditions. For example, certain commenters supported venture capital fund investments in reporting companies only if, at the time the company becomes a reporting company, the fund continued to hold at least a majority of its original investment made when the company was a non-reporting company.[161] Some of these commenters asserted that public offerings, which trigger reporting requirements under the federal

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158 *See* Proposing Release, *supra* note 26, at n.43 and n.60 and following text.

159 Most commenters did not express any objection to our proposed definition of "publicly traded," although one commenter did disagree with the proposed definition's approach to foreign traded securities. This commenter argued that the proposed rule should be modified to "cover securities that have been publicly offered to investors in a foreign jurisdiction and equity securities that are widely held and traded over-the-counter in a foreign jurisdiction." Merkl Letter. We decline to adopt this approach because the definition would require us to define what constitutes a "public offering" notwithstanding the laws of foreign regulators and legislatures.

160 *See* Bessemer Letter; IVP Letter (also suggested additional conditions); Merkl Letter. One commenter also suggested that the definition should not exclude investments in companies that may be deemed to be "controlled" by a public company (or its venture capital investment division). *See* Comment Letter of Berkeley Center for Law, Business and the Economy (Feb. 1, 2011) ("BCLBE Letter"). *See also* Dechert General Letter (argued that restricting the application of the control element may be necessary because an adviser to a venture capital fund could be controlled by a public company, and might itself be deemed to control a portfolio company as a result of its prior investments). Under our rule, a venture capital fund could invest in such companies under the non-qualifying basket.

161 ATV Letter; BIO Letter; NVCA Letter. *See also* Davis Polk Letter; InterWest Letter; McDonald Letter; Mesirow Letter; PTV Sciences Letter. A number of commenters supported expanding the proposed definition but without additional conditions. *See, e.g.*, BioVentures Letter; ESP Letter; Quaker BioVentures Letter; SV Life Sciences Letter.

securities laws, were viewed as an additional financing round, with pre-existing venture investors expected to participate.[162] Alternatively, several commenters recommended that a venture capital fund could limit its investment in reporting companies, such as 15 or 20 percent of the fund's capital commitments.[163]

We understand that venture capital funds seek flexibility to invest in promising portfolio companies, including companies deemed sufficiently profitable to become reporting companies or companies that may be owned directly or indirectly by a public company. Rather than modify the rule to impose additional criteria for investing in reporting companies, however, we have adopted a limit of 20 percent for non-qualifying investments, which may be used to hold securities of reporting companies. We believe that the 20 percent limit appropriately balances commenters' expressed desire for greater flexibility to accommodate existing business practices while providing sufficient limits on the extent of investments that would implicate Congressional statements regarding the interconnectedness of venture capital funds with the public markets.[164]

162 *See, e.g.*, Alta Partners Letter; Gunderson Dettmer Letter; InterWest Letter; McDonald Letter; NVCA Letter; Quaker BioVentures Letter. *See also* Bessemer Letter; BIO Letter; Lowenstein Letter.

163 Alta Partners Letter (supported limiting investments in public companies to 15% of fund capital commitments); Gunderson Dettmer Letter (supported limiting investments in public securities to 20% of fund capital commitments). *See also* Davis Polk Letter (supported limiting investments in public companies to 20% of fund capital commitments provided the fund continues to hold a majority of its original investment in the company when it was private); SVB Letter (supported investments in public securities but did not identify a percentage threshold).

164 *See supra* Section II.A.1.b. One commenter argued that, in addition to funds that would satisfy the proposed definition, a venture capital fund should include any fund that invests at least 75% of its capital in privately held "domestic small business" as defined in the Small Business Investment Act (the "SBIA") regulations, regardless of the equity/debt nature of the investment. *See* NASBIC/SBIA Letter. In the Proposing Release, we noted our concerns with adopting a definition for a "small" company, including reliance on the SBIA regulatory standards for treatment as a "small" company, which generally imposes specific tests for net worth, net income or number of employees for each type of company, depending on its geographic location and industry classification. *See* Proposing Release, *supra* note 26, at n.69 and accompanying and following text. We have considered the issues raised in the NASBIC/SBIA Letter and continue to

Under our rule, a qualifying portfolio company is defined to include a company that is not a reporting company (and does not have a control relationship with a reporting company) at the time of each fund investment.[165] However, one commenter observed that an existing investment in a portfolio company that ultimately becomes a successful venture capital investment (such as when the company issues its securities in a public offering or becomes a reporting company) should not result in the investment becoming a non-qualifying investment.[166] We agree. Under the rule, such an investment would not become a non-qualifying investment because the definition focuses on the time at which the venture capital fund acquires the particular equity security issued by a portfolio company and does not limit the definition of qualifying portfolio company solely to companies that are and remain non-reporting companies. Under this approach, an adviser could continue to rely on the exemption even if the venture capital fund's portfolio ultimately consisted entirely of securities that become securities of reporting companies. We believe that our approach would give advisers to venture capital funds sufficient flexibility to exercise their business judgment on the appropriate time to dispose of portfolio company investments – whether that occurs at a time when the company is or is not a reporting company.[167] Moreover, under the federal securities laws, a person, such as a venture capital fund, that is deemed to be an affiliate of a company may be limited in its ability to

believe that a qualifying portfolio company should not be defined by reference to whether a company is "small" for the reasons cited in the Proposing Release.

165 *See* rule 203(l)-1(c)(4)(i).

166 PTV Sciences Letter (stating that following a merger or public offering of a qualifying portfolio company's securities, the shares held by the fund "are turned into profits to our investors").

167 *See* Proposing Release, *supra* note 26, at n.55 and following text.

dispose of the company's securities.[168] Under the final rule, a qualifying fund would not be in the position of having to dispose of securities of a qualifying portfolio company that subsequently becomes a reporting company.

b. Portfolio Company Leverage

Rule 203(l)-1 defines a qualifying portfolio company for purposes of the exemption as one that does not borrow or issue debt obligations in connection with the venture capital fund's investment in the company and distribute to the fund the proceeds of such borrowing or issuance in exchange for the fund's investment.[169] As a consequence, certain types of funds that use leverage or finance their investments in portfolio companies or the buyout of existing investors with borrowed money (*e.g.*, leveraged buyout funds, which are a different subset of private equity funds) would not meet the rule's definition of a venture capital fund.[170] As discussed in greater detail below and in the Proposing Release, we believe that Congress did not intend the

168 *See* sections 2(a)(11) (defining "underwriter") and 5 of the Securities Act. *See also* E.H. Hawkins, SEC Staff No-Action Letter (June 26, 1997) (staff explained how the term "underwriter" in the Securities Act restricts resales of securities by affiliates of issuing companies).

169 Rule 203(l)-1(c)(4)(ii).

170 Leveraged buyout funds are private equity funds that will "borrow significant amounts from banks to finance their deals—increasing the debt-to-equity ratio of the acquired companies . . . ." U.S. Govt. Accountability Office, Private Equity: Recent Growth in Leveraged Buyouts Exposed Risks that Warrant Continued Attention (2008) ("GAO Private Equity Report"), at 1. A leverage buyout fund in 2005 typically financed a deal with 34% equity and 66% debt. *Id.* at 13. *See also* Fenn *et al.*, *supra* note 150, at 23 (companies that have been taken private in a leveraged buyout (or "LBO") transaction generally "spend less on research and development, relative to assets, and have a greater proportion of fixed assets; their debt-to-assets ratios are high, above 60 percent, and are two to four times those of venture-backed firms." Moreover, compared to venture capital backed companies, LBO-private equity backed companies that are taken public typically use proceeds from an IPO to reduce debt whereas new venture capital backed firms tend to use proceeds to fund growth.); Testimony of Mark Tresnowksi, General Counsel, Madison Dearborn Partners, LLC, on behalf of the Private Equity Council, before the Senate Banking Subcommittee on Securities, Insurance and Investment, July 15, 2009, at 2 (indicating that portfolio companies in which private equity funds invest typically have 60% debt and 40% equity).

venture capital fund definition to apply to these types of private equity funds.[171]

We proposed to define a qualifying portfolio company as a company that does not borrow "in connection" with a venture capital fund investment. We also proposed to define a qualifying portfolio company as a company that does not participate in an indirect buyout involving a qualifying fund (as a corollary to our proposed limitation on venture capital fund acquisitions of portfolio company securities through secondary transactions, *i.e.*, direct buyouts).[172] We proposed these elements to distinguish between venture capital funds that provide capital to portfolio companies for operating and business purposes (in exchange for an equity investment) and leveraged buyout funds, which acquire controlling equity interests in operating companies through the "buyout" of existing security holders or which finance such investments or buyouts with borrowed money.[173] We proposed these elements of the qualifying portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report,[174] and the testimony before Congress that stressed the lack of leverage in venture capital investing.[175]

Some commenters argued that defining a venture capital fund as a fund that does not participate in buyouts was too restrictive or too difficult to apply.[176] Most of the commenters

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171 *See* discussion in section II.A.1.c. and d. of the Proposing Release, *supra* note 26.

172 Proposed rules 203(l)-1(a)(2)(i); (c)(4)(ii) and (c)(4)(iii).

173 *See generally* Proposing Release, *supra* note 26, at sections II.A.1.c. and d.

174 *See* S. Rep. No. 111-176, *supra* note 6, at 74 ("The Committee believes that venture capital funds, a subset of private investment funds specializing in long-term equity investment in small or start-up businesses, do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title."); *id.* at 75 (concluding that private equity funds that use limited or no leverage at the fund level engage in activities that do not pose risks to the wider markets through credit or counterparty relationships).

175 *See* Proposing Release, *supra* note 26, at n.100.

176 *See, e.g.*, McGuireWoods Letter; NVCA Letter; Pine Brook Letter.

who addressed the issue opposed a definition that excluded any buyouts of portfolio company securities by venture capital funds.[177] Some commenters argued that because a venture capital fund could, under the proposed rule, acquire up to 20 percent of portfolio company securities in secondary transactions, indirect buyouts achieved at the portfolio company level should not be precluded.[178] Some commenters stated that buyouts are an important means of providing liquidity to portfolio company founders, employees, former employees and vendors/service providers,[179] while others argued that buyouts occurring as a result of recapitalizations[180] or conversions of permissible bridge loans[181] should not preclude a fund from relying on the definition.[182]

We have eliminated the proposed indirect buyout criterion in the final rule. Because the non-qualifying basket does not exclude secondary market transactions (or other buyouts of existing security holders), it would be inconsistent to define a venture capital fund as a fund that does not participate in a buyout.

We are retaining and clarifying, however, the leveraged buyout criterion as it relates to qualifying portfolio companies. We had proposed to define a qualifying portfolio company as a

177 One commenter sought interpretative guidance on which buyout transactions would be considered to be "in connection with" a venture capital fund investment. Mesirow Letter. *See also* McGuireWoods Letter; NVCA Letter (discussing some interpretative issues with the "in connection with" language).

178 ATV Letter; NVCA Letter. *See also* ABA Letter (also recommending that the buyout bucket be increased to 30%); Charles River Letter (supported a 20% buyout limit to accommodate the increasing industry use of buyouts); First Round Letter (supported 25% buyout limit for each deal and a 20% limit for all fund investments in order to facilitate liquidity to founders).

179 *See, e.g.*, Davis Polk Letter; ESP Letter; SVB Letter.

180 Alta Partners Letter; BioVentures Letter.

181 ATV Letter; NVCA Letter.

182 *See also* Pine Brook Letter (suggesting "careful drafting" that would not preclude transactions in the normal course of business by defining a set of prohibited buyout transactions (*e.g.*, "leveraged dividend recapitalizations")).

company that, among other things, does not borrow "in connection" with a venture capital fund investment. As noted above, we proposed this element to distinguish venture capital funds from leveraged buyout funds, and we continue to believe that this remains an important distinction. We believe that these differences (*i.e.*, the use of buyouts and associated leverage) distinguish venture capital funds from buyout private equity funds for which Congress did not provide an exemption.[183]

One of the distinguishing features of venture capital funds is that, unlike many hedge funds and private equity funds, they invest capital directly in portfolio companies for the purpose of funding the expansion and development of the company's business rather than buying out existing security holders, otherwise purchasing securities from other shareholders, or leveraging the capital investment with debt financing.[184] Testimony received by Congress and our research suggest that venture capital funds provide capital to many types of businesses at different stages of development,[185] generally with the goal of financing the expansion of the company[186] and

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183 *See supra* note 174 and accompanying text.

184 *See* Loy Testimony, *supra* note 151, at 2 ("Although venture capital funds may occasionally borrow on a short-term basis immediately preceding the time when the cash installments are due, they do not use debt to make investments in excess of the partner's capital commitments or 'lever up' the fund in a manner that would expose the fund to losses in excess of the committed capital or that would result in losses to counter parties requiring a rescue infusion from the government."). *See also infra* notes 189-191; Mark Heesen & Jennifer C. Dowling, National Venture Capital Association, *Venture Capital & Adviser Registration* (October 2010), materials submitted in connection with the Commission's Government-Business Forum on Small Business Capital Formation (summarizing the differences between venture capital funds and buyout and hedge funds), *available at* http://www.sec.gov/info/smallbus/2010gbforumstatements.htm.

185 *See, e.g.*, McGuire Testimony, *supra* note 151, at 1; NVCA Yearbook 2010, *supra* note 150; PricewaterhouseCoopers/National Venture Capital Association MoneyTree Report, Q4 2009/Full-year 2009 Report (providing data on venture capital investments in portfolio companies); James Schell, Private Equity Funds: Business Structure and Operations (2010), at § 1.03[1] ("Schell"), at §1.03[1]; PAUL A. GOMPERS & JOSH LERNER, THE VENTURE CAPITAL CYCLE, at 459 (MIT Press 2004), at 178, 180 table 8.2 (displaying percentage of annual venture capital investments by stage of development and classifying "early stage" as seed, start-up, or early stage and "late stage" as expansion, second, third, or bridge financing).

helping it progress to the next stage of its development through successive tranches of investment (*i.e.*, "follow-on" investments) if the company reaches agreed-upon milestones.[187]

In contrast, private equity funds that are identified as buyout funds typically provide capital to an operating company in exchange for majority or complete ownership of the company,[188] generally achieved through the buyout of existing shareholders or other security holders and financed with debt incurred by the portfolio company,[189] and compared to venture capital funds, hold the investment for shorter periods of time.[190] As a result of the use of the

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186 *See* McGuire Testimony, *supra* note 151, at 1; Loy Testimony, *supra* note 151, at 3 ("Once the venture fund is formed, our job is to find the most promising, innovative ideas, entrepreneurs, and companies that have the potential to grow exponentially with the application of our expertise and venture capital investment."). *See also* William A. Sahlman, *The Structure and Governance of Venture-Capital Organizations*, Journal of Financial Economics 27 (1990), at 473, 503 ("Sahlman") (noting venture capitalists typically invest more than once during the life of a company, with the expectation that each capital investment will be sufficient to take the company to the next stage of development, at which point the company will require additional capital to make further progress).

187 *See* Sahlman, *supra* note 186, at 503; Loy Testimony, *supra* note 151, at 3 ("[W]e continue to invest additional capital into those companies that are performing well; we cease follow-on investments into companies that do not reach their agreed upon milestones.").

188 GAO Private Equity Report, *supra* note 170, at 8 ("A private equity-sponsored LBO generally is defined as an investment by a private equity fund in a public or private company (or division of a company) for majority or complete ownership.").

189 *See* Annalisa Barrett *et al.*, Prepared by the Corporate Library Inc., under contract for the IRRC Institute, What is the Impact of Private Equity Buyout Fund Ownership on IPO Companies' Corporate Governance?, at 7 (June 2009) ("Barrett *et al.*") ("In general, VC firms provide funding to companies in early stages of their development, and the money they provide is used as working capital for the firm. Buyout firms, in contrast, work with mature companies, and the funds they provide are used to compensate the firm's existing owners."); Ieke van den Burg and Poul Nyrup Rasmussen, Hedge Funds and Private Equity: A Critical Analysis (2007), at 16-17 ("van den Burg"); Sahlman, *supra* note 186, at 517. *See also* Tax Legislation: CRS Report, Taxation of Hedge Fund and Private Equity Managers, Tax Law and Estate Planning Course Handbook Series, Practicing Law Institute (Nov. 2, 2007) at 2 (noting that in a leveraged buyout "private equity investors use the proceeds of debt issued by the target company to acquire all the outstanding shares of a public company, which then becomes private").

190 Unlike venture capital funds, which generally invest in portfolio companies for 10 years or more, private equity funds that use leveraged buyouts invest in their portfolio companies for shorter periods of time. *See* Loy Testimony, *supra* note 151, at 3 (citing venture capital fund investments periods in portfolio companies of five to 10 years or longer); van den Burg, *supra* note 189, at 19

capital provided and the incurrence of this debt, following the buyout fund investment, the operating company may carry debt several times its equity and may devote significant levels of its cash flow and corporate earnings to repaying the debt financing, rather than investing in capital improvement or business operations.[191]

Some commenters agreed that distinguishing between venture capital and other private funds with reference to a portfolio company's leverage and indirect buyouts is important.[192] Many commenters, however, urged a more narrowly drawn restriction on a portfolio company's ability to borrow (or issue debt) or to effect indirect buyouts.[193] Some argued that the manner in which proceeds from indebtedness are used by a portfolio company (*e.g.*, distributed by the company to the venture capital fund) better distinguishes venture capital funds from leveraged buyout private equity funds.[194] Nevertheless, the majority of commenters who addressed this criterion supported a leverage criterion that would be more specific, or limited, in scope,[195]

(noting that LBO investors generally retain their investment in a listed company for 2 to 4 years or even less after the company goes public). *See also* Paul A. Gompers, *The Rise and Fall of Venture Capital*, Business And Economic History, vol. 23, no. 2, Winter 1994, at 17 (stating that "an LBO investment is significantly shorter than that of a comparable venture capital investment. Assets are sold off almost immediately to meet debt burden, and many companies go public again (in a reverse LBO) in a very short period of time.").

191 *See* Barrett *et al.*, *supra* note 189. *See also* Fenn *et al.*, *supra* note 150, at 23 (companies that have been taken private in an LBO transaction generally "spend less on research and development, relative to assets, and have a greater proportion of fixed assets; their debt-to-assets ratios are high, above 60%, and are two to four times those of venture-backed firms." Moreover, compared to venture capital backed companies, LBO-private equity backed companies that are taken public typically use proceeds from an IPO to reduce debt whereas new venture capital backed firms tend to use proceeds to fund growth.).

192 *See, e.g.*, AFL-CIO Letter; Sen. Levin Letter; Pine Brook Letter.

193 *See, e.g.*, ATV Letter; Charles River Letter; NVCA Letter; Oak Investment Letter; Pine Brook Letter.

194 *See, e.g.*, NVCA Letter; Pine Brook Letter; SV Life Sciences Letter; Vedanta Letter.

195 *See, e.g.*, ATV Letter; Charles River Letter (supports modifying the rule so that up to 20% of fund capital commitments may be invested in portfolio companies that do not adhere to the leverage condition provided that the venture capital fund is not the party providing the leverage to

focusing on the use of proceeds derived from portfolio company leverage.[196] Commenters suggested that the rule define leverage as leverage incurred for the purpose of buying out shareholders at the demand of the venture capital fund[197] or for returning capital to the fund,[198] and not, for example, define leverage to include indebtedness incurred to pay for a qualifying portfolio company's operating expenses.[199]

Some commenters argued that the proposed "in connection with" element would be difficult to apply, arguing that the standard was too vague or raised too many interpretative issues.[200] In response to our request for comment, many commenters sought confirmation that the limitation on portfolio company leverage would be triggered only in the instances of leverage provided to the portfolio company by the venture capital fund or if portfolio company borrowing

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the company); NVCA Letter; Comment Letter of the Securities Regulation Committee of the Business Law Section of the New York State Bar Association, Apr. 1, 2011 ("NYSBA Letter"); SVB Letter.

196 Although two commenters supported the leverage limitation as proposed (*see* AFL-CIO Letter (also supporting a specific prohibition on borrowing by a portfolio company to pay dividends or fees to the venture capital fund); Sen. Levin Letter (together with the equity investment requirement, the definition appropriately excludes leveraged buyout funds)), two other commenters opposed it, arguing that qualifying portfolio company leverage should not be restricted at all (*see* ESP Letter (limits on leverage would prevent portfolio companies from receiving lending from venture debt funds and state governments and lenders rather than regulators should determine the appropriate level of portfolio company debt); Merkl Letter (young negative EBITDA companies would not be able to obtain significant amounts of debt and hence no leverage prohibition is required)). *See also* NASBIC/SBIA Letter (portfolio companies should not be precluded from accessing leverage); Sevin Rosen Letter, Pine Brook Letter (each expressed support for a use of proceeds approach).

197 *See, e.g.*, Gunderson Dettmer Letter; McDonald Letter; NVCA Letter; SVB Letter.

198 *See, e.g.*, McDonald Letter; NVCA Letter.

199 Gunderson Dettmer Letter; Pine Brook Letter; Trident Letter; Vedanta Letter. One commenter suggested that a use of proceeds test would be difficult to enforce because such a test would need to be extremely detailed in order to prevent circumvention. *See* Merkl Letter.

200 *See, e.g.*, Merkl Letter; Sevin Rosen Letter; SVB Letter.

were effected in satisfaction of a contractual obligation with the venture capital fund.[201]

After careful consideration of the intended purpose of the leverage limitation of the proposed rule and the concerns raised by commenters, we are modifying the qualifying portfolio company leverage criterion to define a qualifying portfolio company as any company that does not both borrow (or issue debt) in connection with a venture capital fund investment *and* distribute the proceeds of such borrowing or issuance to the venture capital fund *in exchange for* the fund's investment. In contrast to the proposed rule, the final rule more specifically delineates the types of leveraged transactions involving a qualifying fund (*i.e.*, a company's distribution of proceeds received in a debt offering to the qualifying fund) that would result in the company being excluded from the definition of a qualifying portfolio company. We believe that these modifications more closely achieve our goal of distinguishing advisers to venture capital funds from other types of private funds for which Congress did not provide an exemption because it looks to the substance, not just the form, of a transaction or series of transactions.

This definition of qualifying portfolio company would only exclude companies that borrow in connection with a venture capital fund's investment and distribute such borrowing proceeds to the venture capital fund in exchange for the investment, but would not exclude companies that borrow in the ordinary course of their business (*e.g.*, to finance inventory or capital equipment, manage cash flows, meet payroll, *etc.*). Under the rule, a venture capital fund could provide financing or loans to a portfolio company, provided that the financing meets the definition of equity security or is made subject to the 20 percent limit for non-qualifying investments. Although we would generally view any financing to a portfolio company that was

201 *See, e.g.*, ABA Letter; ATV Letter; Bessemer Letter; Mesirow Letter; NVCA Letter; SV Life Sciences Letter. *See also* Proposing Release, *supra* note 26, discussion at section II.A.1.c.

provided by, or was a condition of a contractual obligation with, a fund or its adviser as part of the fund's investments in the company as being a type of financing that is "in connection with" the fund's investment, the definition's limitation would only apply if the proceeds of such financing were distributed to the venture capital fund in exchange for its investment. Moreover, subsequent distributions to the venture capital fund solely because it is an existing investor would not be inconsistent with this criterion. We believe that this modification to the rule adequately distinguishes between venture capital funds and leveraged buyout funds and provides a simpler and clearer approach to determining whether or not a qualifying portfolio company satisfies the definition.

c. Operating Company

Rule 203(l)-1 defines the term qualifying portfolio company for the purposes of the exemption to exclude any private fund or other pooled investment vehicle.[202] Under the rule, a qualifying portfolio company could not be another private fund, a commodity pool or other "investment companies."[203] We are adopting this criterion because Congress did not express an intent to include venture capital funds of funds within the definition.[204] In the Senate Report, Congress characterized venture capital as a subset of private equity "specializing in long-term

202 Rule 203(l)-1(c)(4)(iii). For this purpose, pooled investment vehicles include investment companies, issuers relying on rule 3a-7 under the Investment Company Act and commodity pools. 17 CFR 270.3a-7.

203 Under the "holding out" criterion (discussed in Section II.A.7. below), a fund that represents itself as pursuing a venture capital strategy to investors implies that the fund invests primarily in operating companies and not for example in entities that hold oil and gas leases.

204 One commenter agreed that "there is no indication that Congress intended the venture capital exemption to apply to 'funds of funds,'" but argued that the qualifying portfolio company definition was "unduly restrictive" because it would exclude such funds of funds and discourage use of special purpose vehicles. ABA Letter.

equity investment in small or start-up businesses"[205] and did not refer to funds investing in other funds. Moreover, testimony to Congress described venture capital investments in operating companies rather than other private funds.[206]

Moreover, without this definitional criterion, a qualifying fund could circumvent the intended scope of the rule by investing in other pooled investment vehicles that are not themselves subject to the definitional criteria under our rule.[207] For example, without this criterion, a venture capital fund could circumvent the intent of the rule by incurring off-balance sheet leverage or indirectly investing in reporting companies in excess of the 20 percent limit for non-qualifying investments.[208] Our exclusion is similar to the approach of other definitions of "venture capital" discussed in the Proposing Release, which limit investments to operating companies and thus would exclude investments in other private funds or securitized asset vehicles.[209]

Many commenters opposed the operating company criterion and recommended that the rule include fund of venture capital fund structures.[210] Some commenters supported no limits on

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[205] S. Rep. No. 111-176, *supra* note 6, at 74.

[206] *See generally* Loy Testimony, *supra* note 151, and McGuire Testimony, *supra* note 151.

[207] One commenter indicated that it was "sympathetic" to the Commission's concerns about the use of fund of funds structures to circumvent the intended purpose of the exemption, and agreed that such "investments would unacceptably heighten the possibility for abuse." *See* NVCA Letter (suggesting that the Commission address this concern by applying the venture capital fund leverage limit on a full "look-through" basis to the underlying funds).

[208] Similarly, a qualifying fund could not, for example, invest in an investment management entity (*e.g.*, a general partner entity) that in turn invests in another pooled vehicle, except as an investment under the non-qualifying basket.

[209] *See* Proposing Release, *supra* note 26, at nn.70-72 (discussing the California venture capital exemption and the VCOC definition under ERISA, 29 CFR 2510.3-101(d)).

[210] *See, e.g.*, NVCA Letter; Sevin Rosen Letter; Comment Letter of VCFA Group (Jan. 21, 2011).

investments in other pooled investment vehicles,[211] while others supported broadening the definition to include funds that invest in other funds if either (i) the underlying funds qualify as venture capital funds (*i.e.*, comply with rule 203(l)-1)[212] or (ii) investment in underlying funds does not exceed a specified threshold (such as a percentage of fund capital).[213] Commenters argued that broadening the definition of qualifying portfolio company was necessary in order to accommodate current business practices,[214] or was appropriate because funds of funds (including secondary funds) provide investors with liquidity or do not pose systemic risk.[215] Other commenters advocated a definition that would permit investments in qualifying portfolio companies held through an intermediate holding company structure formed solely for tax, legal or regulatory reasons.[216]

For purposes of the definition of a qualifying portfolio company, we agree that a fund may disregard a wholly owned intermediate holding company formed solely for tax, legal or

211 *See, e.g.*, Cook Children's Letter; Leland Fikes Letter; Merkl Letter.

212 *See, e.g.*, ATV Letter, Charles River Letter, NVCA Letter, Sevin Rosen Letter (specifically in the context of funds of "seed" funds); SVB Letter, Vedanta Letter (85% cap for investments in rule 203(l)-1 compliant, unleveraged funds). *See also* Dechert General Letter (suggested that funds investing solely in venture capital funds should be permitted or, in the alternative, investments of up to 20% of committed capital should be permitted in "incubator" funds).

213 First Round Letter (supported investments in underlying funds representing no more than 10% of a fund's called capital, measured at the end of the fund's term); ATV Letter and Charles River Letter (supported investments in underlying funds representing no more than 20% of a fund's committed capital subject to other conditions); PEI Funds Letter (supports "substantial" investment in venture capital investments rather than a specific numerical threshold); Comment Letter of Private Equity Investors, Inc. and Willowbridge Partners, Inc. (Jan. 7, 2011) ("PEI/Willowbridge Letter") (supported investments in other qualifying funds representing at least 50% of the qualifying fund's assets or committed capital) and Comment Letter of Venture Investment Associates (Jan. 24, 2011) ("VIA Letter") (supported investments in underlying funds representing at least 50% of a qualifying fund's capital commitments).

214 *See, e.g.*, ATV Letter, Charles River Letter, Cook Children's Letter, Leland Fikes Letter (each of which cited the use of technology incubators).

215 *See, e.g.*, PEI/Willowbridge Letter and VIA Letter.

216 *See, e.g.*, ABA Letter; Davis Polk Letter; NVCA Letter.

regulatory reasons to hold the fund's investment in a qualifying portfolio company. Such structures are used to address the particular needs of venture capital funds or their investors and are not intended to circumvent the rule's general limitation on investing in other investment vehicles.[217]

We do not agree, however, that Congress viewed funds of venture capital funds as being consistent with the exemption, and continue to believe that this criterion remains an important tool to prevent circumvention of the intended scope of the venture capital exemption. A fund strategy of selecting a venture capital or other private fund in which to invest is different from a strategy of selecting qualifying portfolio companies. Nevertheless, we are persuaded that a venture capital fund's limited ability to invest a limited portion of its assets in other pooled investment vehicles would not be inconsistent with the intent of the rule if the fund primarily invests directly in qualifying portfolio companies. As a result, for purposes of the exemption, investments in other private funds or venture capital funds could be made using the non-qualifying basket.

4. Management Involvement

We are not adopting a managerial assistance element of the rule, as originally proposed. We proposed that advisers seeking to rely on the rule have a significant level of involvement in developing a fund's portfolio companies.[218] We modeled our proposed approach to managerial assistance in part on existing provisions under the Advisers Act and the Investment Company Act dealing with BDCs. These provisions were added over the years to ease the regulatory

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[217] *See, e.g.*, Davis Polk Letter for a discussion of these considerations.

[218] *See* Proposing Release, *supra* note 26, section II.A.2.

burden on venture capital and other private equity investments.[219] Congress did not use the existing BDC definitions when determining the scope of the venture capital exemption, and the primary policy considerations that led to the adoption of the BDC exemptions differed from those under the Dodd-Frank Act.[220]

Commenters presented several problems with the application of the managerial assistance criterion and its intended scope under the proposed rule. Some objected to the managerial assistance criterion as proposed, arguing that such assistance to (or control of) a portfolio company is not a key or distinguishing characteristic of venture capital investing;[221] that relationships between qualifying funds and qualifying portfolio companies may be less formal and may not constitute management or control of a portfolio company under the proposed rule;[222] or that the discretion to determine the extent of involvement with a portfolio company should not affect a qualifying fund's ability to satisfy the definitional criterion.[223]

Most commenters sought guidance on determining what activities would constitute managerial assistance or "control."[224] Other commenters specifically requested confirmation

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219 *See id.*, at n.123.

220 *See id.*, at section II.A.2.

221 Merkl Letter; SVB Letter (managerial assistance criterion is unnecessary because it does not distinguish venture capital funds from other types of funds providing managerial assistance).

222 ESP Letter.

223 Sevin Rosen Letter.

224 BCLBE Letter; Gunderson Dettmer Letter; McGuireWoods Letter; Shearman Letter. Shearman sought confirmation on whether control included both direct and indirect control, and BCLBE sought confirmation that board representation would be sufficient for control purposes. Other commenters, however, acknowledged that the "offer-only" element of the proposed rule would provide sufficient flexibility for a venture capital fund to alter its relationship with a portfolio company over time. *See, e.g.*, First Round Letter; NVCA Letter. The NVCA and one other commenter did not support imposing specific requirements as to what constituted managerial assistance. *See* NVCA Letter (definitive requirements are not appropriate); Sevin Rosen Letter (opposed requiring board seat or observer rights).

that a management rights letter for purposes of "venture capital operating company" status under ERISA would be sufficient.[225] Finally, some commenters recommended that the rule address syndicated transactions,[226] and provide that the managerial assistance criterion would be satisfied if one fund within the syndicate provided the requisite assistance or control.[227]

We appreciate the difficulties of applying the managerial assistance criterion under the proposed definition and in particular the issues associated with a qualifying fund proving compliance when it participates in a syndicated transaction involving multiple funds. We are persuaded that to modify the rule to specify which activities constitute "managerial assistance" would introduce additional complexity and require us to insert our judgment for that of a venture capital fund's adviser regarding the minimum level of portfolio company involvement that would be appropriate for the fund, rather than enabling investors to select venture capital funds based in part on their level of involvement.[228] We also appreciate that the offer of managerial assistance may not distinguish venture capital funds from other types of funds.

While many venture capital fund advisers do provide managerial assistance, we believe that the managerial assistance criterion, as proposed, does not distinguish these advisers from other advisers, would be difficult to apply and could be unnecessarily prescriptive without creating benefits for investors. As a consequence of our modification to the proposed rule, a

225 ATV Letter; Charles River Letter; NVCA Letter; Oak Investment Letter; Santé Ventures Letter; Sevin Rosen Letter; Village Ventures Letter.

226 ABA Letter; ESP Letter; McGuireWoods Letter.

227 ABA Letter (asserted that most deals are syndicated deals). *See also* Dechert General Letter; ESP Letter (indicating that in syndicated transactions, there may be varying degrees of managerial involvement by funds participating in the transactions; one fund may take an active role with the other funds taking a more passive role with respect to portfolio companies).

228 For example, one commenter indicated that although it may seek to offer assistance to portfolio companies, not all of the companies have accepted. Charles River Letter. Similarly, a number of venture capital advisers stated that their funds may invest in a significant but non-controlling stake in underlying portfolio companies. *See, e.g.*, ATV Letter; First Round Letter.

qualifying fund is not required to offer (or provide) managerial assistance to, or control any, qualifying portfolio company in order to satisfy the definition.

5. Limitation on Leverage

Under rule 203(l)-1, a venture capital fund is a private fund that does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the fund's capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days.[229] For purposes of this leverage criterion, any guarantee by the private fund of a qualifying portfolio company's obligations up to the value of the private fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit.[230]

The 15 percent threshold is determined based on the venture capital fund's aggregate capital commitments. In practice, this means that a qualifying fund could leverage an investment transaction up to 100 percent when acquiring equity securities of a particular portfolio company as long as the leverage amount does not exceed 15 percent of the fund's total capital commitments.

Although a minority of commenters generally supported the leverage criterion as proposed,[231] many commenters sought to broaden it in several ways. Two commenters that generally supported the leveraged criterion also recommended that the criterion exclude uncalled

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229 Rule 203(l)-1(a)(3).

230 *Id.*

231 *See* Sen. Levin Letter; NVCA Letter. *See also* AFL-CIO Letter, AFR Letter (generally supported the leverage limit but also supported excluding uncalled capital commitments); Oak Investment Letter (generally supported the leverage limit, but did not agree that the 120-day limit should apply to guarantees of portfolio company obligations by venture capital funds).

capital commitments so that a qualifying fund could not incur excessive leverage.[232] Although determining the leverage criterion as a percentage of total fund capital commitments may enable a qualifying fund to incur a degree of leverage that represents a disproportionate percentage of the fund's assets early in the life of the fund, the leverage criterion is also constrained by the 120 calendar day limit. Therefore, we do not believe it is necessary to exclude uncalled capital commitments from the leverage criterion.

Other commenters proposed to exclude from the 15 percent leverage limitation capital call lines of credit (*i.e.*, venture capital fund borrowings repaid with proceeds of capital calls from fund investors),[233] or borrowings by a venture capital fund in order to meet fee and expense obligations.[234] One commenter sought to increase the leverage threshold from 15 percent to 20 percent.[235] One commenter, on behalf of many venture capital advisers, however, agreed with the proposed leverage criterion, arguing that venture capital fund financing would generally not exceed 15 percent of fund capital commitments or remain outstanding for longer than 120 days.[236]

We decline to increase the leverage threshold for a qualifying fund under the rule or exclude other certain types of borrowings as requested by some commenters. Our rule defines a venture capital fund by reference to a maximum of 15 percent of borrowings based on our

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232 AFR Letter; AFL-CIO Letter.

233 Cook Children's Letter; Leland Fikes Letter; SVB Letter. We would view a line of credit used to advance anticipated committed capital that remains available for longer than 120 days to be consistent with the criterion, if each drawdown is repaid within 120 days and subsequent drawdowns relate to subsequent capital calls.

234 Dechert General Letter.

235 *See* Charles River Letter (argued that a qualifying fund should be able to borrow, without limit on duration, up to 20% of capital commitments with the consent of its investors).

236 NVCA Letter. *See also* Merkl Letter.

understanding that venture capital funds typically would not incur borrowings in excess of 10 to 15 percent of the fund's total capital contributions and uncalled capital commitments,[237] which commenters have confirmed.[238] We believe that imposing a maximum at the upper range of borrowings typically used by venture capital funds will accommodate existing practices of the vast majority of industry participants.

Our rule specifies that the 15 percent calculation must be determined based on the fund's aggregate capital contributions and uncalled capital commitments.[239] Unlike most registered investment companies or hedge funds, venture capital funds rely on investors funding their capital commitments from time to time in order to acquire portfolio companies.[240] A capital commitment is a contractual obligation to acquire an interest in, or provide the total commitment amount over time to, a fund, when called by the fund. Accordingly, an adviser to venture capital funds manages the fund in anticipation of all investors fully funding their commitments when due and typically has the right to penalize investors for failure to do so.[241] Venture capital funds

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237 *See* Loy Testimony, *supra* note 151, at 6 ("[M]any venture capital funds significantly limit borrowing such that all outstanding capital borrowed by the fund, together with guarantees of portfolio company indebtedness, does not exceed the lesser of (i) 10-15% of total limited partner commitments to the fund and (ii) undrawn limited partner commitments.").

238 NVCA Letter. *See also* Merkl Letter; Oak Investments Letter.

239 Rule 203(l)-1(a)(3).

240 Schell, *supra* note 185, at §1.03[8] ("The typical Venture Capital Fund calls for Capital Contributions from time to time as needed for investments."); *id.* at §2.05[2] (stating that "[venture capital funds] begin operation with Capital Commitments but no meaningful assets. Over a specific period of time, the Capital Commitments are called by the General Partner and used to acquire Portfolio Investments.").

241 *See* Loy Testimony, *supra* note 151, at 5 ("[Limited partners] make their investment in a venture fund with the full knowledge that they generally cannot withdraw their money or change their commitment to provide funds. Essentially they agree to "lock-up" their money for the life of the fund . . . "). *See also* Stephanie Breslow & Phyllis Schwartz, Private Equity Funds, Formation and Operation 2010 ("Breslow & Schwartz"), at § 2:5.6 (discussing the various remedies that may be imposed in the event an investor fails to fund its contractual capital commitment, including, but not limited to, "the ability to draw additional capital from non-defaulting

are subject to investment restrictions, and, during the initial years of a fund, calculate fees payable to an adviser as a percentage of the total capital commitments of investors, regardless of whether or not the capital commitment is ultimately fully funded by an investor.[242] Venture capital fund advisers typically report and market themselves to investors on the basis of aggregate capital commitment amounts raised for prior or existing funds.[243] These factors would lead to the conclusion that, in contrast to other types of private funds, such as hedge funds, which trade on a more frequent basis, a venture capital fund would view the fund's total capital commitments as the primary metric for managing the fund's assets and for determining compliance with investment guidelines. Hence, we believe that calculating the leverage threshold to include uncalled capital commitments is appropriate, given that capital commitments are already used by venture capital funds themselves to measure investment guideline compliance.

Thus, we are retaining the 15 percent leverage threshold, as proposed, so that a qualifying fund could only incur debt (or provide guarantees of portfolio company obligations) subject to this threshold. However, we are modifying the leverage criterion to exclude from the 120-

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investors;" "the right to force a sale of the defaulting partner's interests at a price determined by the general partner;" and "the right to take any other action permitted at law or in equity").

242 *See, e.g.*, Breslow & Schwartz, *supra* note 241, at § 2:5.7 (noting that a cap of 10% to 25% of remaining capital commitments is a common limitation for follow-on investments). *See also* Schell, *supra* note 185, at §1.01 (noting that capital contributions made by the investors are used to "make investments . . . in a manner consistent with the investment strategy or guidelines established for the Fund."); *id.* at §1.03 ("Management fees in a Venture Capital Fund are usually an annual amount equal to a fixed percentage of total Capital Commitments."); *see also* Dow Jones, *Private Equity Partnership Terms and Conditions*, 2007 edition ("Dow Jones Report") at 15.

243 *See, e.g.*, NVCA Yearbook 2010, *supra* note 150, at 16; John Jannarone, *Private Equity's Cash Problem*, Wall St. J., June 23, 2010, http://online.wsj.com/article/SB10001424052748704853404575323073059041024.html#printMode.

calendar day limit any guarantee of qualifying portfolio company obligations by the qualifying fund, up to the value of the fund's investment in the qualifying portfolio company.[244] Commenters generally argued in favor of extending the period during which a qualifying fund's leverage could remain outstanding. Some recommended extending the 120-day limit with respect to leverage to 180 days with one 180-day renewal in the case of non-convertible bridge loans extended by the venture capital fund to a portfolio company.[245] Others seeking to accommodate business practices and provide maximum flexibility for venture capital fund debt investments in portfolio companies recommended excluding guarantees of portfolio company debt by a venture capital fund from the 120-day limit.[246] Other commenters argued that guarantees of portfolio company obligations would not result in qualifying funds incurring extensive leverage.[247]

We understand that guarantees of portfolio company leverage by a venture capital fund are typically limited to the value of the fund's investment in the company (often through a pledge of the fund's interest in the company).[248] Such guarantees by a qualifying fund may help a qualifying portfolio company obtain credit for working capital purposes, rather than be used by the fund to leverage its investment in the company.[249] We are persuaded that such guarantees of portfolio company indebtedness do not present the same types of risks identified by Congress. Congress cited the implementation of trading strategies that use financial leverage by certain

244 Rule 203(l)-1)(a)(3).

245 *See, e.g.*, NVCA Letter; Davis Polk Letter; Bessemer Letter.

246 Cook Children's Letter; Leland Fikes Letter; Gunderson Dettmer Letter; Oak Investment Letter; SVB Letter. *See also* ABA Letter.

247 *See, e.g.*, SVB Letter.

248 *See also* NVCA Letter.

249 *See, e.g.*, Oak Investments Letter; SVB Letter.

private funds as creating a potential for systemic risk.[250] In testimony before Congress, the venture capital industry identified the lack of financial leverage in venture capital funds as a basis for exempting advisers to venture capital funds[251] in contrast with other types of private funds such as hedge funds, which may engage in trading strategies that may contribute to systemic risk and affect the public securities markets.[252] For this reason, our proposed rule was designed to address concerns that financial leverage may contribute to systemic risk by excluding funds that incur more than a limited amount of leverage from the definition of venture capital fund.[253] We believe that the alternative approach to fund leverage we have adopted in the final rule better reflects industry practice while still addressing Congress' concern that the use of financial leverage may create the potential for systemic risk.

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250 *See* Proposing Release, *supra* note 26, at n.136 and accompanying text.

251 *See* McGuire Testimony, *supra* note 151, at 7 ("Venture capital firms do not use long term leverage, rely on short term funding, or create third party or counterparty risk . . . . [F]rom previous testimony submitted by the buy-out industry, the typical capital structure of the companies acquired by a buyout fund is approximately 60% debt and 40% equity. In contrast, borrowing at the venture capital fund level, if done at all, typically is only used for short-term capital needs (pending drawdown of capital from its partners) and does not exceed 90 days. Not only are our partnerships run without debt but our portfolio companies are usually run without debt as well."); Loy Testimony, *supra* note 151, at 2 ("Although venture capital funds may occasionally borrow on a short-term basis immediately preceding the time when the cash installments are due, they do not use debt to make investments in excess of the partner's capital commitments or 'lever up' the fund in a manner that would expose the fund to losses in excess of the committed capital or that would result in losses to counter parties requiring a rescue infusion from the government.").

252 *See* S. Rep. No. 111-176, *supra* note 6, at 74-75.

253 In proposing an exemption for advisers to private equity funds, which would have required the Commission to define the term "private equity fund," the Senate Banking Committee noted the difficulties in distinguishing some private equity funds from hedge funds and expected the Commission to exclude from the exemption private equity funds that raise significant potential systemic risk concerns. S. Rep. No. 111-176, *supra* note 6, at 75. *See also* G20 Working Group 1, Enhancing Sound Regulation and Strengthening Transparency, at 7 (March 25, 2009) (noting that unregulated entities such as hedge funds may contribute to systemic risks through their trading activities).

6. No Redemption Rights

We are adopting as proposed the definitional element under which a venture capital fund is a private fund that issues securities that do not provide investors redemption rights except in "extraordinary circumstances" but that entitle investors generally to receive *pro rata* distributions.[254] Unlike hedge funds, a venture capital fund does not typically permit investors to redeem their interests during the life of the fund,[255] but rather distributes assets generally as investments mature.[256]

Although venture capital funds typically return capital and profits to investors only through *pro rata* distributions, such funds may also provide extraordinary rights for an investor to withdraw from the fund under foreseeable but unexpected circumstances or to be excluded from particular investments due to regulatory or other legal requirements.[257] These events may

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254 Rule 203(l)-1(a)(4).

255 *See* Schell, *supra* note 185, at §1.03[7] (venture capital fund "redemptions and withdrawals are rarely allowed, except in the case of legal compulsion"); Breslow & Schwartz, *supra* note 241, at §2:14.2 ("the right to withdraw from the fund is typically provided only as a last resort").

256 Loy Testimony, *supra* note 151, at 2-3 ("As portfolio company investments are sold in the later years of the [venture capital] fund–when the company has grown so that it can access the public markets through an initial public offering (an IPO) or when it is an attractive target to be bought–the liquidity from these 'exits' is distributed back to the limited partners. The timing of these distributions is subject to the discretion of the general partner, and limited partners may not otherwise withdraw capital during the life of the venture [capital] fund."). *Id.* at 5 (Investors "make their investment in a venture [capital] fund with the full knowledge that they generally cannot withdraw their money or change their commitment to provide funds. Essentially they agree to 'lock-up' their money for the life of the fund, generally 10 or more years as I stated earlier."). *See also* Dow Jones Report, *supra* note 242, at 60 (noting that an investor in a private equity or venture capital fund typically does not have the right to transfer its interest). *See generally* Proposing Release, *supra* note 26, section II.A.4.

257 *See* Hedge Fund Adviser Registration Release, *supra* note 14, at n.240 and accompanying text ("Many partnership agreements provide the investor the opportunity to redeem part or all of its investment, for example, in the event continuing to hold the investment became impractical or illegal, in the event of an owner's death or total disability, in the event key personnel at the fund adviser die, become incapacitated, or cease to be involved in the management of the fund for an extended period of time, in the event of a merger or reorganization of the fund, or in order to avoid a materially adverse tax or regulatory outcome. Similarly, some investment pools may

be "foreseeable" because they are circumstances that are known to occur (*e.g.*, changes in law, corporate events such as mergers, *etc.*) but are unexpected in their timing or scope. Thus, withdrawal, exclusion or similar "opt-out" rights would be deemed "extraordinary circumstances" if they are triggered by a material change in the tax law after an investor invests in the fund, or the enactment of laws that may prohibit an investor's participation in the fund's investment in particular countries or industries.[258] The trigger events for these rights are typically beyond the control of the adviser and fund investor (*e.g.*, tax and regulatory changes).

Most commenters addressing the redeemability criterion did not oppose it, but rather sought clarification or guidance on the scope of its application.[259] For example, commenters specifically requested confirmation that the lack of redeemability criterion would not preclude a

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offer redemption rights that can be exercised only in order to keep the pool's assets from being considered 'plan assets' under ERISA [Employee Retirement Income Security Act of 1974]."). *See, e.g.*, Breslow & Schwartz, *supra* note 241, at § 2:14.1 ("Private equity funds generally provide for mandatory withdrawal of a limited partner [*i.e.*, investor] only in the case where the continued participation by a limited partner in a fund would give rise to a regulatory or legal violation by the investor or the fund (or the general partner [*i.e.*, adviser] and its affiliates). Even then, it is often possible to address the regulatory issue by excusing the investor from particular investments while leaving them otherwise in the fund.").

258 *See, e.g.*, Breslow & Schwartz, *supra* note 241, at § 2:14.2 ("The most common reason for allowing withdrawals from private equity funds arises in the case of an ERISA violation where there is a substantial likelihood that the assets of the fund would be treated as 'plan assets' of any ERISA partner for purposes of Title I of ERISA or section 4975 of the Code."). *See also* Schell, *supra* note 185, at §9.04[3] ("Exclusion provisions allow the General Partner to exclude a Limited Partner from participation in any or all investments if a violation of law or another material adverse effect would otherwise occur."); *id.* at Appendix D-31 (attaching model limited partnership agreement providing "The General Partner at any time may cancel the obligations of all Partners to make Capital Contributions for Portfolio Instruments if . . . changes in applicable law . . . make such cancellation necessary or advisable . . .").

259 A number of commenters agreed with the redeemability criterion. *See, e.g.*, ATV Letter; Charles River Letter; Gunderson Dettmer Letter. However, one commenter argued that a fund's redeemability is not necessarily characteristic of venture capital funds. Comment Letter of Cooley LLP (Jan. 21, 2011).

qualifying fund from (i) making distributions of carried interest to a general partner,[260] (ii) specifying redemption rights for certain categories of investors under certain circumstances[261] or (iii) specifying opt-out rights for investors.[262] Several commenters, however, indicated that the term "extraordinary circumstances" is sufficiently clear,[263] suggesting that the proposal did not require further clarification.

We believe that the term "extraordinary circumstances" is sufficiently clear. Whether or not specific redemption or "opt out" rights for certain categories of investors under certain circumstances should be treated as "extraordinary" will depend on the particular facts and circumstances.

For these purposes, for example, a fund that permits quarterly or other periodic withdrawals would be considered to have granted investors redemption rights in the ordinary course even if those rights may be subject to an initial lock-up or suspension or restrictions on redemption. We believe, and several commenters confirmed, that the phrase "extraordinary circumstances" is sufficiently clear to distinguish the terms for investor liquidity of venture capital funds, as they operate today, from hedge funds.[264] Congressional testimony cited an investor's inability to withdraw from a venture capital fund as a key characteristic of venture

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260 *See, e.g.*, NVCA Letter. The rule specifies that a qualifying fund is a private fund that "issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw . . ." If a general partner interest is not a "security," then the redeemability criterion of the rule would not be implicated. Whether or not a general partner interest is a "security" depends on the particular facts and circumstances. *See generally Williamson v. Tucker*, 645 F.2d 404 (5th Cir. 1981), *cert. denied*, 454 U.S. 897 (1981).

261 ABA Letter (sought guidance on whether granting redemption rights to certain types of investors such as ERISA funds and state plans, in the event of certain ERISA, tax or regulatory changes would be considered extraordinary).

262 McGuireWoods Letter.

263 *See* Gunderson Dettmer Letter; Merkl Letter; SVB Letter.

264 *See, e.g.*, *id.*

capital funds and a factor for reducing their potential for systemic risk.[265] Although a fund prohibiting redemptions would satisfy the redeemability criterion of the venture capital fund definition, the rule does not specify a minimum period of time for an investor to remain in the fund.

In the Proposing Release, we expressed the general concern that a venture capital fund might seek to circumvent the intended scope of this criterion by providing investors with nominally "extraordinary" rights to redeem that effectively result in *de facto* redemption rights in the ordinary course.[266] One commenter expressly disagreed with this view, asserting that in the case of transfers effected with the consent of a general partner, such transactions are intended to accommodate an investor's internal corporate restructurings, bankruptcies or portfolio allocations rather than to provide investors with liquidity from the fund.[267] While consents to transfer do not raise the same level of concern as *de facto* redemption rights, we do not believe that an adviser or its related persons could, while relying on the venture capital exemption, create *de facto* periodic redemption or transfer rights by, for example, regularly identifying potential investors on behalf of fund investors seeking to transfer or redeem fund interests.[268]

We are not modifying the rule to include additional conditions for fund redemptions, such

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[265] *See supra* notes 255-256 and accompanying text.

[266] For example, in the Proposing Release, we stated that a private fund's governing documents might provide that investors do not have any right to redeem without the consent of the general partner. In practice, if the general partner typically permits investors to redeem their otherwise non-redeemable interests on a periodic basis, then the fund would not be considered to have issued securities that "do not provide a holder with any right, except in extraordinary circumstances, to withdraw." Rule 203(l)-1(a)(4). *See* Proposing Release, *supra* note 26, at n.154.

[267] *See* NVCA Letter (disagreeing with statements in the Proposing Release regarding the *de facto* creation of redemption rights but generally agreeing with the general prohibition on redemptions except in extraordinary circumstances).

[268] Section 208(d) of the Advisers Act.

as specifying a minimum holding or investment period by investors or a maximum amount that may be redeemed at any time. Commenters generally did not support the imposition of such conditions,[269] and we agree that imposing such conditions would not appear to be necessary to achieve the purposes of the rule.

7. Represents Itself as Pursuing a Venture Capital Strategy

Under the rule, a qualifying fund must represent itself as pursuing a venture capital strategy to its investors and potential investors.[270] Without this element, a fund that did not engage in typical venture capital activities could be treated as a venture capital fund simply because it met the other elements specified in our rule (because for example it only invests in short-term holdings, does not borrow, does not offer investors redemption rights, and is not a registered investment company).[271] We believe that only funds that do not significantly differ from the common understanding of what a venture capital fund is,[272] and that are actually offered to investors as funds that pursue a venture capital strategy, should qualify for the exemption. Thus, for example, an adviser to a venture capital fund that is otherwise relying on the exemption could not (i) identify the fund as a hedge fund or multi-strategy fund (*i.e.*, venture capital is one of several strategies used to manage the fund) or (ii) include the fund in a hedge fund database or hedge fund index.

As proposed, rule 203(l)-1 defined a venture capital fund as a private fund that

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269 *See, e.g.*, SVB Letter (expressing opposition to a rule that would limit redemptions following a minimum investment period or limit redemptions to a specified maximum threshold).

270 Rule 203(l)-1(a)(1).

271 We also note that a fund that represents to investors that it is one type of fund while pursuing a different type of fund strategy may raise concerns under rule 206(4)-8 of the Advisers Act.

272 *See* Proposing Release, *supra* note 26, at n.157.

"represents itself as being a venture capital fund to its investors and potential investors."[273] Although several commenters generally supported the "holding out" criterion as proposed,[274] many sought confirmation that the use of specific self-identifying terminology by a fund in its name (*e.g.*, "private equity" fund, "multi-strategy" fund or "growth capital" fund) would not automatically disqualify the fund under the definition.[275] Several commenters argued that historically, some funds have avoided referring to themselves as "venture capital funds."[276] One commenter argued that the proposed condition was too restrictive because it focuses on the fund's name rather than its investment strategy and suggested that the definition instead exclude any fund that markets itself as a hedge fund, multi-strategy fund, buyout fund or fund of funds.[277]

We believe that the "holding out" criterion remains an important distinction between funds that are eligible to rely on the definition and funds that are not, because an investor's understanding of the fund and its investment strategy must be consistent with an adviser's reliance on the exemption. However, we also recognize that it is not necessary (nor indeed sufficient) for a qualifying fund to name itself as a "venture capital fund" in order for its adviser to rely on the venture capital exemption. Hence, we are modifying the proposed definition to refer to the way a qualifying fund describes its investment strategy to investors and prospective investors.

A qualifying fund name that does not use the words "venture capital" and is not inconsistent with pursuing a venture capital strategy would not preclude a qualifying fund from

273 Proposed Rule 203(l)-1(a)(1).

274 *See* Gunderson Dettmer Letter; Sen. Levin Letter; Merkl Letter.

275 *See, e.g.*, IVP Letter; Comment Letter of MissionPoint Capital Partners, Jan. 24, 2011; PEI Funds Letter.

276 *See, e.g.*, NVCA Letter; Pine Brook Letter. *See also* IVP Letter; PEI Funds Letter.

277 *See* Pine Brook Letter.

satisfying the definition.[278] Whether or not a fund represents itself as pursuing a venture capital strategy, however, will depend on the particular facts and circumstances. Statements made by a fund to its investors and prospective investors, not just what the fund calls itself, are important to an investor's understanding of the fund and its investment strategy.[279] The appropriate framework for analyzing whether a qualifying fund has satisfied the holding out criterion depends on all of the statements (and omissions) made by the fund to its investors and prospective investors. While this includes the fund name, it is only part of the analysis.

This approach is similar to our general approach to antifraud provisions under the federal securities laws, including Advisers Act rule 206(4)-8 regarding pooled investment vehicles.[280] The general antifraud rule under rule 206(4)-8 looks to the private fund's statements and omissions in light of the circumstances under which such statements or omissions are made.[281] Similarly, the holding out criterion under our venture capital fund definition looks to all of the relevant statements made by the qualifying fund regarding its investment strategy.

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278 Similarly, misleadingly including the words "venture capital" in the name of a fund pursuing a different strategy would not satisfy the definition.

279 One commenter requested confirmation and examples of what constituted appropriate representations to investors given that "many" venture capital funds do not use private placement memoranda or other offering materials during fundraising. *See* Gunderson Dettmer Letter (expressed the view that the following would be sufficient: (i) checking the "venture capital" box on Form D or (ii) stating on the adviser's website that all of the funds advised by the adviser are venture capital funds). As we noted above, whether or not a venture capital fund satisfies the "holding out" criterion will depend on the particular facts and circumstances surrounding all of the statements and omissions made by the fund in light of the circumstances under which they were made. Moreover, a venture capital fund that seeks to rely on the safe harbor for non-public offerings under rule 506 of Regulation D is subject to all of the conditions of such rule, including the prohibition on general solicitation and general advertising applicable to statements attributable to the fund on a publicly available website. *See* 17 CFR 230.502(c).

280 17 CFR 275.206(4)-8.

281 *See* Pooled Vehicles Release, *supra* note 122, at n.27 ("A fact is material if there is a substantial likelihood that a reasonable investor in making an investment decision would consider it as having significantly altered the total mix of information available," citing *Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988)).

8. **Is a Private Fund**

We define a venture capital fund for purposes of the exemption as a private fund, which is defined in the Advisers Act, and exclude from the definition funds that are registered investment companies (*e.g.*, mutual funds) or have elected to be regulated as BDCs.[282] We are adopting this provision as proposed.

There is no indication that Congress intended the venture capital exemption to apply to advisers to these publicly available funds,[283] referring to venture capital funds as a "subset of private investment funds."[284] The comment letters that addressed this proposed criterion generally supported it.[285]

9. **Application to Non-U.S. Advisers**

The final rule does not define a venture capital fund as a fund advised by a U.S. adviser (*i.e.*, an adviser with a principal office and place of business the United States). Thus, a non-U.S. adviser, as well as a U.S. adviser, may rely on the venture capital exemption provided that such adviser solely advises venture capital funds that satisfy all of the elements of the rule or satisfy the grandfathering provision (discussed in greater detail below). A non-U.S. adviser may rely on the venture capital exemption if all of its clients, whether U.S. or non-U.S., are venture capital funds.

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282 Rule 203(l)-1(a) and (a)(5). *See also* discussion *infra* note 319.

283 Legislative history does not indicate that Congress addressed this matter, nor does testimony before Congress suggest that this was contemplated. *See, e.g.*, McGuire Testimony, *supra* note 151, at 3 (noting that venture capital funds are not directly accessible by individual investors); Loy Testimony, *supra* note 151, at 2 ("Generally . . . capital for the venture fund is provided by qualified institutional investors such as pension funds, universities and endowments, private foundations, and to a lesser extent, high net worth individuals."). *See generally* section 202(a)(29) of the Advisers Act (definition of "private fund").

284 *See* S. Rep. No. 111-176, *supra* note 6, at 74 (describing venture capital funds as a subset of "private investment funds").

285 Gunderson Dettmer Letter; Merkl Letter; NYSBA Letter; Sen. Levin Letter.

Neither the statutory text of section 203(l) nor the legislative reports provide an indication of whether Congress intended the exemption to be available to advisers that operate principally outside of the United States but that invest in U.S. companies or solicit U.S. investors.[286] Testimony before Congress presented by members of the U.S. venture capital industry discussed the industry's role primarily in the U.S. economy including its lack of interconnection with the U.S. financial markets and "interdependence" with the world financial system.[287] Nevertheless, we expect that venture capital funds with advisers operating principally outside of the United States may seek to access the U.S. capital markets by investing in U.S. companies or soliciting U.S. investors; investors in the United States may also have an interest in venture capital opportunities outside of the United States.

Commenters generally did not support defining venture capital fund or qualifying portfolio company by reference to the jurisdiction of formation of the fund or portfolio company.[288] Several commenters, however, supported modifying the rule to apply the venture capital exemption in the same manner as the proposed private fund adviser exemption, with the result that a non-U.S. adviser could disregard its non-U.S. activities when assessing eligibility for the venture capital exemption.[289] Under this approach, only U.S.-domiciled private funds would

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286 *See* section 203(l) of the Advisers Act; H. Rep. No. 111-517, *supra* note 6, at 867; S. Rep. No. 111-176, *supra* note 6, at 74-75.

287 *See* Loy Testimony, *supra* note 151, at 4-5; McGuire Testimony, *supra* note 151, at 5-6.

288 *See, e.g.,* Bessemer Letter; EVCA Letter; McDonald Letter; Merkl Letter; NVCA Letter; SV Life Sciences Letter.

289 *See* McGuireWoods Letter; Shearman Letter. *See also* EFAMA Letter (also noting that as a practical matter, the rule should account for non-U.S. specific practices so that non-U.S. advisers could rely on the exemption); Gunderson Dettmer Letter (exemption should be available to non-U.S. advisers even if non-U.S. funds do not satisfy definitional elements); Dechert General Letter (non-U.S. advisers that manage funds that are not venture capital funds outside of the U.S. should be able to rely on rule 203(l) for funds that are managed in the U.S. or that are marketed to U.S. investors).

be required to satisfy our definition of a venture capital fund in order for the adviser to rely on the venture capital exemption.[290] One commenter suggested that the same policy rationale underlying the private fund adviser exemption justified this approach to the venture capital exemption.[291] Two other commenters supported this approach arguing that non-U.S. funds may operate in a manner that does not resemble venture capital fund investing in the United States or by U.S. venture capital fund advisers.[292]

We do not agree that the private fund adviser exemption is the appropriate framework for the venture capital exemption in the case of non-U.S. advisers. Section 203(l) provides an exemption for an investment adviser based on the strategy of the funds that the adviser manages (*i.e.*, venture capital funds). This exemption thus specifies the activities in which an adviser's clients may engage, and does not refer to activities in the United States.[293] By contrast, section 203(m) is based upon the location where the advisory activity is conducted. Accordingly, we do not believe it would be appropriate for an adviser relying on section 203(l) to disregard its non-U.S. activities. Moreover, a non-U.S. adviser could circumvent the intended scope of the exemption by merely sponsoring and advising solely non-U.S. domiciled funds that are not venture capital funds.

Under our rule, only a private fund may qualify as a venture capital fund. As we noted in the Proposing Release, a non-U.S. fund that uses U.S. jurisdictional means in the offering of the securities it issues and that relies on section 3(c)(1) or 3(c)(7) of the Investment Company Act

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290 *See* EFAMA Letter (certain conditions of the proposed rule, such as the limitation on cash investments to U.S. Treasuries, are inconsistent with practices outside the United States). We believe that these concerns are adequately addressed by the non-qualifying basket.

291 *See* Shearman Letter.

292 *See* EFAMA Letter; McGuireWoods Letter.

293 *See also infra* note 322 and accompanying and following text.

would be a private fund.[294] A non-U.S. fund that does not use U.S. jurisdictional means to conduct an offering would not be a private fund and therefore could not qualify as a venture capital fund, even if it operated as a venture capital fund in a manner that would otherwise meet the criteria under our definition.[295] As a result, under the proposed rule, if a non-U.S. fund did not qualify as a venture capital fund, then the fund's adviser would not be able to rely on the exemption.[296]

In light of this result, we asked in the Proposing Release whether we should adopt a broader interpretation of the term "private fund."[297] In response, commenters supported making the venture capital exemption available to non-U.S. advisers even if they advise venture capital

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294 An issuer that is organized under the laws of the United States or of a state is a private fund if it is excluded from the definition of an investment company for most purposes under the Investment Company Act pursuant to section 3(c)(1) or 3(c)(7). Section 7(d) of the Investment Company Act prohibits a non-U.S. fund from using U.S. jurisdictional means to make a public offering, absent an order permitting registration. A non-U.S. fund may conduct a private U.S. offering in the United States without violating section 7(d) only if the fund complies with either section 3(c)(1) or 3(c)(7) with respect to its U.S. investors (or some other available exemption or exclusion). Consistent with this view, a non-U.S. fund is a private fund if it makes use of U.S. jurisdictional means to, directly or indirectly, offer or sell any security of which it is the issuer and relies on either section 3(c)(1) or 3(c)(7). *See* Hedge Fund Adviser Registration Release, *supra* note 14, at n.226; *Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts*, Securities Act Release No. 7656 (Mar. 19, 1999) [64 FR 14648 (Mar. 26, 1999)] ("Canadian Tax-Deferred Retirement Savings Accounts Release"), at nn.10, 20, 23; *Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, Securities Act Release No. 7516 (Mar. 23, 1998) [63 FR 14806 (Mar. 27, 1998)], at n.41. *See also* Dechert LLP, SEC Staff No-Action Letter (Aug. 24, 2009) at n.8; Goodwin, Procter & Hoar LLP, SEC Staff No-Action Letter (Feb. 28, 1997) ("Goodwin Procter No-Action Letter"); Touche Remnant & Co., SEC Staff No-Action Letter (Aug. 27, 1984) ("Touche Remnant No-Action Letter"); Proposing Release, *supra* note 26, at n.175 and accompanying text.

295 *See* Proposing Release, *supra* note 26, at nn.175 and 188 and accompanying text.

296 Under the Advisers Act, an adviser relying on the venture capital exemption must "solely" advise venture capital funds and under our rule all of the funds advised by the adviser must be private funds.

297 *See* Proposing Release, *supra* note 26, at section II.A.8 ("[S]hould a non-U.S. fund be a private fund under the proposed rule if the non-U.S. fund would be deemed a private fund upon conducting a private offering in the United States in reliance on sections 3(c)(1) or 3(c)(7)?").

funds that are not offered through the use of U.S. jurisdictional means.[298] We agree. Accordingly, as adopted, rule 203(l)-1 contains a note indicating that an adviser may treat as a "private fund"—and thus a venture capital fund, if it meets the rule's other criteria—any non-U.S. fund that is not offered through the use of U.S. jurisdictional means but that would be a private fund if the issuer were to conduct a private offering in the United States.[299] Moreover, a non-U.S. fund that is treated as a private fund under these circumstances by an adviser relying on the venture capital exemption would also be treated as a private fund under the Advisers Act for all purposes. This element is designed to ensure that an adviser relying on the venture capital exemption by operation of the note is subject to the same Advisers Act requirements as other advisers relying on the venture capital exemption without use of the note.

10. Grandfathering Provision

Under the rule, the definition of "venture capital fund" includes any private fund that: (i) represented to investors and potential investors at the time the fund offered its securities that it pursues a venture capital strategy; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to, including accepting any capital commitments from, any person after July 21, 2011 (the "grandfathering provision").[300] A grandfathered fund would thus include any fund that has accepted all capital commitments by July 21, 2011 (including capital commitments from existing and new investors) even if none of

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298 *See, e.g.*, Dechert General Letter; EFAMA Letter; Gunderson Dettmer Letter; McGuireWoods Letter; Shearman Letter.

299 As discussed below, this issue also is relevant to the exemption provided by rule 203(m)-1. *See also infra* note 319.

300 Rule 203(l)-1(b).

the capital commitments has been called by such date.[301] The calling of capital after July 21, 2011 would be consistent with the grandfathering provision, as long as the investor became obligated by July 21, 2011 to make a future capital contribution. As a result, any investment adviser that solely advises private funds that meet the definition in either rule 203(l)-1(a) or (b) would be exempt from registration.

Although several commenters expressed support for the proposed rule,[302] two commenters indicated that the proposed grandfathering provision was too restrictive because of the holding out criterion.[303] In contrast, the North American Securities Administrators Association, Inc. expressed its view that the proposed grandfathering provision was too expansive and urged that the rule impose additional substantive requirements similar to those included among the definitional elements in rule 203(l)-1(a).[304]

As in the case of the holding out criterion discussed above, this element of the grandfathering provision elicited the most comments. Generally, commenters either (i) did not support a grandfathering provision that defined a venture capital fund as a fund that identified itself (or called itself) "venture capital,"[305] or (ii) sought clarification or an expansive interpretation of the holding out element so that existing funds would not be excluded from the

301 *See also Electronic Filing and Revision of Form D*, Securities Act Release No. 8891(Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)], at section VIII, Form D, General Instructions – When to File (noting that a Form D is required to be filed within 15 days of the first sale of securities which would include "the date on which the first investor is irrevocably contractually committed to invest"), n.159 ("a mandatory capital commitment call would not constitute a new offering, but would be made under the original offering").

302 Comment Letter of AustinVentures (Jan. 21, 2011) ("AV Letter"); Norwest Letter; NYSBA Letter. *See also* NVCA Letter.

303 DLA Piper VC Letter; Pine Brook Letter.

304 Comment Letter of North American Securities Administrators Association, Inc., Feb. 10, 2011 ("NASAA Letter").

305 Davis Polk Letter; DLA Piper VC Letter; Pine Brook Letter.

definition merely because they have identified themselves as "growth capital," "multi-strategy" or "private equity,"[306] which commenters asserted is typical of some older funds. No commenter addressed the dates proposed in the grandfathering provision.[307]

As discussed above, we believe that the "holding out" requirement is an important prophylactic tool to prevent circumvention of the intended scope of the venture capital exemption. Thus, we are adopting the grandfathering provision as proposed, with the modifications to the holding out criterion discussed above.[308] As noted above in the definition of a venture capital fund generally, the holding out criterion in the grandfathering provision has also been changed to refer to the strategy pursued by the private fund. A fund that seeks to qualify under our rule should examine all of the statements and representations made to investors and prospective investors to determine whether the fund has satisfied the "holding out" criterion as it is incorporated into the grandfathering provision.[309]

Thus, under the rule, an investment adviser may treat any existing private fund as a venture capital fund for purposes of section 203(l) of the Advisers Act if the fund meets the elements of the grandfathering provision. The current private adviser exemption does not require an adviser to identify or characterize itself as any type of adviser (or impose limits on advising any type of fund). Accordingly, we believe that advisers have not had an incentive to mis-characterize the investment strategies pursued by existing venture capital funds that have already

306 Davis Polk Letter; Gunderson Dettmer Letter; IVP Letter; Norwest Letter; NVCA Letter.

307 The NVCA specifically stated that other than clarification on the names that venture capital funds may use to identify themselves, no "further changes to the grandfathering proposal are necessary or appropriate and [we] do not believe that this criterion, as it exists for new funds, presents problems to the industry." *See* NVCA Letter.

308 *See supra* discussion at Section II.A.7.

309 *Id.*

been marketed to investors. As we note above, a fund that "represents" itself to investors as pursuing a venture capital strategy is typically one that discloses it pursues a venture capital strategy and identifies itself as such.[310] We do not expect existing funds identifying themselves as pursuing a "private equity" or "hedge" fund strategy would be able to rely on this element of the grandfathering provision.

We believe that most funds previously sold as venture capital funds likely would satisfy all or most of the conditions in the grandfathering provision. Nevertheless, we recognize that investment advisers that sponsored new funds before the adoption of rule 203(l)-1 faced uncertainty regarding the precise terms of the definition and hence uncertainty regarding their eligibility for the new exemption. Thus, as proposed, the grandfathering provision specifies that a qualifying fund must have commenced its offering (*i.e.*, initially sold securities) by December 2010 and must have concluded its offering by the effective date of Title IV (*i.e.*, July 21, 2011). This provision is designed to prevent circumvention of the intended scope of the exemption. Moreover, requiring existing venture capital funds to modify their investment conditions or characteristics, liquidate portfolio company holdings or alter the rights of investors in the funds in order to satisfy the definition of a venture capital fund would likely be impossible in many cases and yield unintended consequences for the funds and their investors.[311]

B. Exemption for Investment Advisers Solely to Private Funds With Less Than $150 Million in Assets Under Management

Section 203(m) of the Advisers Act directs the Commission to exempt from registration under the Advisers Act any investment adviser solely to private funds that has less than $150

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310 *See id.*

311 One commenter agreed that it may be difficult for a qualifying fund seeking to rely on the grandfathering provision to change fund terms and liquidate its positions to the possible detriment of the fund and its investors. AV Letter.

million in assets under management in the United States.[312] Rule 203(m)-1, which we are adopting today, provides the exemption and, in addition, addresses several interpretive questions raised by section 203(m). As noted above, we refer to this exemption as the "private fund adviser exemption."

1. Advises Solely Private Funds

Rule 203(m)-1, like section 203(m), limits an adviser relying on the exemption to those advising "private funds" as that term is defined in the Advisers Act.[313] An adviser that has one or more clients that are not private funds is not eligible for the exemption and must register under the Advisers Act unless another exemption is available. An adviser may advise an unlimited number of private funds, provided the aggregate value of the assets of the private funds is less than $150 million.[314]

In the case of an adviser with a principal office and place of business outside of the United States (a "non-U.S. adviser"), the exemption is available as long as *all* of the adviser's clients that are United States persons are qualifying private funds.[315] As a consequence, a non-

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312 Section 408 of the Dodd-Frank Act, which is codified in section 203(m) of the Advisers Act. *See supra* note 19.

313 *See* rule 203(m)-1(a) and (b). Section 202(a)(29) of the Advisers Act defines the term "private fund" as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act." A "private fund" includes a private fund that invests in other private funds. *See also supra* note 294; Proposing Release, *supra* note 26, at n.175 and accompanying text.

314 We note, however, that depending on the facts and circumstances, we may view two or more separately formed advisory entities that each has less than $150 million in private fund assets under management as a single adviser for purposes of assessing the availability of exemptions from registration. *See infra* note 506. *See also* section 208(d), which prohibits a person from doing, indirectly or through or by another person, any act or thing which it would be unlawful for such person to do directly.

315 Rule 203(m)-1(b)(1). As discussed below, we also are adding a note to rule 203(m)-1 that clarifies that a client will not be considered a United States person if the client was not a United States person at the time of becoming a client. *See infra* note 403.

U.S. adviser may enter the U.S. market and take advantage of the exemption without regard to the type or number of its non-U.S. clients or the amount of assets it manages outside of the United States. Under the rule, a non-U.S. adviser would not lose the private fund adviser exemption as a result of the size or nature of its advisory or other business activities outside of the United States. The rule reflects our long-held view that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and that this territorial approach is in keeping with general principles of international comity.[316] Commenters supported the proposed rule's treatment of non-U.S. advisers.[317]

Some commenters urged that the rule should also permit U.S. advisers relying on the exemption to advise other types of clients.[318] Section 203(m) directs us to provide an exemption

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316 These considerations have, for example, been incorporated in our rules permitting a non-U.S. adviser relying on the private adviser exemption to count only clients that are U.S. persons when determining whether it has 14 or fewer clients. Rule 203(b)(3)-1(b)(5) ("If you have your principal office and place of business outside the United States, you are not required to count clients that are not United States residents, but if your principal office and place of business is in the United States, you must count all clients."). *See infra* note 392. The Dodd-Frank Act repeals the private adviser exemption as of July 21, 2011, and we are rescinding rule 203(b)(3)-1 in the Implementing Adopting Release. *See* Implementing Adopting Release, *supra* note 32, at section II.D.2.a.

317 *See, e.g.*, ABA Letter; Comment Letter of Debevoise & Plimpton LLP (Jan. 24, 2011) ("Debevoise Letter"); Comment Letter of Dechert LLP (on behalf of Foreign Adviser) (Jan. 24, 2011) ("Dechert Foreign Adviser Letter"); Gunderson Dettmer Letter; Merkl Letter; Comment Letter of Katten Muchin Rosenman LLP (on behalf of Certain Non-U.S. Advisers) (Jan. 24, 2011) ("Katten Foreign Advisers Letter"); Comment Letter of MAp Airports Limited (Jan. 24, 2011) ("MAp Airports Letter"); Comment Letter of Wellington Financial LP (Jan. 24, 2011) ("Wellington Letter").

318 *See, e.g.*, Letter of Sadis & Goldberg (Jan. 11, 2011) (submitted in connection with the Implementing Proposing Release, avail. at http://www.sec.gov/comments/s7-36-10/s73610.shtml) ("Sadis & Goldberg Implementing Release Letter") (exemption should be available to advisers who, in addition to advising private funds, also have five or fewer clients that are separately managed accounts); Comment Letter of Seward & Kissel LLP (Jan. 31, 2011) ("Seward Letter") (advisers should be permitted to rely on multiple exemptions and advisers relying on the private fund adviser exemption should be permitted to engage in "some activities that do not involve advising clients and have no effect on assets under management," such as providing research to institutional investors).

to advisers that act *solely* as advisers to private funds.[319] Our treatment of non-U.S. advisers with respect to their non-U.S. clients, as we note above, establishes certain appropriate limits on the extraterritorial application of the Advisers Act.[320] In contrast, permitting U.S. advisers with additional types of clients to rely on the exemption would appear to directly conflict with section 203(m), and we therefore are not revising the rule as the commenters proposed.

Some commenters suggested that the rule permit advisers to combine other exemptions with rule 203(m)-1 so that, for example, an adviser could advise venture capital funds with assets under management in excess of $150 million in addition to other types of private funds with less than $150 million in assets under management.[321] We believe that the commenters' proposed interpretation runs contrary to the language of section 203(m), which limits advisers relying on the exemption to advising *solely* private funds with assets under management in the United States of less than $150 million or *solely* venture capital funds in the case of section 203(l).[322]

A few commenters also asked us to address whether a fund with a single investor could

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319 One commenter argued that a U.S. adviser should be permitted to treat as a private fund for purposes of rule 203(m)-1 a non-U.S. fund that has not made an offering to U.S. persons. *See* Comment Letter of Fox Horan & Camerini LLP (Dec. 22, 2010). *See also supra* notes 294 and 313. We agree.

320 In contrast to the foreign private adviser exemption discussed in Section II.C, a non-U.S. adviser relying on the private fund adviser exemption may have a U.S. place of business, but a non-U.S. adviser need not have a U.S. place of business to rely on the private fund adviser exemption.

321 NASBIC/SBIA Letter; Seward Letter.

322 The same analysis also would apply to non-U.S. advisers, which may not for example combine the private fund adviser exemption and the foreign private adviser exemption (*e.g.*, a non-U.S. adviser could not advise private funds that are United States persons with assets in excess of $25 million in reliance on the private fund adviser exemption and also advise other clients in the United States that are not private funds in reliance on the foreign private adviser exemption). We also note that depending on the facts and circumstances, we may view two or more separately formed advisory entities, each of which purports to rely on a separate exemption from registration, as a single adviser for purposes of assessing the availability of exemptions from registration. *See infra* note 506. *See also* section 208(d), which prohibits a person from doing, indirectly or through or by another person, any act or thing which it would be unlawful for such person to do directly.

be a "private fund" for purposes of the exemption.[323] Whether a single-investor fund could be a private fund for purposes of the exemption depends on the facts and circumstances. We are concerned that an adviser simply could convert client accounts to single-investor funds in order to avoid registering under the Advisers Act. These "funds" would be tantamount to separately managed accounts. Section 208(d) of the Advisers Act anticipates these and other artifices and thus prohibits a person from doing, indirectly or through or by another person, any act or thing which it would be unlawful for such person to do directly.[324] We recognize, however, that there are circumstances in which it may be appropriate for an adviser to treat a single-investor fund as a private fund for purposes of rule 203(m)-1.[325]

One commenter argued that advisers should be permitted to treat as a private fund for purposes of rule 203(m)-1 a fund that also qualifies for another exclusion from the definition of "investment company" in the Investment Company Act in addition to section 3(c)(1) or 3(c)(7),

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323 *See* ABA Letter (single-investor funds formed at the request of institutional investors should be considered private funds if they are managed in a manner similar to the adviser's related multi-investor private funds, have audited financial statements, and are treated as private funds for purposes of the custody rule); Comment Letter of Alternative Investment Management Association (Jan. 24, 2011) ("AIMA Letter") (sought guidance concerning single-investor funds and managed accounts structured as funds); Commenter Letter of Managed Funds Association (Jan. 24, 2011) ("MFA Letter") (asserted that single-investor funds are "private funds").

324 We would view a structure with no purpose other than circumvention of the Advisers Act as inconsistent with section 208(d). *See, e.g.*, *Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)] at n.132 (the use of a special purpose vehicle in certain circumstances could constitute a violation of section 208(d) of the Advisers Act). Thus, for example, an adviser would not be eligible for the exemption if it advises what is nominally a "private fund" but that in fact operates as a means for providing individualized investment advice directly to the investors in the "private fund." In this case, the investors would also be clients of the adviser. *Cf.* Advisers Act rule 202(a)(30)-1(b)(1) (an adviser "must count an owner [of a legal organization] as a client if [it] provide[s] investment advisory services to the owner separate and apart from the investment advisory services [it] provide[s] to the legal organization").

325 For example, a fund that seeks to raise capital from multiple investors but has only a single, initial investor for a period of time could be a private fund, as could a fund in which all but one of the investors have redeemed their interests.

such as section 3(c)(5)(C), which excludes certain real estate funds.[326] These funds would not be private funds, because a "private fund" is a fund that would be an investment company as defined in section 3 of the Investment Company Act *but for* section 3(c)(1) or 3(c)(7) of that Act.[327]

The commenter argued, and we agree, that an adviser should nonetheless be permitted to advise such a fund and still rely on the exemption. Otherwise, for example, an adviser to a section 3(c)(1) or 3(c)(7) fund would lose the exemption if the fund also qualified for another exclusion, even though the adviser may be unaware of the fund so qualifying and the fund does not purport to rely on the other exclusion. We do not believe that Congress intended that an adviser would lose the exemption in these circumstances. Accordingly, the definition of a "qualifying private fund" in rule 203(m)-1 permits an adviser to treat as a private fund for purposes of the exemption a fund that qualifies for an exclusion from the definition of investment company as defined in section 3 of the Investment Company Act in addition to the exclusions provided by section 3(c)(1) or 3(c)(7).[328]

An adviser relying on this provision must treat the fund as a private fund under the Advisers Act and the rules thereunder for all purposes.[329] This is to ensure that an adviser

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326 Dechert General Letter. *See also* Comment Letter of Baker McKenzie LLP (Jan. 26, 2011) (submitted in connection with the Implementing Proposing Release, avail. at http://www.sec.gov/comments/s7-36-10/s73610.shtml) (recommended that the Commission revise the calculation of assets under management on Form ADV to exclude assets in certain funds relying on section 3(c)(5)(C) of the Investment Company Act); Comment Letter of DLA Piper LLP (US) (submitted by John H. Heuberger and Hal M. Brown) (similarly sought to exempt advisers to certain funds relying on section 3(c)(5)(C)).

327 Section 202(a)(29) of the Advisers Act (defining the term "private fund").

328 Rule 203(m)-1(d)(5). This provision may also apply to non-U.S. funds that seek to comply with section 7(d) of the Investment Company Act and exclusions in addition to those provided by section 3(c)(1) or 3(c)(7) of that Act.

329 Rule 203(m)-1(d)(5).

relying on the exemption as a result of our modification of the definition of a "qualifying private fund" is subject to the same Advisers Act requirements as other advisers relying on the exemption. Therefore, an adviser to a fund that also qualifies for another exclusion in addition to section 3(c)(1) or 3(c)(7) may treat the fund as a private fund and rely on rule 203(m)-1 if the adviser meets the rule's other conditions, provided that the adviser treats the fund as a private fund under the Advisers Act and the rules thereunder for all purposes including, for example, reporting on Form ADV, which requires advisers to report certain information about the private funds they manage.[330]

2. Private Fund Assets

a. Method of Calculation

Under rule 203(m)-1, an adviser must aggregate the value of all assets of private funds it manages to determine if the adviser is below the $150 million threshold.[331] Rule 203(m)-1 requires advisers to calculate the value of private fund assets pursuant to instructions in Form ADV, which provide a uniform method of calculating assets under management for regulatory purposes under the Advisers Act.[332]

In the Implementing Adopting Release, we are revising the instructions to Form ADV to

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330 *See* Item 7.B of Form ADV, Part 1A.

331 Rule 203(m)-1(d)(4).

332 *See* rules 203(m)-1(a)(2); 203(m)-1(b)(2); 203(m)-1(d)(1) (defining "assets under management" to mean "regulatory assets under management" in item 5.F of Form ADV, Part 1A); 203(m)-1(d)(4) (defining "private fund assets" to mean the "assets under management" attributable to a "qualifying private fund"). In the case of a subadviser, an adviser must count only that portion of the private fund assets for which it has responsibility. *See* Form ADV: Instructions for Part 1A, instr. 5.b.(2) (explaining that, if an adviser provides continuous and regular supervisory or management services for only a portion of a securities portfolio, it should include only that portion of the securities portfolio for which it provides such services, and that an adviser should exclude, for example, the portion of an account under management by another person).

provide a uniform method to calculate assets under management for regulatory purposes, including determining eligibility for Commission, rather than state, registration; reporting assets under management for regulatory purposes on Form ADV; and determining eligibility for two of the new exemptions from registration under the Advisers Act discussed in this Release.[333] Under the revised Form ADV instructions, as relevant here, advisers must include in their calculations proprietary assets and assets managed without compensation as well as uncalled capital commitments.[334] In addition, an adviser must determine the amount of its private fund assets based on the market value of those assets, or the fair value of those assets where market value is unavailable,[335] and must calculate the assets on a gross basis, *i.e.,* without deducting liabilities, such as accrued fees and expenses or the amount of any borrowing.[336]

Use of this uniform method will, we believe, result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Advisers

333 *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3 (discussing the rationale underlying the new instructions for calculating assets under management for regulatory purposes).

334 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(1), (4). Advisers also must include in their "regulatory assets under management" assets of non-U.S. clients. *See* Implementing Adopting Release, *supra* note 32, at n.76 (explaining that a domestic adviser dealing exclusively with non-U.S. clients must register with the Commission if it uses *any* U.S. jurisdictional means in connection with its advisory business unless the adviser qualifies for an exemption from registration or is prohibited from registering with the Commission). *See also infra* note 415.

335 This valuation requirement is described in terms similar to the definition of "value" in the Investment Company Act, which looks to market value when quotations are readily available and, if not, then to fair value. *See* Investment Company Act section 2(a)(41). *See also* Implementing Adopting Release, *supra* note 32, at n.91 and accompanying text. Other standards also may be expressed as requiring that a determination of fair value be based on market quotations where they are readily available. *Id.*

336 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(2), (4). *See also* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

Act's regulatory requirements and assessment of risk.[337] In addition, the uniform method of calculation is designed to ensure that, to the extent possible, advisers with similar amounts of assets under management will be treated similarly for regulatory purposes, including their ability to rely on the private fund adviser exemption and the foreign private adviser exemption, both of which refer to an adviser's assets under management.[338]

Many commenters expressed general support for a uniform method of calculating assets under management in order to maintain consistency for registration and risk assessment purposes.[339] The proposals to use fair value of private fund assets and to include uncalled capital commitments in private fund assets also received support.[340] As discussed below, however, a number of commenters disagreed with or sought changes to one or more of the elements of the proposed method of calculating assets under management for regulatory purposes set forth in

337 *See* Proposing Release, *supra* note 26, discussion at section II.B.2. *See also* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

338 *See* Proposing Release, *supra* note 26, discussion at section V.B.1 (explaining that, because the instructions to Form ADV previously permitted advisers to exclude certain types of managed assets, "it is not possible to conclude that two advisers reporting the same amount of assets under management are necessarily comparable because either adviser may elect to exclude all or some portion of certain specified assets that it manages").

339 *See, e.g.*, AFL-CIO Letter ("We support the SEC's proposal to require funds to use a uniform standard to calculate their assets under management and agree that it is important that the calculation account for asset appreciation."); AFR Letter ("AFR supports the SEC's proposal to require funds to use a uniform standard to calculate their assets under management, and to account for asset appreciation in those calculations"); AIMA Letter ("We agree that a clear and unified approach for calculation of AUM is necessary and we believe that using as a standard the assets for which an adviser has 'responsibility' is appropriate."); Dechert General Letter (commented on particular aspects of the proposed uniform method but stated "[w]e generally agree with the Commission's initiative in creating a single uniform method of calculating an adviser's assets under management ('AUM') for purposes of determining an adviser's registration status ('Regulatory AUM')"). *See also* Implementing Adopting Release, *supra* note 32, at n.68 and accompanying text.

340 *See* ABA Letter (supported use of fair value); AIMA Letter (supported including uncalled capital commitments, provided that the adviser has full contractual rights to call that capital and would be given responsibility for management of those assets).

Form ADV.[341] None of the commenters, however, suggested alternative approaches that could accommodate the specific changes they sought and achieve our goals of consistent asset calculations and reporting discussed above, and we are not aware of such an alternative approach.

For example, some commenters sought to exclude from the calculation proprietary assets and assets managed without compensation because such a requirement would be inconsistent with the statutory definition of "investment adviser."[342] Although a person is not an "investment adviser" for purposes of the Advisers Act unless it receives compensation for providing advice to others, once a person meets that definition (by receiving compensation from *any* client to which it provides advice), the person is an adviser, and the Advisers Act applies to the relationship between the adviser and any of its clients (whether or not the adviser receives compensation from them).[343] Both the private fund adviser exemption and the foreign private adviser

341 *See also* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

342 *See, e.g.*, Dechert General Letter; Seward Letter. *See also* ABA Letter; AIMA Letter (suggested a 12-month exclusion for seed capital consistent with the Volcker rule); Dechert Foreign Adviser Letter; EFAMA Letter; Katten Foreign Advisers Letter; MFA Letter. Under section 202(a)(11) of the Advisers Act, the definition of "investment adviser" includes, among others, "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ." One commenter argued that including proprietary assets would deter non-U.S. advisers that manage large amounts of proprietary assets from establishing U.S. operations. Katten Foreign Advisers Letter. Such an adviser, however, would not be ineligible for the private fund adviser exemption merely because it established U.S. operations. As discussed below, a non-U.S. adviser may rely on the private fund adviser exemption while also having one or more U.S. places of business, provided it complies with the exemption's conditions. *See infra* Section II.B.3.

343 *See* Implementing Adopting Release, *supra* note 32, at n.74 and accompanying text. Several commenters also asserted that including proprietary assets as proposed would in effect require a wholly owned control affiliate to register as an investment adviser. *See, e.g.*, Comment Letter of American Insurance Association (Jan. 24, 2011) ("AIA Letter"); Comment Letter of Katten Muchin Rosenman LLP (on behalf of APG Asset Management US Inc.) (Jan. 21, 2011); Comment Letter of Katten Muchin Rosenman LLP (Jan. 24, 2011) (on behalf of Certain Non-U.S. Insurance Companies) ("Katten Foreign Insurance Letter"). Whether a control affiliate is deemed to be an "investment adviser" under the Advisers Act because, among other things, it

exemption are conditioned upon an adviser not exceeding specified amounts of "assets under management."[344] Neither statutory exemption limits the types of assets that should be included in this term, and we do not believe that such limits would be appropriate.[345] In our view, the source of the assets managed should not affect the availability of the exemptions.

We also do not expect that advisers' principals (or other employees) generally will cease to invest alongside the advisers' clients as a result of the inclusion of proprietary assets, as some commenters suggested.[346] If private fund investors value their advisers' co-investments as suggested by these commenters, we expect that the investors will demand them and their advisers will structure their businesses accordingly.[347]

Other commenters objected to calculating regulatory assets under management on the basis of gross, rather than net, assets.[348] They argued, among other things, that gross asset measurements would be confusing,[349] complex,[350] and inconsistent with industry practice.[351]

"engages in the business of advising others" will depend on the particular facts and circumstances. The calculation of regulatory assets under management, including the mandatory or optional inclusion of specified assets in that calculation, is applicable after the entity is determined to be an investment adviser.

344 *See* sections 203(m) and 202(a)(30) of the Advisers Act.

345 *See also* Implementing Adopting Release, *supra* note 32, at n.75 and accompanying text (explaining that "the management of 'proprietary' assets or assets for which the adviser may not be compensated, when combined with other client assets, may suggest that the adviser's activities are of national concern or have implications regarding the reporting for the assessment of systemic risk").

346 *See, e.g.*, ABA Letter; Katten Foreign Advisers Letter; Seward Letter.

347 Moreover, we note that an adviser seeking to rely on rule 203(m)-1 may have only private fund clients and must include the assets of all of its private fund clients when determining if it remains under the rule's $150 million threshold.

348 ABA Letter; Dechert General Letter; Merkl Letter; MFA Letter; Seward Letter; Shearman Letter.

349 Dechert General Letter. *See also* Implementing Adopting Release, *supra* note 32, at n.80 and accompanying text.

350 MFA Letter.

However, nothing in the current instructions suggests that liabilities should be deducted from the calculation of an adviser's assets under management. Indeed, since 1997, the instructions have stated that an adviser should not deduct securities purchased on margin when calculating its assets under management.[352] Whether a client has borrowed to purchase a portion of the assets managed does not seem to us a relevant consideration in determining the amount an adviser has to manage, the scope of the adviser's business, or the availability of the exemptions.[353]

Moreover, we are concerned that the use of net assets could permit advisers to highly leveraged funds to avoid registration under the Advisers Act even though the activities of such advisers may be significant and the funds they advise may be appropriate for systemic risk reporting.[354] One commenter argued, in contrast, that it would be "extremely unlikely that a net

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351 *See, e.g.*, Merkl Letter; Shearman Letter. One commenter asserted that the "inclusion of borrowed assets may create an incentive for an adviser to reduce client borrowings to qualify for an exemption from registration even though reducing leverage may not be in the best interest of its clients," and that it "could encourage advisers to use methods other than borrowing to obtain financial leverage for their clients (*e.g.*, through swaps or other derivative products, which could be disadvantageous to clients due to the counterparty risks and increased costs that they entail)." Seward Letter. *See also* Gunderson Dettmer Letter. We note that advisers, as fiduciaries, may not subordinate clients' interests to their own such as by altering their investing behavior in a way that is not in the client's best interest in an attempt to remain under the exemption's $150 million threshold. Another commenter argued that a gross assets calculation would make calculations of regulatory assets under management more volatile. *See* Dechert General Letter. As discussed in more detail below, we are permitting advisers relying on rule 203(m)-1 to calculate their private fund assets annually, rather than quarterly as proposed, and are extending the period during which certain advisers may file their registration applications if their private fund assets exceed the exemption's $150 million threshold. *See infra* Section II.B.2.b. We believe these measures will substantially mitigate or eliminate any volatility that may be caused by using a gross assets measurement, as well as potential volatility in currency exchange rates identified by some commenters. *See* CompliGlobe Letter; EVCA Letter; O'Melveny Letter.

352 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(2), as in effect before it was amended by the Implementing Adopting Release ("Do not deduct securities purchased on margin."). Instruction 5.b.(2), as amended in the Implementing Adopting Release, provides "Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities." *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

353 *See id.*

354 *See id.*, at n.82 and preceding and accompanying text.

asset limit of $150,000,000 in private funds could be leveraged into total investments that would pose any systemic risk."[355] But a comprehensive view of systemic risk requires information about certain funds that may not present systemic risk concerns when viewed in isolation, but nonetheless are relevant to an assessment of systemic risk across the economy. Moreover, because private funds are not subject to the leverage restrictions in section 18 of the Investment Company Act, a private fund with less than $150 million in net assets could hold assets far in excess of that amount as a result of its extensive use of leverage. In addition, under a net assets test such a fund would be treated similarly for regulatory purposes as a fundamentally different fund, such as one that did not make extensive use of leverage and had $140 million in net assets.

The use of gross assets also need not cause any investor confusion, as some commenters suggested.[356] Although an adviser will be required to use gross (rather than net) assets for purposes of determining whether it is eligible for the private fund adviser or the foreign private adviser exemptions (among other purposes), we would not preclude an adviser from holding itself out to its clients as managing a net amount of assets as may be its custom.[357]

One commenter opposed the requirement that advisers include in the calculation of private fund assets uncalled capital commitments, asserting that the uncalled capital remains

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355 ABA Letter.

356 *See, e.g.*, Dechert General Letter. *See also* Implementing Adopting Release, *supra* note 32, at n.80 and accompanying text.

357 In addition, in response to commenters seeking clarification of the application of the gross assets calculation to mutual funds, short positions and leverage, we expect that advisers will continue to calculate their gross assets as they do today, even if they currently only calculate gross assets as an intermediate step to compute their net assets. *See* Implementing Adopting Release, *supra* note 32, at n.83. In the case of pooled investment vehicles with a balance sheet, for instance, an adviser could include in the calculation the total assets of the entity as reported on the balance sheet. *Id.*

under the management of the fund investor.[358] As we noted in the Proposing Release, in the early years of a private fund's life, its adviser typically earns fees based on the total amount of capital commitments, which we presume reflects compensation for efforts expended on behalf of the fund in preparation for the investments.[359]

A number of commenters objected to the requirement to determine private fund assets based on fair value, generally arguing that the requirement would cause those advisers that did not use fair value methods to incur additional costs, especially if the private funds' assets that they manage are illiquid and therefore difficult to fair value.[360] We noted in the Proposing Release that we understood that many private funds already value assets in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards that require the use of fair value, citing letters we had received in connection with other rulemaking initiatives.[361] We are sensitive to the costs this new requirement will impose. We believe, however, that this approach is warranted in light of the unique regulatory purposes of the calculation under the Advisers Act. We estimated these costs in the Proposing Release[362] and we have taken several steps to mitigate them.[363]

While many advisers will calculate fair value in accordance with GAAP or another

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358 *See* Merkl Letter.

359 Proposing Release, *supra* note 26, discussion at section II.B.2. *See also* Implementing Adopting Release, supra note 32, at n.90 and accompanying text.

360 *See, e.g.*, Gunderson Dettmer Letter; Merkl Letter; O'Melveny Letter; Seward Letter; Wellington Letter.

361 *See* Proposing Release, *supra* note 26, at n.196 and accompanying text.

362 *See id.*, at n.326 and accompanying text.

363 We recognize that although these steps will provide advisers greater flexibility in calculating the value of their private fund assets, they also will result in valuations that are not as comparable as they could be if we specified a fair value standard (*e.g.*, as specified in GAAP).

international accounting standard,[364] other advisers acting consistently and in good faith may utilize another fair valuation standard.[365] While these other standards may not provide the quality of information in financial reporting (for example, of private fund returns), we expect these calculations will provide sufficient consistency for the purposes that regulatory assets under management serve in our rules, including rule 203(m)-1.[366]

Commenters also suggested alternative approaches to valuation, including the use of local accounting principles;[367] the methodology used to report to the private fund's investors;[368] the

364 Several commenters asked that we not require advisers to fair value private fund assets in accordance with GAAP for purposes of calculating regulatory assets under management because many funds, particularly offshore ones, do not use GAAP and such a requirement would be unduly burdensome. *See, e.g.,* EFAMA Letter; Katten Foreign Advisers Letter. We did not propose such a requirement, nor are we adopting one. *See* Implementing Adopting Release, *supra* note 32, at n.98.

365 *See id.*, at n.99 and accompanying text. Consistent with this good faith requirement, we would expect that an adviser that calculates fair value in accordance with GAAP or another basis of accounting for financial reporting purposes will also use that same basis for purposes of determining the fair value of its regulatory assets under management. *Id.*

366 *See id.*, at n.100 and accompanying text. In addition, the fair valuation process need not be the result of a particular mandated procedure and the procedure need not involve the use of a third-party pricing service, appraiser or similar outside expert. An adviser could rely on the procedure for calculating fair value that is specified in a private fund's governing documents. The fund's governing documents may provide, for example, that the fund's general partner determines the fair value of the fund's assets. Advisers are not, however, required to fair value real estate assets only in those limited circumstances where real estate assets are not required to be fair valued for financial reporting purposes under accounting principles that otherwise require fair value for assets of private funds. For example, in those cases, an adviser may instead value the real estate assets as the private fund does for financial reporting purposes. We note that the Financial Accounting Standards Board ("FASB") has a current project related to investment property entities that may require real estate assets subject to that accounting standard to be measured by the adviser at fair value. *See* FASB Project on *Investment Properties*. We also note that certain international accounting standards currently permit, but do not require, fair valuation of certain real estate assets. *See* International Accounting Standard 40, *Investment Property*. To the extent that an adviser follows GAAP or another accounting standard that requires or in the future requires real estate assets to be fair valued, this limited exception to the use of fair value measurement for real estate assets would not be available.

367 Dechert Foreign Adviser Letter; EFAMA Letter.

368 Merkl Letter; Wellington Letter.

methodologies described in a client's governing documents or offering materials;[369] historical cost;[370] and aggregate capital raised by a private fund.[371] Use of these approaches would limit our ability to compare data from different advisers and thus would be inconsistent with our goal of achieving more consistent asset calculations and reporting across the industry, as discussed above, and also could result in advisers managing comparable amounts of assets under management being subject to different registration requirements. Moreover, these alternative approaches could permit advisers to circumvent the Advisers Act's registration requirements. Permitting the use of any valuation standard set forth in the governing documents of the private fund other than fair value could effectively yield to the adviser the choice of the most favorable standard for determining its registration obligation as well as the application of other regulatory requirements.

For these reasons and as we proposed, rule 203(m)-1 requires advisers to calculate the value of private fund assets pursuant to the instructions in Form ADV.

b. Frequency of Calculation and Transition Period

An adviser relying on the exemption provided by rule 203(m)-1 must annually calculate the amount of the private fund assets it manages and report the amount in its annual updating amendments to its Form ADV.[372] If an adviser reports in its annual updating amendment that it

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369 AIMA Letter; MFA Letter; Seward Letter.

370 O'Melveny Letter.

371 Gunderson Dettmer Letter.

372 An adviser relying on rule 203(m)-1 must file an annual updating amendment to its Form ADV within 90 days after the end of its fiscal year, and must calculate its private fund assets in the manner described in the instructions to Form ADV within 90 days prior to the date it makes the filing. *See* rule 203(m)-1(c); rule 204-4(a); General Instruction 4 to Form ADV; Form ADV: Instructions for Part 1A, instr. 5.b. The adviser must report its private fund assets on Section 2.B of Schedule D to Form ADV. Advisers also must report their private fund assets when they file

has $150 million or more of private fund assets under management, the adviser is no longer eligible for the private fund adviser exemption.[373] Advisers thus may be required to register under the Advisers Act as a result of increases in their private fund assets that occur from year to year, but changes in the amount of an adviser's private fund assets between annual updating amendments will not affect the availability of the exemption.

We proposed to require advisers relying on the exemption to calculate their private fund assets each quarter to determine if they remain eligible for the exemption. Commenters persuaded us, however, that requiring advisers to calculate their private fund assets annually in connection with their annual updating amendments to Form ADV would be more appropriate because it would likely result in the same advisers becoming registered each year while reducing the costs and burdens associated with quarterly calculations.[374] In addition, annual calculations provide a range of dates on which an adviser may calculate its private fund assets, addressing concerns raised by commenters about shorter-term fluctuations in assets under management.[375] The rule as adopted also is consistent with the timeframes for valuing assets under management

their initial reports as exempt reporting advisers. *See* Implementing Adopting Release, *supra* note 32, discussion at section II.B.

373 Under Item 2.B of Part 1A of Form ADV, an adviser relying on rule 203(m)-1 must complete Section 2.B of Schedule D, which requires the adviser to provide the amount of the "private fund assets" it manages. A note to Section 2.B of Schedule D provides that "private fund assets" has the same meaning as under rule 203(m)-1, and that non-U.S. advisers should only include private fund assets that they manage at a place of business in the United States. *See also infra* notes 377-378 and accompanying text.

374 A number of commenters argued, among other things, that calculating private fund assets quarterly would: (i) impose unnecessary costs and burdens on advisers, some of whom might not otherwise perform quarterly valuations; and (ii) inappropriately permit shorter-term fluctuations in assets under management to require advisers to register. *See* ABA Letter; AIMA Letter; Dechert Foreign Adviser Letter; Dechert General Letter; EFAMA Letter; Katten Foreign Advisers Letter; Merkl Letter; NASBIC/SBIA Letter; Seward Letter.

375 As discussed above, an adviser relying on rule 203(m)-1 must calculate its private fund assets in the manner described in the instructions to Form ADV within 90 days prior to the date it files its annual updating amendment to its Form ADV.

and registering with the Commission applicable to state-registered advisers switching from state to Commission registration.[376]

As noted above, if an adviser reports in its annual updating amendment that it has $150 million or more of private fund assets under management, the adviser is no longer eligible for the exemption and must register under the Advisers Act unless it qualifies for another exemption. An adviser that has complied with all Commission reporting requirements applicable to an exempt reporting adviser as such, however, may apply for registration with the Commission up to 90 days after filing the annual updating amendment, and may continue to act as a private fund adviser, consistent with the requirements of rule 203(m)-1, during this transition period.[377] This 90-day transition period is not available to advisers that have failed to comply with all Commission reporting requirements applicable to an exempt reporting adviser as such or that have accepted a client that is not a private fund.[378] These advisers therefore should plan to

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376 *See* General Instruction 4 to Form ADV; Form ADV: Instructions for Part 1A, instr. 5.b.; rule 203A-1(b). *See also* ABA Letter ("We believe an annual measurement would be most appropriate, especially since advisers exempt from registration because they do not meet the $100,000,000 asset threshold will calculate their assets for this purpose annually, and an annual test for both purposes has a compelling consistency.").

377 General Instruction 15 to Form ADV. *See also* Implementing Adopting Release, *supra* note 32, discussion at section II.B.5. We removed what was proposed rule 203(m)-1(d), which contained the proposed transition period, and renumbered the final rule accordingly. The transition period as adopted is described in General Instruction 15 to Form ADV. Rule 203(m)-1(c) refers advisers to this instruction. This transition period is available to an adviser that has complied with "all [Commission] reporting requirements applicable to an exempt reporting adviser as such," rather than "all applicable Commission reporting requirements," as proposed. This condition reflects the importance of the Advisers Act reporting requirements applicable to advisers relying on the private fund adviser exemption.

378 General Instruction 15 to Form ADV. *See also* Implementing Adopting Release, *supra* note 32, discussion at section II.B.5. An adviser would lose the exemption immediately upon accepting a client that is not a private fund. Accordingly, for the adviser to comply with the Advisers Act, the adviser's Commission registration must be approved before the adviser accepts a client that is not a private fund. Moreover, even an adviser to whom the transition period is available could not, consistent with the Advisers Act, accept a client that is not a private fund until the Commission

register before becoming ineligible for the exemption.

Commenters who addressed the issue generally supported the proposed transition period, but requested that we extend the transition period beyond one calendar quarter as proposed or otherwise make it more broadly available.[379] Requiring annual calculations extends the transition period, as commenters recommended, and is consistent with the amount of time provided to state-registered advisers switching to Commission registration. Advisers to whom the transition period is available will have up to 180 days after the end of their fiscal years to register.[380]

One commenter argued that the transition period should be available to all advisers relying on rule 203(m)-1, including those that had not complied with their reporting requirements.[381] The transition period is a safe harbor that provides advisers flexibility in complying with rule 203(m)-1, and we continue to believe that it would be inappropriate to extend this benefit to advisers that have not met their reporting requirements.[382]

3. Assets Managed in the United States

Under rule 203(m)-1, all of the private fund assets of an adviser with a principal office and place of business in the United States are considered to be "assets under management in the

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approves its registration. These same limitations apply to non-U.S. advisers with respect to their clients that are United States persons.

379 ABA Letter; AIMA Letter; CompliGlobe Letter; Gunderson Dettmer Letter; Katten Foreign Advisers Letter; Sadis & Goldberg Implementing Release Letter; Seward Letter; Shearman Letter.

380 An adviser must file its annual Form ADV updating amendment within 90 days after the end of its fiscal year and, if the transition period is available, may apply for registration up to 90 days after filing the amendment. *See also supra* note 378.

381 Shearman Letter.

382 *See* Proposing Release, *supra* note 26, discussion at n.223 and accompanying text.

United States," even if the adviser has offices outside of the United States.[383] A non-U.S. adviser, however, need only count private fund assets it manages at a place of business in the United States toward the $150 million asset limit under the exemption.[384]

As discussed in the Proposing Release, the rule deems all of the assets managed by an adviser to be managed "in the United States" if the adviser's "principal office and place of business" is in the United States. This is the location where the adviser controls, or has ultimate responsibility for, the management of private fund assets, and therefore is *the* place where all the adviser's assets are managed, although day-to-day management of certain assets may also take place at another location.[385] For most advisers, this approach will avoid difficult attribution determinations that would be required if assets are managed by teams located in multiple jurisdictions, or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction.

Most commenters who addressed the issue supported our proposal to treat "assets under management in the United States" for non-U.S. advisers as those assets managed at a U.S. place

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383 Rule 203(m)-1(a). The rule defines the "United States" to have the same meaning as in rule 902(l) of Regulation S under the Securities Act, which is "the United States of America, its territories and possessions, any State of the United States, and the District of Columbia." Rule 203(m)-1(d)(7); 17 CFR 230.902(l).

384 Rule 203(m)-1(b). Any assets managed at a U.S. place of business for clients other than private funds would make the exemption unavailable. *See also supra* note 378. We revised this provision to refer to assets managed "at" a place of business in the United States, rather than "from" a place of business in the United States as proposed. The revised language is intended to reflect more clearly the rule's territorial focus on the location at which the asset management takes place.

385 This approach is similar to the way we have identified the location of the adviser for regulatory purposes under our current rules, which define an adviser's principal office and place of business as the location where it "directs, controls and coordinates" its advisory activities, regardless of the location where some of the advisory activities might occur. *See* rule 203A-3(c); rule 222-1.

of business.[386] One commenter did, however, urge us to presume that a non-U.S. adviser's assets are managed from its principal office and place of business to avoid the inherent difficulties in determining the location from which any particular assets of a private fund are managed if an adviser operates in multiple jurisdictions.[387] As we stated in the Proposing Release, this commenter's approach ignores situations in which day-to-day management of some assets of the private fund does in fact take place "in the United States."[388] It also would permit an adviser engaging in substantial advisory activities in the United States to escape our regulatory oversight merely because the adviser's principal office and place of business is outside of the United States. This consequence is at odds not only with section 203(m), but also with the foreign private adviser exemption discussed below in which Congress specifically set forth circumstances under which a non-U.S. adviser may be exempt provided it does not have any place of business in the United States, among other conditions.[389]

In addition, some commenters supported an alternative approach under which we would interpret "assets under management in the United States" by reference to the source of the assets (*i.e.*, U.S. private fund investors).[390] One of the commenters argued that our interpretation would

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386 ABA Letter; Comment Letter of Association Française de la Gestion financière (Jan. 24, 2011) ("AFG Letter") (sought clarification that assets managed from non-U.S. offices are exempted); AIMA Letter; Comment Letter of Avoca Capital Holdings (Dec. 21, 2010) ("Avoca Letter"); Debevoise Letter; Dechert Foreign Adviser Letter; EFAMA Letter; Gunderson Dettmer Letter; Katten Foreign Advisers Letter; MAp Airports Letter; Merkl Letter; Comment Letter of Non-U.S. Adviser (Jan. 24, 2011) ("Non-U.S. Adviser Letter"). *Cf.* Sen. Levin Letter (advisers managing assets in the United States of funds incorporated outside of the United States "are exactly the type of investment advisers to which the Dodd-Frank Act's registration requirements are intended to apply").

387 Katten Foreign Advisers Letter.

388 *See* Proposing Release, *supra* note 26, at nn.204-205 and accompanying text.

389 *See infra* Section II.C.

390 Comment Letter of Portfolio Manager (Jan. 24, 2011) ("Portfolio Manager Letter"); Merkl Letter (suggested that it "may be useful" to look both to assets managed from a U.S. place of business

disadvantage U.S.-based advisers by permitting non-U.S. advisers to accept substantial amounts of money from U.S. investors without having to comply with certain U.S. regulatory requirements, and cause U.S. advisers to move offshore or close U.S. offices to avoid regulation.[391]

As we explained in the Proposing Release, we believe that our interpretation recognizes that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and is in keeping with general principles of international comity.[392] The rule also is designed to encourage the participation of non-U.S. advisers in the U.S. market by applying the U.S. securities laws in a manner that does not impose U.S. regulatory and operational requirements on a non-U.S. adviser's non-U.S. advisory business.[393] Non-U.S. advisers relying on rule 203(m)-1 will remain subject to the Advisers Act's antifraud provisions and will become subject to the requirements applicable to exempt reporting advisers.

One commenter proposed an additional interpretation under which we would determine the "assets under management in the United States" for U.S. advisers only by reference to the

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and assets contributed by U.S. private fund investors to address both investor protection and systemic risk concerns).

391 Portfolio Manager Letter. *See also* Comment Letter of Tuttle (Nov. 30, 2010) (submitted in connection with the Implementing Adopting Release, avail. at http://www.sec.gov/comments/s7-35-10/s73510.shtml) ("Tuttle Implementing Release Letter") (argued that businesses may move offshore if they become too highly regulated in the United States).

392 *See* Proposing Release, *supra* note 26, at n.207 (identifying Regulation S and Exchange Act rule 15a-6 as examples of Commission rules that adopt a territorial approach).

393 *See generally* Division of Investment Management, SEC, *Protecting Investors: A Half Century of Investment Company Regulation*, May 1992 ("1992 Staff Report"), at 223-227 (recognizing that non-U.S. advisers that registered with the Commission were arguably subject to all of the substantive provisions of the Advisers Act with respect to their U.S. and non-U.S. clients, which could result in inconsistent regulatory requirements or practices imposed by the regulations of their local jurisdiction and the U.S. securities laws; in response, advisers could form separate and independent subsidiaries but this could result in U.S. clients having access to a limited number of advisory personnel and reduced access by the U.S. subsidiary to information or research by non-U.S. affiliates).

amount of assets invested, or "in play," in the United States.[394] We decline to adopt this approach because it would be difficult for advisers to ascertain and monitor which assets are invested in the United States, and this approach thus could be confusing and difficult to apply on a consistent basis. For example, an adviser might invest in the American Depositary Receipts of a company incorporated in Bermuda that: (i) engages in mining operations in Canada, the principal trading market for its common stock; and (ii) derives the majority of its revenues from exports to the United States. It is not clear whether these investments should be considered "in play" in the United States.

Another commenter urged us to exclude assets managed by a U.S. adviser at its non-U.S. offices.[395] This, the commenter argued, would allow more U.S. advisers to rely on the exemption and allow us to focus our resources on larger advisers more likely to pose systemic risk. But the management of assets at these non-U.S. offices could have investor protection implications in the United States, such as by creating conflicts of interest for an adviser between assets managed abroad and those managed in the United States.

In addition, we sought comment as to whether, under the approach we are adopting today, some or most U.S. advisers with non-U.S. branch offices would re-organize those offices as subsidiaries in order to avoid attributing assets managed to the non-U.S. office.[396] No commenter suggested this would occur. We continue to believe that rule 203(m)-1 will have only a limited effect on multi-national advisory firms, which for tax or business reasons keep their non-U.S. advisory activities organizationally separate from their U.S. advisory activities.

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394 Comment Letter of Richard Dougherty (Dec. 14, 2010) ("Dougherty Letter").

395 Comment Letter of T.A. McKay & Co., Inc. (Nov. 23, 2010).

396 *See* Proposing Release, *supra* note 26, at discussion following n.208.

For these reasons, and our substantial interest in regulating all of the activities of U.S. advisers, we decline to revise rule 203(m)-1 as this commenter suggested.

Several commenters asked that we clarify whether certain U.S. activities or arrangements would result in an adviser having a "place of business" in the United States.[397] Commenters also sought guidance as to whether limited-purpose U.S. offices of non-U.S. advisers would be considered U.S. places of business (*e.g.*, offices conducting research or due diligence).[398]

Under rule 203(m)-1, if a non-U.S. adviser relying on the exemption has a place of business in the United States, all of the clients whose assets the adviser manages at that place of business must be private funds and the assets managed at that place of business must have a total value of less than $150 million. Rule 203(m)-1 defines a "place of business" by reference to rule 222-1(a) as any office where the adviser "regularly provides advisory services, solicits, meets with, or otherwise communicates with clients," and "any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with, or otherwise communicates with clients."

Whether a non-U.S. adviser has a place of business in the United States depends on the facts and circumstances, as discussed below in connection with the foreign private adviser exemption.[399] For purposes of rule 203(m)-1, however, the analysis frequently will turn not on whether a non-U.S. adviser has a U.S. place of business, but on whether the adviser manages assets, or has "assets under management," at such a U.S. place of business. Under the Advisers Act, "assets under management" are the securities portfolios for which an adviser provides

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397 *See, e.g.*, EFAMA Letter.

398 AIMA Letter; Dechert General Letter; EFAMA Letter. *See also* ABA Letter; Vedanta Letter.

399 *See infra* Section II.C.4.

"continuous and regular supervisory or management services."[400] This is an inherently factual determination. We would not, however, view providing research or conducting due diligence to be "continuous and regular supervisory or management services" at a U.S. place of business if a person outside of the United States makes independent investment decisions and implements those decisions.[401]

4. United States Person

Under rule 203(m)-1(b), a non-U.S. adviser may not rely on the exemption if it has any client that is a United States person other than a private fund.[402] Rule 203(m)-1 defines a "United States person" generally by incorporating the definition of a "U.S. person" in Regulation S under the Securities Act.[403] Regulation S looks generally to the residence of an individual to

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400 Section 203A(a)(2) of the Advisers Act. The instructions to Item 5 of Form ADV provide guidance on the circumstances under which an adviser would be providing "continuous and regular supervisory or management services with respect to an account." Form ADV: Instructions for Part 1A, instr. 5.b. The calculation of an adviser's assets under management at a U.S. place of business turns on whether the adviser is providing those services with respect to a particular account or accounts at a U.S. place of business.

401 *See* Form ADV: Instructions for Part 1A, instr. 5.b(3)(b) (an adviser provides continuous and regular supervisory or management services with respect to an account if it has "ongoing responsibility to select or make recommendations, based upon the needs of the client, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the client, [it is] responsible for arranging or effecting the purchase or sale"). These research or due diligence services, while not "continuous and regular supervisory or management services," may be investment advisory services that, if performed at a U.S. location, would cause the adviser to have a place of business in the United States. *See infra* note 493 and accompanying text.

402 In response to commenters seeking clarity on this point, we note that a non-U.S. adviser need not have one or more private fund clients that are United States persons in order to rely on the exemption.

403 Rule 203(m)-1(d)(8). We are adding a note to rule 203(m)-1 that clarifies that a client will not be considered a United States person if the client was not a United States person at the time of becoming a client of the adviser. This will permit a non-U.S. adviser to continue to rely on rule 203(m)-1 if a non-U.S. client that is not a private fund, such as a natural person client residing abroad, relocates to the United States or otherwise becomes a United States person. As one commenter recognized, this also will establish similar treatment in these circumstances for non-U.S. advisers relying on rule 203(m)-1 or the foreign private adviser exemption, which contains

determine whether the individual is a United States person,[404] and also addresses the circumstances under which a legal person, such as a trust, partnership or a corporation, is a United States person.[405] Regulation S generally treats legal partnerships and corporations as United States persons if they are organized or incorporated in the United States, and analyzes trusts by reference to the residence of the trustee.[406] It treats discretionary accounts generally as United States persons if the fiduciary is a resident of the United States.[407] Commenters generally supported defining "United States person" by reference to Regulation S because, among other reasons, the definition is well developed and understood by advisers.[408]

Rule 203(m)-1 also contains a special rule that requires an adviser relying on the exemption to treat a discretionary or other fiduciary account as a United States person if the account is held for the benefit of a United States person by a non-U.S. fiduciary who is a related person of the adviser.[409] One commenter expressed concern that the special rule is unnecessary

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an analogous note. *See* EFAMA Letter. *See also* Comment Letter of Investment Funds Institute of Canada (Jan. 24, 2011) ("IFIC Letter"). The note applicable to the foreign private adviser exemption generally describes the time when an adviser must determine if a person is "in the United States" for purposes of that exemption. *See infra* Section II.C.3.

404 17 CFR 230.902(k)(1)(i).

405 *See, e.g.,* 17 CFR 230.902(k)(1) and (2).

406 17 CFR 230.902(k)(1)(ii) and (iv).

407 17 CFR 230.902(k)(1)(vii).

408 AIMA Letter; CompliGlobe Letter; Debevoise Letter; Dechert General Letter; Gunderson Dettmer Letter; Katten Foreign Advisers Letter; O'Melveny Letter. As we explained in the Proposing Release, advisers to private funds and their counsel must today be familiar with the definition of "U.S. person" under Regulation S in order to comply with other provisions of the federal securities laws. *See* Proposing Release, *supra* note 26, at n.217 and accompanying text.

409 Rule 203(m)-1(d)(8) provides that a "United States person means any person that is a 'U.S. person' as defined in [Regulation S], except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on [rule 203(m)-1] and is not organized, incorporated, or (if an individual) resident in the United States." In contrast, under Regulation S, a discretionary account

while another who supported the special rule as proposed noted that the special rule should be "narrowly drawn" to avoid frustrating legitimate subadvisory relationships between non-U.S. advisers and their U.S. adviser affiliates.[410] We believe that the special rule is narrowly drawn and necessary to prevent advisers from purporting to rely on the exemption and establishing discretionary accounts for the benefit of U.S. clients with an offshore affiliate that would then delegate the actual management of the account back to the adviser.[411]

Another commenter suggested the rule apply a different approach with respect to business entities than that under Regulation S, which as noted above generally treats legal partnerships and corporations as U.S. persons if they are organized or incorporated in the United States.[412] The commenter suggested that advisers should instead look to a business entity's principal office and place of business in certain instances because an entity organized under U.S. law should not necessarily be treated as a United States person if it was formed by a non-United States person to pursue the entity's investment objectives.[413]

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maintained by a non-U.S. fiduciary (such as an investment adviser) is not a "U.S. person" even if the account is owned by a U.S. person. *See* 17 CFR 230.902(k)(1)(vii); 17 CFR 230.902(k)(2)(i).

410 Katten Foreign Advisers Letter; AIMA Letter (noting that the special rule should be narrowly drawn but also stating that "[w]e understand the rationale for the special rule proposed by the Commission for discretionary accounts maintained outside the US for the benefit of US persons and we believe that that is an appropriate safeguard against avoidance of the registration requirement").

411 *See* Proposing Release, *supra* note 26, discussion at section II.B.4.

412 Debevoise Letter (noted that, for example, "a private fund, or an entity that is organized as part of a private fund, may be organized under Delaware law to meet certain regulatory and tax objectives, but the fund's principal office and place of business in fact may be outside the U.S.").

413 The commenter asserted that this approach "would not be inconsistent with Regulation S itself, which treats a partnership or corporation organized under the laws of a foreign jurisdiction as a U.S. person if it was '[f]ormed by a U.S. person principally for the purpose of investing in securities not registered under the [Securities] Act, unless it is organized or incorporated, and owned, by accredited investors . . . who are not natural persons, estates or trusts.'" *See also* Comment Letter of Fulbright & Jaworski L.L.P. (on behalf of a German asset manager) (Jun. 15, 2011) ("Fulbright Letter").

We decline to adopt this suggestion because we believe it is most appropriate to incorporate the definition of "U.S. person" in Regulation S with as few modifications as possible. As noted above, Regulation S provides a well-developed body of law with which advisers to private funds and their counsel must today be familiar in order to comply with other provisions of the federal securities laws. Incorporating this definition in rule 203(m)-1, therefore, makes rule 203(m)-1 easier to apply and fosters consistency across the federal securities laws. Deviations from the definition used in Regulation S, including an entirely different approach to defining a "United States person," would detract from these benefits. Moreover, a test that looks to a business entity's principal office and place of business, as suggested by the commenter, would be difficult for advisers to apply. It frequently is unclear where an investment fund maintains its "principal office and place of business" because investment funds typically have no physical presence or employees other than those of their advisers.

C. Foreign Private Advisers

Section 403 of the Dodd-Frank Act replaces the current private adviser exemption from registration under the Advisers Act with a new exemption for a "foreign private adviser," as defined in new section 202(a)(30).[414] The new exemption is codified as amended section 203(b)(3).

Under section 202(a)(30), a foreign private adviser is any investment adviser that: (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United

[414] Section 402 of the Dodd-Frank Act (providing a definition of "foreign private adviser," to be codified at section 202(a)(30) of the Advisers Act). *See supra* notes 22 and 23 and accompanying text.

States and investors in the United States in private funds advised by the investment adviser;[415] (iii) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million;[416] and (iv) does not hold itself out generally to the public in the United States as an investment adviser.[417] Section 202(a)(30) authorizes the Commission to increase the $25 million threshold "in accordance with the purposes of this title."[418]

Today we are adopting, substantially as proposed, new rule 202(a)(30)-1, which defines certain terms in section 202(a)(30) for use by advisers seeking to avail themselves of the foreign private adviser exemption, including: (i) "investor;" (ii) "in the United States;" (iii) "place of business;" and (iv) "assets under management."[419] We are also including in rule 202(a)(30)-1 the safe harbor and many of the client counting rules that appeared in rule 203(b)(3)-1.

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415 One commenter suggested that a non-U.S. adviser with no place of business in the United States would not be subject to the Advisers Act unless the adviser has at least one direct U.S. client. *See* Katten Foreign Advisers Letter. *See also* ABA Letter. We note that section 203(a) of the Advisers Act provides that an adviser may not, unless registered, make use of any means or instrumentality of interstate commerce in connection with its business as an investment adviser. Hence, whether a non-U.S. adviser with no place of business in the United States and no U.S. clients would be subject to registration depends on whether there is sufficient use of U.S. jurisdictional means. *See also supra* note 334.

416 Subparagraph (B) of section 202(a)(30) refers to the number of "clients and investors in the United States in private funds," while subparagraph (C) refers to assets of "clients *in the United States* and investors in the United States in private funds" (emphasis added). As noted in the Proposing Release, we interpret these provisions consistently so that only clients *in the United States* and investors in the United States would be counted for purposes of subparagraph (B). *See* Proposing Release, *supra* note 26, at n.225.

417 In addition, the exemption is not available to an adviser that "acts as (I) an investment adviser to any investment company registered under the [Investment Company Act]; or (II) a company that has elected to be a business development company pursuant to section 54 of [that Act], and has not withdrawn its election." Section 202(a)(30)(D)(ii). As noted in the Proposing Release, we interpret subparagraph (II) to prohibit an adviser *that advises* a business development company from relying on the exemption. *See* Proposing Release, *supra* note 26, at n.226.

418 Section 202(a)(30)(C).

419 Rule 202(a)(30)-1(c).

1. Clients

Rule 202(a)(30)-1 includes a safe harbor for advisers to count clients for purposes of the definition of "foreign private adviser" that is similar to the safe harbor that has been included in rule 203(b)(3)-1.[420] The commenter that generally addressed this aspect of our proposed rule agreed with our approach,[421] which was designed to apply a well-developed body of law to give effect to a statutory provision with a similar purpose.

New rule 202(a)(30)-1 allows an adviser to treat as a single client a natural person and: (i) that person's minor children (whether or not they share the natural person's principal residence); (ii) any relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent of the natural person who has the same principal residence;[422] (iii) all accounts of which the natural person and/or the person's minor child or relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent who has the same principal residence are the only primary beneficiaries; and (iv) all trusts of which the natural person and/or the person's minor child or relative, spouse, spousal equivalent, or relative of the spouse or of the spousal

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[420] Rule 203(b)(3)-1, which we are rescinding with the Implementing Adopting Release, provided a safe harbor for determining who may be deemed a single client for purposes of the private adviser exemption. We are not, however, carrying over from rule 203(b)(3)-1 a provision that distinguishes between advisers whose principal places of business are inside or outside of the United States. *See* rule 203(b)(3)-1(b)(5). Under the definition of "foreign private adviser," an adviser relying on the exemption may not have any place of business in the United States. *See* section 402 of the Dodd-Frank Act (defining "foreign private adviser"). We are also not including rule 203(b)(3)-1(b)(7), which specifies that a client who is an owner of a private fund is a resident where the client resides at the time of the client's investment in the fund. The provision was vacated by a federal court in *Goldstein, supra* note 14. As discussed below, we are including a provision in rule 202(a)(30)-1 that addresses when an adviser must determine if a client or investor is "in the United States" for purposes of the exemption. *See infra* note 476 and accompanying text.

[421] *See* Katten Foreign Advisers Letter.

[422] As suggested by a commenter, we incorporated in rule 202(a)(30)-1(a)(1) the concept of a "spousal equivalent," which we define by reference to rule 202(a)(11)(G)-1(d)(9) as "a cohabitant occupying a relationship generally equivalent to that of a spouse." *See* ABA Letter.

equivalent who has the same principal residence are the only primary beneficiaries.[423] Rule 202(a)(30)-1 also permits an adviser to treat as a single "client" (i) a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization to which the adviser provides investment advice based on the legal organization's investment objectives, and (ii) two or more legal organizations that have identical shareholders, partners, limited partners, members, or beneficiaries.[424]

As proposed, we are omitting the "special rule" providing advisers with the option of not counting as a client any person for whom the adviser provides investment advisory services without compensation.[425] Some commenters argued that an adviser should not have to count such persons, who may be employees and principals of the firm and their family members.[426] But as we explained in the Proposing Release, allowing an adviser not to count as clients persons in the United States who do not compensate the adviser would allow certain advisers to

423 Rule 202(a)(30)-1(a)(1). If a client relationship involving multiple persons does not fall within the rule, whether the relationship may appropriately be treated as a single "client" depends on the facts and circumstances.

424 Rule 202(a)(30)-1(a)(2). In addition, rule 202(a)(30)-1(b)(1) through (3) contain the following related "special rules:" (1) an adviser must count a shareholder, partner, limited partner, member, or beneficiary (each, an "owner") of a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization, as a client if the adviser provides investment advisory services to the owner separate and apart from the investment advisory services provided to the legal organization; (2) an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters; and (3) any general partner, managing member or other person acting as an investment adviser to a limited partnership or limited liability company must count the partnership or limited liability company as a client.

425 *See* rule 203(b)(3)-1(b)(4).

426 *See* Dechert General Letter ("In many instances, advisers manage the assets of employees and principals of the firm and their family members, and use such services as a legitimate compensation arrangement to retain talented employees."); Katten Foreign Advisers Letter ("Such persons are likely to be in a special relationship with the adviser that allows them to benefit from the advisers' investment advice without having to pay."). *See also* ABA Letter.

avoid registration through reliance on the foreign private adviser exemption despite the fact that, as those commenters acknowledge, the adviser provides advisory services to those persons.[427]

The new rule includes two provisions that clarify that advisers need not double-count private funds and their investors under certain circumstances.[428] One provision, as proposed, specifies that an adviser need not count a private fund as a client if the adviser counted any investor, as defined in the rule, in that private fund as an investor in that private fund for purposes of determining the availability of the exemption.[429] The other provision, recommended by commenters,[430] clarifies that an adviser is not required to count a person as an investor if the adviser counts such person as a client of the adviser.[431] Thus, a client who is also an investor in a private fund advised by the adviser would only be counted once.

2. Private Fund Investor

Section 202(a)(30) provides that a "foreign private adviser" eligible for the new

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427 *Cf.* Form ADV: Glossary (stating that for purposes of Form ADV, the term "client" "includes clients from which [an adviser] receives no compensation . . . ."). We also are adopting in the Implementing Adopting Release a uniform method for calculating assets under management for regulatory purposes, including availability of the foreign private adviser exemption, that requires advisers to include in that calculation assets they manage without compensation. *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3. Requiring foreign private advisers to treat as clients persons from whom they receive no compensation is consistent with the use of this new uniform method of calculating assets under management for regulatory purposes.

428 *See* rule 202(a)(30)-1(b)(4)-(5).

429 *See* rule 202(a)(30)-1(b)(4); 202(a)(30)-1(c)(2). *See also infra* Section II.C.2 (discussing the definition of investor). This provision is applicable only for purposes of determining whether an adviser has fewer than 15 clients in the United States and investors in the United States in private funds it advises under section 202(a)(30)(B) of the foreign private adviser exemption. It does not apply to the determination of the assets under management relevant for purposes of that exemption under section 202(a)(30)(C). As a result, an adviser must include the assets of a private fund that is a client in the United States even if the adviser may exclude the private fund when determining whether the adviser has fewer than 15 clients or investors in the United States. *See also infra* note 499.

430 *See* ABA Letter; Katten Foreign Advisers Letter.

431 *See* rule 202(a)(30)-1(b)(5).

registration exemption cannot have more than 14 clients "or investors in the United States in private funds" advised by the adviser. Rule 202(a)(30)-1 defines an "investor" in a private fund as any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act, or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act.[432] In addition, a beneficial owner of short-term paper issued by the private fund also is an "investor," notwithstanding that holders of short-term paper need not be counted for purposes of section 3(c)(1).[433] Finally, in order to avoid double-counting, the rule clarifies that an adviser may treat as a single investor any person who is an investor in two or more private funds advised by the investment adviser.[434] We are adopting rule 202(a)(30)-1 substantially as proposed. In a modification to the proposal, however, we are not including knowledgeable employees in the definition of "investor."[435]

The term "investor" is not currently defined under the Advisers Act or the rules under the Advisers Act. We are adopting the new definition to provide for consistent application of the statutory provision and to prevent non-U.S. advisers from circumventing the limitations in section 203(b)(3). As discussed in the Proposing Release, we believe that defining the term "investor" by reference to sections 3(c)(1) and 3(c)(7) of the Investment Company Act will best achieve these purposes.

Commenters who addressed the issue agreed with our decision to define investor for

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432 *See* rule 202(a)(30)-1(c)(2)(i); *supra* notes 10 and 12 and accompanying text. We note that the definition of "investor" in rule 202(a)(30)-1 is for purposes of the foreign private adviser exemption and does not limit the scope of that term for purposes of rule 206(4)-8.

433 *See* rule 202(a)(30)-1(c)(2)(ii).

434 *See* rule 202(a)(30)-1(c)(2), at note to paragraph (c)(2).

435 *See* rule 202(a)(30)-1(c)(2). *See also infra* notes 448-452 and accompanying text.

purposes of this rule by reference to the well-developed understanding of ownership under sections 3(c)(1) and 3(c)(7).[436] Funds and their advisers must determine who is a beneficial owner for purposes of section 3(c)(1) or whether an owner is a qualified purchaser for purposes of section 3(c)(7).[437] More importantly, defining the term "investor" by reference to sections 3(c)(1) and 3(c)(7) places appropriate limits on the ability of a non-U.S. adviser to avoid application of the registration provisions of the Advisers Act by setting up intermediate accounts through which investors may access a private fund and not be counted for purposes of the exemption. Advisers must "look through" nominee and similar arrangements to the underlying holders of private fund-issued securities to determine whether they have fewer than 15 clients and private fund investors in the United States.[438] Holders of both equity and debt securities must be counted as investors.[439]

Under the new rule, an adviser will determine the number of investors in a private fund based on the facts and circumstances and in light of the applicable prohibition not to do indirectly, or through or by any other person, what is unlawful to do directly.[440] Depending upon the facts and circumstances, persons other than the nominal holder of a security issued by a

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436 *See* ABA Letter; Dechert General Letter; Katten Foreign Advisers Letter.

437 *See supra* notes 10 and 12 and accompanying text. In the Proposing Release, we noted that typically a prospective investor in a private fund must complete a subscription agreement that includes representations or confirmations that it is qualified to invest in the fund and whether it is a U.S. person. This information is designed to allow the adviser (on behalf of the fund) to make the above determination. Therefore, an adviser seeking to rely on the foreign private adviser exemption will have ready access to this information.

438 Rule 202(a)(30)-1(c)(2). *See generally* sections 3(c)(1) and 3(c)(7) of the Investment Company Act.

439 Sections 3(c)(1) and 3(c)(7) of the Investment Company Act refer to beneficial owners and owners, respectively, of "securities" (which is broadly defined in section 2(a)(36) of that Act to include debt and equity).

440 *See* section 208(d) of the Advisers Act; section 48(a) of the Investment Company Act.

private fund may be counted as the beneficial owner under section 3(c)(1), or be required to be a qualified purchaser under section 3(c)(7).[441] An adviser relying on the exemption would have to count such a person as an investor.

For example, the adviser to a master fund in a master-feeder arrangement would have to treat as investors the holders of the securities of any feeder fund formed or operated for the purpose of investing in the master fund rather than the feeder funds, which act as conduits.[442] In addition, an adviser would need to count as an investor an owner of a total return swap on the private fund because that arrangement effectively provides the risks and rewards of investing in the private fund to the swap owner.[443] Whether an owner of another type of instrument

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441 As noted above, we have recognized that in certain circumstances it is appropriate to "look through" an investor (*i.e.*, attribute ownership of a private fund to another person who is the ultimate owner). *See, e.g., Privately Offered Investment Companies*, Investment Company Act Release No. 22597 (Apr. 3, 1997) [62 FR 17512 (Apr. 9, 1997)] ("NSMIA Release") ("The Commission understands that there are other forms of holding investments that may raise interpretative issues concerning whether a Prospective Qualified Purchaser 'owns' an investment. For instance, when an entity that holds investments is the 'alter ego' of a Prospective Qualified Purchaser (as in the case of an entity that is wholly owned by a Prospective Qualified Purchaser who makes all the decisions with respect to such investments), it would be appropriate to attribute the investments held by such entity to the Prospective Qualified Purchaser.").

442 A "master-feeder fund" is an arrangement in which one or more funds with the same or consistent investment objectives ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund") with the same or consistent investment objective and strategies. We have taken the same approach within our rules that require a private fund to "look through" any investor that is formed or operated for the specific purpose of investing in a private fund. *See* rule 2a51-3(a) under the Investment Company Act (17 CFR 270.2a51-3(a)) (a company is not a qualified purchaser if it is "formed for the specific purpose of acquiring the securities" of an investment company that is relying on section 3(c)(7) of the Investment Company Act, unless each of the company's beneficial owners is also a qualified purchaser). *See also* NSMIA Release, *supra* note 441 (explaining that rule 2a51-3(a) would limit the possibility that "a company will be able to do indirectly what it is prohibited from doing directly [by organizing] . . . a 'qualified purchaser' entity for the purpose of making an investment in a particular Section 3(c)(7) Fund available to investors that themselves did not meet the definition of 'qualified purchaser'").

443 One commenter argued that the swap counterparty is not required to hedge its exposure by investing the full notional amount in the private fund. *See* Dechert General Letter. We do not find this distinction persuasive in situations in which the adviser knows or should know of the existence of the swap. *See infra* discussion accompanying and following note 447.

referencing a private fund would be counted as the beneficial owner under section 3(c)(1), or be required to be a qualified purchaser under section 3(c)(7), would depend on the facts and circumstances.

Several commenters generally disagreed that advisers should be required to "look through" total return swaps or similar instruments or master-feeder arrangements in at least certain circumstances, arguing among other things that these instruments or arrangements serve legitimate business purposes.[444] As we explain above, however, the requirement to count as investors persons other than the nominal holder of a security issued by a private fund is derived from provisions in both the Advisers Act and the Investment Company Act prohibiting a person from doing indirectly, or through or by any other person, what is unlawful to do directly, and from sections 3(c)(1) and 3(c)(7).[445]

Some commenters also argued that "looking through" a total return swap or similar instrument would be impractical or unduly burdensome in certain circumstances, including situations in which the adviser did not participate in the swap's creation or know of its existence.[446] An issuer relying on section 3(c)(7) may treat as a qualified purchaser any person whom the issuer reasonably believes is a qualified purchaser, and the definition of investor that we are adopting today provides that an adviser counts as investors those persons who must be qualified purchasers under section 3(c)(7). Therefore, an adviser may treat as an investor a person the adviser reasonably believes is the actual investor.[447] Similarly, if an adviser

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444 *See, e.g.*, ABA Letter; Dechert General Letter; EFAMA Letter.

445 *See supra* notes 440-443 and accompanying text.

446 *See, e.g.*, Dechert General Letter; EFAMA Letter.

447 Rule 202(a)(30)-1(c)(2) defines the term "investor" generally to include persons that must be counted for purposes of section 3(c)(1) of the Investment Company Act or qualified purchasers for purposes of section 3(c)(7) of that Act. *See supra* notes 432-443 and accompanying text.

reasonably believes that an investor is not "in the United States," the adviser may treat the investor as not being "in the United States."

The final rule, unlike the proposal, does not treat as investors beneficial owners who are "knowledgeable employees" with respect to the private fund, and certain other persons related to such employees (we refer to them, collectively, as "knowledgeable employees").[448] In formulating our proposal to include knowledgeable employees in the definition of investor, we were concerned that excluding knowledgeable employees from the definition of investor would allow certain advisers to avoid registration by relying on the foreign private adviser exemption.[449] A number of commenters opposed our proposal.[450] In particular, they argued that the proposed approach was inconsistent with Congressional and prior Commission determinations that such employees do not need the protections of the Investment Company Act.[451]

Advisers to private funds relying on section 3(c)(7) may under Investment Company Act rule 2a51-1(h) treat as qualified purchasers those persons they reasonably believe are qualified purchasers. Persons who must be qualified purchasers for purposes of section 3(c)(7) generally would be the same as those who must be counted for purposes of section 3(c)(1). Accordingly, advisers may, for purposes of determining their investors in the United States under rule 202(a)(30)-1, treat as an investor a person the adviser reasonably believes is the actual investor.

448 *See* proposed rule 202(a)(30)-1(c)(1)(i) (referencing rule 3c-5 under the Investment Company Act (17 CFR 270.3c-5(b)), which excludes from the determinations under sections 3(c)(1) and 3(c)(7) of that Act any securities beneficially owned by knowledgeable employees of a private fund; a company owned exclusively by knowledgeable employees; and any person who acquires securities originally acquired by a knowledgeable employee through certain transfers of interests, such as a gift or a bequest).

449 *See* Proposing Release, *supra* note 26, at n.250 and accompanying text.

450 *See* Dechert General Letter; Katten Foreign Advisers Letter; Seward Letter; Shearman Letter.

451 *See, e.g.*, Dechert General Letter ("[The] Commission promulgated the knowledgeable employee safe-harbors for sections 3(c)(1) and 3(c)(7) in response to the Congressional mandate in the National Securities Markets Improvement Act of 1996 to allow certain informed insiders to invest in a private fund without causing the fund to lose its exception under the 1940 Act."); Shearman Letter (the proposed approach is "contrary to a long history of recognizing that knowledgeable employees should be treated differently than other investors and that their privileged status with

Upon further consideration, we have determined that the same policy considerations that justify disregarding knowledgeable employees for purposes of other provisions provide a valid basis for excluding them from the definition of "investor" under the foreign private adviser exemption.[452] Treating knowledgeable employees in the same manner for purposes of the definition of investor and sections 3(c)(1) and 3(c)(7) will also simplify compliance with regulatory requirements imposed by both the Advisers Act and the Investment Company Act.

The new rule requires advisers to treat as investors beneficial owners of "short-term paper"[453] issued by the private fund.[454] These persons are not counted as beneficial owners for purposes of section 3(c)(1) but must be qualified purchasers under section 3(c)(7).[455] Some commenters opposed this approach, arguing that holders of short-term paper do not make an investment decision but rather are creditors making a credit risk evaluation.[456] We disagree. The

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their organizations in terms of influence and access to information reasonably limits the public's interest in their protection").

452 *See* Advisers Act rule 205-3(d)(1)(iii) (specifying that knowledgeable employees are included among the types of clients to whom the adviser may charge performance fees); Advisers Act rule 202(a)(11)(G)-1 (permitting a family office excluded from the definition of investment adviser under the Advisers Act to provide investment advice to its knowledgeable employees). These provisions reflect a policy determination that knowledgeable employees are likely to be in a position or have a level of knowledge and experience in financial matters sufficient to be able to evaluate the risks and take steps to protect themselves.

453 *See* rule 202(a)(30)-1(c)(2)(ii) (referencing the definition of "short-term paper" contained in section 2(a)(38) of the Investment Company Act, which defines "short-term paper" to mean "any note, draft, bill of exchange, or banker's acceptance payable on demand or having a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof payable on demand or having a maturity likewise limited; and such other classes of securities, of a commercial rather than an investment character, as the Commission may designate by rules and regulations").

454 *See* rule 202(a)(30)-1(c)(2)(ii).

455 *See* sections 3(c)(1) and 3(c)(7) of the Investment Company Act.

456 *See* ABA Letter ("[H]olders of short-term securities do not view themselves as making an investment decision in connection with their extension of credit, but rather assess the risk of holding a private fund's short-term paper based on credit risk."); Shearman Letter ("[A] lender to

acquisition of those instruments involves an investment decision, although the considerations involved in that decision might differ from the considerations involved in a decision to make an equity investment.

One commenter asserted that treating holders of short-term paper as investors could result in a U.S. commercial lender to a fund being treated as an investor, leading non-U.S. advisers to avoid U.S. lenders.[457] Unless the extension of credit by a fund's broker-dealer or custodian bank results in the issuance of a security by the fund to its creditor, the creditor would not be considered an investor for purposes of the foreign private adviser exemption.[458]

As we stated in the Proposing Release, there appears to be no valid reason to treat as investors all debt holders *except* holders of short-term paper.[459] Certain issuers continually roll over short-term paper and effectively use it as a permanent source of capital, further supporting our view that there appears to be no reason to treat holders of short-term paper differently than other longer-term debt holders for purposes of the exemption.[460] Moreover, a private fund's

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a fund, while it makes a 'credit analysis,' does not deploy capital based on the perceived skill of the fund manager and so is not an investor by any traditional measure.").

457 *See* Shearman Letter.

458 *See Reves v. Ernst & Young*, 494 U.S. 56 (1990).

459 *See* Proposing Release, *supra* note 26, at n.251 and accompanying text. One commenter agreed that we should not treat short- and longer-term debt holders differently for purposes of the exemption. *See* ABA Letter (asking that we exclude all holders of conventional debt from the definition of investor).

460 As we noted in the Proposing Release, because commercial paper issuers often refinance the repayment of maturing commercial paper with newly issued commercial paper, they may face roll-over risk, *i.e.*, the risk that investors may not be willing to refinance maturing commercial paper. *See* Proposing Release, *supra* note 26, at n.134. These risks became particularly apparent for issuers of asset-backed commercial paper beginning in August 2007. At that time, structured investment vehicles ("SIVs"), which are off-balance sheet funding vehicles sponsored by financial institutions, issued commercial paper to finance the acquisition of long-term assets, including residential mortgages. As a result of problems in the residential home mortgage market, short-term investors began to avoid asset-backed commercial paper tied to residential mortgages, regardless of whether the securities had substantial exposure to sub-prime mortgages.

losses directly affect the interests of holders of short-term paper in the fund just as they affect the interests of other debt holders in the fund.[461] In contrast to the treatment of knowledgeable employees, holders of short-term paper must be qualified purchasers under section 3(c)(7), the more recent of the two exclusions under the Investment Company Act on which private funds rely.[462] Thus, we are requiring advisers to count as investors all debt holders, *including* holders of short-term paper.

Some commenters expressed concern that the look-through requirement contained in the statutory definition of a "foreign private adviser" could impose significant burdens on advisers to non-U.S. funds, including non-U.S. retail funds publicly offered outside of the United States.[463] Two of these commenters stated, for example, that in their view a non-U.S. fund could be considered a private fund as a result of independent actions of U.S. investors, such as if a non-U.S. shareholder of a non-U.S. fund moves to the United States and purchases additional

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Unable to roll over their commercial paper, SIVs suffered severe liquidity problems and significant losses. *See Money Market Fund Reform*, Investment Company Act Release No. 28807 (June 30, 2009) [74 FR 32688 (July 8, 2009)] ("Money Market Fund Reform Release") at nn.37-39 and preceding and accompanying text; MARCIN KACPERCZYK AND PHILIPP SCHNABL, WHEN SAFE PROVED RISKY: COMMERCIAL PAPER DURING THE FINANCIAL CRISIS OF 2007-2009 (Nov. 2009).

461 As discussed in the Proposing Release, various types of investment vehicles make significant use of short-term paper for financing purposes so holders of this type of security are, in practice, exposed to the investment results of the security's issuer. *See* Proposing Release, *supra* note 26, at n.251. *See also* Money Market Fund Reform Release, *supra* note 460, at nn.37-39 and preceding and accompanying text (discussing how money market funds were exposed to substantial losses during 2007 as a result of exposure to debt securities issued by structured investment vehicles).

462 Congress added section 3(c)(7) to the Investment Company in 1996 as part of the National Securities Markets Improvement Act of 1996. Section 3(c)(1) was included in the Investment Company Act when it was enacted in 1940.

463 *See* AFG Letter; Dechert Foreign Adviser Letter; EFAMA Letter; Shearman Letter.

shares.[464] If these funds were "private funds," their advisers would, if seeking to rely on the foreign private adviser exemption, be required to determine the number of private fund investors in the United States and the assets under management attributable to them.

As we explain above, if an adviser reasonably believes that an investor is not "in the United States," the adviser may treat the investor as not being "in the United States." Moreover, we understand that non-U.S. private funds currently count or qualify their U.S. investors in order to avoid regulation under the Investment Company Act.[465] A non-U.S. adviser would need to count the same U.S. investors (except for holders of short-term paper with respect to a fund relying on section 3(c)(1)) in order to rely on the foreign private adviser exemption. In this respect, therefore, the look-through requirement of the foreign private adviser exemption will generally not impose any new burden on advisers to non-U.S. funds.

3. In the United States

Section 202(a)(30)'s definition of "foreign private adviser" employs the term "in the United States" in several contexts, including: (i) limiting the number of – and assets under management attributable to – an adviser's "clients" "in the United States" and "investors in the

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464 Dechert Foreign Adviser Letter; EFAMA Letter. *See also* Comment Letter of Association Française de la Gestion financière (Jun. 14, 2011) (recommended that "investment funds that already are strictly regulated and supervised by European Union regulators should be excluded from the scope of Title IV of the Dodd Frank Act and should not be considered as 'private funds'" because, among other reasons, the commenter's management company members "very often" do not know the identities of their funds' investors, and "therefore should not [] be held responsible if, unbeknownst to them, US persons decide to invest in their funds").

465 This practice is consistent with positions our staff has taken in which the staff has stated it would not recommend enforcement action in certain circumstances. *See, e.g.*, Goodwin Procter No-Action Letter, *supra* note 294; Touche Remnant No-Action Letter, *supra* note 294. *See also* sections 7(d), 3(c)(1), and 3(c)(7) of the Investment Company Act. *See also, e.g.*, Canadian Tax-Deferred Retirement Savings Accounts Release, *supra* note 294, at n.23 ("The Commission and its staff have interpreted section 7(d) to generally prohibit a foreign fund from making a U.S. private offering if that offering would cause the securities of the fund to be beneficially owned by more than 100 U.S. residents.").

United States" in private funds advised by the adviser; (ii) exempting only those advisers without a place of business "in the United States;" and (iii) exempting only those advisers that do not hold themselves out to the public "in the United States" as an investment adviser.[466] Today, we are defining the term "in the United States" to clarify the term for all of the above purposes as well as to provide specific instructions as to the relevant time for making the related determination.

New rule 202(a)(30)-1 defines "in the United States," as proposed, generally by incorporating the definition of a "U.S. person" and "United States" under Regulation S.[467] In particular, we are defining "in the United States" to mean: (i) with respect to any place of business, any such place that is located in the "United States," as defined in Regulation S;[468] (ii) with respect to any client or private fund investor in the United States, any person who is a "U.S. person" as defined in Regulation S,[469] except that any discretionary account or similar account that is held for the benefit of a person "in the United States" by a non-U.S. dealer or other professional fiduciary is deemed "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption; and (iii) with respect to the public, in the "United States," as defined in Regulation S.[470]

We believe that the use of Regulation S is appropriate for purposes of the foreign private adviser exemption because Regulation S provides more specific rules when applied to various

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466 *See* section 402 of the Dodd-Frank Act.

467 Rule 202(a)(30)-1(c)(3). As discussed above, we are also referencing Regulation S's definition of a "U.S. person" for purposes of the definition of "United States person" in rule 203(m)-1. *See supra* Section II.B.4.

468 *See* 17 CFR 230.902(l).

469 *See* 17 CFR 230.902(k).

470 *See* 17 CFR 230.902(l).

types of legal structures.[471] Advisers, moreover, already apply the Regulation S definition of U.S. person with respect to both clients and investors for other purposes and therefore are familiar with the definition.[472] The references to Regulation S with respect to a place of business "in the United States" and the public in the "United States" also allows us to maintain consistency across our rules. Two commenters specifically supported our approach.[473]

Similar to our approach in new rule 203(m)-1(d)(8) and as we proposed,[474] we are treating as persons "in the United States" for purposes of the foreign private adviser exemption certain persons that would not be considered "U.S. persons" under Regulation S. For example, we are treating as "in the United States" any discretionary account owned by a U.S. person and managed by a non-U.S. affiliate of the adviser in order to discourage non-U.S. advisers from creating such discretionary accounts with the goal of circumventing the exemption's limitation with respect to advising assets of persons in the United States.[475]

We also are including the note to paragraph (c)(3)(i) specifying that for purposes of that definition, a person who is "in the United States" may be treated as not being "in the United

471 *See supra* notes 404-407 and accompanying text.

472 As we noted in the Proposing Release, many non-U.S. advisers identify whether a client is a "U.S. person" under Regulation S in order to determine whether the client may invest in certain private funds and certain private placement offerings exempt from registration under the Securities Act. *See* Proposing Release, *supra* note 26, at n.259. With respect to "investors," our staff has generally taken the interpretive position that an investor that does not meet that definition is not a U.S. person when determining whether a non-U.S. private fund meets the section 3(c)(1) and 3(c)(7) counting or qualification requirements. *See id.*, at n.217. Many non-U.S. advisers, moreover, currently determine whether a private fund investor is a "U.S. person" under Regulation S for purposes of the safe harbor for offshore offers and sales.

473 Dechert Foreign Adviser Letter; Dechert General Letter. Commenters generally addressed our proposal to rely on Regulation S to identify U.S. persons within the context of the private fund adviser exemption. *See supra* Section II.B.4.

474 *See supra* Section II.B.4 (discussing the definition of United States persons and the treatment of discretionary accounts).

475 Rule 202(a)(30)-1(c)(3)(i). *See supra* note 409.

States" if the person was not "in the United States" at the time of becoming a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund.[476] As we explained in the Proposing Release, the note is designed to reduce the burden of having to monitor the location of clients and investors on an ongoing basis, and to avoid placing an adviser in a position whereby it might have to choose between registering with the Commission or terminating the relationship with any client that moved to the United States, or redeeming the interest in the private fund of any investor that moved to the United States.[477]

Several commenters supported the inclusion of the note.[478] Some commenters, however, advocated expanding the note to treat a private fund investor in the same way as a client so that additional investments in a fund made after moving to the United States would not cause the investor to become a U.S. person.[479] They argued that, as discussed above, advisers to non-U.S. funds should not be required to "look through" these funds to ensure that their investors who purchased shares while outside of the United States did not subsequently relocate to the United States and purchase additional shares.

As we explain above, if an adviser reasonably believes that an investor is not "in the United States," the adviser may treat the investor as not being "in the United States." In

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476 Rule 202(a)(30)-1, at note to paragraph (c)(3)(i) ("A person who is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund."). We revised the note to provide that it applies "each time" the investor acquires securities issued by the fund. *Cf.* proposed rule 202(a)(30)-1, at note to paragraph (c)(2)(i). This change to the note as proposed more clearly reflects the note's intended operation.

477 *See* Proposing Release, *supra* note 26, at n.257 and accompanying and following text.

478 *See, e.g.*, Dechert General Letter ("The note provides helpful relief at a time when advisory clients often move across international borders while keeping an existing relationship with a financial institution."). *See also* ABA Letter; Dechert Foreign Adviser Letter.

479 *See* Dechert Foreign Adviser Letter; Dechert General Letter; EFAMA Letter.

addition, we understand that, based on no-action positions taken by our staff, non-U.S. funds do not consider for purposes of section 3(c)(1) beneficial owners who were not U.S. persons at the time they invested in the fund, but do consider those beneficial owners if they make additional purchases in the same fund after relocating to the United States.[480] The note is consistent with the funds' current practices, and thus generally should not impose any new burdens on non-U.S. funds. The note also is consistent with section 3(c)(7), which requires an investor to be a qualified purchaser at the time the investor acquires the securities.

The Investment Funds Institute of Canada (IFIC) and the Investment Industry Association of Canada (IIAC) urged that, for purposes of the look-through provision, the Commission allow non-U.S. advisers not to count persons (and their assets) who invest in a foreign private fund through certain Canadian retirement accounts ("Participants") after having moved to the United States.[481] The commenters noted that this treatment would be consistent with rule 7d-2 under the Investment Company Act and certain related rules.[482] We agree. A non-U.S. fund sold to Participants would be deemed a private fund if it conducted a private

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480 *See* Investment Funds Institute of Canada, SEC Staff No-Action Letter (Mar. 4, 1996) (staff also stated its belief that, to the extent that a dividend reinvestment plan of a non-U.S. fund is consistent with the requirements of Securities Act Release No. 929 (July 29, 1936), such a plan would not involve an offer for purposes of Section 7(d) of the Investment Company Act). *See also* Goodwin Procter No-Action Letter, *supra* note 294; Touche Remnant No-Action Letter, *supra* note 294.

481 *See* IFIC Letter; Comment Letter of Investment Industry Association of Canada (Jan. 18, 2011) ("IIAC Letter").

482 We adopted rule 7d-2, along with rule 237 under the Securities Act, in order to allow Participants who move to the United States to continue to manage their Canadian retirement accounts. *See Offer and Sale of Securities to Canadian Tax-Deferred Retirement Savings Accounts*, Securities Act Release No. 7860 (June 7, 2000) [65 FR 37672 (June 15, 2000)]. U.S. registration requirements were affecting those Participants' ability to purchase or exchange securities for such accounts. Rule 7d-2 generally allows non-U.S. funds to treat as a private offering certain offerings to Participants who are in the United States.

offering in the United States,[483] but we have previously stated that Participants need not be counted toward the 100-investor limit for purposes of section 3(c)(1).[484] As a result, and based on the same policy considerations embodied in rule 7d-2, we believe that a non-U.S. adviser should not be required to treat Participants as investors in the United States under rule 202(a)(30)-1 with respect to investments they make after moving to the United States if the fund is in compliance with rule 7d-2.[485]

4. Place of Business

New rule 202(a)(30)-1, by reference to rule 222-1,[486] defines "place of business" to mean any office where the investment adviser regularly provides advisory services, solicits, meets with, or otherwise communicates with clients, and any location held out to the public as a place where the adviser conducts any such activities.[487] We are adopting this provision as proposed because we believe the definition appropriately identifies a location where an adviser is doing business for purposes of section 202(a)(30) of the Advisers Act and thus provides a basis for an adviser to determine whether it can rely on the exemption in section 203(b)(3) of the Advisers Act for foreign private advisers. As discussed in the Proposing Release, because both the Commission and the state securities authorities use this definition to identify an unregistered

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483 *See supra* notes 294 and 313.

484 *See* Canadian Tax-Deferred Retirement Savings Accounts Release, *supra* note 294, at n.23.

485 This interpretation only applies with respect to Participants' investments in Eligible Securities issued by a Qualified Company, as these terms are defined in rule 7d-2.

486 Rule 222-1(a) (defining "place of business" of an investment adviser as: "(1) An office at which the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and (2) Any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with, or otherwise communicates with clients.").

487 Rule 202(a)(30)-1(c)(4).

foreign adviser's place of business for purposes of determining regulatory jurisdiction,[488] we believe it is logical as well as efficient to use the rule 222-1(a) definition of "place of business" for purposes of the foreign private adviser exemption. The two commenters that considered the proposed definition of "place of business" by reference to rule 222-1 agreed with this analysis.[489]

Some commenters asked us to clarify that a "place of business" would not include an office in the United States where a non-U.S. adviser solely conducts research, communicates with non-U.S. clients, or performs administrative services and back-office books and recordkeeping activities.[490] Under rule 202(a)(30)-1, as under rule 203(m)-1, an adviser must determine whether it has a place of business, as defined in rule 222-1, in the United States in light of the relevant facts and circumstances.[491] For example, any office from which an adviser regularly communicates with its clients, whether U.S. or non-U.S., would be a place of business.[492] In addition, an office or other location where an adviser regularly conducts research would be a place of business because research is intrinsic to the provision of investment advisory services.[493] A place of business would not, however, include an office where an adviser solely performs administrative services and back-office activities if they are not activities intrinsic to

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488 *See* Proposing Release, *supra* note 26, at n.265 (explaining that, under section 222(d) of the Advisers Act, a state may not require an adviser to register if the adviser does not have a "place of business" within, and has fewer than six clients resident in, the state).

489 *See* ABA Letter ("[W]e believe that the definition of place of business set forth in Rule 222-1 is appropriate . . . ."); AIMA Letter ("We consider the definition of 'place of business' by reference to Rule 222-1 of the Advisers Act both logical and appropriate.").

490 *See, e.g.*, ABA Letter; AIMA Letter.

491 As discussed above, investment advisers will also apply this provision for purposes of the private fund adviser exemption. *See supra* Section II.B.3.

492 Rule 222-1 does not distinguish between U.S. and non-U.S. clients.

493 That would include, for example, research conducted in order to produce non-public information relevant to the investments of, or the investment recommendations for, any of the adviser's clients.

providing investment advisory services and do not involve communicating with clients.

A number of commenters sought guidance as to whether the activities of U.S. affiliates of non-U.S. advisers would be deemed to constitute places of business in the United States of the non-U.S. advisers.[494] There is no presumption that a non-U.S. adviser has a place of business in the United States solely because it is affiliated with a U.S. adviser.[495] A non-U.S. adviser might be deemed to have a place of business in the United States, however, if the non-U.S. adviser's personnel regularly conduct activities at an affiliate's place of business in the United States.[496]

5. Assets Under Management

For purposes of rule 202(a)(30)-1 we are defining "assets under management," as proposed, by reference to the calculation of "regulatory assets under management" for Item 5 of Form ADV.[497] As discussed above, in Item 5 of Form ADV we are implementing a uniform method of calculating assets under management that can be used for several purposes under the Advisers Act, including the foreign private adviser exemption and the private fund adviser

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494 *See, e.g.*, Debevoise Letter; Dechert Foreign Adviser Letter; EFAMA Letter.

495 See *infra* note 506.

496 We have provided guidance as to whether certain activities would result in an investment adviser representative having a place of business as defined in rule 203A-3(b), which we believe also is applicable to an adviser's determination as to whether it has a U.S. place of business under rule 222-1 (and therefore under rule 203(m)-1 or rule 203(a)(30)-1). We have explained that the definition in rule 203A-3(b) "encompasses permanent and temporary offices as well as other locations at which an adviser representative may provide advisory services, such as a hotel or auditorium." *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1633 (May 15, 1997) [62 FR 28112 (May 22, 1997)]. We further explained that whether a temporary office or location is a place of business "will turn on whether the adviser representative has let it generally be known that he or she will conduct advisory business at the location, rather than on the frequency with which the adviser representative conducts advisory business there." *Id. See also infra* Section II.D.

497 *See* rule 202(a)(30)-1(c)(1); instructions to Item 5.F of Form ADV, Part 1A. As discussed above, we are taking the same approach under rule 203(m)-1. *See supra* Section II.B.2.a.

exemption.[498] Because the foreign private adviser exemption is also based on assets under management, we believe that all advisers should use the same method for calculating assets under management to determine if they are required to register or may be eligible for the exemption.[499]

We believe that uniformity in the method for calculating assets under management will result in more consistent asset calculations and reporting across the industry and, therefore, in a more coherent application of the Advisers Act's regulatory requirements and assessment of risk.[500] One commenter specifically agreed that the uniform method should be applied for purposes of the foreign private adviser exemption.[501] Most commenters addressed the components of the new method of calculation in reference to the calculation of "regulatory assets under management" under Form ADV, or with respect to the calculation of private fund assets for purposes of the private fund adviser exemption.[502] We address these comments in the Implementing Adopting Release and in Section II.B.2.[503]

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498 *See supra* Section II.B.2.a; Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

499 According to the statutory definition of "foreign private adviser," a non-U.S. adviser calculating the assets relevant for purposes of the foreign private adviser exemption would only include those assets under management (*i.e.*, regulatory assets under management) that are "attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser." *See supra* notes 416 and 429 and accompanying text and note 417.

500 *See supra* Section II.B.2.a; Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

501 *See* Seward Letter.

502 *See supra* Section II.B.2.a; Implementing Adopting Release, *supra* note 32, discussion at section II.A.3. A few commenters raised the same arguments in favor of revising the method of calculation also with respect to the calculation under the foreign private adviser exemption. *See, e.g.*, ABA Letter; EFAMA Letter; Katten Foreign Advisers Letter (arguing that the method should exclude proprietary and knowledgeable employee assets, and assets for which the adviser receives no compensation).

503 *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3. In addition, several commenters requested that we exercise our authority to increase the $25 million asset

D. Subadvisory Relationships and Advisory Affiliates

We generally interpret advisers as including subadvisers,[504] and therefore believe it is appropriate to permit subadvisers to rely on each of the new exemptions, provided that subadvisers satisfy all terms and conditions of the applicable rule.

We are aware that in many subadvisory relationships a subadviser has contractual privity with a private fund's primary adviser rather than the private fund itself. Although both the private fund and the fund's primary adviser may be viewed as clients of the subadviser, we would consider a subadviser eligible to rely on rule 203(m)-1 if the subadviser's services to the primary adviser relate solely to private funds and the other conditions of the rule are met. Similarly, a subadviser may be eligible to rely on section 203(l) if the subadviser's services to the primary adviser relate solely to venture capital funds and the other conditions of the rule are met.

We anticipated that an adviser with advisory affiliates could encounter interpretative issues as to whether it may rely on any of the exemptions discussed in this Release without taking into account the activities of its affiliates. The adviser, for example, might have advisory affiliates that are registered or that provide advisory services that the adviser itself could not

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threshold applicable to the foreign private adviser exemption. *See, e.g.*, ABA Letter ($100 million); AFG Letter ($150 million); AIMA Letter (at least $100 million); Comment Letter of Autorité des Marchés Financiers (Jan. 18, 2011) ($150 million); EVCA Letter ($100 or $150 million); DLA Piper VC Letter ($250 million); Fulbright Letter ($500 million). We acknowledged in the Proposing Release that Section 204 of the Advisers Act provides us with the authority to raise the threshold, but we did not propose to do so. Therefore, we have not considered raising the threshold in connection with this rulemaking, but we will evaluate whether doing so may be appropriate in the future, consistent with a comment we received. *See* ABA Letter (asked that we "monitor this issue . . . undertake dialogue with foreign regulators with respect to their supervisory regimes over investment advisers, and . . . consider proposing an increase in the exemption amount in the near future").

504 *See, e.g.*, Pay to Play Release, *supra* note 9, at nn.391-94 and accompanying and following text; Hedge Fund Adviser Registration Release, *supra* note 14, at n.243.

provide while relying on an exemption. In the Proposing Release, we requested comment on whether any proposed rule should provide that an adviser must take into account the activities of its advisory affiliates when determining eligibility for an exemption, by having the rule, for example, specify that the exemption is not available to an affiliate of a registered investment adviser.

Commenters that responded to our request for comment generally supported treating each advisory entity separately without regard to the activities of, or relationships with, its affiliates.[505] This approach, however, would for example permit an adviser managing $200 million in private fund assets simply to reorganize as two separate advisers, each of which could purport to rely on the private fund adviser exemption. Such a result would in our view be inconsistent with the intent of Congress in establishing the exemption's $150 million threshold and would violate section 208(d) of the Advisers Act, which prohibits any person from doing indirectly or through or by any other person any act or thing which would be unlawful for such person to do directly. Accordingly, we would treat as a single adviser two or more affiliated advisers that are separately organized but operationally integrated, which could result in a requirement for one or both advisers to register.[506] Some commenters acknowledged this, but urged that, in the case of a non-U.S. advisory affiliate, the Commission affirm the staff's positions developed in the

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505 *See, e.g.*, AFG Letter (in determining exemption thresholds, each entity's assets should be determined separately; does not support combining different entities with different business activities); Debevoise Letter (in the context of rule 203(m)-1).

506 Generally, a separately formed advisory entity that operates independently of an affiliate may be eligible for an exemption if it meets all of the criteria set forth in the relevant rule. However, the existence of separate legal entities may not by itself be sufficient to avoid integration of the affiliated entities. The determination of whether the advisory businesses of two separately formed affiliates may be required to be integrated is based on the facts and circumstances. Our staff has taken this position in Richard Ellis, Inc., SEC Staff No-Action Letter (Sept. 17, 1981) (discussing the staff's views of factors relevant to the determination of whether a separately formed advisory entity operates independently of an affiliate). *See also* discussion *infra* following note 515.

Unibanco line of no-action letters ("*Unibanco* letters").[507] In the *Unibanco* letters,[508] the staff provided assurances that it would not recommend enforcement action, subject to certain conditions, against a non-U.S. unregistered adviser that is affiliated with a Commission-registered adviser, despite sharing personnel and resources.[509]

The *Unibanco* letters grew out of recommendations in a 1992 staff study, and sought to limit the extraterritorial application of the Advisers Act while also protecting U.S. investors and markets.[510] In these letters, the staff provided assurances that it would not recommend

507 *See, e.g.*, AIMA Letter, Commenter Letter of Bank of Montreal, Royal Bank of Canada and The Toronto-Dominion Bank (Jan. 24, 2011) ("Canadian Banks Letter"); CompliGlobe Letter; Debevoise Letter; Dechert General Letter (also supported extending the *Unibanco* letters to U.S. advisers); Dechert Foreign Adviser Letter; EFAMA Letter; Katten Foreign Advisers Letter; McGuireWoods Letter; MFA Letter; Comment Letter of MFS Investment Management (Jan. 24, 2011) ("MFS Letter"); Comment Letter of Ropes & Gray LLP (Jan. 24, 2011).

508 *See, e.g.*, ABA Subcommittee on Private Investment Entities, SEC Staff No-Action Letter (Dec. 8, 2005) ("ABA No-Action Letter"); Royal Bank of Canada, SEC Staff No-Action Letter (Jun. 3, 1998); ABN AMRO Bank, N.V., SEC Staff No-Action Letter (Jul. 7, 1997); Murray Johnstone Holdings Limited, SEC Staff No-Action Letter (Oct. 7, 1994); Kleinwort Benson Investment Management Limited, SEC Staff No-Action Letter (Dec. 15, 1993); Mercury Asset Management plc, SEC Staff No-Action Letter (Apr. 16, 1993); and Uniao de Bancos de Brasileiros S.A., SEC Staff No-Action Letter (Jul. 28, 1992) ("Unibanco No-Action Letter"). *See also* 1992 Staff Report, *supra* note 393, at Section III.D.

509 Generally, the staff has provided assurances that it will not recommend enforcement action in situations in which the unregistered non-U.S. adviser, often termed a "participating affiliate" in these letters, and its registered affiliate are separately organized; the registered affiliate is staffed with personnel (located in the U.S. or abroad) who are capable of providing investment advice; all personnel of the participating affiliate involved in U.S. advisory activities are deemed "associated persons" of the registered affiliate; and the Commission has adequate access to trading and other records of the participating affiliate and to its personnel to the extent necessary to enable it to identify conduct that may harm U.S. clients or markets. *See supra* note 508; Hedge Fund Adviser Registration Release, *supra* note 14, at n.211 and accompanying text.

510 *See* 1992 Staff Report, *supra* note 393, at section III.D. In enacting the private fund adviser exemption and the foreign private adviser exemption, both of which focus on an adviser's activities in, or contacts with, the United States, Congress has addressed issues similar to those described in the 1992 Staff Report. *See* section 408 of the Dodd-Frank Act (directing the Commission to exempt private fund advisers with less than "$150 million in assets under management *in the United States*") (emphasis added); sections 402 and 403 of the Dodd-Frank Act (exempting from registration foreign private advisers with no *place of business in the United States* that have a limited number of *clients in the United States and investors in the United States*

enforcement action of the substantive provisions of the Advisers Act with respect to a non-U.S. adviser's relationships with its non-U.S. clients.[511] In addition, and as relevant here, the staff agreed not to recommend enforcement action if a non-U.S. advisory affiliate of a registered adviser, often termed a "participating affiliate," shares personnel with, and provides certain services through, the registered adviser affiliate, without such affiliate registering under the Advisers Act.[512] Many commenters asserted that affirming these positions would accommodate established business practices of global advisory firms without reducing the Commission's ability to protect U.S. markets and investors, because the Commission would continue to have access to records and personnel of unregistered non-U.S. advisory entities that are involved in the U.S. advisory business of an affiliated and registered adviser.[513]

A number of commenters asserted that the staff positions in the *Unibanco* letters are consistent with our approach to the territorial application of the Advisers Act with respect to non-U.S. advisers.[514] As we stated in 2004, we do not apply most of the substantive provisions of the Advisers Act to the non-U.S. clients of a non-U.S. adviser registered with the Commission.[515] However, the *Unibanco* letters were developed by the staff in the context of the

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in private funds and a limited amount of assets attributable to these clients and investors, among other conditions).

511 *See supra* note 508. *See also infra* note 515.

512 *See supra* note 508.

513 *See, e.g.*, Canadian Banks Letter; CompliGlobe Letter; MFA Letter; MFS Letter.

514 *See, e.g.*, Canadian Banks Letter; MFA Letter. *See also supra* notes 510 and 316 and accompanying text.

515 *See* Hedge Fund Adviser Registration Release, *supra* note 14, at nn.211 and 216-222 and accompanying text (noting that this policy was first set forth in the Unibanco No-Action Letter). Although the rules contained in the Hedge Fund Adviser Registration Release were vacated by a federal court in *Goldstein, supra* note 14, the court's decision did not address our statement in that release that we do not apply most of the substantive provisions of the Advisers Act to the non-U.S. clients of a non-U.S. adviser registered with the Commission. In addition, our staff

private adviser exemption,[516] which Congress repealed. Nothing in the rules we are today adopting in this Release is intended to withdraw any prior statement of the Commission or the views of the staff as expressed in the *Unibanco* letters. We expect that the staff will provide guidance, as appropriate, based on facts that may be presented to the staff regarding the application of the *Unibanco* letters in the context of the new foreign private adviser exemption and the private fund adviser exemption.

III. CERTAIN ADMINISTRATIVE LAW MATTERS

The effective date for rules 203(l)-1, 203(m)-1 and 202(a)(30)-1 is July 21, 2011. The Administrative Procedure Act generally requires that an agency publish a final rule in the Federal Register not less than 30 days before its effective date.[517] This requirement does not apply, however, if the rule is a substantive rule which grants or recognizes an exemption or relieves a restriction or is an interpretative rule.[518]

As discussed above, effective July 21, 2011, the Dodd-Frank Act amends the Advisers

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expressed this view in a 2006 no-action letter issued in response to a request for the staff's views on matters affecting investment advisers to certain private funds that arose as a result of the *Goldstein* decision. *See* ABA Subcommittee on Private Investment Companies, SEC Staff No-Action Letter (Aug. 10, 2006) (Commission staff expressed the view that the substantive provisions of the Advisers Act do not apply to offshore advisers with respect to such advisers' dealings with offshore funds and other offshore clients to the extent described in prior staff no-action letters and the Hedge Fund Adviser Registration Release, *supra* note 14. The staff noted, however, that an offshore adviser registered with the Commission under the Advisers Act must comply with the Advisers Act and the Commission's rules thereunder with respect to any U.S. clients (and any prospective U.S. clients) it may have.).

516 Our staff has provided assurances that it would not recommend enforcement action when no participating affiliate has any U.S. clients other than clients of the registered affiliate, consistent with the private adviser exemption, which was conditioned on the number of a non-U.S. adviser's U.S. clients. *See supra* notes 508-509; Hedge Fund Adviser Registration Release, *supra* note 14, at n.211 and accompanying text. Under the *Unibanco* letters, participating affiliates only share personnel with, and provide certain services through, their registered adviser affiliates. *See supra* notes 508-509.

517 *See* 5 U.S.C. 553(d).

518 The statute also provides an exception if the agency finds good cause to make the rule effective less than 30 days after its date of publication in the Federal Register. *Id.*

Act to eliminate the private adviser exemption in pre-existing section 203(b)(3), which will require advisers relying on that exemption to register with the Commission as of July 21, 2011 unless another exemption is available.[519] Also effective July 21, 2011, are the Dodd-Frank Act amendments to the Advisers Act that are described immediately below.

Sections 203(l) and 203(b)(3) of the Advisers Act provide exemptions from registration for advisers to venture capital funds and foreign private advisers, respectively. Rule 203(l)-1 defines venture capital fund, and rule 202(a)(30)-1 defines several terms in the definition of "foreign private adviser" in section 202(a)(30).[520] Thus, these interpretive rules implement the new venture capital and foreign private adviser exemptions added to the Advisers Act by the Dodd-Frank Act.

Section 203(m) of the Advisers Act, as amended by the Dodd-Frank Act, directs the Commission to provide an exemption for advisers solely to private funds with assets under management in the United States of less than $150 million. Rule 203(m)-1, which implements section 203(m), grants an exemption and relieves a restriction and in part has interpretive aspects. Accordingly, we are making the rules effective on July 21, 2011.

IV. PAPERWORK REDUCTION ANALYSIS

The rules do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[521] Accordingly, the Paperwork Reduction Act is not applicable.

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[519] *See* sections 403 of the Dodd-Frank Act; sections 203(b)(3) of the Advisers Act; Section I *supra*.

[520] As discussed above, the Dodd-Frank Act amended the Advisers Act to define "foreign private adviser" in section 202(a)(30).

[521] 44 U.S.C. 3501.

V. COST-BENEFIT ANALYSIS

As discussed above, we are adopting rules 203(l)-1, 203(m)-1 and 202(a)(30)-1 to implement certain provisions of the Dodd-Frank Act. As a result of the Dodd-Frank Act's repeal of the private adviser exemption, some advisers that previously were eligible to rely on that exemption will be required to register under the Advisers Act unless they are eligible for a new exemption. Thus, the benefits and costs associated with registration for advisers that are not eligible for an exemption are attributable to the Dodd-Frank Act.[522] Moreover, the Dodd-Frank Act provides that, unlike an adviser that is specifically exempt pursuant to section 203(b), an adviser relying on an exemption provided by section 203(l) of the Advisers Act or rule 203(m)-1 thereunder may be subject to reporting and recordkeeping requirements.[523] Hence, the benefits and costs associated with being an exempt reporting adviser, relative to being an adviser that is registered or specifically exempted by reason of section 203(b), are attributable to the Dodd-Frank Act. The Commission has discretion, however, to adopt rules to define the terms used in the Advisers Act, and we undertake below to discuss the benefits and costs of the rules that we are adopting to implement the exemptions discussed in this Release.[524]

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522 As we discuss above, although most venture capital advisers agreed with our proposed approach to the definition of venture capital fund, a number of commenters disagreed with our approach to the proposed definition, and argued that it should be expanded to include investments in small companies (regardless of whether they satisfy our definition of qualifying portfolio company) and investments in other private funds. *See, e.g.*, NASBIC/SBIA Letter; PEI Funds/Willowbridge Letter; VIA Letter. We do not believe that these more expansive positions are consistent with the intended scope of the venture capital exemption as expressed by Congress. *See supra* note 204 and accompanying text. Thus, we believe that the costs of registration for advisers to funds that would not satisfy the definition because they hold such investments are attributable to the Dodd-Frank Act.

523 *See supra* note 5.

524 The benefits and costs of the reporting requirements applicable to advisers relying on the venture capital exemption and the private fund adviser exemption are discussed in greater detail in the Implementing Adopting Release, *supra* note 32, discussion at sections V.A.2 and V.B.2.

We are sensitive to the costs and benefits imposed by our rules, and understand that there will be costs and benefits associated with complying with the rules we are adopting today. We recognize that certain aspects of these rules may place burdens on advisers that seek to qualify for the various exemptions discussed in this Release. We believe that these rules, as modified from the proposals, offer flexibility and clarity for advisers seeking to qualify for the exemptions. We have designed the rules to balance these concerns with respect to potential costs and burdens with what we understand was intended by Congress.

In the Proposing Release, we identified possible costs and benefits of the proposed rules and requested comment on the analysis, including identification and assessment of any costs and benefits not discussed in the analysis. We requested that commenters provide analysis and empirical data to support their views on the costs and benefits associated with the proposals. In addition, we requested confirmation of our understanding of how advisers that may seek to rely on the exemptions operate and manage private funds and how the proposals may affect them and their businesses.

A. Definition of Venture Capital Fund

We define a venture capital fund as a private fund that: (i) holds no more than 20 percent of the fund's capital commitments in non-qualifying investments (other than short-term holdings) ("qualifying investments" generally consist of equity securities of "qualifying portfolio companies" and are discussed below); (ii) does not borrow or otherwise incur leverage, other than limited short-term borrowing (excluding certain guarantees of qualifying portfolio company obligations by the fund); (iii) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (iv) represents itself as pursuing a venture capital strategy to investors; and (v) is not registered under the Investment Company Act and has not elected to be treated as a BDC.[525]

We define "qualifying investments" as: (i) directly acquired equities; (ii) equity securities issued by a qualifying portfolio company in exchange for directly acquired equities issued by the same qualifying portfolio company; and (iii) equity securities issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, or a predecessor, and is received in exchange for directly acquired equities of the qualifying portfolio company (or securities exchanged for such directly acquired equities).[526] We define a "qualifying portfolio company" as any company that: (i) is not a reporting company and does not have a control relationship with a reporting company; (ii) does not borrow or issue debt obligations in connection with the investment by the private fund and distribute proceeds of the borrowing or issuance to the private fund in exchange for the private fund investment; and (iii) is not itself a fund (*i.e.*, is an operating company).[527]

The final rule also grandfathers existing funds by including in the definition of "venture capital fund" any private fund that: (i) represented to investors and potential investors at the time the fund offered its securities that it pursues a venture capital strategy; (ii) prior to December 31, 2010, has sold securities to one or more investors that are not related persons of any investment adviser of the venture capital fund; and (iii) does not sell any securities to, including accepting any additional capital commitments from, any person after July 21, 2011 (the "grandfathering provision").[528] An adviser seeking to rely on the exemption under section 203(l) of the Advisers Act would be eligible for the venture capital exemption only if it exclusively advised venture

525. Rule 203(l)-1(a).

526. Rule 203(l)-1(c)(3).

527. Rule 203(l)-1(c)(4). *See also* text accompanying note 148.

528. Rule 203(l)-1(b).

capital funds that satisfy all of the elements of the definition of venture capital fund or the grandfathering provision.

We have identified certain costs and benefits, discussed below, that may result from our definition of venture capital fund, including modifications to the proposal. As we discussed in the Proposing Release, the proposed rule was designed to: (i) implement the directive from Congress to define the term venture capital fund in a manner that reflects Congress' understanding of what venture capital funds are, and as distinguished from other private funds such as private equity funds and hedge funds; and (ii) facilitate the transition to the new exemption.[529] As discussed above, we have modified the proposed rule to give qualifying funds greater flexibility with respect to their investments, partly in response to comments we received.[530] The final rule defines the term venture capital fund consistently with what we believe Congress understood venture capital funds to be,[531] and in light of other concerns expressed by Congress with respect to the intended scope of the venture capital exemption.[532]

Approximately 26 comment letters addressed the costs and benefits of the proposed rule defining venture capital fund.[533] As discussed below, most of these commenters did not provide empirical data to support their views. However, a number of venture capital advisers commenting on the proposed rule offered observations based upon their experiences managing venture capital funds and presented views on the potential impact of the proposed rule on their

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529 *See* Proposing Release, *supra* note 26, discussion at text immediately preceding text accompanying n.273.

530 *See generally* Section II.A.1.

531 *See supra* notes 36-37 and accompanying and following text. *See also infra* note 535.

532 *See supra* discussion at Section II.A.

533 *See, e.g.*, NVCA Letter; NYSBA Letter; Oak Investments Letter; Sevin Rosen Letter; SVB Letter; Trident Letter.

businesses and business practices.

1. Benefits

In the Proposing Release, we stated that based on the testimony presented to Congress and our research, we believed that venture capital funds currently in existence would meet most, if not all, of the elements of our proposed definition of venture capital fund.[534] Several commenters agreed that the proposed rule is consistent with Congressional intent.[535] Many venture capital advisers and related industry groups acknowledged that the proposed definition would generally encompass most venture capital investing activity that typically occurs,[536] but expressed the concern that a venture capital fund may, on occasion, deviate from its typical investing pattern with the result that the fund could not satisfy all of the definitional criteria under the proposed rule with respect to each investment all of the time.[537] Several commenters also expressed the concern that the final rule should provide sufficient flexibility to accommodate future business practices that are not known or contemplated today.[538]

For the reasons discussed above, we have modified the definition of venture capital fund.

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534 Proposing Release, *supra* note 26, at section IV.A.1.

535 AFL-CIO Letter ("[T]he SEC has . . . generally provided appropriate definitions for each of the factors."); AFR Letter ("[W]e believe that the exemption ultimately created in the [Dodd-Frank Act] for venture capital funds must be narrowly defined so as to prevent it from undermining the requirement all other fund managers register. We believe that the language in the proposed rule meets this goal . . ."); Sen. Levin Letter ("[T]he proposed definition captures the essence of venture capital firms whose mission is to encourage the development and expansion of new business."). *See also* DuFauchard Letter ("Congressional directives require the SEC to exclude private equity funds, or any fund that pivots its investment strategy on the use of debt or leverage, from the definition of VC Fund.").

536 *See, e.g.*, Cook Children's Letter ("The Commission's definition of a venture capital fund does a thorough job capturing many of the aspects that differentiate venture capital funds from other types of private investment funds."); Leland Fikes Letter; NVCA Letter ("[T]he Proposed Rules are generally consistent with existing venture capital industry practice . . ."). *See also* CompliGlobe Letter; DLA Piper VC Letter.

537 *See, e.g.*, ATV Letter; BIO Letter; NVCA Letter; Sevin Rosen Letter.

538 *See, e.g.*, NVCA Letter; Oak Investments Letter.

Our modifications include specifying a non-qualifying basket[539] and excluding from the 120-day limit with respect to leverage certain guarantees of portfolio company obligations by a qualifying fund.[540] For the reasons discussed in greater detail above, we are adopting a limit of 20 percent for non-qualifying investments.[541] In summary, the non-qualifying basket is designed to address commenters' concerns regarding occasional deviations from typical venture capital investing activity,[542] inadvertent violations of the definitional criteria[543] and flexibility to address evolving or future business practices.[544] We considered these comments in light of our concerns that the exemption not be expanded beyond what we believe was the intent of Congress[545] and that the definition not operate to foreclose investment funds from investment opportunities that would benefit investors but would not change the character of the fund.[546] We concluded that a non-qualifying basket limit of 20 percent would provide the flexibility sought by many venture capital fund commenters while appropriately limiting the scope of the exemption.[547]

We believe that the final rule (including the modifications from the proposal) better describes the existing venture capital industry and provides venture capital advisers with greater flexibility to accommodate existing (and potentially evolving or future) business practices and take advantage of investment opportunities that may arise. We also believe that the criteria

539 Rule 203(l)-1(a)(2).

540 Rule 203(l)-1(a)(3).

541 *See generally* Section II.A.

542 *See supra* note 56.

543 *See supra* note 58.

544 *See supra* note 56.

545 *See supra* notes 45 and 61 and accompanying text.

546 *See supra* note 60.

547 *See supra* note 72 and following text.

under the final rule will facilitate transition to the new exemption, because it minimizes the extent to which an adviser seeking to rely on the venture capital exemption would need to alter its existing business practices, thus, among other things, reducing the likelihood of inadvertent non-compliance.[548]

As we discuss in greater detail above, many commenters arguing in favor of the modifications that we are adopting generally cited these benefits to support their views.[549] Specifically, several commenters asserted that providing a limited basket for non-qualifying investments would benefit venture capital advisers relying on the venture capital exemption, and the U.S. economy, by facilitating job creation and capital formation[550] and minimizing the extent to which a venture capital fund would need to alter its typical business practices.[551] Other commenters maintained that an approach providing advisers some flexibility on occasion to take advantage of promising investment opportunities that might not be typical of most venture capital activity would benefit those funds and their investors.[552]

We anticipate that a number of benefits, described by commenters, may result from

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548 For example, the final rule does not specify that a qualifying fund must provide managerial assistance or control each qualifying portfolio company in which the fund invests. A number of commenters indicated that venture capital funds may not provide sufficient assistance or exercise sufficient control in order to satisfy this element of the proposed definition. *See, e.g.*, ESP Letter; Merkl Letter. The final rule also allows a qualifying fund to exclude investments in money market funds from the non-qualifying basket. A number of commenters indicated that money market funds are typically used by venture capital funds for cash management purposes. *See, e.g.*, NVCA Letter. We expect that these modifications to the rule would avoid the cost of altering an adviser's existing business practices.

549 *See, e.g.*, NVCA Letter; Oak Investments Letter; Quaker BioVentures Letter. *See also supra* discussion at Section II.A.1.

550 *See, e.g.*, NVCA Letter (stating that a low level of 15% would "allow innovation and job creation to flourish within the venture capital industry"); Sevin Rosen Letter (a 20% limit would be "flexible enough not to severely impair the operations of bona fide [venture capital funds], a critically important resource for American innovation and job creation").

551 *See, e.g.*, McDonald Letter; Pine Brook Letter.

552 *See, e.g.*, DuFauchard Letter; Merkl Letter.

allowing qualifying funds limited investments in non-qualifying investments, including publicly traded securities, securities that are not equity securities (*e.g.*, non-convertible debt instruments) and interests in other private funds.[553] For example, increasing the potential pool of investors that could provide financing to publicly traded companies to include venture capital funds could facilitate access to capital for a portfolio company's expansion and growth.[554] Including investments that are not equity securities could offer funds seeking to qualify as venture capital funds the flexibility to structure an investment in a manner that is most appropriate for the fund (and its investors), including for example to obtain favorable tax treatment, manage risks (such as bankruptcy protection), maintain the value of the fund's equity investment or satisfy the specific financing needs of a portfolio company.[555] Including non-convertible bridge financing also would enable a portfolio company to seek such financing from venture capital funds if it is unable to obtain financing from traditional lending sources.[556] In addition, permitting qualifying funds to invest in other underlying private funds could facilitate capital formation and enhance liquidity for the underlying private funds.[557] Under the final rule, qualifying funds also would have increased flexibility to invest in portfolio companies through secondary market transactions. Commenters asserted that this would help align the interests of portfolio company founders with the interests of venture capital funds[558] and prevent dilution of the venture capital

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553 Rule 203(l)-1(a)(2) (specifying that a qualifying fund must hold, immediately after the acquisition of any asset (excluding short-term holdings) no more than 20% of its committed capital in assets that are not qualifying investments); rule 203(l)-1(c)(3) (defining "qualifying investment").

554 *See, e.g.*, Lowenstein Letter; McDonald Letter; Mesirow Letter; Quaker BIO Letter; Trident Letter.

555 *See, e.g.*, Merkl Letter; Oak Investments Letter; Sevin Rosen Letter; Vedanta Capital Letter.

556 NVCA Letter; Trident Letter.

557 *See, e.g.*, Cook Children's Letter; Leland Fikes Letter; Merkl Letter; SVB Letter.

558 Sevin Rosen Letter.

fund's investment in the portfolio company.[559]

Under the final rule, the non-qualifying basket is determined as a percentage of a qualifying fund's capital commitments, and compliance with the 20 percent limit is determined each time a qualifying fund makes any non-qualifying investment (excluding short-term holdings). We expect that calculating the size of the non-qualifying basket as a percentage of a qualifying fund's capital commitments, which will remain relatively constant during the fund's term, will provide advisers with a degree of predictability when managing the fund's portfolio and determining how much of the basket remains available for new investments. Moreover, we believe that by applying the 20 percent limit as of the time of acquisition of each non-qualifying investment, a fund is able to determine prospectively how much it can invest in the non-qualifying basket. We believe that this approach to determining the non-qualifying basket will appropriately limit a qualifying fund's non-qualifying investments and ease the burden of determining compliance with the criterion under the rule.

As discussed above, a qualifying fund can only invest up to 20 percent of its capital commitments in non-qualifying investments, as measured immediately after it acquires any non-qualifying investment.[560] The final rule treats as a qualifying investment any equity security of a qualifying portfolio company, or a company acquiring the qualifying portfolio company, that is exchanged for directly acquired equities issued by the qualifying portfolio company. This definition should benefit venture capital funds because it allows funds to participate in the

559 SVB Letter.

560 The rule requires a qualifying fund at the time it acquires an asset, to have no more than 20% of its capital commitments invested in assets that are not qualifying investments. Rule 203(l)-1(a)(2).

reorganization of the capital structure of a portfolio company.[561] It also provides qualifying funds with liquidity and an opportunity to take profits from their investments because they can acquire securities in connection with the acquisition (or merger) of a qualifying portfolio company by another company — typical means by which venture capital funds exit an investment.[562]

The final rule excludes from the 120-day limit with respect to leverage any venture capital fund guarantees of portfolio company indebtedness, up to the value of the fund's investment in the company.[563] We agree with several commenters who stated that guarantees of portfolio company indebtedness under these circumstances will facilitate a portfolio company's ability to obtain credit for working capital or business operations.[564] Thus, we believe this provision, which is designed to accommodate existing business practices typical of venture capital funds, may contribute to efficiency, competition and capital formation.

The final rule excludes from the definition of qualifying portfolio company any company that borrows or issues debt if the proceeds of such borrowing or debt are distributed to the venture capital fund in exchange for the fund's investment in the company. This will allow qualifying funds to provide financing on a short-term basis to portfolio companies as a "bridge"

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561 *See supra* note 109 and following text.

562 *See, e.g.*, NVCA Letter; PTV Sciences Letter. The final rule defines equity securities broadly to cover many types of equity securities in which venture capital funds typically invest, rather than limit the definition solely to common stock. *See supra* notes 95-96 and accompanying text. Our definition of qualifying portfolio company is similarly broad because it does not restrict qualifying companies to "small or start-up" companies. As we have noted in the Proposing Release and above, we believe that such definitions would be too restrictive and provide venture capital fund advisers with too little flexibility and limited options with respect to potential portfolio company investments. *See supra* discussion in Section II.A.1.a.

563 Rule 203(l)-1(a)(3).

564 Oak Investments Letter; SVB Letter.

between funding rounds.[565] In addition, a portfolio company can obtain financing for working capital or expansion needs from typical lenders, effect shareholder buyouts and conclude a simultaneous debt and equity offering, without affecting the adviser's eligibility for the venture capital exemption. For the foregoing reasons, commenters maintained, and we agree, that this approach would facilitate compliance with the rule without restricting a portfolio company's access to financing or other capital.[566] We believe that this provision of the final rule will benefit venture capital funds and their investors because it restricts a portfolio company's ability to incur debt that may implicate Congressional concerns regarding the use of leverage and effectively distinguishes advisers to venture capital funds from advisers to leveraged buyout private equity funds for which Congress did not provide an exemption.[567]

Our final rule clarifies that an adviser seeking to rely on the venture capital exemption may treat as a private fund any non-U.S. fund managed by the adviser that does not offer its securities in the United States or to U.S. persons.[568] This treatment will enable an adviser to rely on the exemption when it manages only funds that satisfy the venture capital fund definition, regardless of the funds' jurisdiction of formation and investor base. We believe that this treatment facilitates capital formation and competition because it would allow an adviser to sponsor and advise funds in different jurisdictions in order to meet the different tax or regulatory needs of the fund's investors without risking the availability of the exemption.

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565 *See, e.g.*, *supra* note 181 and accompanying and following text.

566 *See, e.g.*, NVCA Letter; SVB Letter.

567 As discussed above, we have imposed this limitation on qualifying portfolio companies because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee Report, and the testimony before Congress that stressed the lack of leverage in venture capital investing. *See supra* notes 174 and 175.

568 *See* note accompanying rule 203(l)-1.

The final rule includes several other characteristics that provide additional flexibility to venture capital advisers and their funds. For example, a qualifying fund cannot provide its investors with redemption or other liquidity rights except in extraordinary circumstances. Although venture capital funds typically do not permit investors to redeem their interests during the life of the fund,[569] the approach of the final rule allows a venture capital fund to respond to extraordinary events, including redeeming investors from the fund, without resulting in a registration obligation for the fund's adviser. Under the final rule, a venture capital fund must affirmatively represent itself as pursuing a venture capital strategy to its investors, a criterion designed to preclude advisers to certain private funds from claiming an exemption from registration for which they are not eligible. We believe that this element will allow the Commission and the investing public (particularly potential investors) to determine and confirm an adviser's rationale for remaining unregistered with the Commission.[570]

Because it takes into account existing business practices of venture capital funds and permits some flexibility for venture capital funds (and their managers) to adopt, or adapt to, new or evolving business practices, we believe that the final rule will facilitate advisers' transition to the new exemption. The rule generally limits investments of a qualifying fund, but creates a basket that will allow these funds flexibility to make limited investments that may vary from typical venture capital fund investing practices. The final rule also provides an adviser flexibility and discretion to structure transactions in underlying portfolio companies to meet the business objectives of the fund without creating significant risks of the kind that Congress suggested should require registration of the fund's adviser. We expect that this flexibility will benefit

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569 *See supra* notes 255-256 and accompanying text.

570 *See* Merkl Letter (stating that a description of the investment strategy is a key element of any private placement memorandum).

investment advisers that seek to rely on the venture capital exemption because they will be able more easily to structure and operate funds that meet the definition now and in the future, but will not permit reliance on the exemption by private fund advisers that Congress did not intend to exclude from registration.

Our final rule also should benefit advisers of existing venture capital funds that fail to meet the definition of venture capital fund. Our grandfathering provision permits an adviser to rely on the exemption provided that each fund that does not satisfy the definition (i) has represented to investors that it pursues a venture capital strategy, (ii) has initially sold interests by December 31, 2010, and (iii) does not sell any additional interests after July 21, 2011.[571] We expect that most advisers to existing venture capital funds that currently rely on the private adviser exemption would be exempt from registration in reliance on the grandfathering provision.[572] As a result of this provision, we expect that advisers to existing venture capital funds that do not meet our definition will benefit because they can continue to manage existing funds without having to (i) weigh the relative costs and benefits of registration and modification of fund operations to conform existing funds with our definition and (ii) incur the costs associated with registration with the Commission or modification of existing funds. Advisers to venture capital funds that were launched by December 31, 2010 and meet the July 21, 2011 deadline for sales of all securities also would benefit from the grandfathering provision because they would not have to incur these costs. We believe that the grandfathering provision will

571 Rule 203(l)-1(b).

572 A number of commenters specifically inquired about the scope of the holding out criterion and noted that under existing business practice venture capital funds may refer to themselves as private equity funds. As we discuss in greater detail above, we do not believe that the name used by a fund is the sole dispositive factor, and that satisfying the holding out criterion will depend on all of the facts and circumstances. *See supra* Section II.A.7. This criterion is similar to our general approach to antifraud provisions under the federal securities laws and our rules.

promote efficiency because it will allow advisers to existing venture capital funds to continue to rely on the exemption without having to restructure funds that may not meet the definition.[573] It also will allow advisers to funds that were launched by December 31, 2010 and can meet the other requirements of the grandfathering provision to rely on the exemption without the potential costs of having to renegotiate with potential investors and restructure those funds within the limited period before the rule is effective. After the effective date, advisers that seek to form new funds will have sufficient time and notice to structure those funds to meet the definition should they seek to rely on the exemption in section 203(l) of the Advisers Act.

Finally, we believe that our definition would include an additional benefit for investors and regulators. Section 203(l) of the Advisers Act provides an exemption specifically for advisers that "solely" advise venture capital funds. Currently none of our rules requires that an adviser exempt from registration specify the basis for the exemption. We are adopting, however, rules that would require exempt reporting advisers to identify the exemption(s) on which they are relying.[574] Requiring that venture capital funds represent themselves as such to investors should allow the Commission and the investing public (particularly potential investors in venture capital funds) to determine, and confirm, an adviser's rationale for remaining unregistered with the Commission. This element is designed to deter advisers to private funds other than venture capital funds from claiming to rely on an exemption from registration for which they are not eligible.

We believe that existing venture capital funds would meet most, if not all, of the elements of the final definition of venture capital fund. Nevertheless, we recognize that some advisers to

573 Many commenters supported the grandfathering provision, and one specifically cited the benefit of avoiding the need to alter fund terms to the potential detriment of fund investors. AV Letter.

574 *See* Implementing Adopting Release, *supra* note 32, at n.175 and accompanying text.

existing venture capital funds that seek to rely on the exemption in section 203(l) of the Advisers Act might have to structure new funds differently to satisfy the definitional criteria under the final rule. To the extent that advisers choose not to change how they structure or manage new funds they launch, those advisers would have to register with the Commission,[575] which offers many benefits to the investing public and facilitates our mandate to protect investors. Registered investment advisers are subject to periodic examinations by our staff and are also subject to our rules including rules on recordkeeping, custody of client funds and compliance programs. We believe that in general Congress considered registration to be beneficial to investors because of, among other things, the added protections offered by registration. Accordingly, Congress limited the section 203(l) exemption to advisers solely to venture capital funds.

As noted above, we proposed, and are retaining in the final rule, certain elements in the portfolio company definition because of the focus on leverage in the Dodd-Frank Act as a potential contributor to systemic risk as discussed by the Senate Committee report,[576] and the testimony before Congress that stressed the lack of leverage in venture capital investing.[577] We expect that distinguishing between venture capital funds and other private funds that pursue investment strategies involving financial leverage that Congress highlighted for concern would benefit financial regulators mandated by the Dodd-Frank Act (such as the Financial Stability Oversight Council) with monitoring and assessing potential systemic risks. Because advisers that manage funds with these characteristics would be required to register, we expect that financial regulators could more easily obtain information and data regarding these financial

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575 *See infra* text following notes 585, 597-600 and accompanying text for a discussion of potential costs for advisers that would have to choose between registering or restructuring venture capital funds formed in the future.

576 *See supra* note 174.

577 *See supra* note 175.

market participants, which should benefit those regulators to the extent it helps to reduce the overall cost of systemic risk monitoring and assessment.[578] We believe that investors will benefit from enhanced disclosure and oversight of the activities of private fund advisers by regulators, which in turn could contribute to a more efficient allocation of capital.

2. Costs

Costs for advisers to existing venture capital funds. As we discussed in the Proposing Release and above, we do not expect that the definition of venture capital fund would result in significant costs for unregistered advisers to venture capital funds currently in existence and operating.[579] We estimate that currently there are 791 advisers to venture capital funds.[580] We expect that all these advisers, which we assume currently are not registered in reliance on the private adviser exemption, would continue to be exempt after the repeal of that exemption on July 21, 2011 in reliance on the grandfathering provision.[581] We anticipate that such advisers to

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[578] *See* S. Rep. No. 111-176, *supra* note 6, at 39 (explaining the requirement that private funds disclose information regarding their investment positions and strategies, including information on fund size, use of leverage, counterparty credit risk exposure, trading and investment positions and any other information that the Commission in consultation with the Financial Stability Oversight Council determines is necessary and appropriate to protect investors or assess systemic risk).

[579] Proposing Release, *supra* note 26, at text immediately preceding text accompanying n.273.

[580] *See* NVCA Yearbook 2011, *supra* note 152, at Fig. 1.04 (providing the number of "active" venture capital advisers, as of December 2010, that have raised a venture capital fund within the past eight years; 456 of the total number of venture capital advisers manage less than $100 million in capital).

[581] We estimate that these advisers (and any other adviser that seeks to remain unregistered in reliance on the exemption under section 203(l) of the Advisers Act or rule 203(m)-1 thereunder) would incur, on average, $2,311 per year to complete and update related reports on Form ADV, including Schedule D information relating to private funds. *See* Implementing Adopting Release, *supra* note 32, at section V.B.2. This estimate includes internal costs to the adviser of $2,032 to prepare and submit an initial report on Form ADV and $279 to prepare and submit annual amendments to the report. These estimates are based on the following calculations: $2,032 = ($4,064,000 aggregate costs ÷ 2000 advisers); $279 = ($558,800 aggregate costs ÷ 2,000 advisers). *Id.* at nn.579-581 and accompanying text. We estimate that approximately two exempt reporting advisers would file Form ADV-H annually at a cost of $189 per filing. *Id.*, at n.596 and accompanying text. We further estimate that three exempt reporting advisers would file Form

grandfathered funds will incur minimal costs, if any, to confirm that existing venture capital funds managed by the adviser meet the conditions of the grandfathering provision. We estimate that these costs would be no more than $800 to hire outside counsel to assist in this determination.[582]

We recognize, however, that advisers to funds that were launched by December 31, 2010 but have not concluded offerings to investors may incur costs to determine whether they qualify for the grandfathering provision. For example, these advisers may need to assess the impact on the fund of selling interests to initial third-party investors by December 31, 2010 and selling interests to all investors no later than July 21, 2011.[583] We do not expect that the cost of evaluating the grandfathering provision would be significant, however, because we believe that most funds in formation represent themselves as funds that pursue a venture capital strategy to their potential investors[584] and the typical fundraising period for a venture capital fund is approximately 12 months.[585] Thus, we do not anticipate that venture capital fund advisers would

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ADV-NR per year at a cost of $188 per year. *Id.*, at nn.598-602 and accompanying text. We anticipate that filing fees for exempt reporting advisers would be the same as those for registered investment advisers. *See infra* note 598. These estimates, some of which differ from the estimates included in the Proposing Release, *supra* note 26, are discussed in more detail in the Implementing Adopting Release, *supra* note 32, at section V.B.2.

582 As discussed in the Proposing Release, we expect that a venture capital adviser would need no more than 2 hours of legal advice to learn the differences between its current business practices and the conditions for reliance on the proposed grandfathering provision. We estimate that this advice would cost $400 per hour per firm based on our understanding of the rates typically charged by outside consulting or law firms. *See* Proposing Release, *supra* note 26, at n.293. We did not receive any comments on these cost estimates.

583 We did not receive any comments on the dates specified in the grandfathering provision. *See also supra* note 307.

584 *See supra* note 572.

585 *See* Breslow & Schwartz, *supra* note 241, at 2-22 ("Once the first closing [of a private equity fund] has occurred, subsequent closings are typically held over a defined period of time [the marketing period] of approximately six to twelve months."). *See also* Dow Jones Report, *supra* note 242, at 22.

have to alter typical business practices to structure or raise capital for venture capital funds being formed. Nevertheless, we recognize that after the final rule goes into effect, exempt advisers of such funds in formation may forgo the opportunity to accept investments from investors that may seek to invest after July 21, 2011 in order to comply with the grandfathering provision.

To the extent that an existing adviser could not rely on the grandfathering provision with respect to funds in formation, we also expect that the adviser would not be required to modify its business practices significantly in order to rely on the exemption. Our final rule includes many modifications requested by commenters, such as the non-qualifying basket, and as a result, we expect that these modifications would reduce some of the costs associated with modifying current business practices to satisfy the proposed definitional criteria that commenters addressed.[586] As we discuss above, we believe that the final rule better reflects venture capital activity conducted by venture capital advisers that are likely to seek to rely on the exemption, and provides flexibility that will allow these funds to take advantage of new investment opportunities. To the extent that some commenters expressed concerns that they would have to divert personnel time from other functions to monitoring inadvertent failures to meet the definitional elements, we believe that the greater investment flexibility provided by the rule would offset most of these compliance costs.

Our rule does not provide separate definitional criteria for non-U.S. advisers seeking to rely on the exemption. These advisers might incur costs to the extent that cash management instruments they typically acquire may not be "short-term holdings" for purposes of the

586 *See, e.g.*, Charles River Letter; Gunderson Dettmer Letter; NVCA Letter (arguing that as proposed the rule would have required venture capital fund advisers to modify their business practices in order to be eligible for the exemption). *See also* ABA Letter; Davis Polk Letter; Oak Investment Letter; SVB Letter (discussing the potential costs associated with complying with various elements of the proposed rule such as managerial assistance, venture capital fund leverage and solely investing in qualifying portfolio companies).

definition.[587] We expect that these costs would be mitigated, however, to the extent that these advisers can continue to acquire these instruments using the non-qualifying basket.

Costs for new advisers and advisers to new venture capital funds. We expect that existing advisers that seek to form new venture capital funds and investment advisory firms that seek to enter the venture capital industry will incur one-time "learning costs" to determine how to structure new funds they may manage to meet the elements of our definition. We estimate that on average, there are 23 new advisers to venture capital funds each year.[588] We expect that the one-time learning costs would be no more than between $2,800 and $4,800 on average for an adviser if it hires an outside consulting or law firm to assist in determining how the elements of our definition may affect intended business practices.[589] Thus, we estimate the aggregate cost to existing advisers of determining how the definition would affect funds they plan to launch would be from $64,400 to $110,400.[590] As they launch new funds and negotiate with potential investors, these advisers would have to determine whether it is more cost effective to register or to structure the venture capital funds they manage to meet the definition. Such considerations of legal or other requirements, however, comprise a typical business and operating expense of conducting new business. New advisers that enter into the business of managing venture capital

587 *See, e.g.*, EFAMA Letter (asserting that a non-U.S. fund could not invest in non-U.S. equivalent cash holdings under the proposed rule).

588 This is the average annual increase in the number of venture capital advisers between 1981 and 2010. *See* NVCA Yearbook 2010, *supra* note 150, at Fig. 1.04; NVCA Yearbook 2011, *supra* note 152, at Fig. 1.04.

589 We expect that a venture capital adviser would need between 7 and 12 hours of consulting or legal advice to learn the differences between its current business practices and the definition, depending on the experience of the firm and its familiarity with the elements of the rule. We estimate that this advice would cost $400 per hour per firm based on our understanding of the rates typically charged by outside consulting or law firms.

590 This estimate is based on the following calculations: 23 x $2,800 = $64,400; 23 x $4,800 = $110,400. We did not receive any comments on these cost estimates.

funds also would incur such ordinary costs of doing business in a regulated industry.[591]

In the Proposing Release, we stated that we believed that existing advisers to venture capital funds would meet most, if not all, of the elements of the proposed definition.[592] As discussed above, most commenters generally acknowledged that the proposed definition would generally encompass most venture capital investing activity that typically occurs.[593] Several noted, however, that they might deviate from typical investing patterns on occasion or wanted the flexibility to invest small amounts of capital in investments that would be precluded by the proposed definition.[594] Under the final rule, venture capital funds that qualify for the definition may invest in non-qualifying investments subject to availability of the non-qualifying basket, including investments specified by some commenters. As a result of these modifications, the final definition is more closely modeled on current business practices of venture capital funds and provides advisers with flexibility to take advantage of investment opportunities. As a result, we do not anticipate that many venture capital fund advisers would have to change significantly the structure of new funds they launch.

We also recognize that some existing venture capital funds may have characteristics that differ from the criteria in our definition. To the extent that investment advisers seek to form new venture capital funds with these characteristics, those advisers would have to choose whether to structure new venture capital funds to conform to the definition, forgo forming new funds, or register with the Commission. In any case, each investment adviser would assess the costs

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591 For estimates of the costs of registration for those advisers that would choose to register, *see infra* notes 597-600.

592 Proposing Release, *supra* note 26, at Section V.A.1.

593 *See supra* note 51.

594 *See supra* note 52.

associated with registering with the Commission relative to the costs of remaining unregistered (and hence structuring funds to meet our definition in order to be eligible for the exemption). We expect that this assessment would take into account many factors, including the size, scope and nature of an adviser's business and investor base. Such factors will vary from adviser to adviser, but each adviser would determine for itself whether registration, relative to other choices, is the most cost-effective or strategic business option.

The final rule may have effects on competition and capital formation. To the extent that advisers choose to structure new venture capital funds to conform to the definition, or choose not to form new funds in order to avoid registration, these choices could result in fewer investment choices for investors, less competition and less capital formation.[595] For example, to the extent that new venture capital funds do not invest in non-qualifying investments in excess of the 20 percent basket in order to meet the definition, the final rule could decrease competition and capital formation. If venture capital funds invest less in non-qualifying investments or more in qualifying portfolio company securities that are qualifying investments, this could increase competition among qualifying portfolio companies or private funds that invest in such companies. To the extent that funds invest more in less risky but lower yielding non-qualifying investments, this could decrease competition among investors that seek to invest in qualifying investments. To the extent that advisers choose to register in order to structure new venture capital funds without regard to the definitional criteria or in order to expand their businesses (*e.g.*, pursue additional investment strategies beyond venture capital investing or expand the potential investor base to include investors that are required to invest with registered advisers), these choices may result in greater investment choices for investors, greater competition and

595 *See, e.g.*, Lowenstein Letter; NVCA Letter; Venrock Letter.

greater capital formation.[596]

Investment advisers to new venture capital funds that would not meet the definition would have to register and incur the costs associated with registration (assuming the adviser could not rely on the private fund adviser exemption). We note that the costs of registration for advisers that do not qualify for the venture capital fund adviser exemption flow from the Dodd-Frank Act, which removed the private adviser exemption on which they currently rely.

We estimate that the internal cost to register with the Commission would be $15,077 on average for a private fund adviser,[597] excluding the initial filing fees and annual filing fees to the Investment Adviser Registration Depository ("IARD") system operator.[598] These registration costs include the costs attributable to completing and periodically amending Form ADV, preparing brochure supplements, and delivering codes of ethics to clients.[599] In addition to the

596 *See, e.g.*, "Asia's Cash-Poor Small Hedge Funds Vulnerable to U.S. Rules," Bloomberg.com (Feb. 23, 2011) (identifying two fund of funds managers that either require or prefer to allocate client assets to advisers registered with the Commission).

597 This estimate is based upon the following calculations: $15,077 = ($9,627,871 aggregate costs to complete Form ADV ÷ 750 advisers expected to register with the Commission) + ($8,509,000 aggregate costs to complete private fund reporting requirements ÷ 3,800 advisers expected to provide private fund reports). *See* Implementing Adopting Release, *supra* note 32, at nn.612-618 and accompanying text for a more detailed discussion of these costs. This also assumes that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager. *See id.*, at n.608. Data from SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $235 and $273 per hour, respectively.

598 Filing fees paid for submitting initial and annual filings through the IARD currently range from $40 to $225 based on the amount of assets an adviser has under management. The current fee schedule for registered advisers may be found on our website at http://www.sec.gov/divisions/investment/iard/iardfee.shtml. *See* Implementing Adopting Release, *supra* note 32, at n.566-567 and accompanying text (assuming for purposes of the analysis that exempt reporting advisers will pay a fee of $225 per initial or annual report).

599 Part 1 of Form ADV requires advisers to answer basic identifying information about their business, their affiliates and their owners, information that is readily available to advisers, and thus should not result in significant costs to complete. Registered advisers must also complete Part 2 of Form ADV and file it electronically with us. Part 2 requires disclosure of certain

internal costs described above, we estimate that for an adviser choosing to use outside legal services to complete its brochure, such costs would be $5,000.[600]

New registrants would also face costs to bring their business operations into compliance with the Advisers Act and the rules thereunder. These costs, however, will vary significantly among advisers depending on the adviser's size, the scope and nature of its business, and the sophistication of its compliance infrastructure, but in any case would be an ordinary business and operating expense of entering into any business that is regulated.

We estimated in the Proposing Release that the one-time costs to new registrants to establish a compliance infrastructure would range from $10,000 to $45,000, while ongoing annual costs of compliance and examination would range from $10,000 to $50,000.[601] Some commenters suggested that these estimates are too low. Commenters identifying themselves as "middle market private equity fund" advisers estimated that they would incur one-time

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conflicts of interest and could be prepared based on information already contained in materials provided to investors, which could reduce the costs of compliance even further.

600 *See* Implementing Adopting Release, *supra* note 32, at n.729.

601 *See* Proposing Release, *supra* note 26, at n.303 and accompanying text. Our estimate was based on the expectation that most advisers that might choose to register for business reasons have already built compliance infrastructures as a matter of good business practice. Nevertheless, we expect advisers will incur costs for outside legal counsel to evaluate their compliance procedures initially and on an ongoing basis. We estimate that the costs to advisers to establish the required compliance infrastructure will be, on average, $20,000 in professional fees and $25,000 in internal costs including staff time. These estimates were prepared in consultation with attorneys who, as part of their private practice, have counseled private fund advisers establishing their registrations with the Commission. We included a range because we believe there are a number of unregistered advisers of private funds whose compliance operations are already substantially in compliance with the Advisers Act and that would therefore experience only minimal incremental ongoing costs as a result of registration. In connection with previous estimates we have made regarding compliance costs for registered advisers, we received comments from small advisers estimating that their annual compliance costs would be $25,000 and could be as high as $50,000. *See, e.g.*, Comment Letter of Joseph L. Vidich (Aug. 7, 2004). *Cf.* Comment Letter of Venkat Swarna (Sept. 14, 2004) (estimating costs of $20,000 to $25,000). These comment letters were submitted in connection with the Hedge Fund Adviser Registration Release, *supra* note 14, and are available on the Commission's Internet website at http://www.sec.gov/rules/proposed/s73004.shtml.

registration and compliance costs ranging from $50,000 to $600,000, followed by ongoing annual compliance costs ranging from $50,000 to $500,000.[602] Commenters identifying themselves as advisers to venture capital funds, however, provided much lower estimates for one-time registration and compliance costs ranging from $75,000 to $200,000, followed by ongoing annual compliance costs ranging from $50,000 to $150,000.[603]

Although some advisers may incur these costs, the costs of compliance for a new registrant can vary widely among advisers depending on their size, activities, and the sophistication of their existing compliance infrastructure. Advisers, whether registered with us or not, may have established compliance infrastructures to fulfill their fiduciary duties towards their clients under the Advisers Act. Generally, costs will likely be less for new registrants that have already established sound compliance practices and more for new registrants that have not yet established sound practices.

For example, some commenters specifically included in their cost estimates

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[602] *See, e.g.*, Comment Letter of Atlas Holdings (Jan. 21, 2011) ("Atlas Letter") (estimating $500,000 in 2011 and $350,000 per year thereafter for compliance manuals and oversight, employee trading records, legal documentation, and the hiring of additional compliance employees); Comment Letter of Sentinel Capital Partners (Jan. 16, 2011) ("Sentinel Letter") (estimating between $500,000-$600,000 in 2011 and more than $375,000 per year thereafter for compliance manuals and oversight, employee trading records, legal documentation, and the hiring of additional compliance employees); Comment Letter of Charlesbank Capital Partners (Jan. 21, 2011) ("Charlesbank Letter") ("[A]lthough impossible to quantify at this point given the absence of regulations, we anticipate a substantial cost associated with ongoing compliance."); Comment Letter of Crestview Advisors, LLC (Jan. 19, 2011) ("Crestview Letter") (estimating annual costs of $300,000-$500,000); Comment Letter of Azalea Capital (Feb. 17, 2011) ("Azalea Letter") (estimating $50,000 to $100,000 per year); Comment Letter of Gen Cap America, Inc. (Jan. 21, 2011) ("Gen Cap Letter") (estimating $150,000-$250,000 per year). *See also* Memorandum to File No. S7-37-10, dated March 17, 2011, concerning a meeting with certain private fund representatives, avail. at http://www.sec.gov/comments/s7-37-10/s73710-124.pdf ("File Memorandum") (estimating that costs for small firms range from $100,000-$200,000 (exclusive of salary costs for a CCO)).

[603] *See* VIA Letter (estimating an initial cost of $75,000 or more and ongoing costs of $50,000 to $150,000 per year); Pine Brook Letter (estimating initial costs of $125,000 to $200,000 and ongoing compliance costs of $100,000-150,000 per year).

compensation costs for hiring a dedicated chief compliance officer ("CCO").[604] Our compliance rule, however, does not require advisers to hire a new individual to serve as a full-time CCO, and the question of whether an adviser can look to existing staff to fulfill the CCO requirement internally is firm-specific.[605]

Although we recognize that some newly registering advisers will need to designate someone to serve as CCO on a full-time basis, we expect these will be larger advisers—those with many employees and a sizeable amount of investor assets under management. Because there is no currently-available comprehensive database of unregistered advisers, we cannot determine the number of these larger advisers in operation. These larger advisers that are not yet registered likely already have personnel who perform similar functions to a CCO, in order to address the adviser's liability exposure and protect its reputation.

In smaller advisers, the designated CCO will likely also fill another function in the adviser, and perform additional duties alongside compliance matters. Advisers designating a CCO from existing staff may experience costs that result from shifting responsibilities among staff or additional compensation, to the extent the individual is taking on additional compliance

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604 *See, e.g.*, Katten Foreign Insurance Letter ("In addition, there are added salary costs for hiring a chief compliance officer. In all, costs could be expected to total hundreds of thousands of dollars and hundreds of hours of personnel time for each new registrant."); Comment Letter of Cortec Group (Jan. 14, 2011) ("Cortec Letter") ("Furthermore, the Act requires we add a compliance officer (who has to be a senior-level executive), at a minimum annual compensation of $200,000, yet we do not engage in any activity the Act wishes to monitor."). Other commenters may have included such costs in their estimates although they did not provide details on individual components. *See, e.g.*, Crestview Letter ("As part of these new regulations, we are required to develop a compliance program; hire a compliance officer; custody our private company stock certificates, which are worthless to any party not part of the original purchase agreement; and register with the SEC.")

605 *See* Advisers Act rule 206(4)-(7) (requiring, among other things, an adviser registered or required to be registered under the Advisers Act to designate an individual (who is a supervised person) responsible for administering the policies and procedures). In determining whether existing staff can fulfill the CCO requirement, advisers may consider factors such as the size of the firm, the complexity of its compliance environment, and the qualifications of current staff.

responsibilities or giving up other non-compliance responsibilities. Costs will vary from adviser to adviser, depending on the extent to which an adviser's staff is already performing some or all of the requisite compliance functions, the extent to which the CCO's non-compliance responsibilities need to be lessened to permit allocation of more time to compliance responsibilities, and the value to the adviser of the CCO's non-compliance responsibilities.[606]

Some commenters asserted that the costs of ongoing compliance would be substantial.[607] We anticipate that there may be a number of currently unregistered advisers whose operations are already substantially in compliance with the Advisers Act and that would therefore experience only minimal incremental ongoing costs as a result of registration. There likely are other currently unregistered advisers, however, who will face additional ongoing costs to conduct their operations in compliance with the Advisers Act, and these costs may be significant for some of these advisers.

We do not have access to information that would enable us to determine these additional ongoing costs, which are predominantly internal to the advisers themselves. Incremental ongoing compliance costs will vary from adviser to adviser depending on factors such as the complexity of each adviser's activities, the business decisions it makes in structuring its response to its compliance obligations, and the extent to which it is already conducting its operations in compliance with the Advisers Act. Indeed, the broad range of estimated costs we received reflects the individualized nature of these costs and the extent to which they may vary even

[606] Although some commenters noted that requiring existing employees to assume compliance-related responsibilities would involve costs, they did not provide sufficient information on which we could estimate these costs.

[607] *See supra* note 602.

among the relatively small number of commenters who provided cost estimates.[608]

Some commenters expressed concern that compliance costs would be prohibitive in comparison to their revenues or in relation to their size or activities.[609] We note, however, that an adviser is required to adopt policies and procedures that take into consideration the nature of that adviser's operations.[610] We have explained that, accordingly, we would expect smaller advisers without conflicting business interests to require much simpler policies and procedures than larger advisers that, for example, have multiple potential conflicts as a result of their other lines of business or their affiliations with other financial service firms.[611] The preparation of these simpler policies and procedures and their administration should be much less burdensome.[612]

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608 *Compare* Azalea Letter (estimated ongoing compliance costs of $50,000 to $100,000 per year) *with* Crestview Letter (estimated ongoing compliance costs of $300,000 to $500,000 per year). *See also* Charlesbank Letter (stating that costs associated with ongoing compliance are impossible to quantify at this point).

609 *See, e.g.*, Crestview Letter ("The cost of complying with these new regulations is estimated to be $300,000-$500,000 per year, which is a significant sum for a firm that invests in two to three private companies each year in relation to the benefit it provides."); Azalea Letter ("The cost of complying with these new regulations is estimated to be $50,000 to $100,000 per year, which is a significant sum for a firm that invests in two to three private companies each year."); Gen Cap Letter ("The cost of complying with these new regulations is estimated to be $150,000-$250,000 per year, which is a significant sum for a firm that invests in two to three private companies each year in relation to the benefit it provides.").

610 *See Compliance Programs of Investment Companies and Investment Advisers*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)], discussion at section II.A.1.

611 *Id. See also id.* at n.13 (noting that even small advisers may have arrangements, such as soft dollar agreements, that create conflicts; advisers of all sizes, in designing and updating their compliance programs, must identify these arrangements and provide for the effective control of the resulting conflicts).

612 *Id.*, discussion at section II.A.1.

We also note that approximately 570 smaller advisers currently are registered with us.[613] These advisers have absorbed the compliance costs associated with registration, notwithstanding the fact that their assets under management are likely to be smaller than those of an adviser managing one venture capital fund of average size (*e.g.*, with $107.8 million in venture capital under management[614]) that may be required to register because it cannot rely on the venture capital exemption or the private fund adviser exemption. Moreover, as we explained in the Proposing Release, in connection with previous estimates we have made regarding compliance costs for registered advisers, we received comments from small advisers estimating that their annual compliance costs would be $25,000 and could be as high as $50,000.[615] Finally, as we noted in the Proposing Release, to the extent there would be an increase in registered advisers, there are benefits to registration for both investors and the Commission.[616]

We do not believe that the definition of venture capital fund is likely to affect whether advisers to venture capital funds would choose to launch new funds or whether persons would choose to enter into the business of advising venture capital funds because, as noted above, we believe the definition, as revised, reflects the way most venture capital funds currently operate. Thus, for example, we eliminated the managerial assistance criterion in the proposed definition, expanded the short-term instruments in which venture capital funds can invest and provided for a non-qualifying basket. These elements in the proposal could have resulted in costs to advisers that manage venture capital funds with business or cash management practices inconsistent with

613 *See* Implementing Adopting Release, *supra* note 32, at n.823 and accompanying text (noting that, based on data from the Investment Adviser Registration Depository as of April 7, 2011, 572 advisers registered with the Commission were small advisers).

614 *See* NVCA Yearbook 2011, *supra* note 152, at 9, Fig. 1.0.

615 *See* Proposing Release, *supra* note 26, at n.303. *See also supra* note 601.

616 *See supra* text following note 575.

those proposed criteria and that sought to rely on the exemption.[617] As a result, we expect that the definition is not likely to significantly affect the way in which investment advisers to these funds do business and thus compete. For the same reason, we do not believe that our rule is likely to have a significant effect on overall capital formation.

Other Costs. Some commenters argued in favor of a narrow definition of venture capital fund in order to preclude advisers to other types of funds from relying on the definition.[618] One commenter expressed the concern that the definition should be narrow so that advisers generally would be subject to a consistent regulatory regime,[619] and another supported incorporating substantive Advisers Act rules, such as custody, as a condition for reliance on the various exemptions in order to protect investors.[620] To the extent that our final rule includes broader criteria and results in fewer registrants under the Advisers Act, we acknowledge that this could have an adverse impact on investors.[621]

Moreover, to the extent that our final rule includes broader criteria and results in fewer registrants, this also could reduce the amount of information available to regulators with respect to venture capital advisers relying on the exemption. Under the final rule, immediately after it acquires any non-qualifying investment (excluding short-term holdings), no more than 20 percent of a qualifying fund's capital commitments may be held in non-qualifying investments (excluding short-term holdings). As a result, initially, and possibly for a period of time during

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617 *See supra* notes 548, 586 and accompanying text.

618 *See supra* note 43.

619 CalPERS Letter. *See also* NASAA Letter (supported adding substantive requirements to the grandfathering provision).

620 CPIC Letter.

621 *See supra* text accompanying and following note 575 (discussing benefits that result from registration).

the fund's term (subject to compliance with the other elements of the rule), it may be possible for non-qualifying investments to comprise most of a qualifying fund's investment portfolio. The proposal would have required a qualifying fund to be comprised entirely of qualifying investments, which would have enabled regulators and investors to confirm with relative ease at any point in time whether a fund satisfied the definition. Modifying the definition to include a non-qualifying basket determined as a percentage of a qualifying fund's capital commitments may increase the monitoring costs that regulators and investors may incur in order to verify that a fund satisfies the definition, depending on the length of the fund's investment period and the frequency with which the fund invests in non-qualifying investments.

A number of commenters expressed concerns with certain elements of the proposed rule, which we are not modifying. Several commenters suggested that the rule specify that the leverage limit of 15 percent be calculated without regard to uncalled capital commitments because they were concerned about the potential for excessive leverage.[622] We acknowledge that a leverage limitation which includes uncalled capital commitments could result in a fund incurring, in the early stages of the fund's life, a significant degree of leverage by the fund relative to the fund's overall assets. We believe, however, that the 120-day limit would mitigate the effects of any such leverage that is incurred by a venture capital fund seeking to satisfy the definition.

Several commenters also argued that the definition of qualifying portfolio company should include certain subsidiaries that may be owned by a publicly traded company, such as research and development subsidiaries, that may seek venture capital funding.[623] As a result of

622 AFR Letter; AFL-CIO Letter.

623 BCLBE Letter; Dechert General Letter; Gunderson Dettmer Letter.

our final rule, these types of subsidiaries may have reduced access to capital investments by qualifying funds, although this cost would be mitigated by a qualifying fund's investments made through the non-qualifying basket.

Other commenters argued that the definition of venture capital fund should include funds of venture capital funds.[624] We have not modified the rule to reflect this request, because we do not believe that defining the term in this manner is consistent with the intent of Congress.[625] To the extent that an adviser to a fund of venture capital funds ceases business or ceases to offer new funds in order to avoid registration with the Commission, this could reduce the pool of potential investors investing in venture capital funds,[626] and potentially reduce capital formation for potential qualifying portfolio companies.

B. Exemption for Investment Advisers Solely to Private Funds with Less than $150 Million in Assets Under Management

As discussed in Section II.B, rule 203(m)-1 exempts from registration under the Advisers Act any investment adviser solely to private funds that has less than $150 million in assets under management in the United States. The rule implements the private fund adviser exemption, as directed by Congress, in section 203(m) of the Advisers Act and includes provisions for determining the amount of an adviser's private fund assets for purposes of the exemption and when those assets are deemed managed in the United States.[627]

1. Benefits

Method of Calculating Private Fund Assets. As discussed in Section II.B.2 above and in

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624 *See, e.g.*, Cook Children's Letter; Merkl Letter; SVB Letter.

625 *See supra* notes 204-206.

626 *See generally* Merkl Letter; SVB Letter.

627 *See supra* Sections II.B.2-3.

the Implementing Adopting Release, we are revising the instructions to Form ADV to provide a uniform method for calculating assets under management that can be used for regulatory purposes, including determining eligibility for Commission, rather than state, registration; reporting assets under management for regulatory purposes on Form ADV; and determining eligibility for the private fund adviser exemption under section 203(m) of the Advisers Act and rule 203(m)-1 thereunder and the foreign private adviser exemption under section 203(b)(3) of the Advisers Act.[628] We believe that this uniform approach will benefit regulators (both state and federal) as well as advisers, because only a single determination of assets under management is required for purposes of registration and exemption from federal registration.

The instructions to Form ADV previously permitted, but did not require, advisers to exclude certain types of managed assets.[629] As a result, it was not possible to conclude that two advisers reporting the same amount of assets under management were necessarily comparable because either adviser could have elected to exclude all or some portion of certain specified assets that it managed. We expect that specifying in rule 203(m)-1 that assets under management must be calculated according to the instructions to Form ADV will increase administrative efficiencies for advisers because they will have to calculate assets under management only once for multiple purposes.[630] In addition, we believe this will minimize costs relating to software modifications, recordkeeping, and training required to determine assets under management for regulatory purposes. We also believe that the consistent calculation and reporting of assets under

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628 *See supra* notes 332-336 and accompanying text.

629 *See* Form ADV: Instructions to Part 1A, instr. 5.b(1), as in effect before the amendments adopted in the Implementing Adopting Release, *supra* note 32.

630 *See supra* Section II.B.2. As discussed below, we are permitting advisers to calculate their private fund assets annually in connection with their annual updating amendments to their Forms ADV, rather than quarterly as proposed. Requiring annual, rather than quarterly, calculations will be less costly for advisers.

management will benefit investors and regulators because it will provide enhanced transparency and comparability of data, and allow investors and regulators to analyze on a more cost effective basis whether any particular adviser may be required to register with the Commission or is eligible for an exemption.

Many commenters generally expressed support for the implementation of a uniform method of calculating assets under management in order to maintain consistency for registration and risk assessment purposes.[631] Indeed, even some commenters who suggested that we revise aspects of the method of calculating regulatory assets under management nonetheless recognized the benefits provided by a uniform method of valuing assets for regulatory purposes.[632]

We believe that the valuation of private fund assets under rule 203(m)-1 will benefit advisers that seek to rely on the private fund adviser exemption. Under rule 203(m)-1, each adviser annually must determine the amount of its private fund assets, based on the market value of those assets, or the fair value of those assets where market value is unavailable.[633] We are

631 *See supra* note 339.

632 *See, e.g.*, AIMA Letter (suggested modifications to the method of calculating regulatory assets under management but also stated "[w]e agree that a clear and unified approach for calculation of AUM is necessary and we believe that using as a standard the assets for which an adviser has 'responsibility' is appropriate"); O'Melveny Letter (argued that the calculation of regulatory assets under management as proposed "does not provide a suitable basis to determine whether a fund adviser should be subject to the SEC's regulation" but also "agree[s] with the SEC that 'uniformity in the method for calculating assets under management would result in more consistent asset calculations and reporting across the industry and, therefore, in more coherent application of the Advisers Act's regulatory requirements and of the SEC staff's risk assessment program'").

633 *See* rule 203(m)-1(c) (requiring an adviser to calculate private fund assets annually, in accordance with General Instruction 15 to Form ADV, which together with rule 204-4 requires advisers relying on the exemption to determine their private fund assets annually, in connection with the adviser's annual updating amendments to its Form ADV). *See also* rules 203(m)-1(a)(2); 203(m)-1(b)(2); 203(m)-1(d)(1) (defining "assets under management" to mean "regulatory assets under management" in item 5.F of Form ADV, Part 1A); 203(m)-1(d)(4) (defining "private fund assets" to mean the "assets under management" attributable to a "qualifying private fund"). As

requiring advisers to fair value private fund assets so that, for purposes of the exemption, advisers value private fund assets on a meaningful and consistent basis. As we stated in the Proposing Release, we understand that many, but not all, advisers to private funds value assets based on their fair value in accordance with GAAP or other international accounting standards that require the use of fair value.[634] We acknowledged in the Proposing Release that some advisers to private funds may not use fair value methodologies, which may be more difficult to apply when the fund holds illiquid or other types of assets that are not traded on organized markets.[635]

Frequency of Calculations and the Transition Period. Rule 203(m)-1(c) specifies that an adviser relying on the exemption must calculate its private fund assets annually, in accordance with General Instruction 15 to Form ADV, rather than quarterly, as proposed. Advisers registered with us and with the states, and now advisers relying on rule 203(m)-1, must calculate their assets under management for regulatory purposes annually in connection with their annual updating amendments to Form ADV. We expect that requiring these types of advisers to calculate their assets under management for regulatory purposes on the same schedule, and using the same method, will increase efficiencies for these advisers.

The annual calculation also will allow advisers that rely on the exemption to maintain the

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discussed above, advisers are not required to fair value real estate assets in certain limited circumstances. *See supra* note 366 and accompanying text.

634 *See* Proposing Release, *supra* note 26, discussion at section V.B and n.196. *See also* ABA Letter (recommending that the Commission consider using a standard of "fair value" for valuing assets and further recommending that if assets were calculated on a net basis, private funds should be required to prepare audited annual financial statements in accordance with GAAP (or another accounting standard acceptable to the Commission), and to maintain such financial statements under section 203(m)(2)); O'Melveny Letter (agreeing with the statement in the Proposing Release that many private funds value assets based on fair value, and noting that private equity funds in particular are among the private funds that generally do not fair value).

635 *See* Proposing Release, *supra* note 26, discussion at section V.B. *See also infra* Section V.B.2.

exemption despite short-term market value fluctuations that might result in the loss of the exemption if, for example, the rule required daily valuations or, to a less significant extent, quarterly valuations as proposed.[636] Annual calculations should benefit these advisers by allowing them to avoid the cost of more frequent valuations, including costs (such as third-party quotes) associated with valuing illiquid assets, which may be particularly difficult to value because of the lack of frequency with which such assets are traded.[637] Requiring annual, rather than quarterly, calculations thus responds to concerns expressed by commenters who argued that quarterly calculations would (i) impose unnecessary costs and burdens on advisers, some of whom might not otherwise perform quarterly valuations; and (ii) inappropriately permit shorter-term fluctuations in assets under management to require advisers to register.[638]

An adviser relying on the exemption that reports private fund assets of $150 million or more in its annual updating amendment to its Form ADV will not be eligible for the exemption and must register under the Advisers Act unless it qualifies for another exemption. If the adviser

636 *See, e.g.*, ABA Letter ("[A] semi-annual or annual measuring period would perhaps be more appropriate, and [] a longer measuring period would provide an adviser that is exempt from registration under the Private Fund Adviser Exemption assistance in avoiding issues arising from temporary increases in asset values."); AIMA Letter ("Asset valuation is a substantial administrative task and is currently undertaken annually for other purposes (for example, Form ADV), so that a requirement for annual valuation would appear to strike a fair balance between ensuring that firms whose AUM is at or above the applicable threshold are 'captured' and avoiding both complications with short-term market value fluctuations and over-burdening investment advisers.").

637 *See, e.g.*, Dechert Foreign Adviser Letter ("[T]he Foreign Asset Manager submits that a yearly calculation (rather than a quarterly calculation) would be more appropriate, as some private funds may not provide for quarterly calculations of their NAV."); Katten Foreign Advisers Letter (argued for annual calculations, noting that "[m]any advisers only determine their aggregate assets under management on an annual basis"); NASBIC/SBIA Letter ("Unless sought by the adviser, evaluations on whether to register should be made no more often than an annual basis."); Seward Letter ("We believe that annual measurement of assets for purposes of determining an adviser's ability to rely on the private fund adviser exemption would be consistent with the approach established under NSMIA.").

638 *See* AIMA Letter; Dechert Foreign Adviser Letter; Dechert General Letter; EFAMA Letter; Katten Foreign Advisers Letter; Merkl Letter; Seward Letter.

has complied with all Commission reporting requirements applicable to an exempt reporting adviser as such, however, it may apply for registration under the Advisers Act up to 90 days after filing the annual updating amendment, and may continue to act as a private fund adviser, consistent with the requirements of rule 203(m)-1, during this transition period.[639]

The transition period should benefit certain advisers. As discussed above, an adviser that has "complied with all [Commission] reporting requirements applicable to an exempt reporting adviser as such" may apply for registration with the Commission up to 90 days after filing an annual updating amendment reflecting that the adviser has private fund assets of $150 million or more, and may continue to act as a private fund adviser, consistent with the requirements of rule 203(m)-1, during this transition period.[640] In addition, by requiring annual calculations of private fund assets, we are allowing advisers to whom the transition period is available 180 days after their fiscal year-ends to register under the Advisers Act.[641] We expect that providing these advisers additional time to register will reduce the burdens associated with registration by permitting them to register in a more deliberate and cost-effective manner, as suggested by some commenters.[642]

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639 *See supra* Section II.B.2.b; rule 203(m)-1(c) (requiring advisers to calculate their private fund assets annually, in accordance with General Instruction 15 to Form ADV); General Instruction 15 to Form ADV; rule 204-4.

640 *See supra* note 378 (explaining that the transition period is available to an adviser that has complied with "all [Commission] reporting requirements applicable to an exempt reporting adviser as such," rather than "all applicable Commission reporting requirements," as proposed).

641 An adviser must file its annual Form ADV updating amendment within 90 days after the end of its fiscal year and, if the transition period is available, may apply for registration up to 90 days after filing the amendment. We proposed, in contrast, to give advisers three months to register with us after becoming ineligible to rely on the exemption due to an increase in the value of their private fund assets as reflected in the proposed quarterly calculations.

642 *See, e.g.*, Sadis & Goldberg Implementing Release Letter ("Three (3) months provides an insufficient amount of time for an investment adviser to (i) complete its ADV Parts 1, 2A and 2B, including the newly required narrative brochure and brochure supplement; (ii) submit its completed application to the Commission through IARD; and (iii) receive its approval from the

Assets under Management in the United States. Under rule 203(m)-1(a), all of the private fund assets of an adviser with a principal office and place of business in the United States are considered to be "assets under management in the United States," even if the adviser has offices outside of the United States.[643] A non-U.S. adviser must count only private fund assets it manages at a place of business in the United States toward the $150 million limit under the exemption.

As discussed below, we believe that this interpretation of "assets under management in the United States" offers greater flexibility to advisers and reduces many costs associated with compliance.[644] These costs could include difficult attribution determinations that would be required if assets are managed by teams located in multiple jurisdictions or if portfolio managers located in one jurisdiction rely heavily on research or other advisory services performed by employees located in another jurisdiction. Most commenters who addressed the issue supported the proposal to treat "assets under management in the United States" as those assets managed at a U.S. place of business.[645]

Commission, which may take up to forty-five (45) days."); Shearman Letter ("Our experience is that registering an investment adviser firm in a thoughtful and deliberate manner is often closer to a six-month task (that can sometimes take even longer depending on the need to engage new or additional service providers to the firm or its funds), so that an at least 180-day transition period would be more appropriate.").

643 As discussed above, the rule looks to an adviser's principal office and place of business as the location where it directs, controls and coordinates its advisory activities. Rule 203(m)-1(d)(3).

644 *See, e.g.*, Merkl Letter (stated that this interpretation would be easier to apply than the alternative interpretation about which we sought comment which looks to the source of the assets).

645 *See, e.g.*, Debevoise Letter ("In particular, it is our view that the discussion of the proposed definition of the term 'assets under management in the United States' is a fair reflection of the policy underlying Section 203(m) of the Advisers Act (as amended by the Dodd-Frank Act) and is consistent with prior Commission and Staff statements concerning the territorial scope of the Advisers Act."); MAp Airports Letter; Non-U.S. Adviser Letter ("By adopting a very pragmatic and sensible jurisdictional approach to regulation, the Commission is appropriately recognizing general principles of international comity and the fact that activities of non-U.S. advisers outside the United States are less likely to implicate U.S. regulatory interests."). *Cf.* Sen. Levin Letter

To the extent that this interpretation may increase the number of advisers subject to registration under the Advisers Act, we anticipate that our rule also will benefit investors by providing more information about those advisers (*e.g.*, information that would become available through Form ADV, Part I). We further believe that this will enhance investor protection by increasing the number of advisers registering pursuant to the Advisers Act and by improving our ability to exercise our investor protection and enforcement mandates over those newly registered advisers. As discussed above, registration offers benefits to the investing public, including periodic examination of the adviser and compliance with rules requiring recordkeeping, custody of client funds and compliance programs.[646]

Territorial Approach. Under rule 203(m)-1(b), a non-U.S. adviser with no U.S. place of business may avail itself of the exemption even if it advises non-U.S. clients that are not private funds, provided that it does not advise any U.S. clients other than private funds.[647] We believe that this aspect of the rule, which looks primarily to the principal office and place of business of an adviser to determine eligibility for the exemption, will increase the number of non-U.S. advisers that may be eligible for the exemption. As with other Commission rules that adopt a territorial approach, the private fund adviser exemption is available to a non-U.S. adviser (regardless of its non-U.S. advisory or other business activities) in recognition that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and in consideration of general principles of international comity. This aspect of the rule is designed to

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(stated that advisers managing assets in the United States of funds incorporated outside of the United States "are exactly the type of investment advisers to which the Dodd-Frank Act's registration requirements are intended to apply"). *See also supra* note 386.

646 *See supra* text preceding, accompanying, and following note 575.

647 By contrast, a U.S. adviser may "solely advise private funds" as specified in the statute. *Compare* rule 203(m)-1(a)(1) *with* rule 203(m)-1(b)(1).

encourage the participation of non-U.S. advisers in the U.S. market by applying the U.S. securities laws in a manner that does not impose U.S. regulatory and operational requirements on a non-U.S. adviser's non-U.S. advisory business.[648]

We believe that our interpretation of the availability of the private fund adviser exemption for non-U.S. advisers, as reflected in the rule, will benefit those advisers by facilitating their continued participation in the U.S. market with limited disruption to their non-U.S. advisory or other business practices.[649] This approach also should benefit U.S. investors and facilitate competition in the market for advisory services to the extent that it maintains or increases U.S. investors' access to potential advisers. Furthermore, because non-U.S. advisers that elect to avail themselves of the exemption would be subject to certain reporting requirements,[650] we believe that our approach will increase the availability of information publicly available to U.S. investors who invest in the private funds advised by such exempt but reporting non-U.S. advisers.

Most of the commenters who considered this aspect of the rule supported it, citing, among other benefits, that this interpretation would effectively protect U.S. markets and investors and is consistent with the Commission's overall territorial approach to Advisers Act regulation.[651] For example, one commenter stated that the "jurisdictional approach to only considering U.S. activities for non-U.S. advisors is prudent as it focuses on what causes

648 *See supra* note 393 and accompanying text.

649 *See supra* Section II.B.3.

650 *See* Implementing Adopting Release, *supra* note 32, discussion at section II.B.

651 ABA Letter; Debevoise Letter; Dechert Foreign Adviser Letter; Gunderson Dettmer Letter; Katten Foreign Advisers Letter; MAp Airports Letter; Merkl Letter; Wellington Letter.

systematic [sic] risks to the U.S."[652] Another noted that non-U.S. persons dealing with non-U.S. advisers would not expect to benefit from the protections provided by the Advisers Act.[653] Another stated that this approach, together with our interpretation of "assets under management in the United States," will "avoid the issues associated with conflicting and overlapping regulation."[654]

Rule 203(m)-1(b) uses the term "United States person," which generally incorporates the definition of a "U.S. person" in Regulation S.[655] We believe that generally incorporating the definition of a "U.S. person" in Regulation S will benefit advisers, because Regulation S provides a well-developed body of law that, in our view, appropriately addresses many of the questions that will arise under rule 203(m)-1. Moreover, advisers to private funds and their counsel currently must be familiar with the definition of "U.S. person" under Regulation S in order to comply with other provisions of the federal securities laws. Commenters generally supported defining "United States person" by reference to Regulation S, confirming that the

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652 Wellington Letter.

653 Debevoise Letter. *See also* ABA Letter ("When, in the private fund context, United States investors invest with a non-United States-based investment manager, they understand they are not being afforded the investor protection safeguards of the United States Investment Advisers Act."); Avoca Letter ("It is reasonable to assume that U.S. investors who purchase shares of a private fund (as defined in section 202(a)(29)) will not expect an investment adviser that has no United States presence to be registered with the U.S. SEC as an investment adviser.").

654 ABA Letter.

655 Rule 203(m)-1(d)(8) (defining a "United States person" as any person that is a "U.S. person" as defined in Regulation S, except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on rule 203(m)-1 and is not organized, incorporated, or (if an individual) resident in the United States). As discussed above, two commenters that generally supported our incorporation of the definition in Regulation S also urged us to modify our proposed definition in certain respects. *See supra* notes 409-413 and accompanying text. We decline to accept these suggestions for the reasons discussed in Section II.B.4, and we continue to believe that advisers will benefit from the efficiencies created by our general incorporation of the definition of "U.S. person" in Regulation S.

definition is well developed and understood by advisers.[656]

We also are adding a note to rule 203(m)-1 that clarifies that a client will not be considered a United States person if the client was not a United States person at the time of becoming a client of the adviser.[657] This will benefit non-U.S. advisers, which might, absent this note, incur costs in trying to determine whether they would be permitted to rely on rule 203(m)-1 if one of their existing non-U.S. clients that is not a private fund becomes a United States person, for example if a natural person client residing abroad relocates to the United States.[658] The non-U.S. adviser could at that time be considered to have a United States person client other than a private fund.

Definition of a Qualifying Private Fund. We proposed to define a "qualifying private fund" as "any private fund that is not registered under section 8 of the Investment Company Act of 1940 (15 U.S.C 80a-8) and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53)."[659] We are modifying rule 203(m)-1 to also permit an adviser to treat as a "private fund," and thus as a "qualifying private fund," an issuer that qualifies for an exclusion from the definition of "investment company," as defined in section 3 of the Investment Company Act, in addition to those provided by section 3(c)(1) or

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656 AIMA Letter; CompliGlobe Letter; Debevoise Letter; Dechert General Letter; Gunderson Dettmer Letter; Katten Foreign Advisers Letter; O'Melveny Letter.

657 *See supra* Section II.B.4.

658 *See* EFAMA Letter (argued that an analogous note in the foreign private adviser exemption, revised consistent with its comments, "also should apply to the 'private fund adviser exemption' and the 'venture capital fund exemption'"); IFIC Letter ("We ask for clarification from the SEC as to whether it will apply the [analogous note to the foreign private adviser exemption] in other contexts for purposes of compliance with the U.S. federal securities laws, including compliance with Rule 12g3-2(b) of the 1934 Act.").

659 *See* proposed rule 203(m)-1(e)(5).

3(c)(7) of that Act.[660] Absent this modification, an adviser to a section 3(c)(1) or 3(c)(7) fund would lose the exemption if the fund also qualified for another exclusion.[661] For example, an adviser to a section 3(c)(1) or 3(c)(7) fund would lose the exemption if the fund also qualified for another exclusion, even though the adviser may be unaware of the fund so qualifying and the fund does not purport to rely on the other exclusion.

Expanding the range of potential "qualifying private funds," therefore, should benefit advisers to funds that also qualify for other exclusions by permitting these advisers to rely on the exemption.[662] It also will prevent advisers from violating the Advisers Act's registration requirements solely because their funds qualify for another exclusion. In addition, advisers will not be required to incur the time and expense required to assess whether the funds they advise also qualify for an additional exclusion.

2. Costs

Assets under Management in the United States. As noted above, under rule 203(m)-1, we look to an adviser's principal office and place of business as the location where the adviser directs, controls or has responsibility for the management of private fund assets, and therefore as *the* place where all the adviser's assets are managed.[663] Thus, a U.S. adviser must include all of its private fund assets under management in determining whether it exceeds the $150 million

660 Rule 203(m)-1(d)(5). An adviser relying on this provision must treat the fund as a private fund under the Advisers Act and the rules thereunder for all purposes (*e.g.*, reporting on Form ADV). *Id.*

661 A fund that qualifies for an additional exclusion would not be a private fund, because a "private fund" is a fund that would be an investment company as defined in section 3 of the Investment Company Act *but for* section 3(c)(1) or 3(c)(7) of that Act. *See supra* Section II.B.1.

662 *See, e.g.*, Dechert General Letter (argued that advisers should be permitted to treat as a private fund for purposes of rule 203(m)-1 a fund that qualifies for another exclusion from the definition of "investment company" in the Investment Company Act in addition to section 3(c)(1) or 3(c)(7), such as section 3(c)(5)(C), which excludes certain real estate funds).

663 *See supra* note 385 and accompanying text.

limit under the exemption. We also look to where day-to-day management of private fund assets may occur for purposes of a non-U.S. adviser, whose principal office and place of business is outside of the United States.[664] A non-U.S. adviser therefore would count only the private fund assets it manages at a place of business in the United States in determining the availability of the exemption. This approach is similar to the way we have identified the location of the adviser for regulatory purposes under our current rules,[665] and we believe it is the way in which most advisers would have interpreted the exemption without our rule.[666]

We believe that our approach will promote efficiency because advisers are familiar with it, and we do not anticipate that U.S. advisers to private funds would likely change their business models, the location of their private funds or the location where they manage assets as a result of the rule. As noted in the Proposing Release, we expect that non-U.S. advisers may, however, incur minimal costs to determine whether they have assets under management in the United States. We estimate that these costs would be no greater than $6,730 per adviser to hire U.S. counsel and perform an internal review to assist in this determination, in particular to assess whether a non-U.S. affiliate manages a discretionary account for the benefit of a United States

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664 *See supra* note 384 and accompanying text.

665 *See supra* note 385 and accompanying text.

666 We do not believe that the statutory text refers to where the assets themselves may be located or traded or the location of the account where the assets are held. In today's market, using the location of assets would raise numerous questions of where a security with no physical existence is "located." Although physical stock certificates were once sent to investors as proof of ownership, stock certificates are now centrally held by securities depositories, which perform electronic "book-entry" changes in their records to document ownership of securities. This arrangement reduces transmittal costs and increases efficiencies for securities settlements. *See generally* Bank for International Settlements, The Depository Trust Company: Response to the Disclosure Framework for Securities Settlement Systems (2002), http://www.bis.org/publ/cpss20r3.pdf. An account also has no physical location even if the prime broker, custodian or other service that holds assets on behalf of the customer does. Each of these approaches would be confusing and extremely difficult to apply on a consistent basis.

person under the rule.[667]

As noted above, because the rule is designed to encourage the participation of non-U.S. advisers in the U.S. market, we believe that it will have minimal regulatory and operational burdens on non-U.S. advisers and their U.S. clients. Non-U.S. advisers may rely on the rule if they manage U.S. private funds with more than $150 million in assets at a non-U.S. location as long as the private fund assets managed at a U.S. place of business are less than $150 million. This could affect competition with U.S. advisers, which must register when they have $150 million in private fund assets under management regardless of where the assets are managed.

In contrast to the many commenters who supported our approach, one commenter argued that treating U.S. and non-U.S. advisers differently would disadvantage U.S.-based advisers by permitting non-U.S. advisers to accept substantial amounts of money from U.S. investors without having to comply with certain U.S. regulatory requirements, and would cause advisers to move offshore or close U.S. offices to avoid regulation.[668]

As we explained in the Proposing Release, we believe that our interpretation recognizes

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667 We estimated in the Proposing Release that a non-U.S. adviser would need no more than 10 hours of external legal advice (at $400 per hour) and 10 hours of internal review by a senior compliance officer (at $294 per hour) to evaluate whether the adviser would qualify for the exemption provided by rule 203(m)-1, for a total estimated cost of $6,940. We did not receive any comments on these estimates. We are, however, decreasing this estimate slightly, to $6,730, to account for more recent salary data reflecting a $273 per hour wage for senior compliance officers. *See supra* note 597. One commenter suggested that we presume for non-U.S. advisers, like U.S. advisers, that all of their private fund assets are managed at their principal office and place of business. Katten Foreign Advisers Letter. We decline to adopt this suggestion for the reasons discussed above. *See supra* notes 388-389 and accompanying text. In addition, the commenter did not convince us that the costs we estimate a non-U.S. adviser would incur in determining if it has assets under management in the United States justify foregoing our approach and its attendant benefits. To the extent the commenter suggests that we adopt an alternative interpretation to conserve our resources, we note that any interpretation that requires additional advisers to register will contribute to our workload, and registration provides benefits of its own, as discussed above.

668 Portfolio Manager Letter. *See also* Tuttle Implementing Release Letter (argued that businesses may move offshore if they become too highly regulated in the United States).

that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests and is in keeping with general principles of international comity.[669] The rule also is designed to encourage the participation of non-U.S. advisers in the U.S. market by applying the U.S. securities laws in a manner that does not impose U.S. regulatory and operational requirements on a non-U.S. adviser's non-U.S. advisory business.[670] Non-U.S. advisers relying on rule 203(m)-1 will remain subject to the Advisers Act's antifraud provisions and will become subject to the requirements applicable to exempt reporting advisers. Moreover, the commenter appears to suggest that an adviser that moves offshore to avoid registering under the Advisers Act would not be subject to any regulation as an investment adviser, but we understand that most non-U.S. advisers to private funds locate in major financial centers in jurisdictions that regulate investment advisers. We therefore believe that any competitive consequences to U.S. advisers will be diminished.[671]

As we acknowledged in the Proposing Release, to avail themselves of rule 203(m)-1, some advisers might choose to move their principal offices and places of business outside of the United States and manage private funds at those locations.[672] This could result in costs to U.S. investors in private funds that are managed by these advisers because they would not have the investor protection and other benefits that result from an adviser's registration under the Advisers Act. We do not expect that many advisers would be likely to relocate for purposes of avoiding registration, however, because, as we explained in the Proposing Release, we

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669 *See supra* note 392 and accompanying text.

670 *See supra* note 393 and accompanying text.

671 *See also supra* Section II.B.3. We also decline to accept a separate commenter's suggestion to permit U.S. advisers to exclude assets managed at non-U.S. offices. *See supra* notes 395-396 and accompanying and following text.

672 *See* Proposing Release, *supra* note 26, discussion at section V.B.2.

understand that the primary reasons for advisers to locate in a particular jurisdiction involve tax and other business considerations.[673]

We also note that if an adviser did relocate, it would incur the costs of regulation under the laws of most of the foreign jurisdictions in which it may be likely to relocate, as well as the costs of complying with the reporting requirements applicable to exempt reporting advisers, unless it also qualified for the foreign private adviser exemption. We do not believe, in any case, that the adviser would relocate if relocation would result in a material decrease in the amount of assets managed because that loss would likely not justify the benefits of avoiding registration, and thus we do not believe our rule is likely to have an adverse effect on capital formation.

One commenter also proposed that we adopt an alternative approach that would look to the source of the assets.[674] Under this alternative approach, a non-U.S. adviser would count the assets of private funds attributable to U.S. investors towards the $150 million threshold, regardless of the location where it manages private funds, and a U.S. adviser would exclude assets that are not attributable to U.S. investors. As a result, more U.S. advisers might be able to rely on rule 203(m)-1 under this alternative interpretation. To the extent that non-U.S. advisers

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673 We note that the two commenters that suggested U.S. advisers might relocate to rely on the rule provided no data as to the likelihood that this would occur or the number or types of advisers who might relocate, and neither refuted our contention that the primary reasons for advisers to locate in a particular jurisdiction involve tax and other business considerations. *See* Portfolio Manager Letter; Tuttle Implementing Release Letter.

674 Portfolio Manager Letter ("If you raise significant money here you should be on the same level playing field as the fund managers located here so that we can compete fairly."). *See also* Merkl Letter (suggested that it "may be useful" to look both to assets managed from a U.S. place of business and assets contributed by U.S. private fund investors to address both investor protection and systemic risk concerns). Another commenter suggested that we determine the "assets under management in the United States" for U.S. advisers by reference to the amount of assets invested, or "in play," in the United States. Dougherty Letter. We decline to adopt this approach because it would be difficult for advisers to ascertain and monitor which assets are invested in the United States, and this approach thus would be confusing and extremely difficult to apply on a consistent basis. *See supra* note 394 and accompanying and following text.

have U.S. investors in private funds that they manage at a non-U.S. location, fewer non-U.S. advisers would be eligible for the exemption. Thus, this alternative could increase costs for those non-U.S. advisers that would have to register but reduce costs for those U.S. advisers that would not have to register.

This alternative approach also could adversely affect U.S. investors to the extent that it discouraged U.S. advisers from managing U.S. investor assets. A U.S. adviser might avoid managing assets from U.S. investors because, under this alternative interpretation, the assets would be included in determining whether the adviser was eligible to rely on rule 203(m)-1. This could reduce competition for the management of assets from U.S. investors. The likelihood of U.S. advisers seeking to avoid registration in this way might be mitigated, however, to the extent that the loss of managed assets of U.S. investors would exceed the savings from avoiding registration.

Method of Calculating Private Fund Assets. Rule 203(m)-1 incorporates the valuation methodology in the instructions to Form ADV, which requires advisers to use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable, when determining regulatory assets under management and to include in the calculation certain types of assets advisers previously were permitted to exclude. The revised instructions also clarify that this calculation must be done on a gross basis.

We acknowledged in the Proposing Release that some private fund advisers may not use fair value methodologies.[675] As we explained there, the costs incurred by those advisers to use

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675 *See supra* note 634 and accompanying and following text. In addition, we estimate in the Implementing Adopting Release, based on registered advisers' responses to Items 5.D, 7.B, and 9.C of Form ADV, that approximately 3% of registered advisers have at least one private fund client that is not audited, and that these advisers therefore may incur costs to fair value their private fund assets. *See* Implementing Adopting Release, *supra* note 32, at nn.634-641 and

fair valuation methodologies would vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or would rely on a third party for valuation services.[676] Nevertheless, we continue to believe that the requirement to use fair value would not result in significant costs for these advisers, particularly in light of our decision to require annual, rather than quarterly, valuations. We also understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a matter of business practice.[677]

A number of commenters objected to the requirement to determine private fund assets based on fair value, generally arguing that the requirement would cause those advisers that did not use fair value methods to incur additional costs, especially if the private funds' assets that they manage are illiquid and therefore difficult to fair value.[678] As discussed in Section II.B.2, we are sensitive to the costs this new requirement will impose, and we requested comment in the Proposing Release on our estimates concerning the costs related to fair value. Commission staff

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accompanying text. We also estimate in that release that each of these registered advisers that potentially would incur costs as a result of the fair value requirement would incur costs of $37,625 on an annual basis. *Id.*, at n.641 and accompanying text. This is the middle of the range of the estimated fair value costs, which range from $250 to $75,000 annually. *Id. See also infra* notes 680-681 and accompanying text.

676 *See* Proposing Release, *supra* note 26, at n.323 and accompanying text.

677 For example, a hedge fund adviser may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to private equity funds may obtain valuations of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement applicable to private fund assets.

678 *See, e.g.*, Gunderson Dettmer Letter; Merkl Letter; O'Melveny Letter; Seward Letter; Wellington Letter.

estimates that such an adviser would incur $1,320 in internal costs to conform its internal valuations to a fair value standard.[679] In the event a fund does not have an internal capability for valuing specific illiquid assets, we expect that it could obtain pricing or valuation services from an outside administrator or other service provider. Staff estimated that the cost of such a service would range from $1,000 to $120,000 annually, which could be borne by several funds that invest in similar assets or have similar investment strategies.[680] We did not receive any comments on these estimates. These estimates, however, assumed that an adviser would be required to calculate the fair value of its private funds assets quarterly, as required by rule 203(m)-1 as proposed. We are reducing the estimated range to $250 to $75,000 annually to reflect that rule 203(m)-1 requires advisers to calculate their private fund assets annually, rather

[679] We estimated in the Proposing Release that such an adviser would incur $1,224 in internal costs to conform its internal valuations to a fair value standard. *See* Proposing Release, *supra* note 26, at n.325. We received no comments on this estimate. We are, however, increasing this estimate slightly, to $1,320, to account for more recent salary data. This revised estimate is based upon the following calculation: 8 hours x $165/hour = $1,320. The hourly wage is based on data for a fund senior accountant from SIFMA's *Management & Professional Earnings in the Securities Industry 2010*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

[680] These estimates are based on conversations with valuation service providers. We understand that the cost of valuation for illiquid fixed income securities generally ranges from $1.00 to $5.00 per security, depending on the difficulty of valuation, and is performed for clients on a weekly or monthly basis. We understand that appraisals of privately placed equity securities may cost from $3,000 to $5,000 with updates to such values at much lower prices. For purposes of this cost benefit analysis, we are estimating the range of costs for (i) a private fund that holds 50 fixed income securities at a cost of $5.00 to price and (ii) a private fund that holds privately placed securities of 15 issuers that each cost $5,000 to value initially and $1,000 thereafter. We believe that costs for funds that hold both fixed-income and privately placed equity securities would fall within the maximum of our estimated range. We note that funds that have significant positions in illiquid securities are likely to have the in-house capacity to value those securities or already subscribe to a third-party service to value them. We note that many private funds are likely to have many fewer fixed income illiquid securities in their portfolios, some or all of which may cost less than $5.00 per security to value. Finally, we note that obtaining valuation services for a small number of fixed income positions on an annual basis may result in a higher cost for each security or require a subscription to the valuation service for those that do not already purchase such services. The staff's estimate is based on the following calculations: (50 x $5.00 x 4 = $1,000); (15 x $5,000) + (15 x $1,000 x 3) = $120,000).

than quarterly as proposed.[681]

In addition, as discussed above, we have taken several steps to mitigate these costs.[682] While many advisers will calculate fair value in accordance with GAAP or another international accounting standard,[683] other advisers acting consistently and in good faith may utilize another fair valuation standard.[684] While these other standards may not provide the quality of information in financial reporting (for example, of private fund returns), we expect these calculations will provide sufficient consistency for the purposes that regulatory assets under management serve in our rules, including rule 203(m)-1.[685]

Use of the alternative approaches recommended by commenters (*e.g.*, cost basis or any method required by the private fund's governing documents other than fair value) would not meet our objective of having more meaningful and comparable valuation of private fund assets, and could result in a significant understatement of appreciated assets. Moreover, these alternative approaches could permit advisers to circumvent the Advisers Act's registration requirements. Permitting the use of any valuation standard set forth in the governing documents of the private fund other than fair value could effectively yield to the adviser the choice of the most favorable standard for determining its registration obligation as well as the application of other regulatory requirements. For these reasons and those discussed in the Implementing Adopting Release, commenters did not persuade us that the extent of the additional burdens the fair value requirement would impose on some advisers to private funds would be inappropriate in

681 The staff's revised estimate is based on the following calculations: (50 x \$5.00 = \$250; 15 x \$5,000 = \$75,000). *See also supra* note 680.

682 *See supra* notes 363-366 and accompanying text.

683 *See supra* note 364 and accompanying text.

684 *See supra* note 365 and accompanying text.

685 *See supra* note 366 and accompanying text.

light of the value of a more meaningful and consistent calculation by all advisers to private funds.

We also do not expect that advisers' principals (or other employees) generally will cease to invest alongside the advisers' clients as a result of the inclusion of proprietary assets, as some commenters suggested.[686] If private fund investors value their advisers' co-investments as suggested by these commenters, we expect that the investors will demand them and their advisers will structure their businesses accordingly.[687]

One commenter also argued that including proprietary assets would deter non-U.S. advisers that manage large sums of proprietary assets from establishing U.S. operations and employing U.S. residents.[688] Such an adviser, however, would not be ineligible for the private fund adviser exemption merely because it established U.S. operations. As discussed in Section II.B, a non-U.S. adviser may rely on the private fund adviser exemption while also having one or more U.S. places of business, provided it complies with the exemption's conditions.

Some commenters objected to calculating regulatory assets under management on the basis of gross, rather than net, assets. They argued, among other things, that gross asset measurements would be confusing,[689] complex,[690] and inconsistent with industry practice.[691] However, nothing in the current instructions suggests that liabilities should be deducted from the calculation of an adviser's assets under management. Indeed, since 1997, the instructions have

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686 *See, e.g.*, ABA Letter; Katten Foreign Advisers Letter; Seward Letter.

687 *See supra* note 347 and accompanying text.

688 Katten Foreign Advisers Letter.

689 Dechert General Letter. *See also* Implementing Adopting Release, *supra* note 32, at n.80 and accompanying text.

690 MFA Letter.

691 *See, e.g.*, Merkl Letter; Shearman Letter. *See also supra* note 351.

stated that an adviser should not deduct securities purchased on margin when calculating its assets under management.[692] Whether a client has borrowed to purchase a portion of the assets managed does not seem to us a relevant consideration in determining the amount an adviser has to manage, the scope of the adviser's business, or the availability of the exemptions.[693]

Moreover, we are concerned that the use of net assets could permit advisers to highly leveraged funds to avoid registration under the Advisers Act even though the activities of such advisers may be significant and the funds they advise may be appropriate for systemic risk reporting.[694] One commenter argued, in contrast, that it would be "extremely unlikely that a net asset limit of $150,000,000 in private funds could be leveraged into total investments that would pose any systemic risk."[695] But a comprehensive view of systemic risk requires information about certain funds that may not present systemic risk concerns when viewed in isolation, but nonetheless are relevant to an assessment of systemic risk across the economy. Moreover, because private funds are not subject to the leverage restrictions in section 18 of the Investment Company Act, a private fund with less than $150 million in net assets could hold assets far in excess of that amount as a result of its extensive use of leverage. In addition, under a net assets test such a fund would be treated similarly for regulatory purposes as a fundamentally different fund, such as one that did not make extensive use of leverage and had $140 million in net assets.

The use of gross assets also need not cause any investor confusion, as some commenters

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692 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(2), as in effect before it was amended by the Implementing Adopting Release ("Do not deduct securities purchased on margin."). Instruction 5.b.(2), as amended in the Implementing Adopting Release, provides "Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities." *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3.

693 *See id.*

694 *See id.*, at n.82 and preceding and accompanying text.

695 ABA Letter.

suggested.[696] Although an adviser will be required to use gross (rather than net) assets for purposes of determining whether it is eligible for the private fund adviser or the foreign private adviser exemptions (among other purposes), we would not preclude an adviser from holding itself out to its clients as managing a net amount of assets as may be its custom.[697]

Definition of a Qualifying Private Fund. As discussed above, we modified the definition of a "qualifying private fund" to include an issuer that qualifies for an exclusion from the definition of "investment company," as defined in section 3 of the Investment Company Act, in addition to those provided by section 3(c)(1) or 3(c)(7) of that Act. To the extent advisers are able to rely on the exemption as a result of this modification, investors and the Commission will lose the benefits registration would provide. This modification does, however, benefit advisers, as discussed above, and investors (and the Commission) will still have access to the information these advisers will be required to file as exempt reporting advisers.

Solely Advises Private Funds. Some commenters asserted, in effect, that advisers should be permitted to combine other exemptions with rule 203(m)-1 so that, for example, an adviser could advise venture capital funds with assets under management in excess of $150 million in addition to other, non-venture capital private funds with less than $150 million in assets under management.[698] One commenter argued that, by declining to adopt this view, we are imposing unnecessary burdens, particularly on advisers who advise both small private funds and small business investment companies.[699] But as we discuss in Section II.B.1, the approach the

696 *See, e.g.*, Dechert General Letter. *See also* Implementing Adopting Release, *supra* note 32, at n.80 and accompanying text.

697 *See supra* note 357.

698 NASBIC/SBIA Letter; Seward Letter.

699 NASBIC/SBIA Letter.

commenter suggests runs contrary to the language of section 203(m), which directs us to provide an exemption "to any investment adviser of private funds, if each of such investment adviser acts solely as an adviser to private funds and has assets under management in the United States of less than $150,000,000." Thus, we believe that the costs to advisers that may have to register because they do not advise solely private funds with assets under management in the United States of less than $150 million flow directly from the Dodd-Frank Act.

Assessing Whether the Exemption is Available and Costs of Registration and Compliance. We estimate each adviser may incur between $800 to $4,800 in legal advice to learn whether it may rely on the exemption.[700] We did not receive any comments concerning these estimates. We also estimate that each adviser that registers would incur registration costs, which we estimate would be $15,077,[701] initial compliance costs ranging from $10,000 to $45,000, and ongoing annual compliance costs ranging from $10,000 to $50,000.[702] Some commenters suggested that these estimates are too low, and estimated that they would incur one-time registration and compliance costs ranging from $50,000 to $600,000, followed by ongoing annual compliance costs ranging from $50,000 to $500,000.[703] Although some advisers may incur these costs, we do not believe they are representative, as discussed above.[704] Moreover, as discussed above, commenters identifying themselves as "middle market private equity fund" advisers provided the highest estimated costs, but these commenters generally would not qualify

700 We estimate that a private fund adviser would obtain between 2 and 12 hours of external legal advice (at a cost of $400 per hour) to determine whether it would be eligible for the private fund adviser exemption.

701 *See supra* note 597 and accompanying text.

702 *See supra* note 601 and accompanying text.

703 *See supra* notes 602-603 and accompanying text.

704 *See supra* Section V.A.2.

for the private fund adviser exemption we are required to provide under section 203(m).[705] We also note that the costs of registration for advisers that do not qualify for the private fund adviser exemption flow from the Dodd-Frank Act, which removed the private adviser exemption on which they currently rely.

C. Foreign Private Adviser Exemption

Section 403 of the Dodd-Frank Act replaces the current private adviser exemption from registration under the Advisers Act with a new exemption for any "foreign private adviser," as defined in new section 202(a)(30) of the Advisers Act.[706] We are adopting, substantially as proposed, new rule 202(a)(30)-1, which defines certain terms in section 202(a)(30) for use by advisers seeking to avail themselves of the foreign private adviser exemption, including: (i) "investor;" (ii) "in the United States;" (iii) "place of business;" and (iv) "assets under management."[707] We are also including in rule 202(a)(30)-1 the safe harbor and many of the client counting rules that appeared in rule 203(b)(3)-1.[708]

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705 We note that the advisers that gave us these estimates for registration costs have assets under management in excess of the $150 million threshold and they are not representative of advisers that would qualify for the private fund adviser exemption. *See supra* notes 602-603 and accompanying text. We also note that approximately 570 smaller advisers currently are registered with us. *See supra* note 613 and accompanying text. These advisers have absorbed the compliance costs associated with registration, notwithstanding the fact that their revenues are likely to be smaller than those of a typical adviser that will be required to register as a result of Congress's repeal of the private adviser exemption (*e.g.*, an adviser to private funds with $150 million or more of assets under management in the United States, or a "middle market" private equity adviser). *See, e.g.*, Atlas Letter (middle market private equity adviser with $365 million of assets under management); Cortec Letter (middle market private equity adviser with less than $750 million of assets under management). *See also supra* note 614 and accompanying text.

706 *See supra* notes 415-418 and accompanying text. The new exemption is codified as amended section 203(b)(3). *See supra* Section II.C.

707 Rule 202(a)(30)-1(c).

708 *See supra* Section II.C. Rule 203(b)(3)-1, which we are rescinding with the Implementing Adopting Release, provides a safe harbor for determining who may be deemed a single client for purposes of the private adviser exemption. We are not, however, carrying over rules 203(b)(3)-1(b)(4), (5), or (7). *See supra* notes 316, 420 and 425 and accompanying text.

Rule 202(a)(30)-1 clarifies several provisions used in the statutory definition of "foreign private adviser." First, the rule includes a safe harbor for counting clients, which previously appeared in rule 203(b)(3)-1, and which we have modified to account for its use in the foreign private adviser context. Under the safe harbor, an adviser would count certain natural persons as a single client under certain circumstances.[709] Rule 202(a)(30)-1 also includes another provision of rule 203(b)(3)-1 that permits an adviser to treat as a single "client" an entity that receives investment advice based on the entity's investment objectives and two or more entities that have identical owners.[710] As proposed, we are omitting the "special rule" that allowed advisers not to count as a client any person for whom the adviser provides investment advisory services without compensation.[711] Finally, the rule includes two provisions that clarify that advisers need not double-count private funds and their investors under certain circumstances.[712]

Second, section 202(a)(30) provides that a "foreign private adviser" eligible for the new registration exemption cannot have more than 14 clients "or investors in the United States." We

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709 Rule 202(a)(30)-1(a)(1).

710 Rule 202(a)(30)-1(a)(2)(i)-(ii). In addition, rule 202(a)(30)-1(b)(1) through (3) contain the following related "special rules:" (1) an adviser must count a shareholder, partner, limited partner, member, or beneficiary (each, an "owner") of a corporation, general partnership, limited partnership, limited liability company, trust, or other legal organization, as a client if the adviser provides investment advisory services to the owner separate and apart from the investment advisory services provided to the legal organization; (2) an adviser is not required to count an owner as a client solely because the adviser, on behalf of the legal organization, offers, promotes, or sells interests in the legal organization to the owner, or reports periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters; and (3) any general partner, managing member or other person acting as an investment adviser to a limited partnership or limited liability company must treat the partnership or limited liability company as a client.

711 *See* rule 203(b)(3)-1(b)(4); *supra* notes 425-427 and accompanying text.

712 *See* rule 202(a)(30)-1(b)(4) (an adviser is not required to count a private fund as a client if it counts any investor, as defined in the rule, in that private fund as an investor in the United States in that private fund); rule 202(a)(30)-1(b)(5) (an adviser is not required to count a person as an investor if the adviser counts such person as a client in the United States). *See also supra* note 429.

are defining "investor" in a private fund in rule 202(a)(30)-1 as any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act, or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act.[713] We are also treating as investors beneficial owners of "short-term paper" issued by the private fund, who must be qualified purchasers under section 3(c)(7) but are not counted as beneficial owners for purposes of section 3(c)(1).[714]

Third, rule 202(a)(30)-1 defines "in the United States" generally by incorporating the definition of a "U.S. person" and "United States" under Regulation S.[715] In particular, we define "in the United States" in rule 202(a)(30)-1 to mean: (i) with respect to any place of business, any such place located in the "United States," as defined in Regulation S;[716] (ii) with respect to any client or private fund investor in the United States, any person who is a "U.S. person" as defined in Regulation S,[717] except that under the rule, any discretionary account or similar account that is held for the benefit of a person "in the United States" by a non-U.S. dealer or other professional fiduciary is a person "in the United States" if the dealer or professional fiduciary is a related person of the investment adviser relying on the exemption; and (iii) with respect to the public, in

713 *See* rule 202(a)(30)-1(c)(2); *supra* Section II.C.2. In order to avoid double-counting, the rule allows an adviser to treat as a single investor any person who is an investor in two or more private funds advised by the adviser. *See* rule 202(a)(30)-1, at note to paragraph (c)(2).

714 *See* rule 202(a)(30)-1(c)(2)(ii); *supra* notes 453-462 and accompanying text. Consistently with section 3(c)(1) and section (3)(c)(7) of the Investment Company Act, the final rule, unlike the proposed rule, does not treat knowledgeable employees as "investors." *Cf.* proposed rule 202(a)(30)-1(c)(1)(i).

715 Rule 202(a)(30)-1(c)(3). *See supra* Section II.C.3.

716 *See* 17 CFR 230.902(l).

717 *See* 17 CFR 230.902(k). We are allowing foreign advisers to determine whether a client or investor is "in the United States" by reference to the time the person became a client or acquires securities issued by the private fund. *See* rule 202(a)(30)-1, at note to paragraph (c)(3)(i).

the "United States," as defined in Regulation S.[718]

Fourth, rule 202(a)(30)-1 defines "place of business" to have the same meaning as in Advisers Act rule 222-1(a).[719] Finally, for purposes of rule 202(a)(30)-1, we are defining "assets under management" by reference to "regulatory assets under management" as determined under Item 5 of Form ADV.[720]

1. Benefits

We are defining certain terms included in the statutory definition of "foreign private adviser" in order to clarify the meaning of these terms and reduce the potential administrative and regulatory burdens for advisers that seek to rely on the foreign private adviser exemption. As noted above, our rule references definitions set forth in other Commission rules under the Advisers Act, the Investment Company Act and the Securities Act, all of which are likely to be familiar to non-U.S. advisers active in the U.S. capital markets.

As we discussed in the Proposing Release, we anticipate that by defining these terms we will benefit non-U.S. advisers by providing clarity with respect to the terms that advisers would otherwise be required to interpret (and which they would likely interpret with reference to the rules we reference).[721] Our approach provides consistency among these other rules and the new exemption. This should limit non-U.S. advisers' need to undertake additional analysis with

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718 *See* 17 CFR 230.902(l).

719 *See* rule 202(a)(30)-1(c)(4); rule 222-1(a) (defining "place of business" of an investment adviser as: "(1) An office at which the investment adviser regularly provides investment advisory services, solicits, meets with, or otherwise communicates with clients; and (2) Any other location that is held out to the general public as a location at which the investment adviser provides investment advisory services, solicits, meets with, or otherwise communicates with clients."). *See supra* Section II.C.4.

720 Rule 202(a)(30)-1(c)(1); Form ADV: Instructions to Part 1A, instr. 5.b(4). *See also supra* Section II.C.5.

721 *See* Proposing Release, *supra* note 26, at n.350 and accompanying text.

respect to these terms for purposes of determining the availability of the foreign private adviser exemption.[722] We believe that the consistency and clarity that results from the rule will promote efficiency for non-U.S. advisers and the Commission. Commenters that expressed support for the proposed definitions confirmed that the references to other rules will allow advisers to apply existing concepts and maintain consistency with current interpretations.[723]

For example, for purposes of determining eligibility for the foreign private adviser exemption, advisers must count clients substantially in the same manner as they counted clients under the private adviser exemption.[724] In identifying "investors," advisers can generally rely on the determination made to assess whether the private fund meets the counting or qualification requirements under section 3(c)(1) or 3(c)(7) of the Investment Company Act.[725] In determining whether a client, an investor, or a place of business is "in the United States," or whether it holds itself out as an investment adviser to the public "in the United States," an adviser generally will apply the same analysis it would otherwise apply under Regulation S.[726] In identifying whether it has a place of business in the United States, an adviser will use the definition of "place of business" as defined in Advisers Act rule 222-1, which is used to determine whether a state may

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722 This is true for all of the definitions except for "assets under management." An adviser that relies on the foreign private adviser exemption must calculate its assets under management according to the instructions to Item 5 of Form ADV only for purposes of determining the availability of the exemption. As discussed above, rule 202(a)(30)-1 includes a reference to Item 5 of Form ADV in order to provide for consistency in the calculation of assets under management for various purposes under the Advisers Act. *See supra* note 497 and accompanying text.

723 *See, e.g.*, Dechert General Letter (with respect to the definition of "investor"); Dechert Foreign Adviser Letter and IFIC Letter (noting that the proposed definition of "in the United States" has the benefit of relying on existing guidance that is generally used by investment advisers); O'Melveny Letter (with respect to the definition of "U.S. person").

724 *See supra* Section II.C.1.

725 *See supra* note 432 and accompanying text.

726 *See supra* notes 471-472 and accompanying text.

assert regulatory jurisdiction over the adviser.[727]

As noted above, the definitions of "investor" and "United States" under our rule rely on existing definitions, with slight modifications.[728] Our rule also incorporates the safe harbor that appeared in rule 203(b)(3)-1 for counting clients, except that it no longer allows an adviser to disregard clients for whom the adviser provides services without compensation.[729] We are making these modifications (collectively, the "modifications") in order to preclude some advisers from excluding certain assets or clients from their calculation so as to avoid registration with the Commission and the regulatory requirements associated with registration.[730] Without a definition of these terms, advisers would likely rely on the same definitions we reference in rule 202(a)(30)-1, but without the modifications. We expect, therefore, that the rule likely will have the practical effect of narrowing the scope of the exemption, and thus likely will result in more advisers registering than if it reflected no modifications from the current rules.

The final rule does not include one of the modifications we proposed. The final rule does not treat knowledgeable employees as investors, consistent with sections 3(c)(1) and 3(c)(7).[731] As some commenters noted, treating knowledgeable employees in the same manner for purposes of the definition of investor and sections 3(c)(1) and 3(c)(7) will simplify advisers' compliance

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727 *See supra* Section II.C.4. Under section 222 of the Advisers Act, a state may not require an adviser to register if the adviser does not have a "place of business" within, and has fewer than 6 client residents of, the state.

728 *See supra* Sections II.C.2 and II.C.3.

729 *See supra* Section II.C.1.

730 *See supra* notes 453-462 and accompanying and following text and notes 474-477 and accompanying text. *See also infra* notes 744-747 for an estimate of the costs associated with registration.

731 *See supra* notes 448-452 and accompanying text.

with these regulatory requirements.[732] In addition, as a result of this treatment of knowledgeable employees, more non-U.S. advisers will be able to rely on the exemption.

We believe that any increase in registration as compared to the number of non-U.S. advisers that might have registered if we had not adopted rule 202(a)(30)-1 will benefit investors. Investors whose assets are, directly or indirectly, managed by the non-U.S. advisers that will be required to register will benefit from the increased protection afforded by federal registration of the adviser and application to the adviser of all of the requirements of the Advisers Act. As noted above, registration offers benefits to the investing public, including periodic examination of the adviser and compliance with rules requiring recordkeeping, custody of client funds and compliance programs.[733]

2. Costs

As discussed in the Proposing Release, we do not believe our definitions will result in significant costs for non-U.S. advisers.[734] Non-U.S. advisers that seek to avail themselves of the foreign private adviser exemption will incur costs to determine whether they are eligible for the exemption. We expect that these advisers will consult with outside U.S. counsel and perform an internal review of the extent to which an advisory affiliate manages discretionary accounts owned by a U.S. person that would be counted toward the limitation on clients in the United States and investors in the United States. We estimate these costs will be $6,730 per adviser.[735]

Without the rule, we believe that most advisers would have interpreted the new statutory

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732 *See* Seward Letter; Shearman Letter.

733 *See supra* text accompanying and following note 575.

734 *See* Proposing Release, *supra* note 26, at section V.C.2.

735 *See supra* note 667 and accompanying text. As noted above, we are decreasing this estimate to $6,730 to account for more recent salary data. *Id.* We did not receive any comments on the costs we estimated advisers would incur to perform this internal review.

provision by reference to the same rules that rule 202(a)(30)-1 references. Without our rule, some advisers would have likely incurred additional costs because they would have sought guidance in interpreting the terms used in the statutory exemption. By defining the statutory terms in a rule, we believe that we are providing certainty for non-U.S. advisers and limiting the time, compliance costs and legal expenses non-U.S. advisers would have incurred in seeking an interpretation, all of which could have inhibited capital formation and reduced efficiency. Advisers will also be less likely to seek additional assistance from us because they can rely on relevant guidance that we have previously provided with respect to the definitions that rule 202(a)(30)-1 references. We also believe that non-U.S. advisers' ability to rely on the definitions that the rule references and the guidance provided with respect to the referenced rules will reduce Commission resources that would have otherwise been applied to administering the foreign private adviser exemption, which resources can be allocated to other matters.

Our instruction allowing non-U.S. advisers to determine whether a client or investor is "in the United States" by reference to the time the person became a client or an investor acquires securities issued by the private fund should also reduce advisers' costs.[736] Advisers will make the determination only once and will not be required to monitor changes in the status of each client and private fund investor. Moreover, if a client or an investor moved to the United States, the adviser would not have to choose among registering with us, terminating the relationship with the client, or forcing the investor out of the the private fund. Some commenters agreed that the instruction will benefit advisers.[737]

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736 *See* rule 202(a)(30)-1, at note to paragraph (c)(3)(i); *supra* note 476 and accompanying text.

737 *See* Dechert General Letter ("The note provides helpful relief at a time when advisory clients often move across international borders while keeping an existing relationship with a financial institution."); IFIC Letter (the proposed approach "is consistent with the current interpretations on

Some commenters disagreed with the Proposing Release's explanation of how the exemption's requirement that an adviser look through to private fund investors would apply with respect to certain structures, such as master-feeder funds and total return swaps.[738] In both respects, we note that the obligation to look through certain transactions stems from section 208(d) of the Advisers Act (section 48(a) of the Investment Company Act with respect to sections 3(c)(1) and 3(c)(7)) as it applies to an adviser's obligations to look through to private fund investors for purposes of the foreign private adviser exemption. Thus, any costs associated with the statutory provisions that prohibit any person from doing indirectly or through or by another person anything that would be unlawful to do directly flow from those provisions, rather than any definitions we are adopting.

Some commenters expressed concern that the look-through requirement contained in the statutory definition of a "foreign private adviser" could impose significant burdens on advisers to non-U.S. funds, including non-U.S. retail funds publicly offered outside of the United States.[739] Two of these commenters stated, for example, that in their view a non-U.S. fund could be considered a private fund as a result of independent actions of U.S. investors, such as if a non-U.S. shareholder of a non-U.S. fund moves to the United States and purchases additional

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which Canadian advisers have relied for many years, and will ensure continuity and certainty in their business operations.").

738 *See* Dechert General Letter; EFAMA Letter. *See also supra* notes 442-444 and accompanying text. As we discussed above, for purposes of the look-through provision, the adviser to a master fund in a master-feeder arrangement must treat as investors the holders of the securities of any feeder fund formed or operated for the purpose of investing in the master fund rather than the feeder funds, which act as conduits. In addition, an adviser must count as an investor any owner of a total return swap on the private fund because that arrangement effectively provides the risks and rewards of investing in the private fund to the swap owner.

739 *See* AFG letter; Dechert Foreign Adviser Letter; EFAMA Letter; Shearman Letter.

shares.[740] If these funds were "private funds," their advisers would, if seeking to rely on the foreign private adviser exemption, be required to determine the number of private fund investors in the United States and the assets under management attributable to them.

As we explain above, if an adviser reasonably believes that an investor is not "in the United States," the adviser may treat the investor as not being "in the United States." Moreover, we understand that non-U.S. private funds currently count or qualify their U.S. investors in order to avoid regulation under the Investment Company Act.[741] A non-U.S. adviser would need to count the same U.S. investors (except for holders of short-term paper with respect to a fund relying on section 3(c)(1)) in order to rely on the foreign private adviser exemption. In this respect, therefore, the look-through requirement of the foreign private adviser exemption will generally not impose any new burden on advisers to non-U.S. funds.

As discussed in the Proposing Release, the modifications will result in some costs for non-U.S. advisers who might change their business practices in order to rely on the exemption.[742] Some non-U.S. advisers may have to choose to register under the Advisers Act or to limit the scope of their contacts with the United States in order to rely on the statutory exemption for

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740 Dechert Foreign Adviser Letter; EFAMA Letter. *See also supra* note 464 and accompanying text.

741 This practice is consistent with positions our staff has taken in which the staff has stated it would not recommend enforcement action in certain circumstances. *See, e.g.*, Goodwin Procter No-Action Letter, *supra* note 294; Touche Remnant No-Action Letter, *supra* note 294. *See also* sections 7(d), 3(c)(1), and 3(c)(7) of the Investment Company Act. *See also, e.g.*, Canadian Tax-Deferred Retirement Savings Accounts Release, *supra* note 294, at n.23 ("The Commission and its staff have interpreted section 7(d) to generally prohibit a foreign fund from making a U.S. private offering if that offering would cause the securities of the fund to be beneficially owned by more than 100 U.S. residents.").

742 *See* Proposing Release, *supra* note 26, at n.362 and accompanying and following text.

foreign private advisers (or the private fund adviser exemption).[743] As noted above, we have estimated the costs of registration to be $15,077.[744] In addition, we estimate that registered advisers would incur initial costs to establish a compliance infrastructure, which we estimate would range from $10,000 to $45,000 and ongoing annual costs of compliance and examination, which we estimate would range from $10,000 to $50,000.[745] Some commenters suggested that these estimates are too low, and estimated that they would incur one-time registration and compliance costs ranging from $50,000 to $600,000, followed by ongoing annual compliance costs ranging from $50,000 to $500,000.[746] Although some advisers may incur these costs, we do not believe they are representative, as discussed above.[747] Moreover, as discussed above, commenters identifying themselves as "middle market private equity fund" advisers provided the highest estimated costs, but these commenters generally would not qualify for the foreign private adviser exemption (*e.g.*, because these advisers generally appear to have places of business in the United States).

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743 *See, e.g.*, O'Melveny Letter (argued that because the foreign private adviser is subject to a low statutory asset threshold, it is likely "that the cost of enhanced regulatory compliance [resulting from advisers registering or filing reports required of advisers relying on rule 203(m)-1] may, as a commercial matter, have to be borne solely by U.S. investors, which would affect their net returns"; the commenter also stated that, alternatively, "many non-U.S. advisers with less significant amounts of U.S. assets invested in their funds may choose to restrict the participation by U.S. investors rather than attempt to comply with the Proposed Rules and, thereby, decrease the availability of potentially attractive investment opportunities to U.S. investors"). We note, however, that the benefits and costs associated with the elimination of the private adviser exemption are attributable to the Dodd-Frank Act, including the costs of registration incurred by advisers that previously relied on that exemption but that will have to register because they do not qualify for another exemption. In addition, the benefits and costs associated with the reporting requirements applicable to advisers relying on the private fund adviser exemption are associated with the separate rules that impose those requirements. *See* Implementing Adopting Release, *supra* note 32, at section II.B.

744 *See supra* note 597 and accompanying text.

745 *See supra* note 601 and accompanying text.

746 *See supra* notes 602-603 and accompanying text.

747 *See supra* Section V.A.2.

In any case, non-U.S. advisers will assess the costs of registering with the Commission relative to relying on the foreign private adviser or the private fund adviser exemption. This assessment will take into account many factors, which will vary from one adviser to another, to determine whether registration, relative to other options, is the most cost-effective business option for the adviser to pursue. If a non-U.S. adviser limited its activities within the United States in order to rely on the exemption, the modifications might have the effect of reducing competition in the market for advisory services or decreasing the availability of certain investment opportunities for U.S. investors. If the non-U.S. adviser chose to register, competition among registered advisers would increase. One commenter asserted that treating holders of short-term paper as investors could result in a U.S. commercial lender to a fund being treated as an investor, leading non-U.S. advisers to avoid U.S. lenders.[748] To the extent that the modification included in the definition of "investor" causes a non-U.S. adviser seeking to rely on the foreign private adviser exemption to limit U.S. investors in a private fund's short-term notes, the modification could have an adverse effect on capital formation and reduce U.S. lenders as sources of credit for non-U.S. funds. However, unless the extension of credit by a fund's broker-dealer or custodian bank results in the issuance of a security by the fund to its creditor, the creditor would not be considered an investor for purposes of the foreign private adviser exemption.[749]

As a result of the rule's reference to the method of calculating assets under management under Form ADV, non-U.S. advisers will use the valuation method provided in the instructions to Form ADV to verify compliance with the $25 million asset threshold included in the foreign

748 *See* Shearman Letter.

749 *See Reves v. Ernst & Young*, 494 U.S. 56 (1990). *See also supra* note 458 and accompanying text.

private adviser exemption.[750] Among other things, these instructions require advisers to use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable, when determining regulatory assets under management and to include in the calculation certain types of assets advisers previously were permitted to exclude.[751] Most commenters addressed the components of the new method of calculation in reference to the calculation of "regulatory assets under management" under Form ADV, or with respect to the calculation of private fund assets for purposes of the private fund adviser exemption.[752]

As discussed in the Proposing Release, some non-U.S. advisers to private funds may value assets based on their fair value in accordance with GAAP or other international accounting standards that require the use of fair value, while other advisers to private funds currently may not use fair value methodologies.[753] We noted above that the costs associated with fair valuation will vary based on factors such as the nature of the asset, the number of positions that do not have a market value, and whether the adviser has the ability to value such assets internally or relies on a third party for valuation services.[754] Nevertheless, we do not believe that the requirement to use fair value methodologies will result in significant costs for these advisers to

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750 *See supra* Section II.C.5.

751 *See supra* Section II.B.2.a.

752 *See* Implementing Adopting Release, *supra* note 32, discussion at section II.A.3; *supra* Section II.B.2.a. Among those commenters who addressed the components specifically with respect to the foreign private adviser exemption, one noted that because of the requirement to include proprietary assets in the calculation, "managers, in order to qualify for the [exemption], will have an incentive to reduce their personal commitments to the private funds, and manage their own assets individually." *See* ABA Letter. This result, argues the commenter, will not be in the best interest of investors, who benefit from managers having "skin the game." As discussed in Section II.B.2, if private fund investors value their advisers' co-investments as suggested by the commenter, we expect that the investors will demand them and their advisers will structure their businesses accordingly.

753 *See* Proposing Release, *supra* note 26, at n.365 and accompanying text.

754 *See supra* note 676 and accompanying text.

these funds.[755] Commission staff estimates that such advisers will each incur $1,320 in internal costs to conform its internal valuations to a fair value standard.[756] In the event a fund does not have an internal capability for valuing illiquid assets, we expect that it will be able to obtain pricing or valuation services from an outside administrator or other service provider. Staff estimated that the annual cost of such a service will range from $1,000 to $120,000 annually, which could be borne by several funds that invest in similar assets or have similar investment strategies.[757] We did not receive any comments on these estimates.

VI. REGULATORY FLEXIBILITY CERTIFICATION

The Commission certified in the Proposing Release, pursuant to section 605(b) of the Regulatory Flexibility Act,[758] that proposed rules 203(l)-1 and 203(m)-1 under the Advisers Act would not, if adopted, have a significant economic impact on a substantial number of small entities.[759] As we explained in the Proposing Release, under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year ("small

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755 *See supra* text following note 676.

756 *See supra* note 679.

757 *See supra* note 680.

758 5 U.S.C. 605(b)

759 *See* Proposing Release, *supra* note 26, at section VI.

adviser").[760]

Investment advisers solely to venture capital funds and advisers solely to private funds in each case with assets under management of less than $25 million would remain generally ineligible for registration with the Commission under section 203A of the Advisers Act.[761] We expect that any small adviser solely to existing venture capital funds that would not be ineligible to register with the Commission would be able to avail itself of the exemption from registration under the grandfathering provision. If an adviser solely to a new venture capital fund could not avail itself of the exemption because, for example, the fund it advises did not meet the definition of "venture capital fund," we anticipate that the adviser could avail itself of the exemption in section 203(m) of the Advisers Act as implemented by rule 203(m)-1. Similarly, we expect that any small adviser solely to private funds would be able to rely on the exemption in section 203(m) of the Advisers Act as implemented by rule 203(m)-1.

Thus, we believe that small advisers solely to venture capital funds and small advisers to other private funds will generally be ineligible to register with the Commission. Those small advisers that may not be ineligible to register with the Commission, we believe, would be able to rely on the venture capital fund adviser exemption under section 203(l) of the Advisers Act or the private fund adviser exemption under section 203(m) of that Act as implemented by our rules. For these reasons, we certified in the Proposing Release that rules 203(l)-1 and 203(m)-1 under the Advisers Act would not, if adopted, have a significant economic impact on a substantial number of small entities. Although we requested written comments regarding this

760 Rule 0-7(a) (17 CFR 275.0-7(a)).

761 Section 203A of the Advisers Act (prohibiting an investment adviser that is regulated or required to be regulated as an investment adviser in the State in which it maintains its principal office and place of business from registering with the Commission unless the adviser has $25 million or more in assets under management or is an adviser to a registered investment company).

certification, no commenters responded to this request.

VII. STATUTORY AUTHORITY

The Commission is adopting rule 202(a)(30)-1 under the authority set forth in sections 403 and 406 of the Dodd-Frank Act, to be codified at sections 203(b) and 211(a) of the Advisers Act, respectively (15 U.S.C. 80b-3(b), 80b-11(a)). The Commission is adopting rule 203(l)-1 under the authority set forth in sections 406 and 407 of the Dodd-Frank Act, to be codified at sections 211(a) and 203(l) of the Advisers Act, respectively (15 U.S.C. 80b-11(a), 80b-3(l)). The Commission is adopting rule 203(m)-1 under the authority set forth in sections 406 and 408 of the Dodd-Frank Act, to be codified at sections 211(a) and 203(m) of the Advisers Act, respectively (15 U.S.C. 80b-11(a), 80b-3(m)).

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements; Securities

TEXT OF RULES

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

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The general authority citation for Part 275 is revised to read as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6(a), and 80b-11, unless otherwise noted.

* * * * *

2. Section 275.202(a)(30)-1 is added to read as follows:

§ 275.202(a)(30)-1 Foreign private advisers.

(a) *Client.* You may deem the following to be a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)):

(1) A natural person, and:

(i) Any minor child of the natural person;

(ii) Any relative, spouse, spousal equivalent, or relative of the spouse or of the spousal equivalent of the natural person who has the same principal residence;

(iii) All accounts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries; and

(iv) All trusts of which the natural person and/or the persons referred to in this paragraph (a)(1) are the only primary beneficiaries;

(2)(i) A corporation, general partnership, limited partnership, limited liability company, trust (other than a trust referred to in paragraph (a)(1)(iv) of this section), or other legal organization (any of which are referred to hereinafter as a "legal organization") to which you provide investment advice based on its investment objectives rather than the individual investment objectives of its shareholders, partners, limited partners, members, or beneficiaries (any of which are referred to hereinafter as an "owner"); and

(ii) Two or more legal organizations referred to in paragraph (a)(2)(i) of this section that have identical owners.

(b) *Special rules regarding clients.* For purposes of this section:

(1) You must count an owner as a client if you provide investment advisory services to the owner separate and apart from the investment advisory services you provide to the legal organization, provided, however, that the determination that an owner is a client will not affect the applicability of this section with regard to any other owner;

(2) You are not required to count an owner as a client solely because you, on behalf

of the legal organization, offer, promote, or sell interests in the legal organization to the owner, or report periodically to the owners as a group solely with respect to the performance of or plans for the legal organization's assets or similar matters;

(3) A limited partnership or limited liability company is a client of any general partner, managing member or other person acting as investment adviser to the partnership or limited liability company;

(4) You are not required to count a private fund as a client if you count any investor, as that term is defined in paragraph (c)(2) of this section, in that private fund as an investor in the United States in that private fund; and

(5) You are not required to count a person as an investor, as that term is defined in paragraph (c)(2) of this section, in a private fund you advise if you count such person as a client in the United States.

Note to paragraphs (a) and (b): These paragraphs are a safe harbor and are not intended to specify the exclusive method for determining who may be deemed a single client for purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)).

(c) *Definitions.* For purposes of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)):

(1) *Assets under management* means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this chapter).

(2) *Investor* means:

(i) Any person who would be included in determining the number of beneficial owners of the outstanding securities of a private fund under section 3(c)(1) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)(1)), or whether the outstanding securities of a private fund are owned exclusively by qualified purchasers under section 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(7)); and

(ii) Any beneficial owner of any outstanding short-term paper, as defined in section 2(a)(38) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(38)), issued by the private fund.

Note to paragraph (c)(2): You may treat as a single investor any person who is an investor in two or more private funds you advise.

(3) *In the United States* means with respect to:

(i) Any client or investor, any person who is a U.S. person as defined in § 230.902(k) of this chapter, except that any discretionary account or similar account that is held for the benefit of a person in the United States by a dealer or other professional fiduciary is in the United States if the dealer or professional fiduciary is a related person, as defined in § 275.206(4)-2(d)(7), of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

Note to paragraph (c)(3)(i): A person who is in the United States may be treated as not being in the United States if such person was not in the United States at the time of becoming a client or, in the case of an investor in a private fund, each time the investor acquires securities issued by the fund.

(ii) Any place of business, *in the United States*, as that term is defined in § 230.902(l) of this chapter; and

(iii) The public, *in the United States*, as that term is defined in § 230.902(l) of this chapter.

(4) *Place of business* has the same meaning as in § 275.222-1(a).

(5) *Spousal equivalent* has the same meaning as in § 275.202(a)(11)(G)-1(d)(9).

(d) *Holding out*. If you are relying on this section, you shall not be deemed to be holding yourself out generally to the public in the United States as an investment adviser, within the meaning of section 202(a)(30) of the Act (15 U.S.C. 80b-2(a)(30)), solely because you participate in a non-public offering in the United States of securities issued by a private fund under the Securities Act of 1933 (15 U.S.C. 77a).

3. Section 275.203(l) -1 is added to read as follows:

§ 275.203(l)-1 Venture capital fund defined.

(a) *Venture capital fund defined.* For purposes of section 203(l) of the Act (15 U.S.C. 80b-3(l)), a venture capital fund is any private fund that:

(1) Represents to investors and potential investors that it pursues a venture capital strategy;

(2) Immediately after the acquisition of any asset, other than qualifying investments or short-term holdings, holds no more than 20 percent of the amount of the fund's aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments, valued at cost or fair value, consistently applied by the fund;

(3) Does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15 percent of the private fund's aggregate capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days, except that any guarantee by the private fund of a qualifying portfolio company's obligations up to the amount of the value of the private fund's investment in the qualifying portfolio company is not subject to the 120 calendar day limit;

(4) Only issues securities the terms of which do not provide a holder with any right, except in extraordinary circumstances, to withdraw, redeem or require the repurchase of such securities but may entitle holders to receive distributions made to all holders pro rata; and

(5) Is not registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53).

(b) *Certain pre-existing venture capital funds*. For purposes of section 203(l) of the Act (15 U.S.C. 80b-3(l)) and in addition to any venture capital fund as set forth in paragraph (a) of this section, a venture capital fund also includes any private fund that:

(1) Has represented to investors and potential investors at the time of the offering of the private fund's securities that it pursues a venture capital strategy;

(2) Prior to December 31, 2010, has sold securities to one or more investors that are not related persons, as defined in § 275.206(4)-2(d)(7), of any investment adviser of the private fund; and

(3) Does not sell any securities to (including accepting any committed capital from) any person after July 21, 2011.

(c) *Definitions*. For purposes of this section:

(1) *Committed capital* means any commitment pursuant to which a person is obligated to:

(i) Acquire an interest in the private fund; or

(ii) Make capital contributions to the private fund.

(2) *Equity security* has the same meaning as in section 3(a)(11) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(11)) and § 240.3a11-1 of this chapter.

(3) *Qualifying investment* means:

(i) An equity security issued by a qualifying portfolio company that has been acquired directly by the private fund from the qualifying portfolio company;

(ii) Any equity security issued by a qualifying portfolio company in exchange for an equity security issued by the qualifying portfolio company described in paragraph (c)(3)(i) of this section; or

(iii) Any equity security issued by a company of which a qualifying portfolio company is a majority-owned subsidiary, as defined in section 2(a)(24) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(24)), or a predecessor, and is acquired by the private fund in exchange for an *equity security* described in paragraph (c)(3)(i) or (c)(3)(ii) of this section.

(4) *Qualifying portfolio company* means any company that:

(i) At the time of any investment by the private fund, is not reporting or foreign traded and does not control, is not controlled by or under common control with another company, directly or indirectly, that is reporting or foreign traded;

(ii) Does not borrow or issue debt obligations in connection with the private fund's investment in such company and distribute to the private fund the proceeds of such borrowing or issuance in exchange for the private fund's investment; and

(iii) Is not an investment company, a private fund, an issuer that would be an investment company but for the exemption provided by § 270.3a-7 of this chapter, or a commodity pool.

(5) *Reporting or foreign traded* means, with respect to a company, being subject to the reporting requirements under section 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)), or having a security listed or traded on any exchange or organized market

operating in a foreign jurisdiction.

(6) *Short-term holdings* means cash and cash equivalents, as defined in § 270.2a51-1(b)(7)(i) of this chapter, U.S. Treasuries with a remaining maturity of 60 days or less, and shares of an open-end management investment company registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) that is regulated as a money market fund under § 270.2a-7 of this chapter.

Note: For purposes of this section, an investment adviser may treat as a private fund any issuer formed under the laws of a jurisdiction other than the United States that has not offered or sold its securities in the United States or to U.S. persons in a manner inconsistent with being a private fund, provided that the adviser treats the issuer as a private fund under the Act (15 U.S.C. 80b) and the rules thereunder for all purposes.

4. Section 275.203(m)-1 is added to read as follows:

§ 275.203(m)-1 Private fund adviser exemption.

(a) *United States investment advisers*. For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business in the United States is exempt from the requirement to register under section 203 of the Act if the investment adviser:

(1) Acts solely as an investment adviser to one or more qualifying private funds; and

(2) Manages private fund assets of less than $150 million.

(b) *Non-United States investment advisers*. For purposes of section 203(m) of the Act (15 U.S.C. 80b-3(m)), an investment adviser with its principal office and place of business outside of the United States is exempt from the requirement to register under section 203 of the Act if:

(1) The investment adviser has no client that is a United States person except for one

or more qualifying private funds; and

(2) All assets managed by the investment adviser at a place of business in the United States are solely attributable to private fund assets, the total value of which is less than $150 million.

(c) *Frequency of Calculations*. For purposes of this section, calculate private fund assets annually, in accordance with General Instruction 15 to Form ADV (§ 279.1 of this chapter).

(d) *Definitions*. For purposes of this section:

(1) *Assets under management* means the regulatory assets under management as determined under Item 5.F of Form ADV (§ 279.1 of this chapter).

(2) *Place of business* has the same meaning as in § 275.222-1(a).

(3) *Principal office and place of business* of an investment adviser means the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser.

(4) *Private fund assets* means the investment adviser's assets under management attributable to a qualifying private fund.

(5) *Qualifying private fund* means any private fund that is not registered under section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8) and has not elected to be treated as a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-53). For purposes of this section, an investment adviser may treat as a private fund an issuer that qualifies for an exclusion from the definition of an "investment company," as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), in addition to those provided by section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(1) or 15 U.S.C. 80a-3(c)(7)), provided that the

investment adviser treats the issuer as a private fund under the Act (15 U.S.C. 80b) and the rules thereunder for all purposes.

(6) *Related person* has the same meaning as in § 275.206(4)-2(d)(7).

(7) *United States* has the same meaning as in § 230.902(l) of this chapter.

(8) *United States person* means any person that is a U.S. person as defined in § 230.902(k) of this chapter, except that any discretionary account or similar account that is held for the benefit of a United States person by a dealer or other professional fiduciary is a United States person if the dealer or professional fiduciary is a related person of the investment adviser relying on this section and is not organized, incorporated, or (if an individual) resident in the United States.

Note to paragraph (d)(8): A client will not be considered a United States person if the client was not a United States person at the time of becoming a client.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: June 22, 2011

Commissioner Casey
Commissioner Paredes
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

Release No. IA-3221; File No. S7-36-10

RIN 3235-AK82

Rules Implementing Amendments to the Investment Advisers Act of 1940

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting new rules and rule amendments under the Investment Advisers Act of 1940 to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. These rules and rule amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act that, among other things, increase the statutory threshold for registration by investment advisers with the Commission, require advisers to hedge funds and other private funds to register with the Commission, and require reporting by certain investment advisers that are exempt from registration. In addition, we are adopting rule amendments, including amendments to the Commission's pay to play rule, that address a number of other changes made by the Dodd-Frank Act.

EFFECTIVE DATE: The effective date of rules 204-4 and 203A-5(b) and (c), amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 204-1, 204-2, 206(4)-5, 222-1, and 222-2, and amendments to Forms ADV, ADV-E, ADV-H, and ADV-NR is [insert 60 days from date of publication in the Federal Register]. The effective date of rule 203A-5(a) and the amendment to rule 203-1 is July 21, 2011. Rules 202(a)(11)-1, 203(b)(3)-1, 203(b)(3)-2, and 203A-4 are rescinded effective [insert 60 days from date of publication in the Federal Register].

COMPLIANCE DATE: See section III of this Release.

FOR FURTHER INFORMATION CONTACT: David P. Bartels, Attorney-Adviser, Michael J. Spratt, Attorney-Adviser, Jennifer R. Porter, Senior Counsel, Devin F. Sullivan, Senior Counsel, Melissa A. Roverts, Branch Chief, Matthew N. Goldin, Branch Chief, or Daniel S. Kahl, Assistant Director, at (202) 551-6787 or IArules@sec.gov, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is adopting rules 203A-5 and 204-4 [17 CFR 275.203A-5 and 275.204-4] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act"),[1] amendments to rules 0-7, 203-1, 203A-1, 203A-2, 203A-3, 204-1, 204-2, 206(4)-5, 222-1, and 222-2 [17 CFR 275.0-7, 275.203-1, 275.203A-1, 275.203A-2, 275.203A-3 , 275.204-1, 275.204-2, 275.206(4)-5, 275. 222-1, and 275.222-2] under the Advisers Act, and amendments to Form ADV, Form ADV-E, Form ADV-H, and Form ADV-NR [17 CFR 279.1, 279.3, and 279.4] under the Advisers Act. The Commission is also rescinding rules 202(a)(11)-1, 203(b)(3)-1, 203(b)(3)-2, and 203A-4 [17 CFR 275.202(a)(11)-1, 275.203(b)(3)-1, 275.203(b)(3)-2, and 275.203A-4] under the Advisers Act.

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1 Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rule 0-7, rule 202(a)(11)-1, rule 203-1, rule 203(b)(3)-1, rule 203(b)(3)-2, rule 203A-1, rule 203A-2, rule 203A-3, rule 203A-4, rule 203A-5, rule 204-1, rule 204-2, rule 204-4, rule 206(4)-5, rule 222-1, or rule 222-2, or any paragraph of these rules, we are referring to 17 CFR 275.0-7, 17 CFR 275.202(a)(11)-1, 17 CFR 275.203-1; 17 CFR 275.203(b)(3)-1, 17 CFR 275.203(b)(3)-2, 17 CFR 275.203A-1, 17 CFR 275.203A-2, 17 CFR 275.203A-3, 17 CFR 275.203A-4, 17 CFR 275.203A-5, 17 CFR 275.204-1, 17 CFR 275.204-2, 17 CFR 275.204-4, 17 CFR 275.206(4)-5, 17 CFR 275.222-1, or 17 CFR 275.222-2, respectively, of the Code of Federal Regulations ("CFR"), in which these rules are published.

I. BACKGROUND

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") which, among other things, amends certain provisions of the Advisers Act.[2] Title IV of the Dodd-Frank Act ("Title IV") includes most of the amendments to the Advisers Act. These amendments include provisions that reallocate primary responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers – *i.e.*, those that have between $25 million and $100 million of assets under management.[3] These provisions will require a significant number of advisers currently registered with the Commission to withdraw their registrations with the Commission and to switch to registration with one or more state securities authorities. In addition, Title IV repeals the "private adviser exemption" contained in section 203(b)(3) of the Advisers Act on which many advisers, including those to many hedge funds, private equity funds, and venture capital funds, rely in order to avoid registration under the Act.[4] In eliminating this provision, Congress created, or directed us to adopt other, in some ways narrower,

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2 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3 *See* section 410 of the Dodd-Frank Act; Advisers Act section 203A. *See also* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416, § 303 (1996) ("NSMIA") (allocating to states certain responsibility for small investment advisers with less than $25 million in assets under management).

4 *See* section 403 of the Dodd-Frank Act. Section 203(b)(3) currently exempts from registration any investment adviser who during the course of the preceding twelve months, has had fewer than fifteen clients, and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1) ("Investment Company Act"), or a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act (15 U.S.C. 80a-54). Section 403 of the Dodd-Frank Act eliminates this "private adviser" exemption from section 203(b)(3) and replaces it with a new exemption for "foreign private advisers." We are also adopting today a rule to clarify the definition of a "foreign private adviser" in a separate release. *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3222 ("Exemptions Adopting Release").

exemptions for advisers to certain types of private funds – *e.g.*, venture capital funds – which provide that the Commission shall require such advisers to submit such reports "as the Commission determines necessary or appropriate in the public interest."[5] These provisions in Title IV of the Dodd-Frank Act will be effective on July 21, 2011.[6]

On November 19, 2010, we proposed new rules and amendments to existing rules and forms to give effect to these provisions.[7] Specifically, we proposed a new rule and amendments to our rules and forms to facilitate mid-size advisers' transition from Commission to state registration.[8] We also proposed a new rule and rule amendments to require certain advisers to private funds that are exempt from registration under the Advisers Act to submit reports to us.[9] We proposed rule amendments, including amendments to the Commission's "pay to play" rule,[10] to address a number of other changes to the Advisers Act made by the Dodd-Frank Act.[11] Also, in light of our increased responsibility for oversight of private funds, we proposed to require advisers to those funds to provide us with additional information about the operation of those

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5 *See* section 407 of the Dodd-Frank Act ("The Commission shall require such advisers to…provide to the Commission such annual or other reports as the Commission determines necessary or appropriate in the public interest or for the protection of investors"). *See also* section 408 of the Dodd-Frank Act. Section 407 of the Dodd-Frank Act, which adds section 203(l) to the Advisers Act, exempts advisers solely to one or more venture capital funds. Section 408, which adds section 203(m) to the Advisers Act, exempts advisers solely to private funds with assets under management in the United States of less than $150 million.

6 *See* section 419 of the Dodd-Frank Act. For purposes of this Release, unless indicated otherwise, when we refer to the effective date of the Dodd-Frank Act, we are referring to the effective date of Title IV, which is July 21, 2011.

7 *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3110 (Nov. 19, 2010) [75 FR 77052 (Dec. 10, 2010)] ("Implementing Proposing Release").

8 *See id.* at section II.A.

9 *See id.* at section II.B. Throughout this Release, we refer to advisers exempt from registration under sections 203(l) and 203(m) of the Advisers Act as "exempt reporting advisers."

10 Rule 206(4)-5.

11 *See* Implementing Proposing Release, *supra* note 7, at section II.D.

funds.[12] Finally, we proposed additional changes to Form ADV that would enhance our oversight of advisers and also would enable us to identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.[13]

We received more than 70 comment letters on our proposals, most of which were from advisers, trade or professional organizations, and law firms.[14] Commenters generally supported our approach to facilitate mid-size advisers' transition from Commission to state registration, and our amendments to Form ADV, including those requiring disclosure of additional information about private funds. Many, however, urged us to take a different approach to, among other things, our proposed amendments to the pay to play rule. We are adopting the proposed rules and rule amendments with several modifications to address commenters' concerns. We address these modifications and comments in detail below.

II. DISCUSSION

A. Eligibility for Registration with the Commission: Section 410

Section 203A of the Advisers Act, enacted in 1996 as part of the National Securities Markets Improvement Act ("NSMIA"), generally prohibits an investment adviser regulated by the state in which it maintains its principal office and place of business from registering with the

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12 *See* sections 403, 407 and 408 of the Dodd-Frank Act; Implementing Proposing Release, *supra* note 7, at section II.C.

13 *See* Implementing Proposing Release, *supra* note 7, at section II.C; section 956 of the Dodd-Frank Act.

14 Comment letters submitted in File No. S7-36-10 are available on the Commission's website at: http://www.sec.gov/comments/s7-36-10/s73610.shtml. We also considered those comments submitted in File No. S7-37-10 (*Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers with Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3111 (Nov. 19, 2010) [75 FR 77190 (Dec. 10, 2010)] ("Exemptions Proposing Release")) that addressed the rules and amendments adopted in this Release. Those comments are available at on the Commission's website at: http://www.sec.gov/comments/s7-37-10/s73710.shtml.

Commission unless it has at least $25 million of assets under management,[15] and preempts certain state laws regulating advisers that are registered with the Commission.[16] This provision makes the states the primary regulators of smaller advisers and the Commission the primary regulator of larger advisers.[17]

Section 410 of the Dodd-Frank Act creates a new category of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the states by prohibiting from Commission registration an investment adviser that is required to be registered as an investment adviser in the state in which it maintains its principal office and place of business and that has assets under management between $25 million and $100 million.[18] Unlike a small adviser, a mid-sized adviser must register with the Commission: (i) if the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office

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15 Advisers Act section 203A(a)(1). The prohibition does not apply if the investment adviser is an adviser to an investment company registered under the Investment Company Act, or if the adviser is eligible for one of six exemptions the Commission has adopted. *See id.*; rule 203A-2; *infra* section II.A.5.

16 An investment adviser must register with the Commission unless it is prohibited from registering under section 203A of the Advisers Act or is exempt from registration under section 203. Advisers Act section 203(a). Investment advisers that are prohibited from registering with the Commission are subject to regulation by the states, but the antifraud provisions of the Advisers Act continue to apply to them. *See* Advisers Act sections 203A(b), 206. For SEC-registered investment advisers, state laws requiring registration, licensing, and qualification are preempted, but states may investigate and bring enforcement actions alleging fraud or deceit, require notice filings of documents filed with the Commission, and require investment advisers to pay state notice filing fees. *See* Advisers Act section 203A(b); NSMIA, *supra* note 3, at sections 307(a) and (b). Section 410 of the Dodd-Frank Act did not amend sections 203A(a)(1) or 203(a) of the Advisers Act.

17 *See* S. REP. NO. 104-293, at 4 (1996). *See also Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1633, section I (May 15, 1997) [62 FR 28112 (May 22, 1997)] ("NSMIA Adopting Release").

18 *See* section 410 of the Dodd-Frank Act (adding new section 203A(a)(2) of the Advisers Act). This amendment increases the threshold above which all investment advisers must register with the Commission from $25 million to $100 million. *See* S. REP. NO. 111-176, at 76 (2010) ("Senate Committee Report"). We are further increasing this threshold to $110 million, pursuant to authority granted to us by Congress. *See* section 410 of the Dodd-Frank Act; *infra* section II.A.4.

performing like functions) of the state in which it maintains its principal office and place of business; or (ii) if registered with that state, the adviser would not be subject to examination as an investment adviser by that securities commissioner.[19] Section 203A(c) of the Advisers Act, which was not amended by the Dodd-Frank Act, permits the Commission to exempt small and mid-sized advisers from the prohibitions on Commission registration,[20] and we have adopted six exemptions for small advisers pursuant to this authority.[21]

As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 3,200 SEC-registered advisers will be required to withdraw their registrations and register with one or more state securities authorities.[22] We are working closely with the state securities

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19 *See* section 410 of the Dodd-Frank Act. A mid-sized adviser also is required to register with the Commission if it is an adviser to a registered investment company or business development company under the Investment Company Act; therefore, mid-sized advisers to registered investment companies and business development companies are not permitted to withdraw their Commission registrations. *Compare* section 410 of the Dodd-Frank Act *with* Advisers Act section 203A(a)(1). Additionally, a mid-sized adviser may register with the Commission if the adviser is required to register in 15 or more states. *See* section 410 of the Dodd-Frank Act. For a discussion of advisers required to register in multiple states, see *infra* section II.A.5.c.

20 For the Commission to permit the registration of small and mid-sized advisers with the Commission, application of the prohibition from registration must be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of section 203A. Advisers Act section 203A(c). The Commission's exercise of this authority not only would permit registration with the Commission, but also would result in the preemption of state law with respect to the advisers that register with us as a result of an exemption. *See* Advisers Act sections 203(a), 203A(b), and 203A(c).

21 *See* rule 203A-2 (permitting the following types of advisers to register with the Commission: (i) nationally recognized statistical rating organizations ("NRSROs"); (ii) certain pension consultants; (iii) investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) certain multi-state investment advisers; and (vi) certain internet advisers).

22 According to data from the Investment Adviser Registration Depository ("IARD") as of April 7, 2011, 3,531 SEC-registered advisers either: (i) had assets under management between $25 million and $90 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $90 million and are not relying on an exemption from registration. We estimate that 350 of these advisers will not switch to state registration because their principal office and place of business is located in Minnesota, New York, or Wyoming, which did not advise our staff that advisers registered with them are subject to examination. *See*

authorities to provide an orderly transition of investment adviser registrants to state regulation. In addition, we are adopting rules and rule amendments, discussed below, that provide us with a means of identifying advisers that must transition to state regulation, that clarify the application of new statutory provisions, and that modify certain exemptions from the prohibition on Commission registration that we previously adopted under section 203A of the Act.

1. Transition to State Registration

We are adopting new rule 203A-5 to provide for an orderly transition to state registration for mid-sized advisers that will no longer be eligible to register with the Commission.[23]

- *Existing Registrants.* Under the rule, *each* adviser registered with us on January 1, 2012 must file an amendment to its Form ADV no later than March 30, 2012.[24] These amendments will respond to new items in Form ADV (discussed below) and will identify mid-sized advisers no longer eligible to remain registered with the

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infra note 152 (according to IARD data as of April 7, 2011, there were 63 mid-sized advisers in Minnesota, 286 in New York, and 1 in Wyoming). As a result, we estimate that approximately 3,200 advisers will switch to state registration. 3,531 SEC-registered advisers – 350 advisers not switching to state registration = 3,181 advisers. In the Implementing Proposing Release, we estimated that approximately 4,100 SEC-registered advisers would be required to withdraw their registrations and register with one or more state securities authorities, based on IARD data as of September 1, 2010. *See* Implementing Proposing Release, *supra* note 7, at n.15. We have lowered our estimate by 900 advisers to account for the advisers that have between $90 million and $100 million of assets under management that may remain registered with us as a result of the amendments we are adopting to rule 203A-1, the advisers that have withdrawn their registrations with us since that time, and as discussed above, the advisers that will not switch registration because they have a principal office and place of business in Minnesota, New York or Wyoming. *See* section II.A.4. for a discussion of adopted rule 203A-1. Based on IARD data as of April 7, 2011, 244 advisers had assets under management of between $90 million and $100 million and, from September 2, 2010 to April 7, 2011, 405 advisers withdrew their registrations with us and 114 advisers initially registered with us.

23 As proposed, we are also amending the instructions to Form ADV to explain this process. *See* amended Form ADV: General Instructions (special one-time instruction for Dodd-Frank transition filing for SEC-registered advisers).

24 New rule 203A-5(b). In this filing, advisers will report the current market value of their assets under management determined within 90 days of the filing.

Commission.[25] Mid-sized advisers that are no longer eligible for Commission registration must withdraw their registrations with us after filing their Form ADV amendments by filing Form ADV-W[26] no later than June 28, 2012.[27] Mid-sized advisers registered with the Commission as of July 21, 2011 must remain registered with the Commission (unless an exemption from Commission registration is available) until January 1, 2012.[28]

- *New Applicants*. Until July 21, 2011, when the amendments to section 203A(a)(2) take effect, advisers applying for registration with the Commission that qualify as mid-sized advisers under section 203A(a)(2) of the Act[29] may register with either the Commission or the appropriate state securities authority.[30] Thereafter, all such

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25 *See infra* sections II.A.2. and II.C. Advisers will be required to update all of the items in Form ADV, and this filing will serve as the annual updating amendment for most advisers. *See infra* note 48 and accompanying text.

26 17 CFR 279.2 ("Form ADV-W").

27 New rule 203A-5(c)(1).

28 New rule 203A-5(a). We are using the authority provided to us in section 203A(c) of the Act to require mid-sized advisers to remain registered with the Commission until the programming of the IARD is completed. *See infra* notes 35-41 and accompanying text. For a discussion of section 203A(c) of the Act, see *supra* note 20. We believe that the failure to provide a transition period during the beginning of 2012 would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A of the Act. We are also adopting, as proposed, a provision that will permit us to postpone the effectiveness of, and impose additional terms and conditions on, an adviser's withdrawal from SEC registration if we institute certain proceedings before the adviser files Form ADV-W. New rule 203A-5(c)(2). This limitation on withdrawal of an adviser's registration is similar to the one we adopted to implement NSMIA in 1997. *See* NSMIA Adopting Release, *supra* note 17.

29 For a discussion of section 203A(a)(2) of the Act, see *supra* notes 18-19 and accompanying text. As discussed above, the Dodd-Frank Act amendments to this section will be effective on July 21, 2011. *See supra* note 6 and accompanying text.

30 We noted in the Implementing Proposing Release that we would not object if, on or after January 1, 2011 until the end of the transition period, any state-registered or newly-registering adviser is not registered with us, so long as the adviser reports on its Form ADV that it has between $30 million and $100 million of assets under management, is registered as an investment adviser in the state in which it maintains its principal office and place of business, and has a reasonable belief that it is required to be registered with, and is subject to examination as an investment

advisers are prohibited from registering with the Commission and must register with the state securities authorities.[31] We also note that advisers that have assets under management of $100 million or more will continue to register with the Commission (unless an exemption from registration with the Commission otherwise is available).[32]

We have made several changes to these transition provisions in response to comments we received.[33] The proposed rule would have provided mid-sized advisers with a 90-day transitional process with two "grace periods," the first providing until August 20, 2011 for an adviser to determine whether it is eligible for Commission registration and to file an amended Form ADV, and the second providing until October 19, 2011 for an adviser to register in the states and

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adviser by, that state. *See* Implementing Proposing Release, *supra* note 7, at section II.A.1. In order to account for the July 21, 2011 effective date of section 410 of the Dodd-Frank Act and the longer transition period that we are adopting (ending on June 28, 2012 instead of October 19, 2011, as proposed), beginning on July 21, 2011, these advisers will no longer be able to choose to register with us; instead, they will be will be prohibited from registering with us and must instead register with the states. *See infra* note 31. We believe that allowing these advisers to register with the Commission before January 1, 2012 only to require them to withdraw their registrations by June 28, 2012 would be burdensome, and permitting them to choose whether to register with us until the summer of 2012 would be inconsistent with the purposes of Advisers Act section 203A(a)(2), as amended by section 410 of the Dodd-Frank Act. *See supra* note 3 and accompanying text.

31 Once registered, an adviser must remain registered with the Commission (unless an exemption is available) until January 1, 2012, when it may transition to state registration as described above. Until January 1, 2012, we are exempting from section 203A(a)(2) only those mid-sized advisers *already registered* with us on July 21, 2011 that have at least $25 million in assets under management because the IARD will not be able to accept the revised Form ADV by July 21, 2011 and it is our understanding that mid-sized advisers will need additional time to switch to state registration. *See* new rule 203A-5(a); *supra* note 28 and accompanying text. As a result, on or after July 21, 2011, state-registered advisers and newly-registering advisers will be subject to the section 203A(a)(2) prohibition from Commission registration.

32 *See* Advisers Act section 203A(a)(2), as amended by the Dodd-Frank Act. *See also* Advisers Act section 203. For a discussion of the threshold requiring larger advisers to register with the Commission, see *infra* section II.A.4.

33 *See* proposed rule 203A-5(a)-(b); Implementing Proposing Release, *supra* note 7, at section II.A.1.

withdraw its registration with us.[34] We noted in the Implementing Proposing Release, however, that timing of the transition period would be affected by our ability to re-program the IARD, through which advisers file their amendments to Form ADV.[35]

We have worked closely with the Financial Industry Regulatory Authority ("FINRA"), our IARD contractor, to make the needed modifications, but it has informed us that the programming will not be completed by the July 21, 2011 effective date of the Dodd-Frank Act. We understand that beginning in November, the IARD will be updated to reflect the revisions to Form ADV that we are adopting today. We noted in the Implementing Proposing Release that if the IARD is unable to accept filings of revised Form ADV on July 21, 2011, we might consider delaying the transition process until the system could accept electronic filing of the revised form.[36]

Commenters, including the North American Securities Administrators Association, Inc. ("NASAA"), agreed with our assessment and supported delaying the transition if the IARD could not accept the revised Form ADV instead of adopting alternative requirements, such as requiring interim paper filings.[37] Many also urged us to provide additional time for mid-sized advisers to complete the switch to state registration,[38] and recommended that the Commission match the

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34 *See* proposed rule 203A-5(a)-(b); Implementing Proposing Release, *supra* note 7, at section II.A.1.

35 *See* Implementing Proposing Release, *supra* note 7, at section II.A.1.

36 *See id.*

37 Comment letter of the North American Securities Administrators Association, Inc. (Feb. 10, 2011) ("NASAA Letter") ("the benefits of electronic filing, including easy public access to the documents, are significant and would outweigh any disadvantages imposed by a delay in filing deadlines."); comment letter of Bill Dezellem, CFA, Tieton Capital Management (Jan. 4, 2011) ("Dezellem Letter"); comment letter of the National Regulatory Services (Jan. 24, 2011) ("NRS Letter"); comment letter of the New York State Bar Association, Business Law Section, Securities Regulation Committee (Apr. 1, 2011) ("NYSBA Committee Letter").

38 Comment letter of the American Bar Association, Section of Business Law, Committee on Federal Regulation of Securities, Committee on State Regulation of Securities, and the

current 180-day period[39] provided to SEC-registered advisers that must switch to state registration.[40] We are persuaded by these commenters, and, as described above, we are requiring mid-sized advisers registered with us on July 21, 2011 to remain registered until they switch to state registration after January 1, 2012.[41] As noted above, rule 203A-5 provides until March 30, 2012 for each adviser already registered with the Commission to determine whether it is eligible for Commission registration and to file an amended Form ADV,[42] and provides an additional 90

Committee on Private Equity and Venture Capital (Jan. 31, 2011) ("ABA Committees Letter"); comment letter of Altruist Financial Advisors LLC (Dec. 12, 2010) ("Altruist Letter"); comment letter of Capital Markets Compliance, LLC (Feb. 8, 2011) ("CMC Letter"); Dezellem Letter; comment letter of R.H. Dinel Investment Counsel, Inc. (Jan. 20, 2011) ("Dinel Letter"); comment letter of Financial Services Institute (Jan. 24, 2011) ("FSI Letter"); comment letter of Amy Klein (Nov. 30, 2010) ("Klein Letter"); NRS Letter; NYSBA Committee Letter; comment letter of Sadis & Goldberg LLP (Jan. 21, 2011) ("Sadis Letter"); comment letter of L.A. Schnase (Dec. 23, 2010) ("Schnase Letter"); comment letter of Seward & Kissel LLP (Jan. 31, 2011) ("Seward Letter"); comment letter of Shearman & Sterling LLP (Jan. 24, 2011) ("Shearman Letter"). Only one commenter supported the proposed 90-day grace period. Comment letter of Pickard and Djinis LLP (Jan. 21, 2011) ("Pickard Letter").

39 Our current rule provides an SEC-registered adviser that has to switch to state registration a period of 180 days after its fiscal year end to file an annual amendment to Form ADV and to withdraw its SEC registration after reporting to us that it is no longer eligible to remain registered with us. *See* rule 203A-1(b)(2); *cf.* rule 204-1(a) (requiring an adviser to file an annual amendment 90 days after its fiscal year end).

40 Altruist Letter; Dezellem Letter; FSI Letter; Klein Letter; NYSBA Committee Letter; Schnase Letter; Seward Letter; Shearman Letter. *See also* ABA Committees Letter (recommending December 31 deadline); NRS Letter (recommending rolling state registration process). One commenter stated that based on its almost three decades of experience, it "most strongly supports a defined and longer" transition period. NRS Letter. Another stated that "some states may be unable to process such filings in a timely and efficient manner." ABA Committees Letter. Several commenters echoed concerns about timely state processing of applications, noting, in particular, additional registration and compliance requirements in many states and expected delays to approve state registrations given the increase in filings as a result of the Dodd-Frank Act. *See* Altruist Letter (noting that it took 122 days for a state to approve its application). *See also* CMC Letter; Dezellem Letter; Klein Letter; NRS Letter; NYSBA Committee Letter; Schnase Letter; Seward Letter. To address potential timing issues, NASAA noted that it is recommending to advisers to file with the states as soon as possible and to the states to conditionally approve the registrations until the re-filing of Form ADV is completed. NASAA Letter.

41 *See supra* note 28 and accompanying text.

42 New rule 203A-5(a) and (b). This deadline coincides with the deadline for most advisers' required annual updating amendment (90 days from December 31, 2011), eliminating the requirement that they file an additional amendment to their Form ADV. *See* rule 204-1(a); *infra*

days (*i.e.*, by June 28, 2012) for an adviser no longer eligible for Commission registration to register with the states and withdraw its registration with us.[43] After the end of this period, we expect to cancel the registration of advisers no longer eligible to register with us that fail to file an amendment or withdraw their registrations in accordance with the rule.[44] The revised process that we are adopting today allows the Commission and state regulators to manage the transition of mid-sized advisers in an orderly manner.[45]

We are requiring that all advisers registered with us on January 1, 2012 – regardless of size – file amendments to Form ADV no later than March 30, 2012. Some commenters argued that advisers unaffected by the statutory changes effected by the Dodd-Frank Act should not have to complete and file all of Form ADV.[46] We believe such a filing is necessary for each adviser to confirm its current eligibility for Commission registration in light of the multiple

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note 48. Postponing the beginning of the transition process until January, instead of November or December, also will ensure that the refiling of Form ADV does not interfere with the November state registration and license renewal process and annual system outages for the IARD scheduled in December.

43 New rule 203A-5(c)(1). The rule 203A-5 transition period is the same 180-day transition period for advisers that fall below the $25 million threshold and have to switch to state registration. *See* rule 203A-1(b)(2). Other advisers that will be required to withdraw from registration because they are no longer eligible for Commission registration will include, for example, pension consultants with plan assets of $50 million to $200 million. *See infra* section II.A.5.b.

44 *See* Advisers Act section 203(h). As provided in the Advisers Act, an adviser would be given appropriate notice and opportunity for hearing to show why its registration should not be cancelled. Advisers Act section 211(c).

45 *See also supra* notes 24-28 and accompanying text.

46 Comment letter of the Investment Company Institute (Jan. 24, 2011) ("ICI Letter") (recommending exempting advisers that do not rely on assets under management to register with the SEC); comment letter of the Managed Funds Association (Jan. 24, 2011) ("MFA Letter") (recommending exempting private fund advisers that file an initial Form ADV by July 7); NYSBA Committee Letter (recommending exempting advisers who will continue to be eligible for Commission registration and advisers relying on the section 203(b)(3) exemption that we proposed would have to register with the Commission by July 21, 2011); Shearman Letter (recommending a more limited filing of Form ADV to determine eligibility). But most commenters supported the proposal. *See* CMC Letter; FSI Letter; NASAA Letter; NRS Letter; Pickard Letter.

statutory changes (as well as changes to the rules that we are adopting today) that could affect whether the adviser may register with the Commission.[47] These commenters' concerns also should be allayed by the new March 30, 2012 deadline for filing Form ADV that will coincide with most advisers' required annual updating amendment, eliminating the requirement that they file an additional amendment to their Form ADV.[48] Finally, as recommended by several commenters,[49] we are providing additional flexibility for an adviser to choose the date by which it must calculate its assets under management reported on Form ADV by requiring the calculation within 90 days of the transition filing, rather than 30 days.[50] This is the same amount of time that advisers are afforded to report assets under management after the end of their fiscal year on Form ADV today.[51]

2. Amendments to Form ADV

We are adopting several amendments to Item 2.A. of Part 1A of Form ADV to reflect the new threshold for registration and the revisions we are making to related rules in response to the

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47 In addition, we believe that requiring advisers to complete all of the items will provide the Commission and the state regulatory authorities with essential information about the advisers that are transitioning to state registration and the advisers that are remaining registered with the Commission. *See infra* sections II.A.2., II.C.

48 As of April 7, 2011, 10,636 of SEC-registered advisers (approximately 92%) had a fiscal year ending on December 31. These advisers will comply with rule 203A-5(b)'s Form ADV filing requirement by submitting their annual amendment. SEC-registered advisers not required to file an annual updating amendment between January 1, 2012 and March 30, 2012 will file an other-than-annual amendment, but they will complete all of the items on Part 1A of Form ADV (not just the items required to be updated in a typical other-than-annual amendment).

49 Altruist Letter (quarter end); comment letter of Dechert LLP (Jan. 24, 2011) ("Dechert General Letter") (rolling 12-month average); Dezellem Letter (fiscal year end); Dinel Letter (rolling three-year average); NYSBA Committee Letter (quarter end); Seward Letter (quarter end); Shearman Letter (quarter end). Several commenters argued, for example, that providing for the use of end of quarter numbers precludes an administrate burden for many advisers that value assets on a quarterly basis because most advisers already value assets quarterly to calculate fees. Altruist Letter; NYSBA Committee Letter; Seward Letter; Shearman Letter.

50 New rule 203A-5(b).

51 Form ADV: Instructions for Part 1A, instr. 5.b.(4).

enactment of the Dodd-Frank Act.[52] Item 2 requires each investment adviser applying for registration to indicate its basis for registration with the Commission and to report annually whether it is eligible to remain registered. We are adopting the revisions to Item 2.A. substantially as proposed,[53] except that we have revised the instructions and Item 2.A.(1) to reflect our adoption of a "buffer" for advisers with close to $100 million in assets under management, which we discuss below.[54]

To implement the new prohibition on registration for mid-sized advisers, we are amending Item 2.A. to reflect the new statutory threshold for registration. Item 2.A. requires each adviser registered with us (and each applicant for registration) to identify whether it is eligible to register with the Commission because it: (i) is a large adviser that has $100 million or more of regulatory assets under management (or $90 million or more if an adviser is filing its most recent annual updating amendment and is already registered with us);[55] (ii) is a mid-sized

52 We are adopting conforming amendments to Item 2.A. and the related items in Schedule D to reflect revisions to rule 203A-2, which provides exemptions from the prohibition on registration with the Commission. *See* amended Form ADV Items 2.A.(7), (10) and Section 2.A.(10) of amended Schedule D; *infra* sections II.A.4., II.A.5., II.A.7. Additionally, we are making conforming changes to the instructions for Form ADV. *See* amended Form ADV: Instructions for Part 1A, instr. 2. We also are revising the terms used in the rules and Form ADV to refer to the securities authorities in each state with a single defined term, "state securities authority." *Compare* amended rules 203A-1, 203A-2(c) and (d), 203A-3(e); amended Form ADV: Glossary *with* rules 203A-1(b)(1), 203A-2(e)(1), 203A-4; Form ADV: Glossary. *See also* section 410 of the Dodd-Frank Act (amended section 203A(a)(2) of the Advisers Act describes a state securities authority as "the securities commissioner (or any agency or office performing like functions)").

53 One commenter expressed the view that the item was "sufficiently and clearly written." NRS Letter.

54 *See* amended Form ADV: Instructions for Part 1A, instr. 2.a. For a discussion of the buffer, see *infra* section II.A.4.

55 Amended Form ADV, Part 1A, Item 2.A.(1). We are revising Form ADV to use the term "regulatory assets under management" instead of "assets under management." For a discussion of regulatory assets under management, see *infra* section II.A.3.

adviser that does not meet the criteria for state registration or is not subject to examination;[56] (iii) has its principal office and place of business in Wyoming (which does not regulate advisers) or outside the United States;[57] (iv) meets the requirements for one or more of the revised exemptive rules under section 203A discussed below;[58] (v) is an adviser (or subadviser) to a registered investment company;[59] (vi) is an adviser to a business development company and has at least $25 million of regulatory assets under management;[60] or (vii) received an order permitting the adviser to register with the Commission.[61]

Each adviser must check at least one of these items, or indicate that the adviser is no longer eligible to remain registered with the Commission.[62] The IARD will prevent an applicant from registering with us, and an adviser from remaining registered, unless it represents on Form ADV that it meets at least one of the specific eligibility criteria set forth in the Advisers Act or our rules.

3. Assets Under Management

In most cases, the amount of assets an adviser has under management will determine whether the adviser must register with the Commission or one or more states. Section

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56 Amended Form ADV, Part 1A, Item 2.A.(2). For a discussion of the criteria for state registration and examination for mid-sized advisers, see *infra* section II.A.7.

57 Amended Form ADV, Part 1A, Items 2.A.(3), 2.A.(4).

58 Amended Form ADV, Part 1A, Items 2.A.(7)-2.A.(11). For a discussion of the exemptive rules, see *infra* section II.A.5.

59 Amended Form ADV, Part 1A, Item 2.A.(5).

60 Amended Form ADV, Part 1A, Item 2.A.(6).

61 Amended Form ADV, Part 1A, Item 2.A.(12). We are also deleting the item for NRSROs to register as investment advisers. For a discussion of NRSROs, see *infra* section II.A.5.a.

62 Amended Form ADV, Part 1A, Item 2.A.(13). One commenter asked that we clarify whether advisers must check every box in Item 2.A. that they are eligible to check. Schnase Letter. The instructions to the item indicate that an adviser must check "at least one" of the items, but does not require all bases for registration be identified. Amended Form ADV: Instructions for Part 1A, instr. 2.

203A(a)(2) of the Act defines "assets under management" as the "securities portfolios" with respect to which an adviser provides "continuous and regular supervisory or management services."[63] Instructions to Form ADV provide advisers with guidance in applying this provision, and until now have permitted advisers to exclude certain types of assets that otherwise would have to be included.[64]

We are adopting revisions to the instructions to Part 1A of Form ADV to implement a uniform method for advisers to calculate assets under management that will be used under the Act for regulatory purposes in addition to assessing whether an adviser is eligible to register with the Commission.[65] As discussed in more detail below, the amendments improve consistency by eliminating choices the instructions had provided advisers that have enabled some of them to opt in or out of federal or state regulation (by including or excluding a class of assets). We are also amending rule 203A-3 to continue to require that the calculation of "assets under management" for purposes of section 203A of the Act be the calculation of the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services, as reported on the investment adviser's Form ADV.[66] Finally, we are altering the terminology we use in Part 1A of Form ADV to refer to an adviser's "regulatory assets under

63 Advisers Act section 203A(a)(2). The Dodd-Frank Act renumbered current paragraph 203A(a)(2) as 203A(a)(3), but did not amend this definition. *See* section 410 of the Dodd-Frank Act.

64 *See* Form ADV: Instructions for Part 1A, instr. 5.b. These assets include proprietary assets, assets an adviser manages without receiving compensation, and assets of foreign clients.

65 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b. *See also* sections 402(a) and 408 of the Dodd-Frank Act (adding section 202(a)(30) of the Act, which defines a foreign private adviser as having "assets under management" attributable to U.S. clients and private fund investors of less than $25 million, and section 203(m) of the Act, which directs the Commission to provide for an exemption for advisers solely to private funds with assets under management in the United States of less than $150 million); Exemptions Adopting Release, *supra* note 4, at section II.B.

66 *See* amended rule 203A-3(d).

management" in order to acknowledge the "regulatory" purposes of this reporting requirement and to distinguish it from the assets under management disclosure that advisory clients receive in Part 2 of Form ADV.[67]

Many commenters expressed general support for providing a uniform method of calculating assets under management in order to maintain consistency for registration and risk assessment purposes.[68] Others, however, disagreed with or sought changes to one or more of the revisions we are making to the instructions, which we discuss below. We are adopting the amendments as proposed.

Under the revised instructions, advisers must include in their regulatory assets under management securities portfolios for which they provide continuous and regular supervisory or management services, regardless of whether these assets are family or proprietary assets, assets managed without receiving compensation, or assets of foreign clients.[69] We proposed to require advisers to include these assets in light of the new uses of the term "assets under management" in

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67 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.; *Amendments to Form ADV*, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49234 (Aug. 12, 2010)] ("Part 2 Release"). One commenter supported the change of terminology. *See* Schnase Letter (supporting the idea of distinguishing "regulatory assets under management" from "assets under management").

68 *See, e.g.*, comment letter of the American Federation of Labor and Congress of Industrial Organizations (Jan. 24, 2011) ("AFL-CIO Letter") ("an adviser's calculation of its assets under management is central to the determination of whether that adviser is required to register with the SEC and be subject to its oversight . . . . The uniform, comprehensive methodology proposed by the SEC will ensure its ability to oversee advisers to funds that may pose a systemic threat."); comment letter of Americans for Financial Reform (Jan. 24, 2011) ("AFR Letter") ("Because calculations of the amount of assets under management by each adviser are key to the determination of whether or not they are required to register, the comprehensive and uniform definition of these terms in the proposed rule is particularly important."). *See also* comment letter of the Alternative Investment Management Association (Jan. 24, 2011) ("AIMA Letter"); Dechert General Letter; comment letter of the Investment Adviser Association (by Valerie M. Baruch) (Jan. 24, 2011) ("IAA General Letter"); NRS Letter; comment letter of O'Melveny & Myers LLP (on behalf of the China Venture Capital and Private Equity Association) (Jan. 25, 2011) ("O'Melveny Letter"); Schnase Letter; NYSBA Committee Letter; Dezellem Letter.

69 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(1).

the Advisers Act and the new regulatory requirements related to systemic risk that we anticipated would be triggered by registration with the Commission.[70] Eliminating an adviser's ability to exclude all or some of these assets will prevent advisers from excluding these assets from their regulatory assets under management in order to remain below the new asset threshold for registration and to avoid reporting systemic risk information.[71] This approach will also lead to more consistent reporting of assets under management among advisers.

A number of commenters disagreed with the proposed changes.[72] Some argued that advisers should not be required to include proprietary assets and assets managed without receiving compensation in the calculation because such a requirement would be inconsistent with the statutory definition of "investment adviser."[73] Although a person is not an "investment adviser" for purposes of the Advisers Act unless it receives compensation for providing advice to others, once a person meets that definition (by receiving compensation from *any* client to which it provides advice), the person is an adviser, and the Act applies to the relationship between the adviser and any of its clients (whether or not the adviser receives compensation from them).[74] Moreover, the management of "proprietary" assets or assets for which the adviser may not be

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70 *See supra* note 65. Section 404 of the Dodd-Frank Act gives the Commission authority to impose on investment advisers registered with the Commission reporting and recordkeeping requirements for systemic risk assessment purposes.

71 *See* Implementing Proposing Release, *supra* note 7, at nn.44-45 and accompanying text; *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, Investment Advisers Act Release No. IA-3145 (Jan. 26, 2011) [76 FR 8,068 (Feb. 11, 2011)] ("Systemic Risk Reporting Release") (proposing systemic risk reporting).

72 *See* AIMA Letter; Dechert General Letter; MFA Letter; Pickard Letter; Seward Letter; NYSBA Committee Letter.

73 *See* Dechert General Letter; MFA Letter; Seward Letter; NYSBA Committee Letter. *See also* Pickard Letter. Under Section 202(a)(11) of the Advisers Act, the definition of "investment adviser" includes, among others, "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ."

74 *See* section 202(a)(11); Form ADV: Instructions for Part 1A, Glossary of Terms, Client.

compensated, when combined with other client assets, may suggest that the adviser's activities are of national concern or have implications regarding the reporting for the assessment of systemic risk.[75] We are therefore adopting the amendment to the instruction, as proposed.[76]

The revised instructions to Form ADV also clarify that an adviser must calculate its regulatory assets under management on a gross basis, that is, without deduction of "any outstanding indebtedness or other accrued but unpaid liabilities."[77] Several commenters argued that advisers should determine the amount of regulatory assets under management on a net, rather than gross, basis.[78] They asserted that the use of net assets would better reflect the clients' assets at risk that an adviser manages,[79] and that use of gross assets would confuse advisory clients.[80] However, nothing in the current instructions suggests that liabilities should be deducted from the calculation of an adviser's assets under management. Indeed, since 1997, the instructions have stated that an adviser should not deduct securities purchased on margin when

75 *See supra* note 70.

76 One commenter objected to the inclusion of assets of foreign clients because it would require domestic advisers that only have a foreign client base to register with the Commission. Comment letter of Katten Muchin Rosenman LLP (on behalf of APG Asset Management US Inc.) (Jan. 21, 2011). However, a domestic adviser dealing exclusively with foreign clients must register with the Commission if it uses any U.S. jurisdictional means in connection with its advisory business. *See* section 203 of the Advisers Act (requiring registration of *any* investment adviser that uses the United States mails or any other means or instrumentality of interstate commerce in connection with its business as an investment adviser unless the adviser qualifies for an exemption from registration or is prohibited from registering with the Commission).

77 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(2). Accordingly, an adviser cannot deduct accrued fees, expenses, or the amount of any borrowing. Prior to today's amendments, the instructions directed advisers not to "deduct securities purchased on margin."

78 *See, e.g.*, Dechert General Letter; comment letter of Georg Merkl (Jan. 25, 2011) ("Merkl Exemptions Letter"); MFA Letter; Seward Letter; Shearman Letter. *See also* NYSBA Committee Letter.

79 *See* Merkl Exemptions Letter; MFA Letter.

80 *See* Dechert General Letter; MFA Letter.

calculating its assets under management.[81] Whether a client has borrowed to purchase a portion of assets managed does not seem to us a relevant consideration in determining the amount of assets an adviser has to manage and the scope and national significance of an adviser's business. Moreover, we are concerned that the use of net assets could permit advisers that utilize investment strategies with highly leveraged positions to avoid registration with the Commission even though the activities of such advisers may have national significance. The use of a net assets test also could allow advisers to large and highly leveraged funds to avoid systemic risk reporting under our proposed systemic risk reporting rules.[82] In addition, there need not be any investor confusion because although an adviser will be required to use gross (rather than net) assets for regulatory purposes, the instruction would not preclude an adviser from holding itself out to its clients as managing a net amount of assets as may be its custom in, for example, its client brochure. We are therefore adopting the instruction, as proposed.[83]

We are also revising the Form ADV instructions, as proposed, to provide guidance regarding how an adviser that advises private funds determines the amount of assets it has under management. We have designed our new instructions both to provide advisers with greater certainty in their calculation of regulatory assets under management (which they would also use as a basis to determine their eligibility for certain exemptions that we are adopting today in the

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81 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(2). ("Do not deduct securities purchased on margin.").

82 *See* Systemic Risk Reporting Release, *supra* note 71.

83 Some commenters asked that we clarify how the calculation on a gross basis would apply with respect to, among others, mutual funds, short positions, and leverage. *See* IAA General Letter; MFA Letter. We expect that advisers will continue to calculate their gross assets as they do today, even if they currently only calculate gross assets as an intermediate step to compute their net assets. In the case of pooled investment vehicles with a balance sheet, for instance, an adviser could include in the calculation the total assets of the entity as reported on the balance sheet.

Exemptions Adopting Release) and to prevent advisers from understating those assets to avoid registration.

First, an adviser must include in its calculation of regulatory assets under management the value of any private fund over which it exercises continuous and regular supervisory or management services, regardless of the nature of the assets held by the fund.[84] A sub-adviser to a private fund would include in its regulatory assets under management only that portion of the value of the portfolio for which it provides continuous and regular supervisory or management services. Advisers that have discretionary authority over fund assets, or a portion of fund assets, and that provide ongoing supervisory or management services over those assets would exercise continuous and regular supervisory or management services.[85]

Second, an adviser must include the amount of any uncalled capital commitments made to a private fund managed by the adviser.[86] As we explained in the Implementing Proposing Release, advisers to some private funds (such as private equity funds) typically make investments following capital calls on the funds' investors.[87] One commenter agreed with this approach generally,[88] while another disagreed, asserting that the uncalled capital commitments remain under the management of the fund investor.[89] As we noted in the Implementing Proposing Release, in the early years of a private fund's life, its adviser typically earns fees

84 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(1). One commenter specifically addressed this matter, supporting our approach. *See* IAA General Letter.

85 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(3).

86 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(1). A capital commitment is a contractual obligation of an investor to acquire an interest in, or provide the total commitment amount over time to, a private fund, when called by the fund.

87 Implementing Proposing Release, *supra* note 7, at n.53 and accompanying text.

88 *See* AIMA Letter (supporting including uncalled capital commitments, provided that the adviser has full contractual rights to call that capital and would be given responsibility for management of those assets).

89 *See* Merkl Exemptions Letter.

based on the total amount of capital commitments, which we presume reflects compensation for efforts expended on behalf of the fund in preparation for the investments.[90] We are adopting the instruction, as proposed.

Third, advisers must use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable.[91] This requirement is designed to make advisers value private fund assets on a more meaningful and consistent basis for regulatory purposes under the Act and it, therefore, should result in a more coherent application of the Act's regulatory requirements and assessment of risk. This instruction would prevent, for example, an adviser electing to value its assets based on their cost, which could be significantly lower than the value of the assets based on their fair value, thus permitting the adviser to avoid registration with or reporting to the Commission. It is designed to prevent inconsistent application of the Advisers Act to advisers managing the same amount of assets.

We received a number of comments regarding the use of fair value, which represents a change from the current instruction that permits an adviser to calculate the value of its assets under management based on whatever method the adviser uses to report its assets to clients or to calculate fees for investment advisory services.[92] One commenter, for example, supported requiring the use of fair value, noting that it would help achieve more consistent asset calculations and reporting across the investment advisory industry, and that it would enable

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90 Implementing Proposing Release, *supra* note 7, at n.54 and accompanying text.

91 *See* amended Form ADV: Instructions for Part 1A, instr. 5.b.(4). This valuation requirement is described in terms similar to the definition of "value" in the Investment Company Act, which looks to market value when quotations are readily available and, if not, then to fair value. *See* Investment Company Act section 2(a)(41) (15 U.S.C. 80a-2(a)(41)). Other standards also may be expressed as requiring that a determination of fair value be based on market quotations where they are readily available.

92 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(4).

better application of our staff's risk assessment program.[93] Other commenters, including the Managed Funds Association, however, objected to the use of fair value, asserting that the requirement would cause those advisers that did not use fair value standards to incur additional costs, particularly if the assets are illiquid and therefore difficult to fair value.[94]

In the Implementing Proposing Release, we noted that we understood that many private funds already value assets in accordance with U.S. generally accepted accounting principles ("GAAP") or other international accounting standards that require the use of fair value, citing letters we had received in connection with other rulemaking initiatives.[95] We are sensitive to the costs this new requirement will impose. We believe, however, that this approach is warranted in light of the unique regulatory purposes of the calculation under the Advisers Act. We estimated these costs in the Implementing Proposing Release,[96] and have taken several steps to mitigate them.[97] While many advisers will calculate fair value in accordance with GAAP or another international accounting standard,[98] other advisers acting consistently and in good faith may

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93 *See* IAA General Letter. *See also* ABA Committees Letter (addressing the requirement within the context of the asset calculation for purposes of the foreign private adviser and the private fund adviser exemptions).

94 *See* MFA Letter; Merkl Exemptions Letter; O'Melveny Letter; Seward Letter.

95 *See* Implementing Proposing Release, *supra* note 7, at n.56 and accompanying text.

96 *See* Implementing Proposing Release, *supra* note 7, at n.369 and accompanying text.

97 We recognize that although these steps will provide advisers greater flexibility in calculating the value of their private fund assets, they also will result in valuations that are not as comparable as they could be if we specified a fair value standard (*e.g.*, as specified in GAAP).

98 Several commenters asked that we not require advisers to fair value private fund assets in accordance with GAAP for purposes of calculating regulatory assets under management because many funds, particularly offshore ones, do not use GAAP and such a requirement would be unduly burdensome. *See, e.g.*, comment letter of European Fund and Asset Management Association (Jan. 24, 2011) ("EFAMA Letter"); IAA General Letter; Comment letter of Katten Muchin Rosenman LLP (on behalf of non-U.S. Advisers) (Jan. 24, 2011) ("Katten Foreign Advisers Letter"). We did not propose such a requirement, nor are we adopting one.

utilize another fair valuation standard.[99] While these other standards may not provide the quality of information in financial reporting (for example, of private fund returns), we expect these calculations will provide sufficient consistency for the purposes that regulatory assets under management serve in our rules (such as applying annual thresholds to determine the registration status of an adviser).[100]

The alternatives that commenters recommended (*e.g.*, cost basis or any method required by the private fund's governing documents other than fair value) would not meet our objective of having more meaningful and comparable valuation of private fund assets, and could result in a significant understatement of appreciated assets.[101] Moreover, these alternative approaches could permit advisers to circumvent the Advisers Act's registration requirements. Permitting the use of any valuation standard set forth in the governing documents of the private fund other than

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99 Consistent with this good faith requirement, we would expect that an adviser that calculates fair value in accordance with GAAP or another basis of accounting for financial reporting purposes will also use that same basis for purposes of determining the fair value of its regulatory assets under management.

100 The fair valuation process need not be the result of a particular mandated procedure and the procedure need not involve the use of a third-party pricing service, appraiser or similar outside expert. An adviser could rely on the procedure for calculating fair value that is specified in a private fund's governing documents. The fund's governing documents may provide, for example, that the fund's general partner determines the fair value of the fund's assets. Advisers are not, however, required to fair value real estate assets only in those limited circumstances where real estate assets are not required to be fair valued for financial reporting purposes under accounting principles that otherwise require fair value for assets of private funds. For example, in those cases, an adviser may instead value the real estate assets as the private fund does for financial reporting purposes. We note that the Financial Accounting Standards Board ("FASB") has a current project related to investment property entities that may require real estate assets subject to that accounting standard to be measured by the adviser at fair value. *See* FASB Project on *Investment Properties*. We also note that certain international accounting standards currently permit, but do not require, fair valuation of certain real estate assets. *See* International Accounting Standard 40, *Investment Property*. To the extent that an adviser follows GAAP or another accounting standard that requires or in the future requires real estate assets to be fair valued, this limited exception to the use of fair value measurement for real estate assets would not be available.

101 *See* Merkl Exemptions Letter; MFA Letter; O'Melveny Letter; Seward Letter; NYSBA Committee Letter.

fair value could effectively yield to the adviser the choice of the most favorable standard for determining its registration obligation as well as the application of other regulatory requirements, and would not provide consistent outcomes from similarly situated advisers. Accordingly, we are adopting the requirement as proposed.

We also requested comment in the Implementing Proposing Release on whether we should require advisers to report their assets under management more frequently than annually. All commenters who responded to our request asked that we continue to require annual reporting, arguing that more frequent reporting would require additional calculations only for purposes of Form ADV disclosure, thus placing an unnecessary burden on advisers.[102] As commenters recommended, we are not changing the frequency of the reporting requirement.

4. Switching Between State and Commission Registration

Rule 203A-1 is designed to prevent an adviser from having to switch frequently between state and Commission registration as a result of changes in the value of its assets under management or the departure of one or more clients. We are amending the rule to eliminate the current buffer for advisers that have assets under management between \$25 million and \$30 million that permits these advisers to remain regulated by the states, and we are replacing it with a similar buffer for mid-sized advisers.[103] We are also retaining, as proposed, the requirement that eligibility for registration be determined annually as part of an adviser's annual updating

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102 *See, e.g.*, AIMA Letter; NRS Letter; O'Melveny Letter; NYSBA Committee Letter. Under the Systemic Risk Reporting Release, we proposed to require large advisers with \$1 billion or more in assets under management attributable to hedge funds, unregistered money market funds or private equity funds to file systemic risk reports quarterly. *See* Systemic Risk Reporting Release, *supra* note 71.

103 Amended rule 203A-1(a). Additionally, we are revising the provision in rule 203A-1 that does not require an adviser to withdraw its Commission registration until its assets under management fall below \$25 million to reflect the new, \$90 million threshold. *See* amended rule 203A-1(a)(1).

amendment, allowing an adviser to avoid the need to change registration status based on fluctuations that occur during the course of the year.[104]

The amended rule provides a buffer for mid-sized advisers with assets under management close to $100 million to determine whether and when to switch between state and Commission registration.[105] The rule raises the threshold above which a mid-sized investment adviser must register with the Commission to $110 million; but, once registered with the Commission, an adviser need not withdraw its registration until it has less than $90 million of assets under management.[106]

Although commenters did not object to elimination of the current buffer, several argued that we need to include a new buffer for mid-sized advisers that have close to $100 million of assets under management.[107] Some commenters, for example, asserted that the current $5

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104 Amended rule 203A-1(b)(2) (continuing to require an adviser filing an annual updating amendment to its Form ADV reporting that it is not eligible for Commission registration to withdraw its registration within 180 days of its fiscal year end). We are not renumbering this paragraph as proposed. *Compare* proposed rule 203A-1(a)-(b) *with* amended rule 203A-1(b)(1)-(2).

105 Amended rule 203A-1(a).

106 Amended rule 203A-1(a)(1). Mid-sized advisers eligible for a rule 203A-2 exemption and advisers to a registered investment company or business development company under the Investment Company Act will not be able to rely on the buffer because they are required to register with us regardless of whether they have $100 million of assets under management. Amended rule 203A-1(a)(2). In addition, advisers that rely on amended rule 203A-2(c) to register with the Commission because they expect to be eligible for registration within 120 days cannot rely on the buffer – they must have $100 million of assets under management within 120 days to remain registered with the Commission. *See* Form ADV: Instructions for Part 1A, instrs. 2.a., 2.g. *See also* amended rule 203A-1(a)(2)(ii); amended rule 203A-2(c).

107 Altruist Letter; Dezellem Letter; Dinel Letter; FSI Letter; comment letter of Intelligent Capitalworks Investment Advisors (Jan. 24, 2011) ("ICW Letter"); comment letter of JVL Associates, LLC (Jan. 13, 2011) ("JVL Associates Letter"); comment letter of Georg Merkl (Jan. 25, 2011) ("Merkl Implementing Letter"); NASAA Letter; NRS Letter; NYSBA Committee Letter; comment letter of The Wealth Coach, LLC (by Jeffrey W. McClure) (Dec. 31, 2010) ("Wealth Coach Letter"); and comment letter of WJM Financial, LLC (Jan. 4, 2011) ("WJM Letter"). To prevent an adviser from switching frequently between state and Commission registration, we proposed to retain an adviser's ability to rely on the reporting on Form ADV of

million buffer was effective in preventing frequent switching of registration attributable to market fluctuations,[108] while another called the buffer an important element of regulatory flexibility.[109] Several advisers with close to $100 million of assets under management asserted that a buffer is necessary to prevent them from switching to and from Commission registration.[110] Commenters recommended several different buffers, including one for advisers with between $100 million and $120 million (to retain the current buffer's 20 percent increase in assets under management),[111] one that would fall below $100 million,[112] and a buffer that straddled above and below $100 million.[113]

We are persuaded by these comments that a buffer may prevent costs and disruption to advisers that otherwise may have to switch between federal and state registration frequently because of, for example, the volatility of the market values of the assets they manage. Rule 203A-1(a), as amended, raises the threshold above which a mid-sized investment adviser must register with the Commission to $110 million.[114] Once registered with the Commission, an

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assets under management in the annual updating amendment for purposes of determining its eligibility to register. *See* proposed rule 203A-1(b).

108 *See, e.g.,* Altruist Letter; NRS Letter.

109 NASAA Letter.

110 ICW Letter (for 3 years, adviser's assets under management have been greater than $100 million by a few million dollars and at various times throughout the year has been reduced to under $100 million by just a few days of downside market volatility); JVL Associates Letter (adviser's assets under management have fluctuated around $100 million since 2007). *See also* Wealth Coach Letter (from October 2008 through March 2009, adviser's total assets under management fell over 25%).

111 Altruist Letter; FSI Letter; NASAA Letter; WJM Letter. *See also* ICW Letter; Merkl Implementing Letter; NYSBA Committee Letter.

112 Dezellem Letter ($80-$100 million); Dinel Letter ($80-$100 million); JVL Associates Letter ($90-$100 million); NRS Letter ($90-$100 million).

113 Wealth Coach Letter ($85-$115 million).

114 We find that raising the threshold for mid-sized advisers to register with the Commission is appropriate in accordance with the purposes of the Advisers Act. Advisers Act section 203A(a)(2)(B)(ii), as amended by the Dodd-Frank Act.

adviser need not withdraw its registration until it has less than $90 million of assets under management.[115] The amendment operates to provide a buffer of 20 percent of the $100 million statutory threshold for registration with the Commission, which is the same percentage as the current buffer.[116] We believe a 20 percent buffer is appropriate because it is large enough to accommodate market fluctuations or the departure of one or more clients, and does not substantially increase or decrease the $100 million threshold set by Congress in the Dodd-Frank Act.[117]

5. Exemptions from the Prohibition on Registration with the Commission

Using the authority provided by section 203A(c) of the Advisers Act, we are adopting, as proposed, amendments to three of the exemptions in rule 203A-2 from the prohibition on Commission registration in section 203A to reflect developments since their original adoption,

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115 Amended rule 203A-1(a)(1). We find that not providing this buffer and requiring advisers with assets under management of between $90 million and $100 million to register with the states would be unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes of section 203A of the Advisers Act. Advisers Act section 203A(c). Advisers Act section 203A(c) permits the Commission to exempt advisers from the prohibition on Commission registration, including small and mid-sized advisers, if the application of the prohibition from registration would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of section 203A. *See supra* note 20 for a discussion of section 203A(c).

116 Commenters said the current $5 million buffer, which is 20 percent of the $25 million statutory threshold, effectively limits advisers having to switch registrations due to market changes in their assets under management. *See, e.g.,* Altruist Letter (current $5 million buffer "was useful in lessening the need to switch back and forth between state and federal regulation as an IA's AUM grew or fell"). *See also* Advisers Act section 203A(a)(1); rule 203A-1(a). The amendment we are adopting provides a $20 million buffer, which is 20 percent of the $100 million statutory threshold. *See* Advisers Act section 203A(a)(2), as amended by the Dodd-Frank Act; amended rule 203A-1(a)(1).

117 An adviser must register if its assets under management are $110 million or more, which is $10 million higher than the $100 million statutory threshold. *See* Advisers Act section 203A(a)(2), as amended by the Dodd-Frank Act; amended rule 203A-1(a)(1). *See also supra* note 108 (citing commenters discussing market fluctuations); Senate Committee Report, *supra* note 18, at 76 (stating that this amendment increases the threshold above which all investment advisers must register with the Commission from $25 million to $100 million).

including the enactment of the Dodd-Frank Act, which we discuss below.[118] Each of the exemptions (including those we are not amending) also applies to mid-sized advisers, exempting them from the prohibitions on registering with the Commission if they meet the requirements of rule 203A-2.[119]

a. Nationally Recognized Statistical Rating Organizations

We are eliminating, as proposed, the exemption in rule 203A-2(a) from the prohibition on Commission registration for nationally recognized statistical rating organizations ("NRSROs").[120] Since we adopted this exemption, Congress amended the Act to exclude certain NRSROs from the Act's definition of "investment adviser"[121] and provided for a separate

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118 Using the authority provided in section 203A(c) of the Advisers Act, the Commission has permitted six types of investment advisers to register with the Commission under rule 203A-2: (i) NRSROs; (ii) certain pension consultants; (iii) certain investment advisers affiliated with an adviser registered with the Commission; (iv) investment advisers expecting to be eligible for Commission registration within 120 days of filing Form ADV; (v) certain multi-state investment advisers; and (vi) certain internet advisers. *See supra* notes 20-21 and accompanying text. We are also renumbering, and making minor conforming changes to, rule 203A-2(c), (d) and (f) regarding investment advisers affiliated with an SEC-registered adviser, newly formed advisers expecting to be eligible for Commission registration within 120 days, and internet advisers, respectively. *See* amended rule 203A-2(b), (c), and (e). We are requiring advisers to comply with amended rule 203A-2 60 days after publication in the Federal Register. *See infra* section III.

119 Rule 203A-2 provides that advisers meeting the criteria for a category of advisers under the rule will not be prohibited from registering with us by Advisers Act section 203A(a). *See* rule 203A-2; NSMIA Adopting Release, *supra* note 17, at section II.D. The new prohibition on mid-sized advisers registering with the Commission also is established under Advisers Act section 203A(a); therefore, mid-sized advisers meeting the requirements for a category of exempt advisers under rule 203A-2 are eligible to register with us. *See* section 410 of the Dodd-Frank Act; amended rule 203A-2. We asked, but did not receive comment on, whether we should limit rule 203A-2's application to small advisers; however, one commenter agreed that these exemptions should apply to all advisers, including mid-sized advisers. NRS Letter (strongly supporting that the exemptions be applicable to all advisers no matter their assets under management as it "promotes uniformity, clarity and a consistent standard for all."). We are leaving rule 203A-2 unchanged in this regard.

120 *See* rule 203A-2(a).

121 Credit Rating Agency Reform Act of 2006, P.L. 109-291, 120 Stat. 1327 § 4(b)(3)(B) (2006) ("Credit Rating Agency Reform Act"). *See also* Advisers Act section 202(a)(11)(F) (excluding an NRSRO from the definition of investment adviser unless it issues recommendations about purchasing, selling, or holding securities or engages in managing assets that include securities on behalf of others).

regulatory regime for NRSROs under the Securities Exchange Act of 1934 ("Exchange Act").[122] Commenters supported the elimination of this provision.[123]

b. Pension Consultants

We are amending rule 203A-2(b), the exemption available to pension consultants, to increase the minimum value of plan assets required to rely on the exemption from $50 million to $200 million.[124] As discussed in the Implementing Proposing Release, pension consultants typically do not have "assets under management," but we have required these advisers to register with us because their activities have a direct effect on the management of large amounts of pension plan assets.[125] As a result of this amendment, advisers currently relying on the pension consultant exemption advising plan assets of less than $200 million may be required to withdraw from Commission registration and register with one or more states.[126]

122 Credit Rating Agency Reform Act, *supra* note 121, at sections 4(a), 5.

123 NRS Letter (asserting that the proposal is consistent with the Credit Rating Agency Reform Act, which amended the Advisers Act to exclude NRSROs and to provide for a separate regulatory regime for them under the Exchange Act); Pickard Letter (asserting that continued availability of the NRSRO exemption is causing confusion among advisers).

124 Amended rule 203A-2(a). Pension consultants provide services to pension and employee benefit plans and their fiduciaries, including assisting them to select investment advisers that manage plan assets. *See* rule 203A-2(b)(2), (3); NSMIA Adopting Release, *supra* note 17, at section II.D.2. The exemption does not apply to pension consultants that solely provide services to plan participants. *See* NSMIA Adopting Release, *supra* note 17, at section II.D.2. To determine the aggregate value of plan assets, a pension consultant may only include the portion of the plan's assets for which the consultant provides investment advice. Rule 203A-2(b)(3).

125 *See* Implementing Proposing Release, *supra* note 7, at section II.A.5.b.; NSMIA Adopting Release, *supra* note 17, at section II.D.2.; *Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 1601, section II.D.2. (Dec. 20, 1996) [61 FR 68480 (Dec. 27, 1996)].

126 An adviser currently relying on the exemption, but that advises plan assets of less than $200 million and files an annual updating amendment to its Form ADV following the compliance date of the amended rule, will be required to withdraw from Commission registration within 180 days of the adviser's fiscal year end (unless the adviser is otherwise eligible for SEC registration). *See* rule 203A-1(b)(2); *supra* note 118.

We proposed to increase the threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of "assets under management" that requires all advisers to register with the Commission, and to maintain the same ratio as today of plan assets to the statutory threshold for registration.[127] Commenters supported our proposal.[128] One agreed that the new $200 million threshold would continue to ensure that the activities of a pension consultant registered with the Commission are significant enough to have an impact on national markets.[129] We are adopting the amendment, as proposed.

c. Multi-State Advisers

We are adopting, as proposed, amendments to the multi-state adviser exemption to align the rule with the multi-state exemption that Congress provided for mid-sized advisers in section 410 of the Dodd-Frank Act.[130] Amended rule 203A-2(d) permits all investment advisers who are required to register as an investment adviser with 15 or more states to register with the Commission, rather than 30 states, as currently required.[131] An adviser relying on the rule must

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127 Proposed rule 203A-2(a).

128 *See* NRS Letter; Pickard Letter.

129 NRS Letter. *See also* NSMIA Adopting Release, *supra* note 17, at n.60 (the $50 million "higher threshold is necessary to demonstrate that a pension consultant's activities have an effect on national markets."). The higher asset requirement also reflects that a pension consultant has substantially less control over client assets than an adviser that has "assets under management." *Id.*

130 Amended rule 203A-2(d). Form ADV will not be amended to reflect the changes to the multi-state adviser exemption until the end of the calendar year. *See supra* section II.A.1. Until that time, both a mid-sized adviser eligible for the statutory multi-state exemption and a small adviser eligible for the exemption under amended rule 203A-2(d) because it is required to register as an adviser in 15 or more states may register or remain registered (as the case may be) with the Commission by checking the boxes (Item 2.A.(9) and the relevant section of Schedule D) indicating that it is exempt because it is required to register in 30 or more states. *See supra* note 118. Upon making its next amendments to Form ADV, the adviser should revise its filing to report reliance on the new multi-state adviser exemption.

131 We note that amended rule 203A-2(d) permits an adviser otherwise eligible to rely on the exemption to choose to maintain its state registrations and not switch to SEC registration. *See*

withdraw from registration with the Commission when it is no longer required to be registered with 15 states.[132] We are also rescinding, as proposed, the provision in the current rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not adopting a similar cushion for the 15-state threshold.[133]

Commenters generally agreed with our proposal to align our multi-state exemption for small advisers with the statutory exemption for mid-sized advisers.[134] A few, however, recommended a lower threshold of required state registrations for eligibility for the multi-state exemption.[135] In light of Congressional determination to set the threshold at 15 states and our stated purpose in amending the rule to align it with the Dodd-Frank Act, we have determined not

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amended rule 203A-2(d)(2) (adviser elects to rely on the exemption by making the required representations on Form ADV).

132 *See* amended rule 203A-2(d). To rely on this exemption, an adviser also must continue to: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with the required number of states; (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that it would be required by the laws of fewer than 15 states to register as an investment adviser with the state; and (iii) maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. Amended rule 203A-2(d)(2)-(3). The adviser may not include in the number of states those in which it is not required to register because of applicable state laws or the national *de minimis* standard of section 222(d) of the Advisers Act. *See Exemption for Investment Advisers Operating in Multiple States; Revisions to Rules Implementing Amendments to the Investment Advisers Act of 1940; Investment Advisers with Principal Offices and Places of Business in Colorado or Iowa*, Investment Advisers Act Release No. 1733, n.17 (July 17, 1998) [63 FR 39708 (July 24, 1998)].

133 *See* rule 203A-2(e)(1). Eliminating this buffer simplifies the requirements of the exemption. *See* NRS Letter ("The Dodd-Frank Act has addressed the multi-state adviser exemption to simplify the requirements of this exemption.")

134 *See* NASAA Letter; comment letter of the National Education Association Member Benefits Corporation (Jan. 21, 2011) ("NEA Letter"); NRS Letter; Pickard Letter; Seward Letter; Shearman Letter.

135 *See* Seward Letter and Shearman Letter (in each case supporting the 15-state threshold we proposed, and suggesting the burdens of maintaining multiple state registrations can be significant). *See also* NEA Letter. One of these commenters also would support further decreasing the number of states to five and requiring advisers relying on the exemption to have at least $25 million of assets under management. Seward Letter. Another "would support an even lower threshold." Shearman Letter.

to lower the threshold further.[136] We also note that the requirement that advisers annually assess their eligibility for registration and the grace periods provided to switch to and from state registration should further mitigate the frequency with which an investment adviser required to register in 15 states will have to switch between state and federal registration.[137]

6. Elimination of Safe Harbor

We are rescinding, as proposed, rule 203A-4, which has provided a safe harbor from Commission registration for an investment adviser that is registered with the state securities authority of the state in which it has its principal office and place of business based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[138] One commenter argued that the safe harbor should be retained for mid-sized advisers because advisers calculating regulatory assets under management face similar challenges today as when the safe harbor was adopted.[139] We disagree. As stated in the Implementing Proposing Release, the safe harbor was designed for smaller advisory businesses with assets under management of less than $30 million, which may not employ the same tools or otherwise have a need to calculate assets as precisely as advisers with greater assets under management.[140] We also believe that the revisions we are adopting to the Form ADV instructions to implement a uniform method for advisers to calculate assets under

136 *See* section 410 of the Dodd-Frank Act (a mid-sized adviser that otherwise would be prohibited may register with the Commission if it would be required to register with 15 or more states); H. REP. NO. 111-517, at 867 (2010) ("Conference Committee Report") ("Those advisers who qualify to register with their home state must register with the SEC should the adviser operate in more than 15 states.").

137 *See supra* section II.A.4.

138 Rule 203A-4.

139 NYSBA Committee Letter. Another commenter asserted that there has been and continues to be confusion among smaller advisers in calculating assets under management. NRS Letter.

140 Implementing Proposing Release, *supra* note 7, at section II.A.6. (*citing* rule 203A-4; NSMIA Adopting Release, *supra* note 17, at section II.B.3.).

management will clarify the requirements and reduce confusion among advisers.[141] Moreover, the rule is a safe harbor only from our enforcement actions, and to our knowledge few, if any, advisers have relied upon it in the 14 years since it was adopted.[142] Accordingly, we are rescinding the rule.

7. Mid-Sized Advisers

We are amending Form ADV to require a mid-sized adviser registering with us to affirm, upon application and annually thereafter, that it is either: (i) not required to be registered as an adviser with the state securities authority in the state where it maintains its principal office and place of business; or (ii) is not subject to examination as an adviser by that state.[143] These form revisions implement the Dodd-Frank Act amendment to section 203A of the Advisers Act that prohibits mid-sized advisers from registering with the Commission, but only: (i) if the adviser is required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; and (ii) if registered, the adviser would be subject to examination as an investment adviser by such commissioner, agency, or office.[144] The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is

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141 *See supra* section II.A.3.

142 *See* NRS Letter (noting a belief that the safe harbor has been little used by small advisers based upon the commenter's years of consulting for such advisers).

143 *See* amended Form ADV, Part 1A, Item 2.A.(2). For a discussion of changes to Form ADV, Part 1A, Item 2.A., see *supra* section II.A.2.

144 *See* section 410 of the Dodd-Frank Act. An adviser reporting that it is no longer able to make this affirmation will have 180 days from its fiscal year end to withdraw from Commission registration. *See* amended rule 203A-1(b)(2). Thus, the rule will operate to permit an adviser to rely on this affirmation reported in its annual updating amendments for purposes of determining its eligibility to register with the Commission.

"subject to examination" by a particular state securities authority.[145] We are therefore providing an explanation of these provisions in instructions to Form ADV.[146]

a. Required to be Registered

The Form ADV instructions we are adopting reflect that the "required to be registered" standard that Congress included in new section 203A(a)(2) of the Advisers Act for mid-sized advisers is different from the "regulated or required to be regulated" standard set forth in section 203A(a)(1) for small advisers.[147] The instruction explains that a mid-sized adviser "is not required to be registered" with the state securities authority and must register with the Commission (unless an exemption from registration with the Commission otherwise is available)[148] if the adviser is exempt from registration under the law of the state in which it has its principal office and place of business, or is excluded from the definition of investment adviser

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145 The Advisers Act defines the term "state" to include any U.S. state, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. Advisers Act section 202(a)(19). For purposes of section 203A of the Advisers Act and the rules thereunder, rule 203A-3(c) defines "principal office and place of business" to mean the executive office of the investment adviser from which its officers, partners, or managers direct, control, and coordinate its activities. We are not changing this definition. *See* amended rule 203A-3(c). For a discussion of amendments we are making to the calculation of assets under management, see *supra* section II.A.3.

146 *See* amended Form ADV: Instructions for Part 1A, instr. 2.b.

147 *See* amended Form ADV: Instructions for Part 1A, instr. 2.b. Under section 203A(a)(1) of the Act, an adviser that is not regulated or required to be regulated as an investment adviser in the state in which it has its principal office and place of business must register with the Commission regardless of the amount of assets it has under management. Advisers Act section 203A(a)(1). *See also* Advisers Act section 203(a). We have interpreted "regulated or required to be regulated" to mean that a state has enacted an investment adviser statute, regardless of whether the adviser is actually registered in that state. *See* NSMIA Adopting Release, *supra* note 17, at section II.E.1. The bills originally introduced and passed in the House and Senate increased up to $100 million the threshold for Commission registration under the "regulated or required to be regulated" standard that is used today in section 203A(a)(1). *See* The Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173, 111th Cong. § 7418 (2009); Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong. § 410 (2010). But the final version of the Dodd-Frank Act prohibits a mid-sized adviser from registering with the Commission if, among other things, it is "required to be registered" as an adviser with the state securities authority where it maintains its principal office and place of business. *See* section 410 of the Dodd-Frank Act.

148 *See, e.g.,* Advisers Act sections 203(a) and (b), 203A(b); rule 203A-2.

in that state.[149] Thus, for example, an adviser with $75 million of assets under management that is exempt from registration in the state in which its principal office and place of business is located will have to register with the Commission (unless an exemption from Commission registration is available). None of the commenters disputed our interpretation or suggested an alternative interpretation of the "required to be registered" element,[150] and we are adopting the instructions, as proposed.[151]

b. Subject to Examination

As we discussed in the Implementing Proposing Release, our staff contacted the state securities authority for each state and, based upon information they have provided us, identified those states that do not subject advisers registered with them to examination.[152] We have posted this list on our website,[153] and it also will be available to advisers using the IARD to register or amend their registration forms.[154] Based on those responses, advisers with their principal office

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149 *See, e.g.*, Uniform Securities Act §§ 102(15), 403(b) (2002). An adviser not registered under a state adviser statute in contravention of such statute, however, is not eligible for registration with the Commission. Similarly, an adviser could not voluntarily register with the Commission to avoid state registration.

150 One commenter suggested that we clarify whether mid-sized advisers that are exempt from registration in their home states may or are required to register with us. Sadis Letter. As discussed above and in the Form ADV instructions, if a mid-sized adviser is not required to be registered in the state where it has its principal office and place of business, the adviser must register with the Commission (unless an exemption from Commission registration is available). *See supra* notes 148-149 and accompanying text; amended Form ADV: Instructions for Part 1A, instr. 2.b.

151 *See* amended Form ADV: Instructions for Part 1A, instr. 2.b.

152 All state securities authorities other than Minnesota, New York and Wyoming have advised our staff that advisers registered with them are subject to examination. According to IARD data as of April 7, 2011, there were 63 advisers with assets under management between $25 million and $90 million and a principal office and place of business in Minnesota, 286 in New York, and 1 in Wyoming.

153 *See* http://www.sec.gov/divisions/investment/midsizedadviserinfo.htm.

154 *See* amended Form ADV, Part 1A, Item 2.A.(2)(b); amended Form ADV: Instructions for Part 1A, instr. 2.b. The staff also requested that each state notify us promptly if advisers in the state

and place of business in Minnesota, New York and Wyoming with assets under management between $25 million and $100 million must register with the Commission.[155]

Several commenters agreed with our approach of relying on responses from the state regulators rather than determinations by the Commission to identify whether an adviser is "subject to examination" by a state.[156] Two commenters, however, suggested that we should instead establish our own criteria for whether an adviser is "subject to examination," and one further recommended that we should engage in an evaluation of each state's adviser examination program.[157] We do not believe that the alternatives suggested are practical or appropriate. As we explained in the Implementing Proposing Release, the states are the most familiar with their own circumstances and are in the best position to determine whether advisers in their states are subject to examination.[158]

B. Exempt Reporting Advisers: Sections 407 and 408

To implement new sections 203(l) and 203(m) of the Advisers Act, we are adopting a new rule, as proposed, that requires advisers relying on those exemptions from registration to

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will begin to be subject to examination or will no longer be subject to examination, and we will update the list on the IARD and our website accordingly.

155 *See supra* note 152. The requirement for such an adviser to register with the Commission, as opposed to one of these states, will be effective on July 21, 2011.

156 *See* NASAA Letter (proposed approach "complies with the clear and unambiguous language of the statute" and "attempting to define or otherwise interpret terms that are plain and direct is contrary to long-established rules of statutory construction."); NRS Letter; Pickard Letter. *See also* Sadis Letter (recommending the Commission clarify whether an adviser in a particular state is required to register with the Commission).

157 ABA Committees Letter (recommending the Commission construe "examination" to indicate a "structured adviser examination program, rather than one conducted on an occasional, sporadic or informal basis," and require an annual affirmation from each state that it subjects advisers to examination); FSI Letter (recommending the Commission engage in a stringent evaluation of each state's adviser examination program and expressly define "subject to examination" to, at a minimum, include a "uniform or risk based routine examination process" and that it "mirrors the frequency of broker-dealer examination by FINRA and the SEC").

158 *See* Implementing Proposing Release, *supra* note 7, at section II.A.7.b.

submit to us, and to periodically update, reports that consist of a limited subset of items on Form ADV.[159] We are also adopting the amendments we proposed to Form ADV to permit the form to serve as both a reporting and registration form and to specify the seven items these "exempt reporting advisers" must complete.[160]

As discussed above, the Dodd-Frank Act amends the Advisers Act, as of July 21, 2011, to create two new exemptions from registration for advisers to certain types of "private funds" and to repeal the private adviser exemption contained in section 203(b)(3) of the Advisers Act on which advisers to many hedge and other private funds relied in order to avoid registration.[161] Both section 203(l) (which provides an exemption for an adviser that advises solely one or more "venture capital funds") and section 203(m) of the Advisers Act (which instructs the Commission to exempt any adviser that acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million) provide that the Commission shall require such advisers to maintain such records and to submit such reports "as the Commission determines necessary or appropriate in the public interest."[162] The rules and

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159 We refer to advisers that rely on the exemptions from registration provided in either new section 203(l) or new section 203(m) of the Advisers Act as "exempt reporting advisers." For a brief discussion of these exemptions, see *infra* note 162 and accompanying text; for a more in-depth discussion, see Exemptions Adopting Release, *supra* note 4.

160 For a discussion of additional amendments we are proposing to Part 1 of Form ADV, see *infra* section II.C.

161 Section 403 of the Dodd-Frank Act. Section 203(b)(3) exempts from registration any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act, or a company which has elected to be a business development company pursuant to Section 54 of the Investment Company Act (15 U.S.C. 80a-54). *See supra* note 4; Implementing Proposing Release, *supra* note 7, at n.112 and accompanying text.

162 *See* sections 407 and 408 of the Dodd-Frank Act, adding Advisers Act sections 203(l) and (m). See *supra* note 5. *See also* Exemptions Adopting Release, *supra* note 4, at section II.; section 204(a) of the Advisers Act and section 204(b)(5), as added by section 404 of the Dodd-Frank Act.

amendments to Form ADV that we are adopting today are designed to address the reporting aspects of these two exemptions.[163]

1. Reporting Required

Rule 204-4 requires exempt reporting advisers to file reports with the Commission electronically on Form ADV through the IARD using the same process used by registered investment advisers.[164] An exempt reporting adviser must submit its initial Form ADV within 60 days of relying on the exemption from registration under either section 203(l) or section 203(m) of the Advisers Act.[165] Each Form ADV is considered filed with the Commission upon acceptance by the IARD.[166] An exempt reporting adviser unable to file electronically as a result of unanticipated technical difficulties may, like a registered adviser, request a temporary hardship exemption of up to seven business days after the filing was due.[167] Advisers filing the

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163 Recordkeeping requirements for exempt reporting advisers will be addressed in a future release. *See* sections 407 and 408 of the Dodd-Frank Act (providing that the Commission shall require investment advisers exempt from registration under either section 407 or 408 of the Dodd-Frank Act to maintain such records as the Commission determines necessary or appropriate in the public interest or for the protection of investors.).

164 New rule 204-4. *See* amended Form ADV: General Instructions 6, 7, 8 and 9 (providing guidance about the IARD entitlement process, signing the form, and submitting it for filing). We are also adopting technical amendments, as proposed, to Form ADV-NR, to enable exempt reporting advisers to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers. *See* amended Form ADV-NR; amended Form ADV: General Instruction 19.

165 *See* amended Form ADV: General Instruction 13. An adviser may not be both registered with us and filing as an exempt reporting adviser at the same time. An SEC registered adviser switching from being registered to being an exempt reporting adviser must first file a Form ADV-W to withdraw its SEC registration before submitting its first report as an exempt reporting adviser. We have modified General Instruction 13 from the proposal to reflect IARD system functionality, which we continue to develop.

166 New rule 204-4(c). *Cf.* rule 0-4(a)(2) ("All filings required to be made electronically with the . . . [IARD] shall, unless otherwise provided by the rules and regulations in this part, be deemed to have been filed with the Commission upon acceptance by the IARD.").

167 *See* new rule 204-4(e) (providing a temporary hardship exemption for an adviser having unanticipated technical difficulties that prevent submission of a filing to IARD); amended Form ADV-H; amended Form ADV: General Instruction 17.

form must pay a filing fee designed to pay the reasonable costs associated with the filing and maintenance of the system.[168] We anticipate that filing fees, which the Commission will consider separately, will be the same as those for registered investment advisers, which currently range from $40 to $225 based on the amount of assets an adviser has under management.[169]

Several commenters expressed the view that use of Form ADV and the IARD for exempt reporting advisers would be efficient, because the system is familiar to many advisers and because it would integrate the process of filing with the Commission with any parallel filing the adviser may be obligated to make with state securities authorities.[170] Commenters agreed with our expectation that use of Form ADV and the IARD would facilitate a transition from filing reports with us to applying for registration with us.[171] Two commenters urged that we create a separate reporting system.[172] One recommended a new, more interactive system; and the other suggested a separate filing system to avoid confusion among investors who might mistakenly assume that an exempt reporting adviser is registered if its information comes up in an IARD

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168 New rule 204-4(d).

169 The current fee schedule applicable to advisers applying for registration may be found on our website at http://www.sec.gov/divisions/investment/iard/iardfee.shtml.

170 The Dodd-Frank Act exempts exempt reporting advisers from registration with the Commission. *See* sections 407 and 408 of the Dodd-Frank Act. It does not, however, exempt these advisers from registering or filing reports with state securities regulators. *See also* amended Form ADV: General Instruction 14 (noting that exempt reporting advisers who file reports with the SEC may continue to be subject to state registration, reporting, or other obligations).

171 ABA Committees Letter; comment letter of Better Markets, Inc. (Jan. 24, 2011) ("Better Markets Letter"); NRS Letter; NASAA Letter. Form ADV, as amended, permits an adviser to transition from filing reports with us to applying for registration under the Act by simply amending its Form ADV; the adviser would check the box to indicate it is filing an initial application for registration, complete the items it did not have to answer as an exempt reporting adviser, and update the pre-populated items that it already has on file. *See* amended Form ADV: General Instruction 15 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser).

172 Merkl Implementing Letter; Seward Letter. *See also* Shearman Letter (making similar arguments regarding the potential for investor confusion, but not advocating use of a different form or reporting system).

search. We share these commenters' general goals of innovation and the avoidance of investor confusion as our staff works with FINRA (our IARD contractor) to continue improving the IARD.[173] However, the expense and delay of initiating and developing a new system with adequate functionality, which neither commenter addressed, argues against these commenters' recommendations. We are adopting rule 204-4 as proposed.

2. Information in Reports

We are also amending Form ADV to accommodate its use by exempt reporting advisers. First, we are re-titling the form to reflect its dual purpose as both the "Uniform Application for Investment Adviser Registration," as well as the "Report by Exempt Reporting Advisers." Second, we are revising the cover page to require exempt reporting advisers to indicate the type of report they are filing.[174] Finally, we are amending Item 2 of Part 1A, which today requires advisers to indicate their eligibility for SEC registration, to add a new subsection B that requires an exempt reporting adviser to identify the exemption(s) on which it is relying to report, rather than register, with the Commission.[175]

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173 Our staff, for example, recently completed a study mandated by section 919B of the Dodd-Frank Act on ways to improve investor access to information about certain financial service providers, including data contained in the IARD. *See* Staff of the Office of Investor Education and Advocacy of the U.S. Securities and Exchange Commission, *Study and Recommendations on Improved Investor Access to Registration Information about Investment Advisers and Broker-Dealers*, Jan. 2011, available at http://www.sec.gov/news/studies/2011/919bstudy.pdf.

174 An exempt reporting adviser must indicate whether it is submitting an initial report, an annual updating amendment, an other-than-annual amendment, or a final report. We are also adopting corresponding changes to General Instruction 2.

175 An exempt reporting adviser must check that it qualifies for an exemption from registration: (i) as an adviser solely to one or more venture capital funds; and/or (ii) because it acts solely as an adviser to private funds and has assets under management in the United States of less than $150 million. *See* amended Form ADV, Part 1A, Item 2.B, questions 1 and 2. An exempt reporting adviser relying on the latter exemption, for private fund advisers, must also indicate the amount of private fund assets it manages in Section 2.B. of Schedule D to Form ADV, Part 1A. Investment advisers who have their principal office and place of business outside of the United States, however, need only include private fund assets that they manage at a place of business in the United States. *See* Exemptions Adopting Release, *supra* note 4, at section II.B.3. An adviser

Some commenters asserted that it would be inconsistent with these new exemptions to require exempt reporting advisers to submit reports to the Commission,[176] while others argued that we proposed to require too much information.[177] Congress, however, gave us broad authority to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[178] In addition, the Dodd-Frank Act neither limits the types of information we could require in the reports nor specifies the purpose for which we would use the information.

We are adopting, as proposed, a requirement that exempt reporting advisers complete the following items of Part 1A of Form ADV: Items 1 (Identifying Information), 2.B. (SEC Reporting by Exempt Reporting Advisers), 3 (Form of Organization), 6 (Other Business Activities), 7 (Financial Industry Affiliations and Private Fund Reporting), 10 (Control Persons), and 11 (Disclosure Information).[179] In addition, we are requiring, as proposed, that exempt reporting advisers also complete corresponding sections of Schedules A, B, C, and D.[180] Responses to these items will assist us to identify exempt reporting advisers, their owners, and their business models. The information we collect will provide us with information as to

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that acts solely as an adviser to private funds but is no longer eligible to check box 2.B.(2) because it has assets under management in the United States of $150 million or more may, subject to certain conditions, check a separate box to continue filing as an exempt reporting adviser during the safe harbor transition period described below. *See infra* note 211 and accompanying text. *See also* amended Form ADV, Part 1A, Item 2.B, question 3; Form ADV: General Instruction 15.

176 Comment letter of Avoca Capital Holdings (Dec. 21, 2011) ("Avoca Letter"); AIMA Letter; comment letter of AustinVentures (Jan. 21, 2011) ("AV Letter").

177 Comment letter of Berkeley Center for Law, Business and the Economy (Jan. 31, 2011) ("BCLBE Letter"); Shearman Letter; comment letter of Village Ventures, Inc. (Jan. 24, 2011) ("Village Ventures Letter").

178 *See* sections 407 and 408 of the Dodd-Frank Act.

179 *See* amended Form ADV: General Instruction 3. We will continue to monitor whether we should also require exempt reporting advisers to complete other items on Form ADV (*e.g.*, Part 2).

180 *See id.*; Implementing Proposing Release, *supra* note 7, at section II.B.2.

whether these advisers or their activities might present sufficient concerns to warrant our further attention in order to protect their clients, investors, and other market participants.[181] The reports will also provide the public with some basic information about these advisers and their businesses.

Items 1, 3, and 10 elicit basic identification details such as name, address, contact information, form of organization, and who controls the adviser. Items 6 and 7.A. provide us with details regarding other business activities in which the adviser and its affiliates are engaged, which would permit us to identify conflicts that the adviser may have with its clients that may suggest significant risks to those clients. Item 11 requires advisers to disclose the disciplinary history of the adviser and its employees and to complete a separate schedule containing details of each disciplinary event.[182] Item 7.B. and Section 7.B. of Schedule D require advisers to private funds, which these advisers manage by terms of the exemptions, to disclose information regarding each private fund they advise. As discussed in more detail in Section II.C. of this Release, we are adopting significant amendments to Section 7.B. of Schedule D that are designed to provide us with a comprehensive overview, or census, of private funds.[183] Exempt reporting advisers' responses to Item 7.B., and Section 7.B.(1) of Schedule D, in conjunction with information provided by registered advisers, will provide us with important data about these funds that we would use to identify risks to their investors.

181 One commenter agreed. *See* ABA Committees Letter (stating that most of the information exempt reporting advisers would have to provide is of a nature that will assist the Commission to identify compliance risks posed by exempt reporting advisers and thus such disclosure responds to the mandate set forth in the Dodd-Frank Act).

182 *See* amended Form ADV, Part 1A, Disclosure Reporting Pages.

183 For instance, advisers who complete Section 7.B.(1) of Schedule D would have to provide identifying information about each private fund, such as its name and domicile, as well as information about its service providers and its gross assets. *See* amended Form ADV, Part 1A, Schedule D, Section 7.B.(1). *See also infra* Section II.C.1.

Several commenters expressed general support for the Commission's proposed reporting requirement.[184] One commenter urged us not to require exempt reporting advisers to report information about their other business activities in response to Item 6, their related persons in response to Item 7.A., their private funds in response to Item 7.B., and their control persons in response to Item 10 because, among other reasons, such information "would not add to the Commission's ability to protect the public interest or investors."[185] We disagree. Without this information, the reports would contain little more than basic identifying data, which would be inadequate to help us to meaningfully identify significant risks to an exempt reporting adviser's clients, investors, or other market participants. Moreover, to require such limited information to be reported would deny investors an opportunity to verify disclosures they receive directly from the adviser.

Some commenters urged that we broaden the scope of information we proposed to collect, suggesting among other things that the Commission should require all or some of the additional information that registered advisers must submit on Form ADV, including a requirement to prepare and deliver a client brochure (Part 2) and brochure supplements.[186] We have considered our need for this information in light of the exemptions Congress provided in the Dodd-Frank Act and the regulatory role we expect to assume with respect to exempt reporting advisers. We have not sought to apply most of the prophylactic rules we have adopted

184 *See, e.g.*, AFL-CIO Letter; comment letter of Council of Institutional Investors (Jan. 20, 2011) ("CII Letter"); NRS Letter; Better Markets Letter; ABA Committees Letter; NASAA Letter.

185 Village Ventures Letter (asserting also that the requirements would be burdensome). We address the anticipated costs and burdens associated with these requirements below. *See infra* Section V.

186 *See* Better Markets Letter; CII Letter. Part 2 of Form ADV, which requires advisers to prepare a narrative, plain English client brochure, contains 18 items including information on the adviser's business practices, conflicts of interest, and background. Part 2 also requires advisers to prepare brochure supplements that include information about advisory personnel on whom clients rely for investment advice. *See also* AFL-CIO Letter (suggesting requiring performance reporting).

for registered advisers,[187] and we do not anticipate that our staff will conduct compliance examinations of these advisers on a regular basis.[188] One commenter who urged us to collect a broader set of information recommended that we apply additional prophylactic rules to exempt reporting advisers, the consequence of which would be to reduce the distinctions between these advisers and registered advisers, which those urging us to collect less information argued we should avoid.[189] We believe that requiring advisers to complete the items we proposed strikes an appropriate balance. As discussed in more detail below, we have revised some of these items in response to comments we received.

3. Public Availability of Reports

Several commenters urged that we not make public any information filed by exempt reporting advisers.[190] Other commenters, however, supported public disclosure of information

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187 *See, e.g.*, rule 206(4)-2 (the custody rule), which applies to advisers registered or required to be registered with the Commission. *But see* rule 206(4)-5 (the "pay to play" rule) (applied to exempt reporting advisers that previously relied on the private adviser exemption and continues to apply to exempt reporting advisers that currently rely on exemptions from registration under sections 203(l) and 203(m) of the Advisers Act). *See infra* section II.D.1. (discussing amendments we are adopting today to the pay to play rule to continue to apply the rule to exempt reporting advisers and foreign private advisers).

188 Our staff will conduct cause examinations where there are indications of wrongdoing, *e.g.*, those examinations prompted by tips, complaints, and referrals. Under section 204(a) of the Advisers Act, however, the Commission has the authority to examine records, unless the adviser is "specifically exempted" from the requirement to register pursuant to section 203(b) of the Advisers Act. Investment advisers that are exempt from registration in reliance on section 203(l) or 203(m) of the Advisers Act are not "specifically exempted" from the requirement to register pursuant to section 203(b).

189 *Compare* comment letter of Coalition of Private Investment Companies (Jan. 28, 2011) ("CPIC Letter") *with* AV Letter; AIMA Letter; Shearman Letter; Village Ventures Letter. *See* Merkl Implementing Letter (indicating that our proposal created a meaningful distinction between registered advisers and exempt reporting advisers by not subjecting exempt reporting advisers to all of Form ADV, to compliance program requirements under rule 206(4)-7, to custody requirements under rule 206(4)-2, and to regular examinations, consistent with a primary concern of Congress in adopting the Dodd-Frank Act).

190 *See* AV Letter; AIMA Letter; ABA Committees Letter; Avoca Letter; Katten Foreign Advisers Letter; MFA Letter; NRS Letter; comment letter of the National Venture Capital Association (Jan. 24, 2011) ("NVCA Letter"); Shearman Letter; Seward Letter.

by these advisers and suggested that such data would be useful, for example, for prospective clients who were conducting "due diligence" reviews of advisers.[191]

Section 210(a) of the Advisers Act requires information contained in reports filed with the Commission to be made available to the public, unless we find that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors. Commenters did not persuade us that we could make such a finding.[192] On the contrary, we believe the public reporting requirements we are adopting will provide a level of transparency that will help us to identify practices that may harm investors,[193] will aid investors in conducting

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191 *See* AFL-CIO Letter; CII Letter; Better Markets Letter (each lauding the Commission's initiative to create, for the first time, a database of public information on private investment funds). *See also* Merkl Implementing Letter (noting that a potential investor would be better able to perform due diligence if the information were made available to the public); CII Letter (arguing that an investor could make an informed decision regarding the integrity of a prospective adviser if he or she were able to review the disciplinary history of the exempt reporting adviser and its employees).

192 *See* AV Letter (claiming that the public disclosure of the reports would be "unnecessary and intrusive" and would be done "for no apparent reason"); MFA Letter (urging that, absent a compelling policy reason for public disclosure, the reports should not be publicly available because some of the information is competitively sensitive); NVCA Letter (arguing that making public the ownership or control persons of an exempt reporting adviser would cause competition for scarce human resources among these advisers and could reveal strategic relationships to competitors); NRS Letter (claiming that because investors and prospective investors receive voluminous offering documents, due diligence questionnaires, and other materials, limited Form ADV Part 1A information would be of little value and limited use); ABA Committees Letter (indicating there would be no benefit in members of the general public having access to this information because they are not qualified to invest); Katten Foreign Advisers Letter (claiming that private fund investors already receive an offering document that should cover the items that would be included in the reports). *See also* Katten Foreign Advisers Letter; NVCA Letter; AIMA Letter (each conditioning its support for the scope of the reporting requirement on making the reports non-public).

193 For instance, census data about a private fund's gatekeepers, including administrators and auditors, will be available on Section 7.B.1. of Schedule D and will be verifiable by investors and the Commission. Recent enforcement actions suggest that the availability of such information could be helpful. *See, e.g., SEC v. Grant Ivan Grieve, et al.*, Litigation Release No. 21402 (Feb. 2, 2010) (default judgment against hedge fund adviser that was alleged to have fabricated and disseminated false financial information for the fund that was "certified" by a sham independent back-office administrator and phony accounting firm).

their own due diligence,[194] and will deter advisers' fraud and facilitate earlier discovery of potential misconduct.[195] For instance, investors will be able to compare Form ADV information to the information they have received in offering documents and due diligence to identify potential misrepresentations. For these reasons, we believe public availability of these reports is in the public interest and will help to protect investors. Suggestions by some that the Dodd-Frank Act compels us to deny public access to these reports are misplaced.[196] In the Dodd-Frank Act, Congress sought to protect only certain proprietary and similarly sensitive information submitted by advisers about their private funds in reports for the assessment of systemic risk.[197] In light of section 210 of the Act, which presumes reports submitted to us by advisers to be publicly available, together with the Freedom of Information Act,[198] which generally supports disclosure of such documents, we believe at this time that the information should be publicly available.[199]

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194 *See supra* note 191.

195 *See In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not).

196 ABA Committees Letter; Avoca Letter; AV Letter; Seward Letter; Shearman Letter.

197 *Compare* section 404 of the Dodd-Frank Act, codified at Advisers Act section 204(b), *with* sections 407 and 408 of the Dodd-Frank Act, codified at Advisers Act sections 203(l) and 203(m). *See also* Systemic Risk Reporting Release, *supra* note 71 (proposing confidential reporting by advisers to private funds designed to assist the Financial Stability Oversight Council ("FSOC") in its assessment of systemic risk in the U.S. financial system).

198 5 U.S.C. 552(a).

199 Information on Form ADV is available to the public through the Investment Adviser Public Disclosure System ("IAPD"), which allows the public to access the most recent Form ADV filing made by an investment adviser and is available at http://www.adviserinfo.sec.gov. In response to commenters' suggestions we will, however, make it clear to the public viewing reports filed by an exempt reporting adviser on IAPD that the adviser is not registered with us. *See* Shearman Letter; Seward Letter (expressing concerns that public access to reports by exempt reporting advisers might cause confusion if an unregistered adviser's information comes up in an IARD search, an investor's perception may be that the adviser is registered).

Some commenters expressed more narrow concerns that certain of the information we proposed to require could require them to disclose proprietary or competitively sensitive information.[200] As discussed below, we have responded to those concerns by revising certain of our items in a manner that will affect the information that both registered and exempt reporting advisers will provide to us.[201]

4. Updating Requirements

We are also amending rule 204-1 under the Advisers Act, which requires advisers to update their Form ADV filings, to require exempt reporting advisers to file updating amendments to reports filed on Form ADV.[202] As amended, rule 204-1 requires an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days of the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Similarly, we are amending General Instruction 4 to Form ADV to require an exempt reporting adviser, like a registered adviser, to update promptly Items 1 (Identification Information), 3 (Form of Organization), and 11 (Disciplinary Information) if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[203]

Most of the commenters who addressed updating and amendment requirements agreed with our approach to update the report annually and to amend it according to the same schedule

200 *See infra* note 238. The NVCA also argued that requiring a venture capital fund adviser to report information about the adviser's control persons, as required by Item 10 of Part 1A of Form ADV, could increase competition among these advisers for human resources. While this information could result in competitive effects among these advisers, the effects of this item are not unique to these advisers, and they may result in benefits.

201 *See infra* Section II.C.1.

202 Rule 204-1. We are also amending the title of the rule to be "Amendments to Form ADV," rather than "Amendments to application for registration," to reflect use of the form by exempt reporting advisers.

203 *See* amended Form ADV: General Instruction 4.

as is applicable to registered advisers.[204] In order to permit us to receive timely information from exempt reporting advisers, we are adopting the rule amendments as proposed.

5. Final Reports

When an adviser ceases to be an exempt reporting adviser, new rule 204-4 requires the adviser to file an amendment to its Form ADV to indicate that it is filing a final report.[205] Final report filings will allow us to distinguish such a filer from one that is failing to meet its filing obligations.[206] In some cases an exempt reporting adviser will file a final report because it ceases to do business as an investment adviser and thus is no longer subject to reporting under the Act.[207] In other cases an exempt reporting adviser will file a final report in connection with becoming registered with the Commission, in which case it will continue to periodically update its Form ADV, but as a registered adviser.[208]

Amended general instruction 15 to Form ADV provides guidance to exempt reporting advisers transitioning to becoming registered with the Commission. An exempt reporting adviser wishing to register with the Commission can file a single amendment to its Form ADV that will serve both as a final "report" as an exempt reporting adviser and an application for

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204 NRS Letter; Merkl Implementing Letter; CII Letter; ABA Committees Letter. Some of the commenters added that information reported by exempt reporting advisers that is allowed to become significantly outdated or inaccurate would not serve the Commission's or public's interest or protect investors as mandated by the Dodd-Frank Act and could be misleading. ABA Committees Letter; Merkl Implementing Letter. *But see* NVCA Letter (indicating that, because venture capital fund investments are long-term and illiquid, there would be little, if any, benefit to investors, regulators or the public to update the report more frequently).

205 New rule 204-4(f).

206 *Id.* Advisers filing a final report are not required to pay a filing fee. An adviser that failed to file a final report would violate rule 204-4(f).

207 Such an adviser must indicate that it is filing a final report and update Item 1 (Identifying Information) of Part 1A of Form ADV. Amended Form ADV: General Instruction 15.

208 An exempt reporting adviser may be required to become registered with the Commission if, for example, it is relying on the exemption provided by section 203(l) of the Act and accepts a client that is not a venture capital fund. *See* amended Form ADV: General Instruction 15; Exemptions Adopting Release, *supra* note 4, at Section II.A.

registration under the Advisers Act.[209] While an application is pending, but before it is approved, an adviser may continue to operate as an exempt reporting adviser in accordance with the terms of the relevant exemption.[210] In addition, General Instruction 15 provides a safe harbor for certain exempt reporting advisers relying on the "private fund adviser" exemption provided by rule 203(m)-1. Such an adviser that has complied with all of its reporting obligations as an exempt reporting adviser may continue advising private fund clients for up to 90 days after filing an annual updating amendment indicating that it has private fund assets of $150 million or more before filing its final report and application for registration.[211] This transition period is designed to accommodate events that may be beyond the adviser's control, such as an increase in the value of the adviser's assets under management, but it is not available to an adviser that otherwise would not qualify for the exemption provided by rule 203(m)-1. The transition period also is not available to advisers relying on the "venture capital adviser" exemption in section 203(l) of the Act. Advisers seeking to rely on that exemption may not accept a client that is not a venture capital fund without first registering under the Adviser Act.[212] Commenters who addressed the proposal to require a final report endorsed the Commission's approach.[213]

C. Form ADV

209 *See* amended Form ADV: General Instruction 15.

210 *See* amended Form ADV: General Instruction 15. For example, an adviser transitioning from exempt reporting to registered would violate the Advisers Act registration requirement if it provides advisory services to a client that is not a private fund before the Commission approves its application for registration.

211 *See* amended Form ADV: General Instruction 15. This condition reflects the importance of the Advisers Act reporting requirements applicable to advisers relying on the exemption provided by rule 203(m)-1. *See also* Exemptions Adopting Release, *supra* note 4, at n.377. An adviser that meets or exceeds $150 million in assets under management in the United States must indicate that change by checking the box in Item 2.B.(3) of Form ADV in its annual updating amendment.

212 *See* amended Form ADV: General Instruction 15.

213 ABA Committees Letter; Merkl Implementing Letter.

We are adopting today a number of amendments to Form ADV that will improve our ability to oversee investment advisers. Data collected from Form ADV is of critical importance to our regulatory program and our ability to protect investors. We use information reported to us on Form ADV for a number of purposes, such as to efficiently allocate our examination resources based on the risks we discern, or to identify common business activities, from information provided by advisers. The information is used to create risk profiles of investment advisers and permits our examiners to better prepare for, and more efficiently conduct, their examinations. Moreover, the information in Form ADV allows us to better understand the investment advisory industry and to evaluate the implications of policy choices we must make in administering the Advisers Act.

As amended, Form ADV requires advisers to provide us with additional information about three areas of their operations.[214] First, we require advisers to provide additional information about private funds they advise. Second, we expand the data advisers provide us about their advisory business (including data about the types of clients they have, their employees, and their advisory activities), as well as about their business practices that may present significant conflicts of interest (such as the use of affiliated brokers, soft dollar arrangements, and compensation for client referrals). Third, we require additional information about advisers' non-advisory activities and their financial industry affiliations. Some additional changes to the Form (described below) improve our ability to assess compliance risks and also to

214 In addition, we are making several clarifying or technical amendments in response to comments, frequently asked questions we receive, and our experience administering the form. *See infra* sections II.C.5. and 7.

identify advisers that are subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.[215]

The commenters that addressed these proposed amendments to Form ADV generally supported the amendments,[216] although many expressed concerns with or urged changes to the proposed private fund reporting requirements contained in Item 7.B. and Section 7.B.(1) of Schedule D.[217] Two commenters argued that the new information requirements we proposed to Part 1A of Form ADV overlap in some respects with the new brochure requirements (Part 2 of Form ADV) and should not be adopted.[218] We acknowledge some overlap in the information required to be reported, but note that overlap may be necessary as the two parts of Form ADV serve very different purposes. Part 2 of Form ADV may overlap Part 1 to ensure that investors are fully informed about a particular practice or conflict, while the information we collect in Part 1 permits us to collect data about that practice or conflict for regulatory purposes.

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215 *See* section 956 of the Dodd-Frank Act.

216 *See, e.g.*, NASAA Letter; IAA General Letter (stating that enhanced disclosure in Part 1 of Form ADV will improve the Commission's ability to gather data about firms and to conduct appropriate inquiries, inspections, and other activities based on that data, and noting that certain additional information will allow the Commission to focus its examination and enforcement resources on those advisers that appear to present greater compliance risks); CPIC Letter (noting that additional information that the revised form will collect should be of assistance to the Commission in its efforts to identify fund advisers, to verify the existence and location of assets and to carry out general market surveillance, and it should also be of use to investors as they conduct due diligence and research the background of fund managers).

217 *See, e.g.*, ABA Committees Letter; AV Letter; AIMA Letter; comment letter of CompliGlobe Ltd. (Jan. 24, 2011) ("CompliGlobe Letter"); comment letter of Debevoise & Plimpton LLP (Jan. 24, 2011) ("Debevoise General Letter"); comment letter of DLA Piper LLP (US) (on behalf of Emerging Growth and Venture Capital Group) (Jan. 24, 2011)) ("DLA Piper VC Letter"); comment letter of Gunderson Dettmer Stough Villeneuve Franklin & Hachigian, LLP (Jan. 24, 2011) ("Gunderson Letter"); IAA General Letter; Katten Foreign Advisers Letter; MFA Letter; NRS Letter; NVCA Letter; O'Melveny Letter; Seward Letter; Shearman Letter.

218 *See* NRS Letter (asserting that parts of the proposed amendments to Items 5, 6, 7, 8, and 10 would result in duplicative reporting); Seward Letter.

We are adopting amendments to the form, with several substantive and technical or clarifying revisions that respond to comments we received.

1. Private Fund Reporting: Item 7.B.

We are adopting amendments to Item 7.B. and Schedule D of Form ADV that expand the information advisers must report to us about the private funds they advise. This information will provide us with a more complete understanding of private funds and permit us to enhance our assessment of advisers for purposes of targeting our examinations. The information will also improve our ability to identify practices that could harm investors and help expose and deter fraud and other misconduct.[219] Both registered and exempt reporting advisers are required to complete Item 7.B. and the related portions of Schedule D.

Item 7.B. requires an adviser to complete a separate Section 7.B. of Schedule D for each private fund that it advises. Part A of Section 7.B.(1) requires an adviser to provide basic information regarding the size and organizational, operational, and investment characteristics of each fund. Part B requires information about five types of private fund service providers that perform important roles as "gatekeepers." This information will be publicly available, as is other information reported on Form ADV. We are adopting these amendments with several changes, discussed below, that respond to comments we received.

Item 7.B. has required an adviser to complete section 7.B. of Schedule D for each "investment-related" limited partnership or limited liability company that it or a related person advises.[220] We are modifying, as proposed, the scope of Item 7.B. by requiring an adviser to

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219 *See* Implementing Proposing Release, *supra* note 7, at nn.148-150 and accompanying text.

220 Section 7.B. of Schedule D previously required an adviser to a private fund that is a limited partnership or limited liability company to provide only the following information: (i) the name of the fund; (ii) the name of the general partner or manager; (iii) whether the adviser's clients are solicited to invest in the fund; (iv) the approximate percentage of the adviser's clients that have invested in the fund; (v) the minimum investment commitment; and (vi) the current value of the

complete a separate Schedule D for each "private fund" that the adviser (but not a related person) manages. We use the new term "private fund," defined in section 202(a)(29) of the Act,[221] with the result that advisers must report on pooled investment vehicles regardless of how they are organized. In addition, as proposed, we are narrowing the reporting requirement so that advisers are no longer required to report on the funds of their related persons, which in most cases are now required to be reported to us by a related person that is either registered under the Act or is an exempt reporting adviser.[222]

We are also adopting several measures that will help to avoid multiple reporting for each private fund and minimize the overall burden of reporting private fund information. First, only one adviser must report the full scope of information for each private fund, even where there are other advisers to the same fund (*e.g.*, subadvisers).[223] Second, an adviser managing a master-feeder arrangement may submit a single Section 7.B.(1) for the master fund and all of the feeder

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total assets of the fund. As we discussed in the Implementing Proposing Release, this information provided us with little data about the operations of the many large hedge funds and other private funds managed by a growing number of advisers registered with the Commission.

221 This section defines a "private fund" as an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a–3), but for section 3(c)(1) or 3(c)(7) of that Act.

222 The Dodd-Frank Act repealed the private adviser exemption effective July 21, 2011, so many private fund advisers that were previously unregistered will now be required to register under the Advisers Act. *See supra* at sections I. and II.B.

223 If an investment adviser completes section 7.B.(1) of Schedule D for a private fund, other advisers to that fund do not have to complete section 7.B.(1) for that private fund. *See* amended Form ADV, Part 1A, Note to Item 7.B.; Section 7.B.(2) of Schedule D. Section 7.B.(1) of Schedule D requires advisers to provide a private fund identification number, which is a unique identification number for each fund. Advisers must obtain an identification number for each private fund by logging onto the IARD website and using the private fund identification number generator. Once an adviser obtains a private fund identification number for a private fund, all advisers to the fund must use that same number on Sections 7.B.(1) and 7.B.(2) for that fund and continue using that same number whenever they amend either section of Schedule D. *See* amended Form ADV: Instructions for Part 1A, instr. 6.b.

funds if these funds would otherwise report substantially identical information.[224] Finally, an adviser with a principal office and place of business outside the United States is not required to complete Schedule D for any private fund that, during the adviser's last fiscal year, was not a United States person, was not offered in the United States and was not beneficially owned by any United States person.[225] Commenters did not address any of the issues raised by these changes to Item 7.B., which we are adopting as proposed.

An adviser must file a separate Section 7.B.(1) (Parts A and B) for each private fund it manages.[226] Part A of Section 7.B.(1) requires an adviser to provide the name of the fund and the state or country in which the fund is organized and to identify other persons involved in the management of the fund.[227] Part A also requires the adviser to report whether the fund is part of a master-feeder arrangement[228] or is a fund of funds[229] and to provide information about the

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224 *See* amended Form ADV: Instructions for Part 1A, instr. 6.d. The feeder funds need not have a direct relationship with the master fund's prime broker or custodian to rely on this instruction. In a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund").

225 *See* amended Form ADV: Instructions for Part 1A, instr. 6.a. This instruction is only necessary for those funds that fall within the definition of "private fund." A non-U.S. fund that has never used U.S. jurisdictional means in the offering of the securities it issues would not be a private fund. *See* Exemptions Adopting Release, *supra* note 4, at n.285 and accompanying text. We have modified this instruction from the proposal to more closely follow the requirements of Regulation S; the instruction now looks to whether the offering was made "in the United States" rather than "to... any *United States person*." *See also* amended Form ADV: Glossary. "United States person" is defined by reference to the definition in rule 203(m)-1, which tracks the definition of a "U.S. person" under Regulation S, except that it contains a special rule for discretionary accounts maintained for the benefit of United States persons. *See* Exemptions Adopting Release, *supra* note 4, at section II.B.4.

226 *See* amended Form ADV, Part 1A, Item 7.B.

227 An adviser is required to report the names of the fund's general partner, trustee and directors and persons occupying similar positions as well as the name and SEC file number of any other advisers to the fund. *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, questions 1-3 and 17-18.

228 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, questions 6 and 7. As discussed above, an adviser managing a master-feeder arrangement may submit a single Schedule D for the relevant funds if the information provided would otherwise be substantially identical. *See supra* note 224 and accompanying text. We have added a note to question 6 to clarify that an

regulatory status of the fund, such as the exclusion from the Investment Company Act on which the fund relies, whether the fund is subject to the jurisdiction of a foreign regulatory authority, and whether the fund relies on an exemption from registration under the Securities Act of 1933 (the "Securities Act") with respect to its securities.[230] An adviser must also identify, within seven broad categories, the type of investment strategy the fund employs,[231] report whether the fund invests in securities of registered investment companies,[232] and provide the gross asset value of the fund.[233] Finally, an adviser must provide limited information regarding investors in the fund, including: (i) the minimum amount that investors are required to invest;[234] (ii) the

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adviser must respond to that question regardless of whether it is filing a single Schedule D, Section 7.B.(1) for the master-feeder arrangement or reporting on the funds separately.

229 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 8. Clause (b) of this question also requires the adviser to indicate whether the fund invests in funds managed by the adviser or its related persons.

230 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, questions 4-5 and 21-22. Two commenters asserted that requiring advisers to report whether the fund relies on an exemption from registration under the Securities Act with respect to its securities is unnecessarily duplicative because the information is already reported on Form D. *See* Debevoise General Letter; NYSBA Committee Letter. We are not persuaded that providing this information will significantly increase the reporting burden, and the information will assist both the Commission and the public in quickly and accurately locating additional relevant information regarding the fund.

231 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 10. The categories, which are defined in the Instructions for Part 1A, include: (i) hedge fund; (ii) liquidity fund; (iii) private equity fund; (iv) real estate fund; (v) securitized asset fund; (vi) venture capital fund; and (vii) other private fund. *See infra* note 248 and accompanying text for a discussion of changes to these definitions.

232 This information relates to compliance with the provision of the Investment Company Act that limits the ability of one investment company to invest in shares of another. *See* section 12(d)(1) of the Investment Company Act (15 U.S.C. 80a-12(d)(1)) and amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 9. We have modified this question from the proposal to cross-reference Instruction 6.e. of the Instructions for Part 1A, which excludes from this question investments in money market funds made in reliance on rule 12d1-1 under the Investment Company Act because that rule exempts (subject to the conditions described in the rule) investments in money market funds from the limitations contained in section 12(d)(1) of the Investment Company Act. 17 CFR 270.12d1-1.

233 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 11.

234 *See* amended Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 12. We made one

approximate number of beneficial owners of the fund and the approximate percentage of the fund beneficially owned by the adviser and its related persons, funds of funds and non-United States persons;[235] and (iii) the extent to which clients of the adviser are solicited to invest, and have invested, in the fund.[236] We are adopting Part A with several changes discussed below.[237]

Several commenters argued that certain information we proposed to include in Part A is competitively sensitive or proprietary and, as a result, should not be disclosed publicly.[238] These commenters focused in particular on three of the proposed questions in Part A. The first would have required an adviser to report both the gross and net asset values of each private fund it manages.[239] Commenters asserted that public disclosure of this information could reveal a fund's leverage, which may be competitively sensitive strategy information.[240] In addition, commenters expressed concerns regarding the competitive effects of our proposal to require that

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change in this item in response to a comment, which pointed out that a private fund manager may have discretion to lower the minimum amount, meaning that the minimum investment may in practice be different from the amount set out in the organizational documents of the fund. IAA General Letter. We have added an instruction clarifying that the amount reported should be the amount that is routinely required of investors who are not related persons of the adviser.

235 *Id.* questions 13-16. For purposes of these questions, beneficial owners are persons who would be counted as beneficial owners under section 3(c)(1) of the Investment Company Act or who would be included in determining whether the owners of the fund are qualified purchasers under section 3(c)(7) of that Act. (15 U.S.C. 80a-3(c)(1) or (7)). We added the word "approximate" to question 13 to make this question more consistent with questions 14-16 and because we understand based on comments received that, in some cases, the number of beneficial owners may change frequently, making a precise number more difficult to provide and less meaningful. *See* IAA General Letter.

236 *Id.* questions 19-20. This information helps to identify where a fund manager may have conflicts of interest with fund investors of the sort that implicate the adviser's fiduciary obligations to the fund and, in some cases, create risks for the fund investors.

237 *See also infra* notes 264 through 279 and accompanying text for a general discussion of comments on Section 7.B.(1). Some of these comments relate to all or portions of the proposed reporting requirements in Part A.

238 *See* IAA General Letter; MFA Letter; NVCA Letter; NYSBA Committee Letter; O'Melveny Letter.

239 *See* the Implementing Proposing Release for the as proposed version of Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, questions 11(a) and 11(b).

240 *See, e.g.*, MFA Letter. *See also* NYSBA Committee Letter.

advisers report the assets and liabilities of each fund broken down by class and categorization in the fair value hierarchy established under GAAP.[241] Commenters explained that this disclosure could harm an adviser's competitiveness and could, for instance, be used to ascertain the values of private companies held by venture capital funds that make only one or a few investments, potentially harming the private company and the interests of the private fund and its investors.[242] Finally, our proposal would have required that advisers report the approximate percentage of each fund beneficially owned by certain types of investors.[243] Commenters argued that the public disclosure of these data could reveal potentially sensitive information and, in particular, that they could be used to reverse engineer investor identities where a fund is owned by a few investors and that it could serve to deter certain institutional clients from investing in private funds.[244] We are persuaded at this time that, with respect to these three questions, the benefit of public disclosure would not outweigh the potential competitive harm. Therefore, we are not adopting the amendments that would have required an adviser: (i) to disclose each private fund's net assets;[245] (ii) to report private fund assets and liabilities by class and categorization in the fair

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241 *See* the Implementing Proposing Release for the as proposed version of Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 12. *See also* FASB ASC 820-10-50-2b.

242 *See* MFA Letter; NVCA Letter; O'Melveny Letter.

243 *See* the Implementing Proposing Release for the as proposed version of Form ADV, Part 1A, Section 7.B.(1)A. of Schedule D, question 17. The investor types included individuals, broker-dealers, insurance companies, registered investment companies, private funds, non-profits, pension funds, banks and thrift institutions, and state and municipal government entities.

244 IAA General Letter. *See also* MFA Letter.

245 We are, however, adopting question 11(a), concerning gross assets, as proposed. This question retains the requirement, included in Form ADV prior to today's amendments, that advisers report the total (or gross) assets of their private funds on Section 7.B. of Schedule D. Net asset values of individual funds may be important to our investor protection mission and to FSOC's systemic risk monitoring activities. *See* Systemic Risk Reporting Release, *supra* note 71 (proposing non-public reporting of gross and net asset values for private funds managed by registered investment advisers).

value hierarchy established under GAAP;[246] and (iii) to specify the percentage of each fund owned by particular types of beneficial owners.[247]

As noted above, Part A of Section 7.B.(1) requires an adviser to classify each of its private funds by strategy, using definitions that we proposed in the instructions to Form ADV.[248] In the Systemic Risk Reporting Release, we also proposed to use these definitions for purposes of Form PF.[249] Although we received no comments on these definitions in this rulemaking, we received several comments on the same definitions in response to Form PF.[250] We have considered these comments in the context of this rulemaking and have determined to make several changes. We will also consider these comments in the context of the Form PF release.

The first of the changes we are making clarifies the definitions to address concerns that a securitized asset fund may be classified as a hedge fund because of its borrowings.[251] We

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246 The fair value breakdown for individual funds may be important to our investor protection mission and to FSOC's systemic risk monitoring activities, and we will consider whether to adopt it as part of our Form PF proposal. *See* Systemic Risk Reporting Release, *supra* note 71. Some commenters also expressed concern with respect to the burden of reporting this information. *See, e.g.*, ABA Committees Letter; AIMA Letter; Dechert General Letter; DLA Piper VC Letter; IAA General Letter; Katten Foreign Advisers Letter; Merkl Implementing Letter; NVCA Letter. We will consider these comments in connection with our consideration of other comments on proposed Form PF.

247 Beneficial ownership percentages of funds may be important to our investor protection mission and to FSOC's systemic risk monitoring activities, and we will consider whether to adopt it as part of our Form PF proposal. *See* Systemic Risk Reporting Release, *supra* note 71. Some commenters also expressed concern with respect to the burden of reporting this information. *See, e.g.*, Debevoise General Letter; IAA General Letter; Shearman Letter. We will consider these comments in connection with our consideration of other comments on proposed Form PF.

248 The definitions appear in Instruction 6 of the instructions to Part 1A of Form ADV. *See supra* at note 231 and accompanying text.

249 *See* Systemic Risk Reporting Release, *supra* note 71, at section II.B.1. If adopted, registered advisers would use Form PF to report information about the private funds they manage for use by FSOC in its assessment of systemic risk in the U.S. financial system.

250 These comments were submitted in response to the Systemic Risk Reporting Release, *supra* note 71, and are available on the Commission's website at: http://www.sec.gov/comments/s7-05-11/s70511.shtml.

251 *See* Comment letter of TCW Group, Inc. (Apr. 12, 2011) ("TCW Systemic Risk Reporting

believe that the quality and usefulness of the data reported depends in part on accurately grouping funds and that securitized asset funds should not be categorized as hedge funds based on their issuance of debt. To clarify the definitions, we have excluded securitized asset funds from the definition of "hedge fund" and modified "securitized asset fund" so that it is no longer defined by reference to "hedge fund."

Second, we have modified clause (a) of the "hedge fund" definition, which classifies funds based on whether performance fees or allocations are calculated by taking into account unrealized gains. One commenter pointed out that even funds that do not allow for the payment of such fees or allocations, such as private equity funds, may be required to accrue or allocate these amounts in their financial statements to comply with applicable accounting principles.[252] We did not intend for funds that accrue or allocate these fees or allocations solely for financial reporting purposes to be classified as hedge funds, so we have clarified that clause (a) relates only to fees or allocations that may be *paid* to an investment adviser (or its related persons).

Third, we have addressed another commenter's concern that clause (a) could inadvertently capture certain private equity funds because, although these funds typically calculate currently payable performance fees and allocations based on realized amounts, they will sometimes reduce these fees and allocations by taking into account "unrealized losses net of unrealized gains in the portfolio."[253] We agree that funds should not be classified as hedge funds based solely on this practice and have clarified that clause (a) would not include performance fees or allocations the calculation of which may take into account unrealized gains solely for the purpose of reducing such fees or allocations to reflect net unrealized losses.

Letter").

252 *See* TCW Systemic Risk Reporting Letter.

253 *See* comment letter of the Private Equity Growth Capital Council (Apr. 12, 2011) ("PEGCC Systemic Risk Reporting Letter").

Finally, several commenters asserted that clause (c) of the "hedge fund" definition, which looks to whether a fund may engage in short selling, should include an exception for a *de minimis* amount of short selling or exclude short selling intended to hedge the fund's exposures.[254] We continue to believe that short selling is a potentially important distinguishing feature of hedge funds, many of which may, as the name suggests, use short selling to hedge or manage risk of various types. We are persuaded, however, that many funds pursuing traditional investment strategies use short positions to hedge foreign exchange risk and to manage the duration of interest rate exposure, and we are concerned that including funds within the definition of "hedge fund" solely because they use these particular techniques would dilute the meaningfulness of the category. Therefore, we have modified clause (c) to provide an exception for short selling that hedges currency exposure or manages duration.[255] We expect that the

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254 *See* comment letter of the Investment Adviser Association (Apr. 12, 2011) ("IAA Systemic Risk Reporting Letter"); PEGCC Systemic Risk Reporting Letter; Comment letter of Securities Industry and Financial Markets Association (Apr. 12, 2011) ("SIFMA Systemic Risk Reporting Letter"); TCW Systemic Risk Reporting Letter.

255 We have also made a change to clause (c) to clarify that this clause includes traditional short sales and any transaction resulting in a short exposure to a security or other asset (such as using a derivative instrument to take a short position). The purpose of this definition is to appropriately categorize funds that engage in certain types of market activity, and whether the definition applies should not depend on the form in which the fund engages in that activity. In addition, we note that several commenters expressed concern that clauses (b) and (c) of the "hedge fund" definition are too broad because many funds have the capacity to borrow or incur derivative exposures in excess of the specified amounts or to engage in short selling but do not in fact engage, or intend to engage, in these practices. *See, e.g.*, comment letter of the Alternative Investment Management Association (Apr. 12, 2011); IAA Systemic Risk Reporting Letter; PEGCC Systemic Risk Reporting Letter; SIFMA Systemic Risk Reporting Letter; TCW Systemic Risk Reporting Letter. These commenters generally argued that clauses (b) and (c) should focus on actual or contemplated use of these practices rather than potential use. We have not made changes to the "hedge fund" definition in response to these comments because we continue to believe that clauses (b) and (c) properly focus on a fund's ability to engage in these practices. Even a fund for which leverage or short selling is an important part of its strategy may not engage in that practice during every reporting period. We would, however, not regard a private fund to be a "hedge fund" solely because its organizational documents fail to prohibit the fund from borrowing or incurring derivative exposures in excess of the specified amounts or from engaging in short selling so long as the fund in fact does not engage in these practices (other than, in the case of clause (c), short selling for the purpose of hedging currency exposure or managing

changes to the private fund definitions discussed above will provide for a more accurate classification of private funds and reduce the number of funds categorized as hedge funds.

Part B of Section 7.B.(1), as amended, requires advisers to report information concerning five types of service providers that generally perform important roles as "gatekeepers" for private funds — auditors, prime brokers, custodians, administrators, and marketers.[256] An adviser must identify each of these service providers, report their locations, and indicate which of them, if any, are related persons of the adviser.[257] In addition, for certain types of service providers, an adviser would report information intended to help us and investors understand the nature of the services provided. For instance, with respect to each prime broker, an adviser must indicate whether the prime broker has custody of fund assets.[258]

We are adopting Part B with minor changes from the Implementing Proposing Release that are designed to clarify instructions. Where we ask for the percentage of the fund's assets valued by a third party, we have revised the question and instructions to clarify that a person should be viewed as valuing an asset for this purpose only if that person carried out the valuation procedure for that asset (if any) and that person's determination as to value was used for purposes of subscriptions, redemptions, distributions and fee calculations.[259] We have decided not to require advisers to report the name and location of the third parties performing these valuations because we recognize, as commenters pointed out, that identifying the specific person

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duration) and a reasonable investor would understand, based on the fund's offering documents, that the fund will not engage in these practices.

256 *See* amended Form ADV, Part 1A, Section 7.B.(1)B. of Schedule D.

257 *Id.* questions 23-28.

258 *Id.* question 24(e). *See also id.* questions 23(a), 23(g), 23(h), 26(e), 26(f), 28(f), and 28(g).

259 *Id.* question 27. We are making this change in response to commenter requests for clarification regarding "what constitutes assets 'valued' by a third-party administrator." IAA General Letter; *see also* ABA Committees Letter.

carrying out the valuation could be difficult where two or more third parties are involved (such as where an unaffiliated administrator obtains a quote from an electronic pricing service).[260] In addition, we are modifying question 23, which requires information about the relevant private fund's auditing firm, so that advisers must indicate whether the fund's auditor issued an unqualified opinion on the fund's financial statements.[261] By requiring this information in question 23, we are able to relieve advisers from the burden of reporting similar information with respect to private funds in Section 9.C. of Schedule D.[262] Few commenters specifically addressed the proposed reporting requirements in Part B.[263]

Many commenters who addressed the private fund reporting requirements did not comment on specific items but provided comments more generally on the proposals. Several expressed strong support for the proposal as a whole,[264] and some agreed with our assessment that the new information will allow us to identify harmful practices, to improve risk assessment,

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260 *See* IAA General Letter and ABA Committees Letter, each discussing the difficulty of identifying who is "valuing" an asset. *See* the Implementing Proposing Release for the as proposed version of Form ADV, Part 1A, Section 7.B.(1)B. of Schedule D, question 28(f)(2) and (3).

261 *See* amended Form ADV, Part 1A, Section 7.B.(1)B. of Schedule D, question 23(h).

262 *See* amended Form ADV, Part 1A, Item 9.C., which provides that "[i]f you checked Item 9.C.(2), you do not have to list auditor information in Section 9.C. of Schedule D if you already provided this information with respect to the private funds you advise in Section 7.B.(1) of Schedule D." An adviser must still complete Section 9.C. of Schedule D with respect to clients other than private funds to the extent required by the instructions to Item 9.C.

263 *See, e.g.*, Debevoise General Letter (contending that the service provider information "goes beyond what is necessary" because it requests "**both** the legal name of the custodian as well as the custodian's primary business name" (original emphasis)); Shearman Letter (arguing that a "fund's investors will generally already receive [information identifying the fund's service providers] and it generally has little public interest"). With respect to the comment in the Debevoise General Letter, we are not persuaded that providing both a legal name and business name will significantly increase the reporting burden, and the information will assist both the Commission and the public in quickly and accurately identifying the relevant custodian. With respect to the comment in the Shearman Letter, see the discussion accompanying note 272 below regarding the value of public disclosure of Section 7.B.(1) information generally.

264 *See, e.g.*, AFL-CIO Letter; AFR Letter; Better Markets Letter; CII Letter; CPIC Letter; comment letter of U.S. Senator Carl Levin ("Sen. Levin Letter").

and to more efficiently target examinations.[265] A few recommended that we expand the requirements to include reporting of performance information.[266] Many commenters offered more measured support, generally agreeing with the Commission's proposal but expressing reservations about the public availability of the information or concerns about the difficulty of responding to specific reporting items.[267] Often citing these same concerns, some commenters disagreed more generally with the Commission's proposal.[268]

Critics of the proposal most frequently focused on public disclosure of the information required by Section 7.B., arguing that all or part of the required private fund information is competitively sensitive or proprietary.[269] As discussed above, we have made several changes to Part A of Section 7.B.(1) to address some of these concerns. However, we continue to believe

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265 *See, e.g.*, CII Letter; CPIC Letter; NASAA Letter; Sen. Levin Letter (also asserting that the data would assist FSOC in monitoring systemic risk).

266 *See* AFL-CIO Letter and AFR Letter, each favoring public disclosure of 1-, 5- and 10-year performance numbers. We note that performance data may be important to our investor protection mission and to FSOC's systemic risk monitoring activities, and we will consider these comments in connection with our consideration of other comments on proposed Form PF. *See* Systemic Risk Reporting Release, *supra* note 71.

267 *See, e.g.*, IAA General Letter (supporting the "increased oversight of private funds and increased information gathering" but arguing that "the Commission should limit the public availability of private fund information provided on Part 1 of Form ADV."); MFA Letter ("MFA strongly supports private fund managers reporting to the Commission information about their businesses or the funds they manage. We believe, however, that the Commission should carefully consider whether the additional step of publicly disclosing information it collects would enhance its oversight capabilities, and whether any such benefits would outweigh the potentially significant costs to managers in sharing sensitive business information with market participants."); Dechert General Letter (stating that they "generally agree with the information the Revised Form ADV would be soliciting with respect to private funds managed by registered or exempt reporting advisers" but expressing reservations regarding the requirement to report private fund assets and liabilities by class and categorization in the fair value hierarchy established under GAAP). *See also* DLA Piper VC Letter; Merkl Implementing Letter; NVCA Letter.

268 *See, e.g.*, AIMA Letter; AV Letter; CompliGlobe Letter; Debevoise General Letter; Katten Foreign Advisers Letter; NRS Letter; NYSBA Committee Letter; Seward Letter; Shearman Letter; AV Letter.

269 *See, e.g.*, ABA Committees Letter; AIMA Letter; AV Letter; CompliGlobe Letter; Debevoise Letter; DLA Piper VC Letter; Gunderson Letter; IAA General Letter; Katten Foreign Advisers Letter; MFA Letter; NRS Letter; NVCA Letter; NYSBA Committee Letter; O'Melveny Letter; Seward Letter; Shearman Letter.

that, as a general matter, the information we collect in response to Item 7.B. is important for several reasons, including to inform prospective clients and other investors.[270] Moreover, and as we discussed in the Implementing Proposing Release, the public availability of this information will serve as a check on fund managers, helping to deter fraud and other misconduct.[271] We are not persuaded that public disclosure is unnecessary simply because, as some commenters asserted, investors in these pooled investment vehicles meet certain sophistication standards or may otherwise receive similar information from advisers.[272] To the contrary, it is precisely the ability of these investors to compare Form ADV information to the information they have received in offering documents and due diligence that makes public disclosure valuable. We also believe that public disclosure could reduce the likelihood of advisers making false representations regarding fund service providers, such as administrators and auditors, who could uncover false representations by reviewing the information that advisers report to us and comparing it to their own client lists.[273] In addition, as discussed above, the Advisers Act requires that information filed in a report with the Commission be made available to the public unless the Commission finds that public disclosure is neither necessary nor appropriate in the

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270 Several commenters agreed. *See, e.g.*, AFL-CIO Letter ("This information will assist investors as they perform due diligence before making investment decisions..."); AFR Letter ("making clear and uniform information on private investment funds available to the public will make it easier for investors to perform due diligence..."); CII Letter; CPIC Letter ("The additional information that the revised Form will collect... should also be of use to investors as they conduct due diligence and research the background of fund managers.").

271 *See* Implementing Proposing Release, *supra* note 7, at nn.150 and 175 and accompanying text. *See also* CII Letter (agreeing that "the public availability of such basic information would aid investors in their due diligence efforts and help investors and other industry participants protect against fraud").

272 *See, e.g.*, ABA Committees Letter; AV Letter; NRS Letter; NYSBA Committee Letter; Shearman Letter.

273 *See, e.g.*, *In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not).

public interest or for the protection of investors.[274] We are not convinced that withholding the private fund information reported on Form ADV is in the public interest. Therefore, as proposed, it will be available to the public.

Commenters expressing disagreement with all or parts of our proposal also pointed to what they viewed as an excessive reporting burden, particularly where valuation or ownership information would be required.[275] As discussed above, we are adopting Part A of Section 7.B.(1) with several changes that reduce the amount of information required in respect of private funds. We are not convinced that the burden associated with Item 7.B. and Schedule D will be excessive, in part because commenters confirmed that much of the required information is readily available to private fund advisers.[276] These commenters also acknowledged that the required information is similar to, and at times less extensive than, the information that investors in hedge funds and other private funds commonly receive in response to due diligence questionnaires or in offering documents.[277] Moreover, responses to many of the items are unlikely to change from year to year.

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274 Advisers Act section 210(a). *See supra* section II.B.3. for discussion of public availability of exempt reporting adviser filings.

275 *See, e.g.*, AIMA Letter; AV Letter; BCLBE Letter; Debevoise General Letter; comment letter of Dechert LLP (on behalf of foreign asset manager) (Jan. 24, 2011) ("Dechert Foreign Adviser Letter"); Gunderson Letter; Katten Foreign Advisers Letter; NRS Letter; Seward Letter; Shearman Letter; Village Ventures Letter.

276 *See, e.g.*, ABA Committees Letter ("We expect that most ERAs will already have most of the information requested by Form ADV Part 1 readily available."); Katten Foreign Advisers Letter ("Virtually all of the requested information would already have been provided to investors in the fund through an offering document or follow up status reports."); NRS Letter (arguing that the expanded private fund disclosures on Schedule D would "replicate the due diligence questionnaire information....").

277 *See, e.g.*, ABA Committees Letter; NRS Letter. *See also* AIMA's Illustrative Questionnaire For Due Diligence of Hedge Fund Managers, available at (registration required) http://www.aima.org/en/knowledge_centre/index.cfm.

Finally, a few commenters expressed concern that an adviser's required public disclosure on Section 7.B.(1) of Schedule D could call into question a private fund's reliance on the non-public offering exemption in the Securities Act.[278] We believe public disclosure of the information required by Section 7.B.(1) of Schedule D through IAPD would not, in and of itself, jeopardize the fund's reliance on that exemption (or the safe harbor for offshore offerings provided by Regulation S under the Securities Act).[279]

2. Advisory Business Information: Employees, Clients and Advisory Activities: Item 5

Item 5 of Part 1A requires a registered adviser to provide basic information regarding the business of the adviser that allows us to identify the scope of the adviser's business, the types of services it provides, and the types of clients to whom it provides those services. The item also requires information from the adviser about the number of its employees, the amount of assets it manages, and the number and types of its clients.

We are adopting the amendments that we proposed to Item 5.B., which require an adviser to indicate how many of its employees are registered as investment adviser representatives or are licensed insurance agents.[280] An adviser must also provide a single numerical approximation (instead of a range) in response to these questions as well as to the existing questions that ask about employees that perform investment advisory functions or are registered representatives of

278 *See* IAA General Letter; MFA Letter. The non-public offering exemption is found in Section 4(2) of the Securities Act. Offers and sale of securities by an issuer that satisfy the conditions of Rule 506 of Regulation D (17 CFR 230.501 et seq.) are deemed to be non-public within the meaning of Section 4(2).

279 We have previously taken a similar position with respect to mandatory reporting in Part 2 of Form ADV. *See* Part 2 Release, *supra* note 67, at n. 276 and accompanying text. Regulation S is codified at 17 CFR 230.901 *et seq.*

280 Amended Form ADV, Part 1A, Items 5.B.(1) - (5).

a broker-dealer, and firms that solicit advisory clients.[281] Commenters did not object to these new questions and revisions.

We are adopting amendments to Items 5.C. and 5.D., which require advisers to report the number and types of clients the adviser services. Specifically, the amendments require each registered adviser to: (i) provide an approximate number of clients it has if over 100;[282] (ii) report the approximate percentage of its clients that are not United States persons;[283] (iii) specify the types of clients that it advises (adding categories for business development companies, other investment advisers, and insurance companies) and the percentage that each client type comprises of its total number of clients (adding a box to check if 100% of an adviser's clients are a particular type);[284] and (iv) report in a new item the approximate percentage (in broad ranges) of assets under management attributable to each client type.[285] These form amendments are designed to help us better understand an adviser's business.

Commenters did not address our proposed amendments to Item 5.C., which we are adopting as proposed. We are making one change to Item 5.D., as suggested by one commenter, so that advisers report approximate percentages of assets under management by client type in broad ranges (*i.e.*, 25 percent segments).[286] This change will decrease the burden on advisers gathering the data necessary to respond to this item while retaining the substance of the information we need for our risk-assessment program. We are also, at the suggestion of a

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281 Amended Form ADV, Part 1A, Item 5.B.(6).

282 Amended Form ADV, Part 1A, Item 5.C.(1).

283 Amended Form ADV, Part 1A, Item 5.C.(2). *See supra* note 225 (discussing the definition of "United States person").

284 Amended Form ADV Part 1A, Item 5.D.(1).

285 Amended Form ADV Part 1A, Item 5.D.(2).

286 Advisers should not, however, include as clients the investors in a private fund they advise unless they have a separate advisory relationship with those investors. Amended Form ADV, Part 1A, Items 5.C., 5.D. and 5.H.

commenter, adding a note to Items 5.D.(1) and (2) to clarify that an adviser should check all applicable boxes.[287]

We are adopting, as proposed, amendments to Item 5.G. that require an adviser to select from a list set forth in the form the types of advisory services that it provides, and that add two additional types of services: (i) portfolio management for pooled investment vehicles, *other* than registered investment companies; and (ii) educational seminars or workshops.[288] At the request of a commenter, we are clarifying that educational seminars and workshops would not include episodic meetings at which advisers educate existing clients about issues related to the ongoing management of their accounts.[289] In addition, the revised item requires that if an adviser selects from that list "portfolio management for an investment company," the adviser must provide the SEC file number for the registered investment company, as well as business development companies that have made an election pursuant to section 54 of the Investment Company Act of 1940, in Section 5.G.(3) of Schedule D. This information will connect information reported on Form ADV to information reported on forms filed through our EDGAR system by investment companies managed by these advisers. We have made a few technical changes to avoid potential overlap of some of the listed types of advisory services.[290]

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287 *See* IAA General Letter. For example, an adviser to a state pension plan should check boxes for both "pension and profit sharing plans" and "state or municipal government entities." We also note that we are not adopting our proposal to divide the category for pension and profit sharing plans into those subject to ERISA and those that are not. *See id.* (noting that there could be substantial confusion about what it means to be "subject to" ERISA because some plans are subject to some, but not all, of ERISA's provisions).

288 Amended Form ADV, Part 1A, Item 5.G.

289 *See* IAA General Letter (requesting clarification that such episodic meetings would not be reportable educational seminars or workshops). We also confirm this commenter's understanding that educational seminars and workshops would not include events sponsored by third parties that are merely attended by an adviser's supervised persons.

290 *See* amended Form ADV, Part 1A, Items 5.G.(4) and 5.G.(5).

We are adopting new Item 5.J. to require advisers to indicate whether they report, in response to Item 4.B. of Part 2A of Form ADV, that they provide investment advice only with respect to limited types of investments. We had proposed to require advisers to indicate the types of investments they provided advice about during the previous fiscal year. Commenters expressed skepticism about whether such an item would provide us with much useful information because many advisers would simply indicate all the items.[291] We agree, and have revised the item to provide us with information that will identify advisers that disclose to their clients that they provide specialized advice, which is the type of information we had intended to collect.

3. Other Business Activities and Financial Industry Affiliations: Items 6 and 7

Items 6 and 7 of Part 1A require advisers, including exempt reporting advisers, to report those financial services the adviser or a related person is actively engaged in providing, from lists of financial services set forth in the items. We are adopting amendments to these items largely as proposed to provide us with a more complete picture of the activities of an adviser and its related persons, which would better enable us to assess the conflicts of interest and risks that may be created by those relationships and to identify affiliated financial service businesses.

First, we are expanding the lists of types of financial service businesses in both Items 6.A. and 7.A. As a result, an adviser must also report whether it or a related person is a trust company, registered municipal advisor, registered security-based swap dealer, or major security-based swap participant, the latter three of which are or will be new SEC-registrants under the

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291 IAA General Letter.

Dodd-Frank Act's amendments to the Exchange Act.[292] Second, to parallel Item 7.A. for related persons, an adviser must also report if it is an accountant (or accounting firm) or lawyer (or law firm). Last, amendments to Item 7.A. require an adviser to report if a related person is a sponsor, general partner or managing member of a pooled investment vehicle,[293] and add an instruction to clarify that advisers' responses must include related persons that are foreign affiliates, regardless of whether they are registered or required to be registered in the United States. One commenter expressed support for the additions we proposed to make to the lists in Items 6.A. and 7.A., which we are adopting as proposed.[294] In response to commenters, we are clarifying that for responses to Item 7.A. relating to natural persons (*e.g.*, accountant, lawyer), the adviser should respond affirmatively only for such persons that have a separate business in that field rather than for those persons that the adviser may employ as accountants or lawyers.[295]

We also are amending Schedule D, which contains expanded reporting requirements that correspond to Items 6 and 7. Section 6.A. of Schedule D requires an adviser that checks the box in Item 6.A. to indicate that it is engaged in another financial service business under a different

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292 Amended Form ADV, Part 1A, Items 6.A. and 7.A. Section 975 of the Dodd-Frank Act amends the Exchange Act to require "municipal advisors" to register with the Commission; Section 761 of that Act amends the Exchange Act to define the terms "security-based swap dealer" and "major security-based swap participant"; and section 764 amends the Exchange Act to require these entities to register with the Commission.

293 This serves to retain information about related persons that would otherwise not be required as a result of amendments we are adopting to Item 7.B. Amended Item 7.B. and section 7.B.(1) of Schedule D require advisers to report private fund information only about funds they advise, not funds advised by a related person. *See supra* section II.C.1. We have also deleted "investment company" from the list in Item 7 as duplicative of information we obtain in another category of Item 7.A., as well as Item 5. *See, e.g.*, amended Form ADV, Part 1A, Items 5.D., 5.G., Section 5.G.(3) of Schedule D, and Item 7.A.(2).

294 NRS Letter.

295 NEA Letter; IAA General Letter. Many of the questions in Item 5.B. elicit information about an adviser's employees acting in the scope of employment. We note that because Item 6 asks questions about the advisory *firm*, responses should not relate to natural persons, unless the adviser is operating as a sole proprietor.

name, to list that other business name, and to identify the other lines of business in which the adviser engages using that name.[296] Sections 6.B.(2) and 6.B.(3) of Schedule D similarly require advisers that are primarily engaged in another business or that sell products or provide services other than investment advice to advisory clients to describe that business and provide the name under which it conducts that business, if different. One commenter, an association comprised of state regulators, expressed particular support for the Schedule D reporting requirement we are adopting with respect to 6.B.(3).[297]

Section 7.A. of Schedule D, requires advisers to provide certain identifying information for any type of related person listed in Item 7.A. as well as to provide more details about the relationship between the adviser and the related person, including whether the related person is registered with a foreign financial regulatory authority, whether they share employees or the same physical location, and, if the adviser is reporting a related person investment adviser, whether the related person is exempt from registration.[298] Responses to these questions will allow us to link disparate pieces of information to which we have access concerning an adviser and its affiliates as well as to identify whether the adviser controls the affiliate or vice versa. It will also provide us with a tool to identify where there may be advisory activities by unregistered affiliates.

Commenters who addressed Section 7.A. of Schedule D urged that we limit the reporting of related persons, which could be significant in the case of advisers that are part of a large

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296 For example, an adviser registered with us under the name "Adam Bob Charlie Advisers LLC" that is also actively engaged in business as an insurance agent under the name "ABC Insurance LLC" would put the name "ABC Insurance LLC" in Section 6.A. of Schedule D and would check the box for "Insurance broker or agent."

297 NASAA Letter. We note, "6.B.(3)" was inadvertently renumbered in Part 1A of Form ADV as "6.C." in our proposal.

298 The questions we are adopting in Section 7.A. of Schedule D contain a few minor modifications from the proposal to renumber the questions and to clarify wording (*e.g.*, questions 11 and 12).

organization.[299] Many of these commenters pointed out that in some cases the adviser and its clients have no business dealings with some affiliates and thus there is less of a chance of conflicts developing. We agree and have revised the proposed item to permit an adviser to omit reporting about certain related persons in a manner that is similar to the approach suggested by a commenter.[300] In particular, an adviser need not complete Section 7.A. of Schedule D for any related person if: (1) the adviser has no business dealings with the related person in connection with advisory services it provides to its clients; (2) the adviser does not conduct shared operations with the related person; (3) the adviser does not refer clients or business to the related person, and the related person does not refer prospective clients or business to the adviser; (4) the adviser does not share supervised persons or premises with the related person; and (5) the adviser has no reason to believe that its relationship with the related person otherwise creates a conflict of interest with its clients.[301] These criteria are designed so that advisers need not report about affiliates who are likely to present little, if any, potential for conflicts of interest. Under these criteria, an adviser may omit, for example, an offshore adviser that has no business dealings with the adviser, a bank that merely provides payroll services to the adviser, an accounting firm that prepares the adviser's annual tax return filings, or a real estate broker that represents the adviser in securing office space. However, an adviser may *not* omit an affiliated adviser with whom the adviser shares information technology infrastructure, for example, as the advisers would be considered to share operations.

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299 *See, e.g.*, Shearman Letter.

300 *See* IAA General Letter (suggesting we adopt a standard for omitting a related person based on factors established several years ago by our staff in Frequently Asked Questions on Form ADV and IARD).

301 Amended Form ADV, Part 1A, Item 7.A.

Finally, we have moved to this item a question that had been in Item 9 that requires advisers to report whether a related person foreign financial institution acts as a qualified custodian for client assets under the adviser custody rule, to centralize reporting of related qualified custodians in a single item.[302]

4. Participation in Client Transactions: Item 8

Item 8 requires a registered adviser to report information about its transactions, if any, with clients, including whether the adviser or a related person (including a foreign related person) engages in transactions with clients as a principal, otherwise sells securities to clients, or has discretionary authority over client assets. We are adopting three amendments to this item. First, an adviser that indicates it has discretionary authority to determine the brokers or dealers for client transactions or that it recommends brokers or dealers to clients[303] must additionally report whether any of such brokers or dealers are related persons of the adviser.[304] Second, an adviser that indicates that it receives "soft dollar benefits" must also report whether all those benefits qualify for the safe harbor under section 28(e) of the Exchange Act for eligible research or brokerage services.[305] Third, an adviser must report whether it or its related person receives direct or indirect compensation for client referrals.[306] These amendments, which we are adopting as proposed, are designed to enhance our ability to identify additional conflicts of interest that

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302 Amended Form ADV, Part 1A, Section 7.A. of Schedule D, question 8. At the suggestion of commenters, we have also modified this question to include the remainder of the questions in what had been Section 9.D. of the previous version of Form ADV Part 1A, which we inadvertently failed to include when we relocated this question in Proposed Form ADV Part 1A. Consequently, we have also eliminated Section 9.D. *See* IAA General Letter; Schnase Letter.

303 Amended Form ADV, Part 1A, Items 8.C.3. and 8.E.

304 Amended Form ADV, Part 1A, Items 8.D. and 8.F.

305 Amended Form ADV, Part 1A, Item 8.G.(2). *See also Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Exchange Act Release No. 54165 (July 18, 2006) [71 FR 41978 (July 24, 2006)] ("28(e) Release").

306 Amended Form ADV, Part 1A, Items 8.H. and 8.I.

advisers may face that we have identified through our experience administering the Advisers Act.

Comments on these amendments were limited to the question about soft dollars, which commenters supported, but these commenters urged us to permit advisers to answer based on an adviser's reasonable belief that the benefits received are eligible research and brokerage services under the safe harbor provided by section 28(e) of the Exchange Act.[307] We are not making this change as the safe harbor itself does not include a "reasonable belief" standard and the Form ADV item is intended to track the language of the statute. We also remind advisers that we have issued interpretive guidance on section 28(e) of the Exchange Act and direct advisers to it if relying on this safe harbor.[308]

5. Custody: Item 9

We are amending Item 9 to require each registered adviser to indicate the *total* number of persons that act as qualified custodians for the adviser's clients in connection with advisory services the adviser provides to its clients.[309] In 2009, we amended certain items of Form ADV in connection with amendments we made to Advisers Act rule 206(4)-2 (the "2009 Custody Amendments"). At that time, we modified Item 9 to elicit information about the adviser or its related person(s) acting as qualified custodian.[310] We did not, however, request information about *other* qualified custodians. This additional data will provide us with a more complete

307 *See* ICI Letter; IAA General Letter.

308 *See* 28(e) Release, *supra* note 305, at Sections II.B. and III.

309 Amended Form ADV, Part 1A, Item 9.F. We have also made a minor modification from the proposal to make clear that an adviser need only respond if it has custody of client funds or securities, including if it has custody because a related person has custody in connection with advisory services the adviser provides to its clients.

310 *See Custody of Funds or Securities of Clients by Investment Advisers*, Investment Advisers Act Release No. 2968 (Dec. 30, 2009) [75 FR 1456 (Jan. 11, 2010)] ("2009 Custody Release").

picture of an adviser's custodial practices.[311] Commenters suggested that advisers be permitted to provide an approximate number of qualified custodians in response to this item.[312] We have not made such a change. An adviser with custody of client funds or securities must maintain those assets with a qualified custodian,[313] and must therefore know the identity (and therefore number) of qualified custodians that maintain its clients' assets.

We are also adopting several clarifications urged by commenters, and to make certain technical changes.[314] The first of these changes clarifies that Item 9 asks whether the adviser or a related person has custody of funds and securities of clients that are not registered investment companies. The questions in Item 9 relate to various provisions of rule 206(4)-2 (the custody rule), and advisers are not required to comply with rule 206(4)-2 with respect to the account of an investment company registered under the Investment Company Act.[315] Second, we are amending the notes within Item 9.A. to correct a drafting error.[316] The amended note within Item 9.A. requires an adviser to exclude from 9.A. and to report in 9.B. only client assets for

311 Consistent with the updating requirements for Items 9.A.(2), 9.B.(2), and 9.E., advisers are required to update new Item 9.F. only annually. *See* amended Form ADV: General Instruction 4.

312 IAA General Letter; NRS Letter. *But see* NRS Letter (indicating that many advisers have only one or two qualified custodians).

313 Rule 206(4)-2(a)(1) (defining "qualified custodian").

314 Investment advisers registered with us were required to begin completing revised Item 9 in connection with amendments we made to rule 206(4)-2 (the custody rule) as of their first annual updating amendment after January 1, 2011. *See* 2009 Custody Release, *supra* note 310 at n.161 and accompanying text. We are also making a technical amendment to Form ADV-E to reflect the requirement that the accountant's report be filed electronically. Staff notified advisers in November 2010 that the IARD system had been programmed to accept Form ADV-E. *See* 2009 Custody Release, *supra* note 310 at n.53 and accompanying text (establishing the requirement for Form ADV-E to be filed electronically, explaining that accountants performing surprise examinations should continue paper filing of Form ADV-E until the IARD system is programmed to accept Form ADV-E, and noting that advisers would be informed when that programming was completed).

315 Rule 206(4)-2(b)(5). These advisers must instead comply with custody requirements under the Investment Company Act.

316 *See* IAA General Letter; Pickard Letter; Schnase Letter (each urging us to correct this drafting error).

which custody is attributed to the adviser as a result of related person custody.[317] Third, we are also clarifying in Items 9.B. and 9.C. that advisers' responses must include funds and securities of which a related person has custody *in connection with advisory services the adviser provides to clients*.[318] This clarification aligns the reporting requirements of these items with the amended definition of custody adopted in the 2009 Custody Amendments.[319] Finally, amended question (6) within Section 9.C. of Schedule D enables an adviser to check a box to indicate that it has not yet received a report prepared by an independent accountant that audited a pooled investment vehicle or that examined internal controls.[320] Under the previous version of this question, an adviser who had not yet received the independent public accountant's report by the time the adviser submitted its Form ADV filing could not accurately respond. The updating requirements of Item 9.C. and Section 9.C. of Schedule D, however, require advisers to promptly file an amendment to update their response when the accountant's report is available.[321]

6. Reporting $1 Billion in Assets: Item 1.O.

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317 When we adopted the 2009 Custody Amendments we explained that Items 9.A. and 9.B. require a registered adviser to report to us whether the adviser or a related person *has custody* of client funds or securities, and if so, both the total U.S. dollar amount of those assets as well as the number of clients for whose accounts the adviser or its related person *has custody*. *See* 2009 Custody Release, *supra* note 310 at n.145 and accompanying text. Item 9.A., which was intended to limit reporting of assets the adviser has custody of other than through a related person, inadvertently required the adviser to include assets attributable to it in certain circumstances where a related person had custody of the assets.

We also are making a technical revision to the note within Item 9.A. to remind advisers that their responses should not include assets of which they have custody solely because they deduct advisory fees from client accounts.

318 *See* IAA General Letter.

319 We amended the definition of "custody" to include circumstances under which a related person "holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, *in connection with advisory services [an adviser] provide[s] to clients*." *See* rule 206(4)-2(d)(2).

320 Question 6 does not require a response about reports related to an independent verification (or "surprise examination") of client assets because the independent public accountant that conducts the surprise examination separately files a certificate on Form ADV-E. *See* rule 206(4)-2(a)(4).

321 *See* amended Form ADV: General Instruction 4.

We are adopting, as proposed, Item 1.O. and related instructions to require each adviser to indicate whether it had $1 billion or more in total assets shown on the adviser's balance sheet as of the last day of the most recent fiscal year,[322] which we will use to identify those advisers that could be subject to rules regarding certain excessive incentive-based compensation arrangements required by section 956 of the Dodd-Frank Act.[323] Two commenters supported the proposal,[324] while another suggested that we allow an adviser to exclude certain assets from the calculation so that certain advisers would not be covered by any future rule regarding section 956.[325] Although we retain certain flexibility to adopt a different standard for purposes of the incentive-based compensation rule,[326] we believe, as noted above, that this new item will assist us in identifying the advisers that may be subject to such future rule.[327]

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322 *See* amended Form ADV, Part 1A, Item 1.O. (adviser must mark "yes" or "no" to indicate whether it has $1 billion or more in assets). For purposes of this reporting requirement only, the amount of assets will be determined in the same manner as the amount of "total assets" is determined on the adviser's balance sheet for its most recent fiscal year end, using the same accounting method used to prepare the balance sheet. *See* amended Form ADV: Instructions for Part 1A, instr. 1.b. We are not requiring advisers to use GAAP or another accounting method.

323 The Commission and other federal regulators proposed a joint rule that addresses certain excessive incentive-based compensation arrangements, including those of investment advisers with $1 billion or more in assets, pursuant to section 956 of the Dodd-Frank Act. *See Incentive-Based Compensation Arrangements*, Release No. 34-64140 (Mar. 29, 2011) [76 FR 21170 (Apr. 14, 2011)] ("Incentive Compensation Proposing Release"). We construe section 956 as specifying, and thus define "assets" to mean, the total assets of the advisory firm rather than the total "assets under management," *i.e.*, assets managed on behalf of clients. *See* Implementing Proposing Release, *supra* note 7, at n.196; Incentive Compensation Proposing Release, at section III.

324 *See* IAA Letter; ICI Letter. One commenter argued that Form ADV is not the correct reporting mechanism for this information, but did not recommend an alternative way to identify these advisers. NRS Letter.

325 MFA Letter.

326 In the Incentive Compensation Proposing Release, we invited comments on whether the determination of total balance sheet assets should be further tailored for certain types of advisers. *See* Incentive Compensation Proposing Release, *supra* note 323, at section III.

327 We also note that almost all of the other covered financial institutions under section 956 already report the amount of their total assets to their federal regulator. *See* Incentive Compensation

7. Other Amendments to Form ADV

The amendments we are adopting today also include a number of additional changes unrelated to the Dodd-Frank Act that are intended to improve our ability to assess compliance risks. To improve certain identifying information we obtain from other items of Part 1A of Form ADV, we are amending Item 1.J. to require an adviser to provide contact information for its chief compliance officer to give us direct access to the person designated to be in charge of its compliance program.[328] An adviser also has the option, in Item 1.K., to provide an additional regulatory contact for Form ADV.[329] Neither Items 1.K. nor 1.J. will be viewable by the public on our website.[330] One commenter expressed its support for this change to the form.[331] We are also amending Item 1 to require an adviser to indicate whether it or any of its control persons is a public reporting company under the Exchange Act.[332] An affirmative response to this item will provide a signal, not only to us, but to investors and to prospective investors, that additional public information is available about the adviser and/or its control persons. New Item 1.P.

Proposing Release, supra note 323, at section III. (proposing to calculate "total consolidated assets" based on reports filed with each federal regulator).

328 Amended Form ADV, Part 1A, Item 1.J. An adviser is also required to provide the name of its chief compliance officer on Schedule A of Form ADV. *See also* 17 CFR 275.206(4)-7; *Compliance Programs of Investment Companies and Investment Advisers*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) [68 FR 74714 (Dec. 24, 2003)] (adopting rule 206(4)-7 requiring registered investment advisers to designate a chief compliance officer). An exempt reporting adviser that does not have a chief compliance officer must instead provide a designated person's contact information in Item 1.K. Likewise, an exempt reporting adviser need not provide the name of a chief compliance officer on Schedule A of Form ADV.

329 Amended Form ADV, Part 1A, Item 1.K.

330 We note that clients will be provided with a supervisory contact in brochure supplements. *See* Part 2 Release, *supra* note 67.

331 *See* NRS Letter.

332 Amended Form ADV, Part 1A, Items 1.N. and 10.B., and Section 10.B. of Schedule D.

requires an adviser to provide a "legal entity identifier" if it has one.[333] In addition, we are adding "Limited Partnership" as another choice advisers may select to indicate how their organization is legally formed.[334] Other than the addition of Item 1.P., we are adopting amended Item 1 as proposed.

We are also adopting three technical changes with respect to the reporting of disciplinary events. First, with commenters' support, we are adding a box to Item 11, as proposed, for advisers to check if any disciplinary information reported in that item and the corresponding disclosure reporting pages is being reported about the adviser or any of its supervised persons.[335] Second, we are adding a third reason to each disclosure reporting page ("DRP") that permits an adviser to remove the DRP from its filing by adding a box an adviser could check if it was filed in error. One commenter supported this aspect of the proposal.[336] Third, we are amending Item 3.D. of Part 2B, the brochure supplement, to correct a drafting error regarding when a brochure supplement would need to include disclosure regarding the revocation or suspension of a professional attainment, designation, or license. Advisers are required to include in brochure supplements disclosure regarding hearings or formal adjudications relating to the revocation or

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333 Amended Form ADV, Part 1A, Item 1.P. *See also* Amended Form ADV: Glossary (defining "Legal Entity Identifier"). A legal entity identifier is a unique number that companies use to identify each other in the financial marketplace. It is a number assigned by or on behalf of an internationally recognized standards setting body and it is required for reporting purposes by the U.S. Department of the Treasury's Office of Financial Research or a financial regulator. The legal entity identifier standard is still in development, and an adviser may not have one. An adviser is required to respond to Item 1.P. only if it has a legal entity identifier.

334 Amended Form ADV, Part 1A, Item 3.A.

335 Amended Form ADV, Part 1A, Item 11. *See* IAA General Letter; Pickard Letter.

336 *See* NRS Letter.

suspension of a professional attainment, designation, or license of the supervised person by the designating authority.[337]

Finally, we had requested comment in the Implementing Proposing Release on whether we should accelerate the deadline for filing an annual updating amendment to an adviser's Form ADV filing from 90 to 60 days after the adviser's fiscal year end.[338] All of the commenters who responded to the question opposed it.[339] We are not adopting a requirement to accelerate the annual updating amendment deadline at this time.

D. Other Amendments

1. Amendments to "Pay to Play" Rule

We are adopting amendments to rule 206(4)-5, the "pay to play" rule, to address certain consequences arising from the Dodd-Frank Act's amendments to the Advisers Act and the Exchange Act.[340] First, we are amending the scope of the rule, as proposed, so that it applies

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337 As originally adopted, this item stated "Any other *proceeding* in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished his attainment, designation, or license) in anticipation of such a proceeding (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event." (emphasis added).

338 *See* Implementing Proposing Release, *supra* note 7, at nn.207 and 208 and accompanying text.

339 Pickard Letter (citing additional burdens it would place on advisory firm personnel and resources); IAA General Letter (stating that many advisers need the full 90 days to ensure accurate and complete disclosures); ICI Letter (urging the Commission to at least give advisers time to become acclimated with all of the new filing requirements before imposing an accelerated deadline); NRS Letter (claiming it will add little benefit and will impose a substantial burden); Schnase Letter.

340 *See* amended rule 206(4)-5. We are not, however, adopting an amendment we proposed to specify that a legal entity, not just a natural person, that is a general partner or managing member of an investment adviser would meet the definition of "covered associate" in the rule. Upon reflection, it would broaden the application of the rule more than we intended. For example, because political action committees ("PACs") controlled by a covered associate are themselves treated as covered associates, were we to make this amendment, contributions by an adviser's parent company's PAC could trigger the two-year time out. However, as we noted in the release adopting the pay to play rule, depending on facts and circumstances, there may be instances in which a supervisor of an adviser's covered associate (who, for example, engages in solicitation of

both to exempt reporting advisers and foreign private advisers.[341] The rule currently applies to advisers either registered with the Commission or unregistered in reliance on the "private adviser" exemption under section 203(b)(3) of the Advisers Act.[342] The amendment prevents the unintended narrowing of the application of the rule resulting from the repeal of the "private adviser" exemption.[343]

Commenters generally favored the amendment,[344] although one commenter opposed applying the rule to foreign private advisers and foreign exempt reporting advisers, contending that the costs of doing so would outweigh the benefits.[345] However, many advisers that will qualify for the foreign private adviser exemption are currently subject to the pay to play rule, either because they are currently registered with us or exempt under the "private adviser" exemption. We continue to believe that the pay to play rule is necessary and appropriate to prevent these advisers and others from engaging in fraudulent pay to play practices in the U.S.

Second, we are amending the rule to add municipal advisors to the categories of registered entities – referred to as "regulated persons" – excepted from the rule's prohibition on

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government entity clients for the adviser) formally resides at a parent company, but whose contributions should trigger the two-year time out because they raise the same conflict of interest issues that we are concerned about, irrespective of that person's location or title. *See* Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 3043, n. 179 (Jul. 1, 2010) [75 FR 41018 (Jul. 15, 2010)] ("Pay to Play Release").

341 *See* amended rule 206(4)-5(a)(1); Implementing Proposing Release, *supra* note 7, at section II.D.1. *See also* sections 403, 407 and 408 of the Dodd-Frank Act (replacing the "private adviser" exemption at section 203(b)(3) of the Advisers Act with an exemption for "foreign private advisers" and adding exemptions for exempt reporting advisers at sections 203(l) and 203(m) of the Advisers Act).

342 *See* rule 206(4)-5(a).

343 Section 203(b)(3) was revised by the Dodd-Frank Act to create a new exemption for foreign private advisers. *See supra* note 4.

344 *See, e.g.*, Better Markets Letter; NRS Letter; NYSBA Committee Letter; Schnase Letter.

345 *See* Dechert General Letter.

advisers paying third parties to solicit government entities.[346] To qualify as a "municipal advisor" (and thereby a "regulated person"), a solicitor must be registered under section 15B of the Exchange Act and subject to pay to play rules adopted by the Municipal Securities Rulemaking Board ("MSRB").[347] Notably, for municipal advisors to qualify as "regulated persons," we must find that applicable MSRB pay to play rules: (i) impose substantially equivalent or more stringent restrictions on municipal advisors than the pay to play rule imposes on investment advisers; and (ii) are consistent with the objectives of the pay to play rule.[348]

We had proposed to limit the exception to the third-party solicitation ban to registered municipal advisors.[349] But commenters urged us to preserve the existing "regulated person" exception as well.[350] Commenters explained that affiliated broker-dealers or investment advisers – which would not meet the statutory definition of a "municipal advisor" under section 15B(e)(4)

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346 *See* amended rule 206(4)-5(a)(2)(i)(A), (f)(9). "Regulated persons" also include registered investment advisers and broker-dealers subject to the rules of a registered national securities association, such as the Financial Industry Regulatory Authority ("FINRA"), that has adopted pay to play rules that the Commission determines satisfy the criteria of amended rule 206(4)-5(f)(9)(iii)(B).

347 *See* amended rule 206(4)-5(f)(9)(iii).

348 *See* amended rule 206(4)-5(f)(9)(iii)(B). The MSRB issued a draft pay to play rule for municipal advisors and request for comment on January 14, 2011. *See* MSRB, *Request for Comment on Pay to Play Rule for Municipal Advisors,* MSRB Notice 2011-04 (Jan. 14, 2011) *available at* http://www.msrb.org/Rules-and-Interpretations/Regulatory-Notices/2011/2011-04.aspx?n=1. The Commission's authority to consider rules proposed by a self-regulatory organization is governed by section 19(b) of the Exchange Act [15 U.S.C. 78s(b)] ("No proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this subsection.").

349 *See* Implementing Proposing Release, *supra* note 7, at sections II.D.1.

350 *See* Comment letter of Debevoise & Plimpton LLP (Feb. 22, 2011) ("Debevoise Pay to Play Letter"); Dechert General Letter; comment letter of Investment Adviser Association (by Monique S. Botkin) (Jan. 24, 2011) ("IAA Pay to Play Letter"); ICI Letter; comment letter of Securities Industry and Financial Markets Association (Jan. 24, 2011) ("SIFMA Letter"); comment letter of T. Rowe Price Associates, Inc. (Jan. 24, 2011) ("T. Rowe Letter"). *But see* NRS Letter (supporting the proposal).

of the Exchange Act if they solicit government entities only on behalf of *affiliates*[351] – are often paid by investment advisers to solicit on their behalf.[352] While commenters recognized that adviser-affiliated solicitors may be permitted to voluntarily register as municipal advisors, they argued that voluntary registration of these solicitors would subject them to regulatory requirements unrelated to pay to play practices and thus impose significant additional costs, which they argued are unnecessary, particularly when they already are subject to a comprehensive regulatory regime as broker-dealers or advisers.[353]

The amended rule retains the approach of the current rule by permitting advisers to compensate persons that are "regulated persons" for soliciting government entities if they are subject to restrictions at least as stringent as the pay to play rule. We have expanded "regulated persons" to include registered municipal advisors. Accordingly, the pay to play rule continues to impose critical restrictions on third-party solicitors and their personnel designed to minimize the potential for their engaging in pay to play on behalf of investment advisers. Advisers may only compensate third-party solicitors that are subject to the Commission's regulatory oversight and

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351 *See* section 15B(e)(4) of the Exchange Act (defining "municipal advisor" to include "a person (who is not a municipal entity or an employee of a municipal entity) that…undertakes a solicitation of a municipal entity"); section 15B(e)(9) of the Exchange Act (defining "solicitation of a municipal entity or obligated person" to mean "a direct or indirect communication with a municipal entity or obligated person made by a person, for direct or indirect compensation, on behalf of…[an] investment adviser…*that does not control, is not controlled by, or is not under common control with the person undertaking such solicitation* for the purpose of obtaining or retaining an engagement by a municipal entity or obligated person…of an investment adviser to provide investment advisory services to or on behalf of a municipal entity" (emphasis added)). In recognition of this limitation, we separately proposed to allow adviser-affiliated solicitors to register voluntarily as municipal advisors. *See Registration of Municipal Advisors,* Exchange Act Release No. 63576, at nn. 102-104 and accompanying text (Dec. 20, 2010) [76 FR 824, (Jan. 6, 2011)] ("Municipal Advisors Registration Release").

352 *See, e.g.*, IAA Pay to Play Letter; SIFMA Letter.

353 *See* Municipal Advisor Registration Release, *supra* note 351, at 831 (stating that solicitors acting on behalf of affiliates may voluntarily register as municipal advisors).

examination and to a regulatory regime that the Commission has determined is equally or more stringent than the pay to play rule.[354]

Finally, we are extending the date by which advisers must comply with the ban on third-party solicitation from September 13, 2011 to June 13, 2012 due to the fact that we are modifying our proposal and expanding the definition of "regulated persons."[355] This extension will provide time for the MSRB and FINRA to adopt pay to play rules if they choose to do so and give third-party solicitors additional time to come into compliance with such rules.[356]

2. Technical and Conforming Amendments

a. Rules 203(b)(3)-1 and 203(b)(3)-2

We are rescinding rules 203(b)(3)-1[357] and 203(b)(3)-2[358] under the Advisers Act. These rules specify how advisers "count clients" for purposes of determining whether the adviser is eligible for the private adviser exemption of section 203(b)(3) of the Advisers Act (which, as

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354 Several commenters further urged the Commission to amend the pay to play rule also to permit an adviser to pay any affiliate and/or its employees to solicit clients on the adviser's behalf so long as the adviser treats such solicitors as its own "covered associates." *See* Debevoise Pay to Play Letter; IAA Pay to Play Letter; ICI Letter; NYSBA Committee Letter; comment letter of Skadden, Arps, Slate, Meagher & Flom LLP (Mar. 8, 2011) ("Skadden Letter"); T. Rowe Letter. In light of the approach we are adopting (discussed above), we believe that such an amendment is unnecessary.

355 *See* comment letter of American Council of Life Insurers (Jan. 24, 2011) ("ACLI Pay to Play Letter"); IAA Pay to Play Letter; ICI Letter (suggesting that the Commission extend the compliance date for the third-party solicitation ban). *See also* SIFMA Letter (suggesting that the Commission delay adoption of amendments to the pay to play rule until it completes its municipal advisor registration rulemaking).

356 The extension applies only to the third-party solicitation ban and not to any other provisions in the pay to play rule. *See supra* note 348 (referencing the MSRB's issuance of a draft pay to play rule for municipal advisors).

357 Rule 203(b)(3)-1.

358 Rule 203(b)(3)-2. We adopted rule 203(b)(3)-2 in 2004 in order to require certain hedge fund advisers to register under the Act. *See Registration under the Advisers Act of Certain Hedge Fund Advisers,* Investment Advisers Act Release No. 2333 (Dec. 2, 2004) [69 FR 72054 (Dec. 10, 2004)]. That rule, and certain amendments to rule 203(b)(3)-1 and other rules, were vacated by a federal appeals, but have remained in the CFR. *See Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. June 23, 2006) ("Goldstein").*

discussed above, Congress repealed in section 403 of the Dodd-Frank Act). In the Exemptions Adopting Release, we are adopting a new client counting rule, rule 202(a)(30)-1, for purposes of the new foreign private adviser exemption.[359]

b. Rule 204-2

We are adopting amendments to rule 204-2 under the Advisers Act, the "books and records" rule. The first amendment updates the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register after the exemption is eliminated on July 21, 2011.[360] Upon registration, these advisers will become subject to the recordkeeping requirements of the Act, including the requirement to keep certain records relating to performance.[361] The amendment clarifies that these advisers are not obligated to keep certain performance-related records for any period when they were not registered with the Commission; however, to the extent that these advisers preserved these performance-related records even though they were not required to keep them, they must continue to preserve them.[362] As discussed in section III, we are providing these

359 *See* Exemptions Adopting Release, *supra* note 4, at section II.C.1.

360 *See* amended rule 204-2(e)(3)(ii); Implementing Proposing Release, *supra* note 7, at section III.D.2.b. Our proposal would have applied the grandfathering provision only to those periods prior to the date that the Dodd-Frank Act removes the "private adviser" exemption in section 203(b)(3)—July 21, 2011. However, as discussed in section III of this Release, we are providing a transition period for advisers relying on the "private adviser" exemption, requiring that they register by March 30, 2012 and comply with all Advisers Act provisions and rules by that date. To reflect this transition period in the grandfathering provision in rule 204-2, we are adopting a modification from our proposal to provide that the grandfathering period applies to any period prior to such adviser's registration.

361 *See* rule 204-2(a)(16).

362 *See* amended rule 204-2(e)(3)(ii) (stating, "[i]f you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, [this rule] does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under [certain sections of this rule] to the extent those books and records pertain to the performance or rate of return of such private fund (as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)), or other account you advise for any period ended prior to your registration, provided that that you

advisers with additional time to register and establish compliance with rules under the Advisers Act to which they will become subject as registered advisers, including rule 204-2.[363] The second amendment modifies rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added by the Dodd-Frank Act.[364] The third amendment rescinds rule 204-2(l)[365] because it was vacated by the federal appeals court in *Goldstein* and because the Dodd-Frank Act's addition of section 204(b)(2) to the Advisers Act codifies this approach in the Advisers Act itself.[366]

We received three comment letters in favor of the proposed amendment to apply the grandfathering provision to advisers that will be required to register due to the Dodd-Frank Act's elimination of the "private adviser" exemption.[367]

c. Rule 0-7

We are adopting, as proposed, an amendment to rule 0-7(a)(1)[368] under the Advisers Act to update a cross reference to section 203A(a)(2) of the Advisers Act, which has been renumbered as section 203A(a)(3) by the Dodd-Frank Act.[369]

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continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period." Advisers to private funds that registered with the Commission based on adoption of rule 203(b)(3)-2 in the Hedge Fund Adviser Registration Release and then withdrew their registration based upon the decision by the U.S. Court of Appeals for the District of Columbia Circuit in *Goldstein* are permitted to rely on the grandfathering provision for periods during which they were unregistered.

363 An adviser that must register with the Commission because of the Dodd-Frank Act's elimination of the "private adviser" exemption and that files an application for registration on or before the transition deadline of March 30, 2012, may rely on the grandfathering provision for any period prior to registering, but must begin keeping performance-related records in accordance with the rule upon registering.

364 *See* rule 204-2(e)(3)(ii) (using the term "private fund" without reference to a definition). We are adding a parenthetical noting that the term is defined in section 202(a)(29) of the Advisers Act.

365 Rule 204-2(l) states that books and records of a private fund are, under certain circumstances, treated as books and records of its adviser.

366 Section 404 of the Dodd-Frank Act (adding section 204(b)(2) to the Advisers Act, which states that "[t]he records and reports of any private fund to which an investment adviser registered under this title provides investment advice shall be deemed to be the records and reports of the investment adviser.").

367 *See* MFA Letter; NYSBA Committee Letter; Seward Letter.

d. Rule 222-1

We are replacing, as proposed, the term "principal place of business" in rule 222-1(b)[370] under the Advisers Act with the term "principal office and place of business" to conform to the Dodd-Frank Act's amendments to section 222 of the Advisers Act.[371] We are not modifying the definition.

e. Rule 222-2

We are adopting, as proposed, amendments to rule 222-2 to define "client" for purposes of the national *de minimis* standard by cross-referencing the definition of "client" in rule 202(a)(30)-1 rather than the definition in rule 203(b)(3)-1. The cross-reference to rule 203(b)(3)-1 must be updated because we are rescinding rule 203(b)(3)-1.[372] We are also changing, as proposed, a cross-reference to paragraph (b)(6) of rule 203(b)(3)-1 to paragraph (b)(4) of rule 202(a)(30)-1 to account for the changed location of that particular provision.

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368 Rule 0-7(a) defines "small entities" under the Advisers Act for purposes of the Regulatory Flexibility Act.

369 *See* amended rule 0-7(a)(1) (stating that the term "small business" or "small organization" for purposes of the Advisers Act means an investment adviser that: "Has assets under management, as defined under Section 203A(a)(3) of the Act (15 U.S.C. 80b-3a(a)(3)) and reported on its annual updating amendment to Form ADV [17 CFR 279.1], of less than $25 million, or such higher amount as the Commission may by rule deem appropriate . . . ."); Implementing Proposing Release, *supra* note 7, at section II.D.2.c.

370 Rule 222-1 contains definitions relevant to section 222 of the Advisers Act's provisions regarding state regulation of investment advisers. Amended rule 222-1(b) defines "principal office and place of business" exactly as it defined "principal place of business" of an investment adviser: "the executive office of the investment adviser from which the officers, partners, or managers of the investment adviser direct, control, and coordinate the activities of the investment adviser."

371 *See* section 985 of the Dodd-Frank Act (replacing the term "principal place of business" each time it appears – *i.e.*, six times – with the term "principal office and place of business" in section 222 of the Advisers Act).

372 *See supra* section II.D.2.a. (discussing rescinding rule 203(b)(3)-1); new rule 202(a)(30)-1; Exemptions Adopting Release, *supra* note 4, at section II.C.1. (discussing the definition of "client" in rule 202(a)(30)-1).

We are not adopting a proposed amendment to specify that, for purposes of the national *de minimis* standard, an adviser is not required to count as a client any person for whom the adviser provides investment advisory services without compensation.[373] We received a comment letter opposing this amendment, citing the fact that under proposed rule 202(a)(30)-1, an adviser would be required to count such a person as a client for purposes of the "foreign private adviser" definition in section 202(a)(30) of the Act.[374] The commenter stated that it would be confusing and inconsistent to require an adviser to count the same person as a client for purposes of the "foreign private adviser" definition, but not for the national *de minimis* standard. We agree. Thus, in the interests of consistency and clarity, advisers must count such clients for both purposes.

f. Rule 202(a)(11)-1

We are rescinding rule 202(a)(11)-1 under the Advisers Act.[375] Although the rule was vacated by a federal appeals court (and is therefore not in effect), it has remained in the CFR.[376]

III. EFFECTIVE AND COMPLIANCE DATES

A. Effective Dates

The effective date of rules 204-4 and 203A-5(b) and (c), amendments to rules 0-7, 203A-1, 203A-2, 203A-3, 204-1, 204-2, 206(4)-5, 222-1, and 222-2, and amendments to Forms ADV, ADV-E, ADV-H, and ADV-NR is [insert 60 days from date of publication in the Federal Register]. The effective date of rule 203A-5(a) and the amendment to rule 203-1 is July 21,

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373 *See* Implementing Proposing Release, *supra* note 7, at section II.D.2.e.

374 *See* NASAA Letter; Exemptions Adopting Release, *supra* note 4, at section II.C.1.

375 Rule 202(a)(11)-1. Rule 202(a)(11)-1 addressed the application of the Advisers Act to broker-dealers offering certain types of brokerage programs.

376 *See Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007).

2011.[377] Rules 202(a)(11)-1, 203(b)(3)-1, 203(b)(3)-2, and 203A-4 are rescinded effective [insert 60 days from date of publication in the Federal Register].

B. Compliance Dates

1. Transition to State Registration and Form ADV

As discussed in section II.A.1 above, new rule 203A-5 provides 90 days from December 31, 2011 for each adviser registered with us to determine whether it is eligible for Commission registration.[378] Accordingly, the rule requires all registered advisers to file an amended Form ADV by March 30, 2012,[379] which for most of our registrants will be their annual updating amendments that are due 90 days after their December 31, 2011 fiscal year ends.[380] For an adviser that is no longer eligible to remain registered with us, rule 203A-5 provides an additional 90 days for it to register in one or more of the states and withdraw its registration with us.[381] After January 1, 2012, any adviser filing an amendment to Form ADV to meet the filing requirements of rule 203A-5 or for any other purpose will be required to provide responses to the form revisions we are adopting today.[382] Our staff is working closely with FINRA, our IARD contractor, to re-program IARD and we understand that the system is expected to be able to

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377 *See* section IV *infra* (discussing certain administrative law matters associated with the effective date for new rule 203A-5(a) and amended rule 203-1(e)).

378 *See* new rule 203A-5; *supra* section II.A.1.

379 *See* new rule 203A-5(b); *supra* section II.A.1.

380 Advisers not filing an annual updating amendment from January 1 to March 30, 2012, must file an other than annual amendment updating Form ADV.

381 *See* new rule 203A-5(c)(1). A mid-sized adviser that must switch to state registration may not withdraw its SEC registration until January 1, 2012. *See* new rule 203A-5(a); *supra* section II.A.1.

382 *See supra* note 25 and accompanying text.

accept filings of revised Form ADV by January 1, 2012.[383] Investment advisers filing initial applications for registration after the IARD is re-programmed to accommodate filing of the revised Form ADV must complete the revised form.

2. Advisers Previously Exempt under Section 203(b)(3)

We are adopting a transition provision in rule 203-1 for advisers that are newly required to register due to the Dodd-Frank Act's repeal of the "private adviser" exemption in section 203(b)(3).[384] Under rule 203-1(e), an adviser that was relying on, and was entitled to rely on, the "private adviser" exemption in section 203(b)(3) on July 20, 2011, may delay registering with the Commission until March 30, 2012.[385] Because initial applications for registration can take up to 45 days to be approved, advisers relying on this transition provision to remain unregistered until March 30, 2012 should file a complete application, both Part 1 and a brochure(s) meeting the requirements of Part 2 of Form ADV at least by February 14, 2012.[386]

To qualify for the delayed transition under rule 203-1(e) an adviser must, during the course of the preceding 12 months, have had fewer than 15 clients and neither hold itself out generally to the public as an investment adviser nor act as an adviser to a registered investment

383 As discussed in section II.B.1, we are also making technical amendments to Forms ADV-H and ADV-NR to account for the fact that exempt reporting advisers, along with registered advisers, will file these forms.

384 *See* amended rule 203-1(e); section 203(b)(3) of the Advisers Act.

385 *See* amended rule 203-1(e). *See also* Letter from Robert E. Plaze, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to David Massey, Deputy Securities Administrator, North Carolina Securities Division, and President, NASAA (Apr. 8, 2011) *available at* http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf (stating that the Commission would potentially consider extending the date by which these advisers must register and come into compliance with the obligations of a registered adviser until the first quarter of 2012).

386 *See* section 203(c)(2) of the Advisers Act (providing that the Commission will grant registration or institute proceedings to determine whether registration should be denied within 45 days of the date an adviser files and application for registration).

company or business development company.[387] The transition period will provide these advisers with needed additional time to work through any technical issues associated with applying for registration and to establish compliance with Advisers Act provisions and rules to which they are newly subject as advisers required to register.[388] As such, we believe that the temporary extension of the registration deadline provided by rule 203-1(e) will assure an orderly transition to registration that will minimize costs to these advisers and their clients.

3. Exempt Reporting Advisers

Exempt reporting advisers must file their first reports on Form ADV through IARD between January 1 and March 30, 2012. We originally proposed to require exempt reporting advisers to file initial reports by August 20, 2011.[389] However, we are further delaying the compliance date to accommodate re-programming of the IARD system on which these reports

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387 *See* amended rule 203-1(e). An adviser relying on the transition provision must come into compliance with Advisers Act statutory provisions and rules applicable to registered advisers by the time it is registered, which must occur no later than March 30, 2012. However, nothing in the transition provision exempts these advisers from Advisers Act provisions and rules to which they are currently subject. For example, the Advisers Act pay to play rule, rule 206(4)-5, currently applies to advisers exempt from registration under the "private adviser" exemption in section 203(b)(3) of the Act. *See supra* section II.D.1. (discussing our amendments to the pay to play rule, one of which is designed so that advisers exempt from registration under the "private adviser" exemption in section 203(b)(3) continue to be subject to the pay to play rule after the Dodd-Frank Act eliminates the exemption).

388 We received a number of comment letters requesting that these advisers have additional time after July 21, 2011 (the date the Dodd-Frank Act's repeal of the section 203(b)(3) private adviser exemption becomes effective) to become registered and to establish compliance with all provisions of the Advisers Act and rules thereunder to which they are newly subject by virtue of their required registration. *See* CompliGlobe Letter; MFA Letter; Schnase Letter; Shearman Letter. We are using our authority under section 206A of the Act to implement this transition to registration. We believe that providing advisers newly required to register with this additional transition period is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act.

389 *See* Implementing Proposing Release, *supra* note 7, at section II.B.4.

will be filed.[390] The extended deadline of March 30, 2012 will also address concerns raised by commenters that advisers will not have sufficient time to determine whether they qualify for the new exemptions, familiarize themselves with Form ADV and IARD, collect the data necessary to file an initial report, and to file the report.[391]

4. Other Amendments

As discussed in section II.A.5., advisers may rely on our amendments to rule 203A-2 beginning on [insert date that is 60 days from date of publication in the Federal Register].[392] These include our amendments to increase the threshold for pension consultants from $50 million to $200 million and to create a uniform threshold for small and mid-sized advisers that permits them to register with the Commission if they are required to register in 15 or more states.[393] Advisers may begin relying on our amendment to the buffer in rule 203A-1 on [insert date that is 60 days from date of publication in the Federal Register]. In addition, as discussed in section II.D.1, we are extending the compliance date for the pay to play rule's ban on third-party solicitation from September 13, 2011 to June 13, 2012. Advisers must comply with any other amendments not discussed in this section III.B by their effective dates.

IV. CERTAIN ADMINISTRATIVE LAW MATTERS

As discussed in section III.A above, the effective date for rule 203A-5(a) and the amendment to rule 203-1 is July 21, 2011. The Administrative Procedure Act generally requires that an agency publish a final rule in the Federal Register not less than 30 days before its

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390 *See supra* section II.A.1. (discussing the expectation that the IARD will be re-programmed in November 2011).

391 *See* ABA Committees Letter; Merkl Implementing Letter.

392 *See supra* note 118.

393 *See supra* section II.A.5.

effective date.[394] However, this requirement does not apply if the rule is a substantive rule which grants or recognizes an exemption or relieves a restriction, if the rule is interpretive, or if the agency finds good cause to make the rule effective less than 30 days after its date of publication in the Federal Register.[395] Effective July 21, 2011, the Dodd-Frank Act amends section 203A of the Advisers Act to prohibit certain mid-sized advisers from registering with the Commission, and eliminates the "private adviser" exemption in section 203(b)(3), requiring advisers relying on that exemption to register as of July 21, 2011.[396] Rule 203A-5(a) provides a temporary extension of the deadline by which certain mid-sized advisers must withdraw their Commission registration, and rule 203-1(e) provides a temporary extension of the registration deadline for advisers relying on the "private adviser" exemption in section 203(b)(3).[397] Thus, both rule 203A-5(a) and rule 203-1(e) recognize an exemption or relieve a restriction. Furthermore, as discussed in sections II.A and III.B.2 of this Release, we believe that these temporary extensions are necessary to facilitate an orderly process for advisers relying on the "private adviser" exemption in section 203(b)(3) to apply for registration and for mid-sized advisers to withdraw from registration, and to provide sufficient time for the re-programming of IARD. Thus, we find good cause to make rules 203A-5(a) and 203-1(e) effective on July 21, 2011.

V. COST-BENEFIT ANALYSIS

We are sensitive to the costs and benefits imposed by our rules, and understand that there will be costs associated with compliance with the new rules and rule amendments. The new rules and amendments we are adopting are designed to give effect to provisions of Title IV of the

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394 *See* 5 U.S.C. 553(d).

395 *See id.*

396 *See* sections 403, 410, and 419 of the Dodd-Frank Act; sections 203(b)(3), 203A(a)(2) of the Advisers Act; *supra* sections I and II.A.

397 *See* amended rule 203-1(e) and new rule 203A-5(a); *supra* section II.A and section III.B.2.

Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser" exemption contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting by advisers to certain types of private funds that are exempt from registration. As part of these amendments, we are also adopting amendments to the Advisers Act pay to play rule, rule 206(4)-5. Additionally, we are identifying the advisers that may be subject to the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements. Because many of the new rules and rule amendments will implement or clarify provisions of the Dodd-Frank Act, they will not create benefits and costs separate from the benefits and costs considered by Congress in passing the Dodd-Frank Act.[398] However, certain of the rules and rule amendments that we are adopting will generate costs and benefits independent of those generated by the Dodd-Frank Act itself. These costs and benefits are discussed below.[399]

In the Implementing Proposing Release, we requested comment on the proposed rules and amendments, suggestions for additional changes to the existing rules, and comment on other matters that might have an effect on our proposals. We received approximately 73 comment letters on the proposal. Commenters generally supported our approach facilitating mid-sized advisers' transition from Commission to state registration, and our amendments to Form ADV

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398 *See* Dodd-Frank Act, *supra* note 2; Conference Committee Report, *supra* note 136; Senate Committee Report, *supra* note 18; *supra* section I. Rules and amendments not generating costs and benefits independent of those generated by the Dodd-Frank Act include the amendments to rules 0-7, 204-2, 222-1, 222-2 and our rescinding of rules 202(a)(11)-1, 203(b)(3)-1, and 203(b)(3)-2.

399 To indicate the scale of the market which is addressed by Title IV of the Dodd-Frank Act and the amendments to Advisers Act rules we are adopting today—the market for investment advisory services—based on IARD data as of April 7, 2011, our staff estimates that SEC-registered advisers manage approximately $43.822 trillion in assets.

requiring disclosure of additional information about private funds. Many, however, urged us to take a different approach to revising the pay to play rule.

A. Benefits

1. Eligibility to Register with the Commission: Section 410

Section 410 of the Dodd-Frank Act amends section 203A of the Advisers Act to create a new category of "mid-sized advisers" and shifts primary responsibility for their regulatory oversight to the states. Specifically, section 410 prohibits an investment adviser from registering with the Commission if the adviser is required to be registered and is subject to examination as an investment adviser in the state in which it maintains its principal office and place of business, and has assets under management between $25 million and $100 million.[400] We are adopting rules and rule amendments that provide us with a means of identifying advisers that must transition to state regulation, clarify the application of new statutory provisions, and modify certain exemptions we previously adopted under section 203A of the Act.

Transition to State Registration

We are adopting new rule 203A-5, which requires *each* investment adviser registered with us on January 1, 2012 to file an amendment to its Form ADV no later than March 30, 2012, and withdraw from Commission registration by June 28, 2012, if no longer eligible.[401] As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 3,200 SEC-registered advisers will be required to withdraw their registration and register with one or more

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[400] *See supra* notes 18-19 and accompanying text (discussing section 410 of the Dodd-Frank Act, which amends section 203A of the Advisers Act to increase the threshold above which all investment advisers must register with the Commission from $25 million to $100 million).

[401] New rule 203A-5(b)-(c); *supra* section II.A.1. Mid-sized advisers registered with the Commission as of July 21, 2011 must remain registered with the Commission (unless an exemption from Commission registration otherwise is available) until January 1, 2012. New rule 203A-5(a). *See supra* note 28.

state securities authorities.[402] We believe this filing is necessary for each adviser to confirm its current eligibility for Commission registration in light of multiple statutory changes (as well as changes to the rules that we are today adopting) that could affect whether the adviser may register with the Commission.[403] Given this significant realignment of regulatory authority over numerous advisers, requiring all advisers to file the new Form ADV and complete all items also will allow us and the state securities authorities to easily and efficiently identify the advisers that are subject to our regulatory authority and which advisers have switched to state registration after the implementation of the Dodd-Frank Act's amendment to section 203A of the Advisers Act. Additionally, the filing will help minimize any potential uncertainty among investors and other market participants about the effects of the Dodd-Frank Act on the registration status of a particular adviser by providing a simple, efficient means of determining an adviser's registration status after the implementation of the Dodd-Frank Act through the IARD as of a specific date. This could help minimize any disruption in advisory business that such uncertainty could provoke. One commenter agreed with our expectation that the transition rule will benefit advisers, noting that the rule will "assist mid-sized advisers in transitioning from federal to state registration."[404]

Rule 203A-5 that we are adopting today differs from the one we proposed in several respects. First, rule 203A-5 requires advisers already registered with the Commission to refile Form ADV beginning on January 1, 2012, instead of beginning on July 21, 2011 as proposed.[405]

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402 *See supra* note 22 and accompanying text.

403 In addition, we believe that requiring advisers to complete all of the items will provide the Commission and the state regulatory authorities with essential information about the advisers that are transitioning to state registration and the advisers that are remaining registered with the Commission. *See infra* section II.C.

404 Pickard Letter.

405 *See* new rule 203A-5(b); proposed rule 203A-5(a); *supra* section II.A.1.

We stated in the Implementing Proposing Release that a delay might be necessary if the IARD was not re-programmed to reflect the revised Form ADV by July 21.[406] We now understand that beginning in November 2011, the IARD will be updated to reflect the revisions to Form ADV that we are adopting today.[407] Several commenters agreed with our approach to delay the transition instead of adopting alternative requirements, such as requiring interim paper filings, to reduce burdens for both advisers and regulators.[408] Additionally, we believe that delaying the beginning of the transition until January 1, 2012 will allow the Commission and state regulators to manage the transition of mid-sized advisers in an orderly manner, and will accommodate the re-programming of the IARD that eliminates the need and cost of alternatives such as interim paper filings.

Second, rule 203A-5 provides a 180-day transition period, which is longer than the 90-day period we proposed.[409] Advisers will be required to file an amended Form ADV by March 30, 2012 (instead of August 20, 2011, as proposed), and mid-sized advisers no longer eligible for Commission registration will be required to withdraw by June 28, 2012 (instead of October 19, 2011, as proposed).[410] Changing the deadline for advisers to refile amended Form ADV to March 30, 2012, which coincides with most advisers' required annual updating amendment,

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406 Implementing Proposing Release, *supra* note 7, at section II.A.1.

407 FINRA informed us that the IARD will be updated to reflect the revisions to Form ADV that we are adopting today beginning in November. *See supra* section II.A.1.

408 *See* Dezellem Letter (urging the Commission to wait for the IARD to be reprogrammed because it is efficient and reduces risks of misplacing paper documents and possible filing errors); NASAA Letter ("the benefits of electronic filing, including easy public access to the documents, are significant and would outweigh any disadvantages imposed by a delay in filing deadlines."); NRS Letter (urging Commission not to "regress to paper filings" which would be "a huge step into the past" and "appears to be counter to Dodd-Frank Act purposes of transparency and consistency."). *See also* NYSBA Committee Letter.

409 *See* new rule 203A-5(b)-(c); proposed rule 203A-5(a)-(b) and *supra* section II.A.1.

410 *See* new rule 203A-5(b)-(c); proposed rule 203A-5(a)-(b); Implementing Proposing Release, *supra* note 7, at section II.A.1.

significantly reduces the burden of rule 203A-5 by eliminating the costs associated with a special one-time filing requirement for most registered advisers.[411] In addition, the change in deadline to refile also coincides with the filing deadline for newly registering private fund advisers, which, as one commenter pointed out, eliminates the need for these advisers also to file Form ADV solely for the purposes of determining eligibility for registration.[412] Also, the June 28, 2012 deadline to withdraw from registration will provide additional time for advisers to complete the switch to state registration and to comply with their obligations under state law, and will reduce administrative burdens for the state securities authorities that must review and process mid-sized adviser state registrations, as underscored by several commenters.[413] Several commenters expressed concerns about the burdens of requiring all advisers to amend all of Form ADV solely to indicate their eligibility to register[414] and requiring mid-sized advisers to switch to state

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411 *See, e.g.,* CMC Letter (suggesting "timing of the transition from federal to state registration could be centered around renewals for 2012"). As of April 7, 2011, 10,636 SEC-registered advisers had a fiscal year ending on December 31. We expect that these advisers will comply with new rule 203A-5(b)'s Form ADV filing requirement by submitting their annual updating amendment. The 868 SEC-registered advisers not required to file an annual updating amendment between January 1, 2012 and March 30, 2012 will file an other-than-annual amendment, but they will complete all of the items on the form (not just the items required to be updated in a typical other-than-annual amendment). *See supra* note 48.

412 *See* MFA Letter.

413 Many commenters urged us to provide additional time for mid-sized advisers to complete the switch to state registration. *See* ABA Committees Letter; Altruist Letter; CMC Letter; Dezellem Letter; Dinel Letter; FSI Letter; Klein Letter; NRS Letter; NYSBA Committee Letter; Sadis Letter; Schnase Letter; Seward Letter; Shearman Letter. Several commenters echoed concerns about timely state processing of applications, noting, in particular, additional registration and compliance requirements in many states and expected delays to approve state registrations given the increase in filings as a result of the Dodd-Frank Act. *See* ABA Committees Letter ("some states may be unable to process such filings in a timely and efficient manner."); Altruist Letter (noting that it took 122 days for a state to approve its application). *See also* CMC Letter; Dezellem Letter; Klein Letter; NRS Letter; NYSBA Committee Letter; Schnase Letter; Seward Letter. One commenter, while supporting the method and timeline for transition contained in proposed rule 203A-5, suggested that it would be prudent to include in the rule flexibility to extend this timeline if necessary. *See* NASAA Letter.

414 *See, e.g.,* ICI Letter; MFA Letter; NYSBA Committee Letter; Shearman Letter.

registration within 90 days after July 21, 2011.[415] The revised transition discussed above should allay these concerns. We believe that providing advisers with 180 days, rather than 90 days, to transition to state registration will allow them to do so in a more orderly manner.[416] It will provide them greater time to collect the information necessary for state registration and to assess and to come into compliance with state regulations governing advisers. As such, it may promote efficiency and reduce advisers' costs.

Finally, we are providing additional flexibility for an adviser to choose the date by which it must calculate its assets under management that it reports on Form ADV by requiring the same 90 day period as in Form ADV today, instead of 30 days, as proposed.[417] This change will make an additional administrative burden unnecessary for the majority of advisers that already value assets on a quarterly basis, as underscored by several commenters.[418]

Switching Between State and Commission Registration

Rule 203A-1 is designed to prevent an adviser from having to switch frequently between state and Commission registration as a result of changes in the value of its assets under management or the departure of one or more clients. We are amending the rule to eliminate the

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415 *See, e.g.*, ABA Committees Letter; Altruist Letter; CMC Letter; Dezellem Letter; Dinel Letter; FSI Letter; Klein Letter; NRS Letter; NYSBA Committee Letter; Sadis Letter; Schnase Letter; Seward Letter; Shearman Letter. Only one commenter supported the proposed 90-day grace period. Pickard Letter.

416 Our current rules provide an SEC-registered adviser that has to switch to state registration a period of 180 days after its fiscal year end to file an annual amendment to Form ADV and to withdraw its SEC registration after reporting to us that it is no longer eligible to remain registered with us. *See* rule 203A-1(b)(2); *cf.* rule 204-1(a). Several commenters recommended the Commission match the current 180-day period. *See* Altruist Letter; Dezellem Letter; FSI Letter; Klein Letter; NYSBA Committee Letter; Schnase Letter; Seward Letter; Shearman Letter.

417 *See* new rule 203A-5(b); amended Form ADV: Instructions for Part 1A, instr. 5.b.(4); *supra* section II.A.1.

418 Several commenters recommended that advisers be able to calculate assets under management as of the quarter-end. *See* Altruist Letter; NYSBA Committee Letter; Seward Letter; Shearman Letter.

current buffer for advisers with assets under management between $25 million and $30 million that permits these advisers to remain regulated by the states, and we are replacing it with a similar buffer for mid-sized advisers with assets under management of close to $100 million.[419] The rule raises the threshold above which a mid-sized adviser must register with the Commission to $110 million; but, once registered with the Commission, an adviser need not withdraw its registration until it has less than $90 million of assets under management.[420] Commenters did not object to elimination of the current buffer, but several argued that we need to include a new buffer for mid-sized advisers that have close to $100 million of assets under management.[421] These comments persuaded us to adopt a buffer that, as discussed below, may prevent costs and disruption to advisers that otherwise may have had to switch between federal and state registration frequently.[422] The rule also maintains the 180-day grace period from the adviser's fiscal year end for advisers no longer eligible to switch to state registration,[423] which further addresses commenters' concerns about advisers frequently having to switch registration.[424]

We are eliminating the current $5 million buffer, as proposed, because, as one commenter noted, it seems "unnecessary and potentially confusing,"[425] particularly in light of Congress's determination generally to require most advisers having between $25 million and $100 million of

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419 *See* amended rule 203A-1(a); *supra* note 103 and accompanying text.

420 *See* amended rule 203A-1(a); *supra* note 106.

421 *See* Altruist Letter; Dezellem Letter; Dinel Letter; FSI Letter; ICW Letter; JVL Associates Letter; Merkl Implementing Letter; NASAA Letter; NRS Letter; NYSBA Committee Letter; Wealth Coach Letter; WJM Letter.

422 Several commenters discussed the costs of switching frequently between federal and state registration. *See, e.g.*, Altruist Letter; ICW Letter; JVL Associates Letter; NRS Letter; Wealth Coach Letter.

423 *See* amended rule 203A-1(b)(2); *supra* note 104 and accompanying text.

424 *See* Altruist Letter; Dezellem Letter; Dinel Letter; FSI Letter; ICW Letter; JVL Associates Letter; Merkl Implementing Letter; NRS Letter; NYSBA Committee Letter; Wealth Coach Letter; WJM Letter.

425 ABA Committees Letter.

assets under management to be registered with the states.[426] Elimination of the current buffer also promotes efficiency and competition by making the registration requirements for advisers with assets under management between $25 million and $30 million consistent with the requirements for advisers with assets under management between $30 million and $100 million.

The new buffer yields several benefits, also identified by commenters, including enhancing efficiency because it will prevent advisers from frequently switching to and from Commission registration due to market fluctuations.[427] The buffer also will eliminate the additional costs and resulting competitive disadvantages these advisers would therefore incur (such as paying filing fees and changing compliance programs to reflect a different regulatory regime).[428] The amendment operates to provide a buffer of 20 percent of the $100 million statutory threshold for registration with the Commission, which is the same percentage as the current buffer. We believe a 20 percent buffer is appropriate because it is large enough to create a flexible regime that accommodates market fluctuations or the departure of one or more clients, and does not substantially increase or decrease the $100 million threshold set by Congress in the

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426 *See supra* note 18.

427 Commenters said a 20 percent buffer should prevent advisers from having to switch as a result of changes in market values due to volatility in the securities markets. *See, e.g.*, Dezellem Letter; Dinel Letter; WJM Letter. *See also* Altruist Letter; FSI Letter; ICW Letter; Merkl Implementing Letter; NYSBA Committee Letter. Several advisers with close to $100 million of assets under management asserted that a buffer is necessary to prevent them from switching to and from Commission registration. ICW Letter (for three years, adviser's assets under management have fluctuated above and below $100 million due to market volatility); JVL Associates Letter (adviser's assets under management have fluctuated around $100 million since 2007). *See also* Wealth Coach Letter (from October 2008 through March 2009, adviser's total assets under management fell over 25 percent).

428 *See* ICW Letter (having to switch back and forth "would create a disproportionate regulatory burden and cost structure" and would "place them at a significant operating and financial disadvantage to advisory firms clearly exposed to only one regulatory regime that is not likely to change."); WJM Letter (not having a buffer potentially puts an unreasonable and unfair burden on the smaller SEC advisers and could mean they would re-register several times before getting into a "safe" zone). *See also* Dezellem Letter; FSI Letter; Wealth Coach Letter.

Dodd-Frank Act.[429] Commenters further asserted that the buffer will reduce burdens for investors, clients and regulators,[430] and will provide regulatory flexibility.[431]

Exemptions from the Prohibition on Registration with the Commission

We are amending three of the exemptions from the prohibition on registration in rule 203A-2 to reflect developments since their original adoption, including the enactment of the Dodd-Frank Act.[432] First, we are eliminating the exemption in rule 203A-2(a) from the prohibition on Commission registration for NRSROs.[433] Currently, no advisers indicate that they are NRSROs by marking Item 2.A.(5) of Part 1A of Form ADV.[434] Given that NRSROs do not currently rely on the exemption and Congress excluded certain NRSROs from the Act's definition of "investment adviser" since we adopted this exemption,[435] the amendment will not generate any benefits or costs and will not impact efficiency, competition or capital formation,

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429 *See supra* note 117.

430 *See* Dezellem Letter (arguing new registrations are time consuming and costly for regulators and advisers, and adopting a buffer will decrease investor confusion); FSI Letter (arguing a buffer will reduce costs associated with re-registration that would be passed on to investors); Wealth Coach Letter (arguing different registrations could overwhelm clients, and the resources required to change registration could negatively impact an adviser's client services and portfolio management); WJM Letter (arguing clients would be "puzzled or concerned" by registration changes, and multiple re-registrations would put additional burdens on states).

431 *See* NASAA Letter (arguing a buffer "provides an element of regulatory flexibility.").

432 *See* amended rule 203A-2; *supra* section II.A.5. We are also renumbering and making minor conforming changes to rule 203A-2(c), (d) and (f). *See* amended rule 203A-2(b), (c) and (e). Each of the exemptions from the prohibition on registration in rule 203A-2 (including those we are not amending) also apply to mid-sized advisers, which one commenter asserted "promotes uniformity, clarity and a consistent standard for all." NRS Letter. *See supra* note 119.

433 *See supra* section II.A.5.a.

434 Based on IARD data as of April 7, 2011.

435 *See supra* notes 121-122.

separate from the benefit of simplifying our rules and, as one commenter noted, will increase "consistency across legislative and regulatory requirements."[436]

Second, we are amending the exemption available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets on which an adviser must consult from $50 million to $200 million.[437] We are increasing the threshold to $200 million in light of Congress's determination to increase from $25 million to $100 million the amount of assets under management that requires advisers to register with the Commission, and to maintain the same ratio as today of plan assets to the statutory threshold for registration.[438] This amendment will provide the benefit to these firms of registering with a single securities regulator, and will provide the regulatory benefit of allowing the Commission to focus its resources on oversight of those pension consultants that are more likely to have an effect on national markets.[439]

Finally, we are amending the multi-state adviser exemption to align the rule with the multi-state exemption Congress provided for mid-sized advisers in section 410 of the Dodd-Frank Act.[440] Amended rule 203A-2(d) permits all investment advisers who are required to register as an investment adviser with 15 or more states to register with the Commission, rather than 30 states, as currently required.[441] An adviser relying on the rule must withdraw from

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436 NRS Letter (asserting that the proposal is consistent with the Credit Rating Agency Reform Act, which amended the Advisers Act to exclude NRSROs and to provide for a separate regulatory regime for them under the Exchange Act). *See also* Pickard Letter (asserting that continued availability of the NRSRO exemption is causing confusion among advisers).

437 *See* amended rule 203A-2(a); *supra* section II.A.5.b.

438 *See supra* note 127.

439 One commenter expressed support for the $200 million threshold. *See* NRS Letter (agreeing that the $200 million threshold would continue to ensure that the activities of a pension consultant registered with the Commission are significant enough to have an impact on national markets).

440 *See* amended rule 203A-2(d); *supra* section II.A.5.c.

441 *See supra* note 131.

registration with the Commission when it is no longer required to register with 15 states.[442] We believe this change reflects the Congressional determination to set the threshold at 15 states.[443] This amendment reduces the regulatory burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator — the Commission.[444] Additionally, the amendment promotes efficiency and reduces the effect on competition between small and mid-sized investment advisers by imposing a consistent multi-state exemption standard.[445] We also are rescinding, as proposed, the provision in the current rule that permits advisers to remain registered until the number of states in which they must register falls below 25 states, and we are not adopting a similar cushion for the 15-state threshold.[446] We do not see any significant benefit of retaining this buffer, and we believe it is unnecessary because advisers elect to rely on the exemption and we are lowering the number of states from 30 to 15. As one commenter observed, eliminating the buffer also simplifies the requirements of the exemption.[447]

Elimination of Safe Harbor

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442 *See supra* note 132.

443 *See supra* note 136.

444 *See* Seward Letter, and Shearman Letter (in each case supporting the 15-state threshold we proposed, and suggesting the burdens of maintaining multiple state registrations can be significant). *See also* NEA Letter. One of these commenters also would support further decreasing the number of states to five and requiring advisers relying on the exemption to have at least $25 million of assets under management. Seward Letter. Another "would support an even lower threshold." Shearman Letter.

445 NASAA Letter (supporting amendment "as an effort to be more consistent in the registration requirements for all advisers when analyzing the thresholds for registration with the SEC or the states."); NRS Letter ("Establishing one uniform standard for all advisers of a 15-state requirement provides a uniform and clear standard."). *See also* NEA Letter (strongly recommending the 15-state threshold be applied to both small and mid-sized advisers).

446 *See* rule 203A-2(e)(1); *supra* section II.A.5.c.

447 *See* NRS Letter ("The Dodd-Frank Act has addressed the multi-state adviser exemption to simplify the requirements of this exemption.").

We are rescinding, as proposed, rule 203A-4, which has provided a safe harbor from Commission registration for an investment adviser that is registered with the state securities authority of the state in which it has its principal office and place of business based on a reasonable belief that it is prohibited from registering with the Commission because it does not have sufficient assets under management.[448] As discussed above, the safe harbor was designed for smaller advisory businesses with assets under management of less than $30 million, which may not employ the same tools or otherwise have a need to calculate assets as precisely as advisers with greater assets under management.[449] We also believe that the revisions we are adopting to the Form ADV instructions to implement a uniform method for advisers to calculate assets under management will clarify the requirements and reduce confusion among advisers.[450] Moreover, the rule is a safe harbor only from our enforcement actions, and to our knowledge few, if any, advisers have relied upon it in the 14 years since it was adopted.[451] We believe rescinding the safe harbor will simplify our rules in general, thereby marginally reducing costs of compliance, and will have little, if any, other effect on efficiency, competition or capital formation.

Mid-Sized Advisers

The Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers registering with the

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448 *See* rule 203A-4; *supra* section II.A.6.

449 *See supra* note 140.

450 *See supra* note 141.

451 *See supra* note 142.

Commission.[452] We are providing in the instructions to Form ADV an explanation of how we construe these statutory provisions.[453] Our instructions are intended to clarify the meaning of these provisions, promoting efficiency by mitigating uncertainty about their meaning. For example, as underscored by commenters, because we are identifying to advisers filing on the IARD the states that do not subject advisers to examination, a mid-sized adviser will not be required to independently determine whether it is subject to examination in a particular state.[454] Simplifying the process for mid-sized advisers to determine whether they are required to register with us would decrease any competitive disadvantages compared to smaller advisers.

2. Exempt Reporting Advisers: Sections 407 and 408

Congress gave us broad authority under sections 203(l) and 203(m) of the Advisers Act to require exempt reporting advisers to file reports as necessary or appropriate in the public interest or for the protection of investors.[455] To implement these new sections of the Advisers Act, we are adopting new rule 204-4, as proposed, that requires exempt reporting advisers to submit to us, and to periodically update, reports that consist of a limited subset of items on Form ADV.[456] We are also adopting the amendments we proposed to Form ADV to permit the form to

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452 *See supra* note 145.

453 *See* amended Form ADV: Instructions for Part 1A, instr. 2.b.; *supra* section II.A.7.

454 *See* NRS Letter (noting "the wide range of state regulatory regimes and processes" and supporting "efforts to verify those states which do or will subject advisers to examinations."); Sadis Letter (noting different state examination practices and arguing that clarification of registration requirements "is vital to the compliance of mid-sized advisers in states…which do not have routine examination programs in place for its investment advisers.").

455 *See* sections 407 and 408 of the Dodd-Frank Act, codified as new sections 203(l) and 203(m) of the Advisers Act.

456 New rule 204-4(a); amended Form ADV: General Instructions 3 and 4. *See supra* section II.B.

serve as both a reporting and registration form and to specify the seven items that exempt reporting advisers must complete.[457]

While the benefits of the reporting requirement under new rule 204-4 are difficult to quantify, we believe they are substantial. The information exempt reporting advisers provide on Form ADV will be beneficial to both the Commission and investors. This information will help us to identify exempt reporting advisers, their owners, and their business models and will provide us with information as to whether these advisers or their activities might present concerns sufficient to warrant our further attention in order to protect their clients, investors, and other market participants.[458] The reports, which will be publicly available, will also provide investors with some basic information about these advisers and their businesses. Several commenters agreed, expressing general support for the proposed reporting requirements.[459]

Under rule 204-4, exempt reporting advisers are required to file their Form ADV reports electronically through the IARD.[460] We believe that using Form ADV and the IARD for exempt reporting adviser reports will yield several important benefits. For instance, using Form ADV and the IARD creates efficiencies that benefit both us and filers by taking advantage of an established and proven filing system, while avoiding the expense and delay of developing a new form and filing system. Several commenters agreed,[461] and one explained that, in its view, there

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457 *See supra* section II.B.2.

458 One commenter agreed. ABA Committees Letter.

459 *See, e.g.*, AFL-CIO Letter; CII Letter; NRS Letter; Better Markets Letter; ABA Committees Letter; NASAA Letter.

460 New rule 204-4(b) and (d).

461 *See, e.g.*, AFL-CIO Letter; Better Markets Letter; NRS Letter; NASAA Letter. Responding to our request for comment regarding the possible use of EDGAR in place of the IARD, one commenter argued that "[s]uch an approach would be confusing and burdensome for any adviser that transitions between [exempt reporting adviser] and SEC-registered status." ABA Committees Letter.

is "no reason to create a new form or filing system when the existing ones have been designed for use by advisers and are suitable for that purpose."[462] In addition, because an exempt reporting adviser may be required to register on Form ADV with one or more state securities authorities, use of the existing form and filing system (which is shared with the states) should reduce regulatory burdens for exempt reporting advisers because they can satisfy multiple filing obligations through a uniform form.[463] Commenters agreed with our expectation that regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[464] Finally, certain items in Form ADV Part 1 are also linked to Form BD, which will create efficiencies if the exempt reporting adviser were to apply for broker-dealer registration.[465]

Requiring exempt reporting advisers to file their reports through the IARD will also benefit investors, prospective investors, and other members of the public who can readily access the information, without cost, through the Commission's website on the Investment Adviser Public Disclosure (IAPD) system. Investors will have access to some information that may have been previously unavailable or not easily attainable, such as whether an exempt reporting adviser has certain disciplinary events and whether its affiliates present conflicts of interest or allow broader access to other financial services.

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462 ABA Committees Letter.

463 *See supra* note 170 and accompanying text.

464 *See* ABA Committees Letter; Better Markets Letter; NRS Letter; NASAA Letter. Form ADV, as amended, permits an adviser to transition from filing reports with us to applying for registration under the Act by simply amending its Form ADV; the adviser would check the box to indicate it is filing an initial application for registration, complete the items it did not have to answer as an exempt reporting adviser, and update the pre-populated items that it already has on file. *See* amended Form ADV: General Instruction 15 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser).

465 Form BD is the Uniform Application for Broker-Dealer Registration. 17 CFR 249.501.

Several commenters supported the public availability of exempt reporting adviser reports as beneficial to the protection of investors.[466] Investor advocacy groups, for instance, lauded the Commission's initiative to create, for the first time, a database of public information on advisers to private investment funds.[467] Others added that an investor would be better able to perform due diligence if the information were made available to the public,[468] and could make an informed decision regarding the integrity of a prospective adviser if he or she were able to review the disciplinary history of the exempt reporting adviser and its employees.[469] In addition, requiring exempt reporting advisers to complete Section 7.B. of Schedule D for each private fund they manage should result in many of the same benefits that this information produces with respect to registered advisers that we address in the discussion of the amendments to Form ADV below.[470]

We have considered the broad public interest in making this information generally available, and we agree with commenters who assert there will be important benefits of providing information about these advisers to the public. In addition to furnishing us with important data about the private funds advised by exempt reporting advisers that we can use to identify practices that may harm investors,[471] and to administer our regulatory programs, these

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466 AFL-CIO Letter; CII Letter; Better Markets Letter.

467 *Id.*

468 Merkl Implementing Letter.

469 CII Letter.

470 *See infra* notes 483-488 and accompanying text.

471 For instance, census data about a private fund's gatekeepers, including administrators and auditors, would be available on amended Section 7.B.(1) of Schedule D and would be verifiable by investors and the Commission. Recent enforcement actions suggest that the availability of such information could be helpful. *See, e.g.*, *SEC v. Grant Ivan Grieve, et al.*, Litigation Release No. 21402 (Feb. 2, 2010) (default judgment against hedge fund adviser that was alleged to have fabricated and disseminated false financial information for the fund that was "certified" by a sham independent back-office administrator and phony accounting firm); *In the Matter of John Hunting Whittier*, Investment Advisers Act Release No. 2637 (Aug. 21, 2007) (settled action against hedge fund manager for, among other things, misrepresenting to fund investors that a particular auditor audited certain hedge funds, when in fact it did not).

reports will create a publicly accessible foundation of basic information that could aid investors and prospective investors in conducting due diligence and could further help investors and other industry participants protect against fraud.[472] The easy availability of information about these advisers and their advisory affiliates may also discourage advisers from engaging in certain practices (such as maintaining client assets with a related person custodian) or hiring certain persons (such as those with disciplinary history). Investors' access to information may also facilitate greater competition among advisers, which may in turn benefit clients.

Electronic reporting by exempt reporting advisers of certain items within Form ADV will give us better access to information about these advisers, which will improve the administration of our regulatory programs and allow us to identify advisers whose activities suggest a need for closer scrutiny. We routinely use the IARD to generate reports on the advisory industry, its characteristics and trends. These reports would help us anticipate regulatory problems, identify potential conflicts of interest, allocate our resources, and more fully evaluate various regulatory actions we may consider taking, which should increase both the efficiency and effectiveness of our programs and thus increase investor protection.

We are also amending rule 204-1 under the Advisers Act, which addresses when and how advisers must amend their Form ADV, to require that exempt reporting advisers file updating amendments to reports filed on Form ADV.[473] As amended, rule 204-1 requires an exempt reporting adviser, like a registered adviser, to amend its reports on Form ADV: (i) at least annually, within 90 days after the end of the adviser's fiscal year; and (ii) more frequently, if required by the instructions to Form ADV. Similarly, we are amending General Instruction 4 to Form ADV to require an exempt reporting adviser, like a registered adviser, to update promptly

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472 *See infra* section V.A.3.

473 Amended rule 204-1. *See supra* section II.B.4.

Items 1 (Identification Information), 3 (Form of Organization), and 11 (Disciplinary Information) if they become inaccurate in any way, and to update Item 10 (Control Persons) if it becomes materially inaccurate.[474]

Requiring advisers to amend and update their reports assures that we have access to updated information. For example, these updates will allow us to know when an exempt reporting adviser has added or no longer advises a private fund client or has reported a disciplinary event, which will provide us with the information necessary to assess whether the adviser might present sufficient concerns to warrant our further inquiry. Updated information also benefits investors, prospective investors, and other members of the public that could use this information in evaluating, for example, whether to invest in a venture capital fund managed by an exempt reporting adviser. Many commenters who addressed updating and amendment requirements agreed with our approach to update the report annually and to amend it according to the same schedule as is applicable to registered advisers.[475]

When an adviser ceases to be an exempt reporting adviser, new rule 204-4 requires the adviser to file an amendment to its Form ADV to indicate that it is filing a final report.[476] Final report filings will allow us and the public to distinguish such a filer from one that is failing to

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474 *See* Form ADV: General Instruction 4.

475 *See* NRS Letter (expressing general support); Merkl Implementing Letter (stating that less frequent reporting would result in information that is less useful or materially inaccurate); CII Letter (expressing general support); ABA Committees Letter (asserting that information reported by exempt reporting advisers that is allowed to become significantly outdated or inaccurate would not serve the Commission's or public's interest or protect investors as mandated by the Dodd-Frank Act, and could be misleading).

476 New rule 204-4(f); Form ADV: General Instruction 15. *See* section II.B.5.

meet its filing obligations.[477] Commenters who addressed the proposal to require a final report endorsed the Commission's approach.[478]

To accommodate their use by exempt reporting advisers, we also are making technical amendments to Form ADV-H, the form advisers use to request a hardship exemption from electronic filing,[479] and Form ADV-NR, the form certain non-resident advisers use to appoint the Secretary of the Commission as an agent for service of process.[480] Rule 204-4(e) and the amendments to Form ADV-H benefit exempt reporting advisers by allowing them to avoid non-compliance with reporting requirements based purely on unanticipated technical difficulties. The amendments to Form ADV-NR benefit investors by allowing us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws. Commenters did not specifically address these changes to Form ADV-H and ADV-NR.

3. Form ADV Amendments

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477 New rule 204-4(f). Advisers filing a final report are required only to update Item 1 of Part 1A of Form ADV and are not required to pay a filing fee. An adviser that failed to file a final report would violate rule 204-4(f).

478 ABA Committees Letter (agreeing that a final report is a reasonable way for an exempt reporting adviser to notify the Commission that it is no longer an exempt reporting adviser and endorsing the concept of allowing exempt reporting advisers that are transitioning to registration to use a single Form ADV filing for the purposes of submitting their final report and their application for registration); Merkl Implementing Letter (indicating that the Commission should not require some other approach than a final report when an adviser ceases to be an exempt reporting adviser).

479 New rule 204-4(e) allows exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD to request a temporary hardship exemption from electronic filing requirements.

480 *See* amended Form ADV-H; amended Form ADV-NR; amended Form ADV: General Instruction 19. The amendments to Form ADV-H and Form ADV-NR reflect that exempt reporting advisers use the forms in the same way and for the same purpose as they are currently used by registered investment advisers.

As discussed above, we are adopting amendments to Form ADV that will require advisers to provide us additional information about: (i) the private funds they advise, (ii) their advisory business and conflicts of interest, and (iii) their non-advisory activities and financial industry affiliations.[481] We are also adopting certain additional changes intended to improve our ability to assess compliance risks and to identify the advisers that are covered by section 956 of the Dodd-Frank Act, which addresses certain incentive-based compensation arrangements.

Private Fund Reporting Requirements

We are adopting amendments to Item 7.B. and Schedule D of Form ADV that expand the information advisers must report to us about the private funds they advise. This reporting will provide us with information designed to help us better understand private fund investment activities and the scope and potential impact of those activities on investors and markets. The information will also assist us in identifying particular practices that may harm investors and will allow us to conduct targeted examinations of private fund advisers based on these practices or other criteria. The amended reporting items are designed to improve our ability to assess risk, identify funds with service provider arrangements that raise a "red flag," identify firms for examination, and allow us to more efficiently conduct examinations. For instance, it would be relevant to us to know that a private fund is using a service provider that we are separately investigating for alleged misconduct. Responses to the service provider questions will also allow us to identify private funds that do not make use of independent service providers and provide other key information regarding the identity and role of these private fund gatekeepers. Advisers are required to report the gross asset value of the fund, which will help us understand the scope

481 *See supra* section II.C.

of its operations.[482] While no particular item of information may by itself indicate an elevated risk of a compliance failure, the reporting as a whole is designed to serve as an input to the risk metrics by which our staff identifies potential risk and allocates examination resources. The staff conducts similar analyses today, but with fewer inputs.

Several commenters agreed with our assessment that the new information will allow us to identify harmful practices, improve risk assessment and more efficiently target examinations,[483] and a U.S. Senator added that the data would aid the Financial Stability Oversight Council in monitoring systemic risk.[484] In its comment letter, NASAA wrote that "the information required of these advisers will be of critical importance to regulators in identifying practices that may harm investors." One commenter who criticized certain aspects of the proposal nonetheless conceded that "these disclosures would assist the Commission in seeking to achieve these goals [protecting against fraud and assisting in systemic risk evaluation]."[485]

Prospective and current private fund investors will also benefit from the public disclosure of this expanded private fund reporting. Private fund advisers must report information about their business, affiliates, owners, gatekeepers, and disciplinary history. This will create a publicly accessible foundation of basic information that could aid investors in conducting due diligence and could further help investors and other industry participants protect against fraud. For example, investors (and their consultants) will be able to compare representations made on Schedule D with those made in private offering documents or other materials provided to prospective investors. Fund service providers, such as administrators and auditors, may review

482 *See* amended Form ADV, Part 1A, Schedule D, Section 7.B.(1)A., question 11.

483 *See infra* note 265.

484 Sen. Levin Letter.

485 Seward Letter.

the information that advisers report in order to uncover false representations regarding the identity of service providers.[486] Some commenters agreed that the public availability of private fund data would aid investors.[487] We continue to believe that public disclosure of this information will be valuable to investors precisely because they will be able to compare the Form ADV information to the information they have received in offering documents and as a result of due diligence.[488]

The expanded private fund reporting will also benefit investors and market participants by providing us and other policy makers with improved data. This data will enhance our ability to form and frame regulatory policies regarding the private fund industry and its advisers, and to evaluate the effect of our policies and programs on this industry, including for the protection of private fund investors. Today, we frequently have to rely on data from other sources, when available. Private fund reporting will provide us with important information about this rapidly growing segment of the U.S. financial system.

Other Amendments to Form ADV

We are adopting other amendments to Form ADV that refine or expand existing questions. These changes will give us a more complete picture of an adviser's practices, help us better understand an adviser's operations, business and services, and provide us with more information to determine an adviser's risk profile and prepare for examinations. The information reported will help us to identify practices that may harm clients, including by detecting data or patterns that suggest further inquiry may be warranted and distinguishing additional conflicts of

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486 *See* Implementing Proposing Release, *supra* note 7, at n.149 and accompanying text.

487 *See, e.g.*, AFL-CIO Letter; CII Letter; Better Markets Letter (each lauding the Commission's initiative to create, for the first time, a database of public information on private investment funds).

488 *See supra* note 270. *See, e.g.*, Merkl Implementing Letter (noting that a potential investor would be better able to perform due diligence if the information were made available to the public).

interest that advisers may face. For example, the new reporting on related persons will allow us to link disparate pieces of information to which we have access concerning an adviser and its affiliates to identify whether those relationships present conflicts of interest that create higher risks for advisory clients. Another example is the amendment that requires advisers to switch from ranges to approximate numbers of employees; although this change refines data we previously received, it will enable us to better develop risk-based profiles of advisers. The expanded list of activities in which an adviser might engage will help us better understand the operations of advisers. Additionally, requiring advisers to report whether they have $1 billion or more in assets will help us to identify the advisers that could be subject to rules regarding certain excessive incentive-based compensation arrangements required by section 956 of the Dodd-Frank Act. Overall, the information to be collected on amended Form ADV is designed to improve our risk-assessment capabilities and help us improve our allocation of examination resources. Commenters who addressed these proposed amendments to Form ADV expressed general support.[489] One commenter, for instance, agreed that these amendments will improve our ability to gather data about firms, to conduct appropriate inquiries, inspections, and other activities based on that data, and to focus examination and enforcement resources on those advisers that appear to present greater compliance risks.[490] Another indicated that the additional information the amended form will collect would assist the Commission to identify fund advisers, to verify the existence and location of assets and to carry out general market surveillance.[491]

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489 *See supra* note 216.

490 *See* IAA General Letter.

491 *See* CPIC Letter.

Advisory clients and prospective clients will also benefit from the changes to Form ADV. As one commenter indicated, information reported on Form ADV is publicly available, allowing investors to use the IAPD as a resource in evaluating potential managers and understanding their practices.[492] For example, clients and prospective clients will be able to see whether an adviser or one of its control persons is a public reporting company registered under the Exchange Act and then access additional public information about the adviser and/or the control person on the EDGAR system. Requiring an adviser to report whether it has $1 billion or more of assets helps to inform the adviser, its clients and the public whether or not the adviser may be subject to section 956 of the Dodd-Frank Act and any rules or guidelines thereunder. The additional information about the adviser's related persons will assist investors that compare business practices, strategies, and conflicts of a number of advisers, which may help them to select the most appropriate adviser for them. Clients may also benefit indirectly because advisers may be incentivized to implement stronger controls and practices, particularly related to any conflicts of interest or business practices that may result in additional risks, because of enhanced client awareness. Third parties will also be able to access the new information reported in filings of the amended form, allowing academics, businesses, and others to access additional information about registered investment advisers and exempt reporting advisers, which they can use to study the advisory industry.

Among the amendments to Form ADV are improvements to its instructions. We expect these changes to assist advisers in determining their regulatory assets under management and whether they are eligible or required to register with us, which may result in cost savings for

[492] CPIC Letter.

some advisers because they may more readily be able to make this determination.[493] Eliminating the choices we have given advisers in the Form ADV instructions for calculating assets under management, for example, provides for a uniform method of determining assets under management for purposes of the form and the new exemptions from registration under the Advisers Act. These updates will also include, for the first time, specific instructions on how to determine the amount of private fund assets an adviser has under management. We expect that these changes will promote competition, increase certainty when an adviser chooses to rely on an exemption from registration, and improve consistency in reporting across the industry.[494] Some of the technical amendments we are adopting, such as those to Item 9, are designed, at commenter request, to alleviate adviser confusion.[495]

4. Amendments to Pay to Play Rule

We are making two amendments to the pay to play rule that we believe are appropriate as a result of the enactment of the Dodd-Frank Act.[496] First, we are amending the rule to make it continue to apply to advisers that previously relied on the "private adviser" exemption, including exempt reporting advisers and foreign private advisers.[497] We are making this amendment to prevent the narrowing of the application of the rule as a result of the amendments

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493 *See* section II.A.3.

494 *See id.* *See also* Exemptions Adopting Release at sections II.B.2., II.C., II.C.5. (discussing exemption for foreign private advisers and certain private fund advisers).

495 *See supra* section II.C.5. We are also making a technical amendment to Form ADV-E to reflect the requirement that the accountant's report be filed electronically. Staff notified advisers in November 2010 that the IARD system had been programmed to accept Form ADV-E. *See* 2009 Custody Release, *supra* note 310 at n.53 and accompanying text (establishing the requirement for Form ADV-E to be filed electronically, explaining that accountants performing surprise examinations should continue paper filing of Form ADV-E until the IARD system is programmed to accept Form ADV-E, and noting that advisers would be informed when that programming was completed). This technical change will alleviate adviser confusion about the appropriate filing method for this form.

496 *See* section II.D.1.

497 Rule 206(4)-5(a). *See* section II.D.1.

to the Act made by the Dodd-Frank Act.[498] We do not believe that this amendment will create any benefits (or costs) beyond those created by the rule as originally adopted,[499] but rather will merely assure that the rule continues to apply to the same advisers as we intended when we adopted the rule.

Second, we are amending the rule to add municipal advisors to the categories of registered entities – referred to as "regulated persons" – excepted from the rule's prohibition on advisers paying third parties to solicit government entities.[500] To qualify as a "municipal advisor" (and thereby a "regulated person"), a solicitor must be registered under section 15B of the Securities Exchange Act and subject to pay to play rules adopted by the MSRB.[501] Notably, for municipal advisors to qualify as "regulated persons," we must find that applicable MSRB pay to play rules: (i) impose substantially equivalent or more stringent restrictions on municipal advisors than the pay to play rule imposes on investment advisers; and (ii) are consistent with the objectives of the pay to play rule.[502]

Our amendment will continue to permit advisers to pay two other categories of persons to solicit government entities on their behalf—investment advisers and broker-dealers—so long as

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498 *See supra* section II.D.1. Rule 206(4)-5 currently applies to "private advisers" exempt from registration with the Commission under section 203(b)(3) of the Advisers Act. As discussed in note 4, the Dodd-Frank Act has eliminated the "private adviser" exemption from registration with the Commission in section 203(b)(3), but has created new exemptions for exempt reporting advisers and foreign private advisers. Advisers that qualify for these new exemptions generally are subsets of the advisers that qualify for the existing section 203(b)(3) "private adviser" exemption.

499 *See* Pay to Play Release, *supra* note 340, at section IV.

500 *See* amended rule 206(4)-5(a)(2)(i)(A), (f)(9). "Regulated persons" also include registered investment advisers and broker-dealers subject to the rules of a registered national securities association, such as FINRA, that has adopted pay to play rules that the Commission determines satisfy the criteria of amended rule 206(4)-5(f)(9)(iii)(B).

501 *See* amended rule 206(4)-5(f)(9)(iii).

502 *See* amended rule 206(4)-5(f)(9)(iii)(B).

such third parties are registered with us and subject to pay to play rules of their own.[503] Due to the fact that the definition of a municipal advisor may include categories of persons other than registered investment advisers and broker-dealers, our amendment may increase the number of solicitors that an adviser could hire.[504] This could benefit advisers by increasing competition in the market for solicitation services and reducing the cost of such services. It could also benefit those solicitors that are not registered investment advisers or broker-dealers, but may meet the municipal advisor definition, by allowing advisers to hire them.

5. Advisers Previously Exempt under Section 203(b)(3)

We are adopting a transition provision in rule 203-1 for advisers that are newly required to register due to the Dodd-Frank Act's repeal of the "private adviser" exemption in section 203(b)(3).[505] Specifically, under rule 203-1(e), an adviser that was relying on, and was permitted to rely on, the "private adviser" exemption in section 203(b)(3) on July 20, 2011, may delay registering with the Commission until March 30, 2012.[506] The transition period will provide these advisers with needed additional time to work through any technical issues associated with

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503 Pay to Play Release, *supra* note 340, at section II.B.2.(b).

504 Our current "regulated person" definition does not include, for example, advisers prohibited from registering with the Commission under section 203A of the Advisers Act, such as state-registered advisers, or advisers unregistered in reliance on an exemption other than section 203(b)(3) of the Act. The definition of "municipal advisor" does not exclude these advisers. *See* section 975 of the Dodd-Frank Act. We adopted the third party solicitor ban to prevent advisers from circumventing the rule through third parties. *See* section II.B.2.(b) of the Pay to Play Release. Given the Dodd-Frank Act's creation of the "municipal advisor" category, and given that it requires these persons to register with the Commission and subjects them to MSRB rulemaking authority, we believe that expanding the current "regulated person" exception to the third party solicitor ban to include registered municipal advisors subject to pay to play rules would not undermine the ban's purpose. By allowing advisers to choose from a broader set of potential third party solicitors, we believe our amendments may promote efficiency and competition in the market for advisory services to the extent third party solicitors that are not registered investment advisers or broker-dealers participate.

505 *See* rule 203-1(e); section 203(b)(3) of the Advisers Act; *supra* section III.B.2.

506 *See* rule 203-1(e); *supra* note 385.

applying for registration and to establish compliance with Advisers Act provisions and rules to which they are newly subject as advisers required to register.[507] As such, we believe that the temporary extension of the registration deadline provided by rule 203(e)-1 will assure an orderly transition to registration that will minimize costs to these advisers—costs that could otherwise be passed on to clients. We believe that maintaining an orderly transition process promotes efficiency and may reduce the costs of filing an initial application for registration and coming into compliance with Advisers Act provisions and rules to which these advisers are newly subject.

B. Costs

1. Eligibility to Register with the Commission: Section 410

Transition to State Registration

Rule 203A-5 will impose one-time costs on certain investment advisers registered with us by requiring them to file an amendment to Form ADV, and on advisers that are no longer eligible to remain registered with us by requiring them to file Form ADV-W to withdraw from Commission registration.[508] According to IARD data, approximately 11,500 investment advisers are registered with us and will be required to file an amended Form ADV,[509] and approximately 3,200 of those advisers will be required to withdraw their registration and register with one or

[507] We received a number of comment letters requesting that these advisers have additional time after July 21, 2011 (the date the Dodd-Frank Act's repeal of the section 203(b)(3) private adviser exemption becomes effective) to become registered and to establish compliance with all provisions of the Advisers Act and rules thereunder to which they are newly subject by virtue of their required registration. *See* CompliGlobe Letter; MFA Letter; Schnase Letter; Shearman Letter.

[508] *See* new rule 203A-5; *supra* section II.A.1.

[509] Based on IARD data as of April 7, 2011, 11,504 investment advisers are registered with the Commission. We have rounded this number to 11,500 for purposes of our analysis.

more state securities authorities.[510] As we discuss below, although all SEC-registered advisers will be required to file Form ADV, we estimate that only 3,900 of them will have to make an additional filing not in the usual course of business.[511]

Some commenters argued that we should decrease the costs of proposed rule 203A-5 by exempting advisers unaffected by the statutory changes from the Form ADV filing

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510 According to data from the IARD as of April 7, 2011, 3,531 SEC-registered advisers either: (i) had assets under management between $25 million and $90 million and did not indicate on Form ADV Part 1A that they are relying on an exemption from the prohibition on Commission registration; or (ii) were permitted to register with us because they rely on the registration of an SEC-registered affiliate that has assets under management between $25 million and $90 million and are not relying on an exemption from registration. We estimate that 350 of these advisers will not switch to state registration because their principal office and place of business is located in Minnesota, New York, or Wyoming. *See supra* note 152 (according to IARD data as of April 7, 2011, there were 63 mid-sized advisers in Minnesota, 286 in New York, and 1 in Wyoming). As a result, we estimate that approximately 3,200 advisers will switch to state registration. 3,531 SEC-registered advisers – 350 advisers not switching to state registration = 3,181 advisers. In the Implementing Proposing Release, we estimated that approximately 4,100 SEC-registered advisers would be required to withdraw their registrations and register with one or more state securities authorities, based on IARD data as of September 1, 2010. *See* Implementing Proposing Release, *supra* note 7, at n.15. We have lowered our estimate by 900 advisers to account for the advisers that have between $90 million and $100 million of assets under management that may remain registered with us as a result of the amendments we are adopting to rule 203A-1, the advisers that have withdrawn their registrations with us since that time, and as discussed above, the advisers that will not switch registration because they have a principal office and place of business in Minnesota, New York or Wyoming. *See supra* note 22.

511 Based on IARD data as of April 7, 2011, 10,636 advisers reported on Form ADV a December 31 fiscal year end, of which we estimate approximately 3,013 will file a Form ADV to comply with the Form ADV filing requirement of new rule 203A-5 before switching to state registration because they reported assets under management of less than $90 million and either: (i) they did not indicate on Part 1A of Form ADV that they are relying on an exemption from the prohibition on Commission registration; or (ii) they do not have a principal office and place of business in Minnesota, New York or Wyoming. Additionally, 868 advisers reported a fiscal year end other than December 31 and will file an additional, other-than-annual amendment to comply with new rule 203A-5. 3,013 + 868 = 3,881. We have rounded this number to 3,900 for purposes of our analysis. The revised PRA burden for Form ADV includes the annual amendment filing by the approximately 7,623 advisers with a December 31 fiscal year end that we estimate will remain registered with us after the switch because they reported assets under management of more than $90 million, indicated on Part 1A of Form ADV that they are relying on an exemption from the prohibition on Commission registration, or have a principal office and place of business in Minnesota, New York or Wyoming. *See infra* section VI.B. We have rounded this number to 7,600 for purposes of our analysis.

requirement,[512] or only requiring advisers to report their assets under management.[513] As discussed above, we believe there are significant benefits of requiring all advisers to file Form ADV, including having each adviser confirm its eligibility for Commission registration in light of multiple statutory and rule changes, and allowing us and the state regulatory authorities to easily and efficiently identify the advisers that are transitioning to state registration and the advisers that are remaining registered with the Commission.[514] We also note that commenters' concerns also should be allayed by the new March 30, 2012 deadline for filing Form ADV that will coincide with most advisers' required annual updating amendment, eliminating the requirement that they file an additional amendment to their Form ADV,[515] and that will coincide with the filing requirements for newly registering private fund advisers.[516] In addition, providing additional flexibility for an adviser to choose the date by which it must calculate its assets under management reported on Form ADV further reduces the cost of the filing and promotes uniformity by requiring the same 90 day period as in Form ADV today.[517] We believe that the rule will have little impact on competition among advisers registered with us because they will

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512 ICI Letter (recommending exempting advisers that do not rely on assets under management to register with the SEC); MFA Letter (recommending exempting private fund advisers that file an initial Form ADV by July 21); NYSBA Committee Letter (recommending exempting advisers who will continue to be eligible for Commission registration and advisers relying on the section 203(b)(3) exemption that we proposed would have to register with the Commission by July 21, 2011).

513 Shearman Letter.

514 *See supra* section II.C.

515 *See supra* note 511.

516 *See* MFA Letter ("Requiring private fund managers to file two Form ADV's would be costly, inefficient and potentially confusing."). *See also supra* section III.

517 *See* new rule 203A-5(b); Form ADV: Instructions for Part 1A, instr. 5.b.(4). Several commenters that requested more flexibility asserted that the use of end of quarter numbers precludes an administrate burden for many advisers that value assets on a quarterly basis because most advisers already value assets quarterly to calculate fees. *See, e.g.,* Altruist Letter; NYSBA Committee Letter; Seward Letter; Shearman Letter.

all be subject to these requirements, but the rule could have an impact of limited duration on competition between advisers registered with us as of July 21, 2011 who are subject to the rule, and state-registered advisers who are not.[518] We also believe that the rule will have little, if any, effect on capital formation.

For purposes of calculating the currently approved Paperwork Reduction Act ("PRA") burden for Form ADV, we estimated that an annual updating amendment will take each adviser approximately 6 hours,[519] and we estimate the one-time transition amendment will have a similar burden. In addition, for purposes of the increased PRA burden for Form ADV, we estimate that the amendments to Part 1A of Form ADV will take each adviser approximately 4.5 hours, on average, to complete.[520] As a result, we estimate a total average time burden of 10.5 hours for each adviser completing the amendment to Form ADV required by rule 203A-5 (excluding private fund information which is addressed below).[521] We estimate that each adviser will incur average costs of approximately $2,667.[522]

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518 For example, the rule requires mid-sized advisers registered with us on July 21, 2011 to remain registered (unless an exemption from Commission registration is available) until they switch to state registration in 2012. *See supra* note 23. All of these advisers must file an amended Form ADV with us by March 30, 2012, and any advisers maintaining dual registrations with the SEC and states will incur renewal fees and compliance costs to maintain both registrations until the beginning of 2012. *See, e.g., infra* note 543. Mid-sized advisers that are not registered with us on July 21, 2011 will not have similar costs.

519 *See infra* section VI.B.2.a.iii.

520 *See infra* sections VI.B.1.a.

521 6 hours (Form ADV amendment) + 4.5 hours (new Form ADV items) = 10.5 hours.

522 We expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the Securities Industry Financial Markets Association's *Management & Professional Earnings in the Securities Industry 2010* ("SIFMA Management and Earnings Report"), modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for a senior compliance examiner and a compliance manager are $235 and $273 per hour, respectively. (5.25 hours x $235 = $1,233.75) + (5.25 hours x $273 = $1,433.25) = $2,667.

Proposed rule 203A-5 would have required all advisers registered with us on July 21, 2011 to file a Form ADV amendment, in addition to the amendment that each adviser is required to file annually,[523] and we estimated that 11,850 advisers would file the form.[524] To address commenters' concerns about the burdens of an additional filing,[525] we modified the rule so that approximately 7,600 advisers that will remain registered with the SEC after the transition will satisfy the Form ADV filing requirement by filing their annual amendment following their fiscal year ending on December 31, 2011.[526] This reduces the number of advisers that will file an additional Form ADV attributable to the rule 203A-5 to approximately 3,900.[527] As a result, the total aggregate cost of the Form ADV filing requirement will be approximately $10,401,300.[528] In addition, of these 3,900 registered advisers, we estimate that 850 advise one or more private funds and will have to complete the private fund reporting requirements.[529] We expect this will take 8,373 hours,[530] in the aggregate, for a total cost of $2,126,742.[531] As a result, the total

523 *See* proposed rule 203A-5(a).

524 *See* Implementing Proposing Release, *supra* note 7, at n.293 and accompanying text.

525 *See supra* note 414 and accompanying text.

526 *See supra* note 511.

527 *See id.*

528 3,900 advisers x $2,667 = $10,401,300.

529 Based on IARD data as of April 7, 2011, 839 advisers out of the estimated 3,700 current SEC-registered advisers that advise private funds do not have a December fiscal year end or are expected to switch to state registration. We have rounded this number to 850 for purposes of this analysis.

530 Based on IARD data as of April 7, 2011, we estimate that approximately 52 percent of these 850 private fund advisers, or 442, currently advise an average of 3 private funds each; 43 percent, or 365 advisers, currently advise an average of 10 private funds each; and the remaining 5 percent, or 43 advisers, currently advise an average of 79 private funds each. *See infra* note 697 and accompanying text. (442 advisers x 3 funds x 1 burden hour per fund) + (365 x 10 funds x 1 burden hour per fund) + (43 advisers x 79 funds x 1 burden hour per fund) = 1,326 hours + 3,650 hours + 3,397 hours = 8,373 hours.

531 (4,186.5 hours x $235) + (4,186.5 x $273) = $983,827.5 + $1,142,914.5 = $2,126,742. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 522.

estimated costs associated with filing amended Form ADV as required by rule 203A-5 will be $12,528,042.[532]

For the estimated 3,200 advisers that will be required to withdraw their registrations, we estimate that the average burden for each respondent is 0.25 hours for filing a partial withdrawal on Form ADV-W.[533] An adviser will likely use compliance clerks to prepare the filings and review the prepared Form ADV-W.[534] We estimate that each adviser will incur average costs of approximately $16.75[535] to comply with the Form ADV-W filing requirements, for a total one-time cost of $53,600.[536] As a result, rule 203A-5 will result in a total one-time cost of $12,581,642.[537]

Switching Between State and Commission Registration

We are adopting amendments to rule 203A-1 to eliminate the $5 million buffer that permits, but does not require, an adviser to register with the Commission if the adviser has

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532 $10,401,300 (total cost for Form ADV filing excluding private fund reporting) + $2,126,742 (total cost for private fund reporting) = $12,528,042 (total cost for Form ADV filing).

533 Form ADV-W is designed to accommodate the different types of withdrawals an investment adviser may file. An investment adviser ceasing operations will complete the entire form to withdraw from all of the jurisdictions in which it is registered (full withdrawal), while an adviser withdrawing from some, but not all, of the jurisdictions in which it is registered will omit certain items that we do not need from an adviser continuing in business as a state-registered adviser. We expect that advisers required to file Form ADV-W will file only a partial withdrawal because switching to state registration only requires a partial withdrawal. Compliance with the requirement to complete Form ADV-W imposes an average burden of 0.25 hours for an adviser filing for partial withdrawal.

534 We have assumed for purposes of the current approved PRA burden for rule 203-2 and Form ADV-W that advisers will use clerical staff to file a partial withdrawal. Data from the Securities Industry Financial Markets Association's *Office Salaries in the Securities Industry 2010* ("SIFMA Office Salaries Report") modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the hourly rate for a compliance clerk is $67.

535 0.25 hours x $67 (hourly wage for clerk) = $16.75 (total cost for Form ADV-W filing).

536 $16.75 x 3,200 = $53,600.

537 $12,528,042 (total cost for Form ADV filing) + $53,600 (total cost for Form ADV-W filing) = $12,581,642 (total cost for new rule 203A-5).

between \$25 million and \$30 million of assets under management.[538] Specifically, the amendment will require advisers with between \$25 million and \$30 million in assets under management that relied on the buffer to switch their registration to the states.[539] As of April 7, 2011, approximately 300 advisers registered with the Commission had between \$25 million and \$30 million of assets under management.[540] Because the Dodd-Frank Act has amended section 203A to prohibit approximately 240 of these advisers from registering with the Commission, we believe that 240 advisers will see increased costs as a result of the amendment.[541] These costs include those associated with withdrawing their registration with the Commission and registering with the states, including filing a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act. We have estimated for purposes of our current approved hour

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538 *See* amended rule 203A-1(a); *supra* section II.A.4.

539 *See supra* section II.A.4. Under the Dodd-Frank Act, a mid-sized adviser (with at least \$25 million of assets under management) is not prohibited from registering with the Commission if: (i) the adviser is not required to be registered as an investment adviser with the securities commissioner (or any agency or office performing like functions) of the state in which it maintains its principal office and place of business; (ii) if registered, the adviser will not be subject to examination as an investment adviser by that securities commissioner; or (iii) the adviser is required to register in 15 or more states. *See* section 410 of the Dodd-Frank Act; *supra* section II.A.

540 Based on IARD data as of April 7, 2011, 305 advisers registered with the Commission had between \$25 million and \$30 million of assets under management. We have rounded this number to 300 for purposes of this analysis.

541 *See supra* section II.A. (discussing new section 203A(a)(2) of the Advisers Act, which prohibits certain mid-sized advisers from registering with the Commission). Based on IARD data as of April 7, 2011, 242 advisers registered with the Commission had between \$25 million and \$30 million of assets under management. For purposes of this analysis, we have rounded this number to 240 and assume that all of these advisers will not remain eligible to register with the Commission because they will be required to be registered and subject to examination by securities authorities in the states where they maintain their respective principal offices and places of business. *See* Advisers Act section 203A(a)(2) (as amended by the Dodd-Frank Act); *supra* section II.A.7.b. (discussing the fact that each state securities commissioner (or official with similar authority) advised our staff whether investment advisers registered in the state will be subject to examination as an investment adviser by that state's securities commissioner (or agency or office with similar authority)). All state securities authorities other than Minnesota, New York, and Wyoming have advised our staff that advisers registered with them are subject to examination. *See supra* note 152.

burden under the PRA for rule 203-2 and Form ADV that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser, and the filing (and costs associated with the filing) by these 240 advisers are included in our discussion above of the Form ADV-W filing requirement under rule 203A-5.[542] These advisers also will incur the costs of state registration and of compliance with state laws and regulations, which we expect will vary widely depending on the number of, and which, states with which each adviser is required to register. For example, individual state registration fees generally range from approximately $60 to $400 annually, and some states require advisers to submit documentation in addition to Form ADV.[543]

The buffer we are adopting for mid-sized advisers with assets under management of close to $100 million may marginally increase costs for advisers initially as they determine how to comply with the new requirements and complete the amended Form ADV,[544] but, as underscored by several commenters, the buffer decreases costs for advisers in the aggregate.[545] As discussed

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542 *See supra* notes 533-536 and accompanying text (addressing the costs of filing Form ADV-W for advisers that will be required to withdraw their registrations).

543 *See, e.g.,* Colorado Division of Securities Fee Schedule ($60 registration fee), *available at* http://www.dora.state.co.us/securities/feeschedule.htm; Illinois Secretary of State, Securities Fees ($400 registration fee), *available at* http://www.sos.state.il.us/departments/securities/investment_advisers/fees.html; OHIO REV. CODE § 1707.17(B)(3) (2010) ($100 registration fee); ARK. CODE § 23-42-304(a)(3) (2010) ($300 registration fee); Texas State Securities Board, Check Sheet For a Sole Proprietor Corporation LLC or Partnership Applying For Registration as an Investment Adviser ($275 registration fee and requiring copies of adviser's organizational documents, balance sheet, fee schedule, advisory contract, and brochure or disclosure document delivered to clients), *available at* http://www.ssb.state.tx.us/Dealer_And_Investment_Adviser_Registration/Check_Sheet_For_a_Sole_Proprieter_Corporation_LLC_or_Partnership_Applying_For_Registration_as_an_Investment_Adviser.php; North American Securities Administrators Association, Inc., *State Securities Regulators Report on Regulatory Effectiveness and Resources with Respect to Broker-Dealers and Investment Advisers,* 7 (2010) (among other things, states review registrants' disclosure history, financial status, business practices, and provisions in client contracts).

544 The PRA burdens for Form ADV and rule 203A-5 include a burden of 4.5 hours per adviser to complete the amended Form ADV, including the assets under management calculation and eligibility requirements. *See infra* sections IV.B.1. and IV.C.

545 Several commenters argued that the buffer would decrease costs, for example, by preventing advisers with close to $100 million of assets under management from having to switch to and

above, the buffer permits mid-sized advisers to determine whether and when to switch between state and Commission registration, which will prevent costs and disruption for these advisers to frequently switch their registrations.[546] We believe these amendments will have little, if any, effect on capital formation.

Exemptions from the Prohibition on Registration with the Commission

Amending the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) to increase the minimum value of plan assets from $50 million to $200 million[547] may impose costs on some of the approximately 325 advisers that currently rely on the exemption.[548] These costs, which include those associated with withdrawing their registration with the Commission and registering with the states, if required, will have a negative impact on competition for the advisers that no longer qualify for the exemption and potentially must register as an adviser with more than one state securities authority. We estimate that 50 of the 325 advisers relying on the exemption will have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their registration.[549] We

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from Commission registration frequently. *See, e.g.,* Altruist Letter; Dezellem Letter; Dinel Letter; FSI Letter; ICW Letter; JVL Associates Letter; Merkl Implementing Letter; NRS Letter; Wealth Coach Letter; and WJM Letter.

546 *See supra* notes 427-428 and accompanying text.

547 *See* amended rule 203A-2(a); *supra* section II.A.5.b.

548 Based on IARD data as of April 7, 2011, 322 SEC-registered advisers, which we rounded to 325, indicated that they rely on the exemption for pension consultants by marking Item 2.A.(6) on Part 1A of Form ADV. These advisers do not report the amount of plan assets for which they provide investment advice, so we are unable to determine how many have between $50 million and $200 million of plan assets and, therefore, may have to register with the state securities authorities as a result of the amendment. It is also difficult to determine whether such advisers will be prohibited from registering with the Commission because they are required to register with and are subject to examination by the state securities authority where they maintain a principal office and place of business under the Dodd-Frank Act.

549 Based on IARD data as of April 7, 2011, approximately 190 pension consultants reported assets under management of less than $90 million, and 166 of those advisers reported assets under management of less than $25 million. We believe that most pension consultants relying on the

have estimated that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[550] Thus, we estimate that the amendment to rule 203A-2(b) associated with filing Form ADV-W will generate a burden of 12.5 hours[551] at a cost of approximately $840.[552] These advisers will incur the costs of state registration, which we expect will vary widely depending on the number of, and which, states with which an adviser is required to register.[553] We believe the amendment will have little, if any, effect on capital formation.

As discussed above, the amendment to the multi-state adviser exemption in rule 203A-2(e) will reduce costs for advisers in the aggregate because more advisers will be permitted to register with one securities regulator – the Commission – rather than being required to register with multiple states.[554] Advisers newly relying on the amended exemption will incur costs associated with completing and filing Form ADV for purposes of registration with the Commission, and all of the advisers relying on the exemption will incur the costs associated with keeping records sufficient to demonstrate that they would be required to register with 15 or more states. In addition, these advisers will incur costs of complying with the Advisers Act and our rules.

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exemption provide advice regarding a large amount of plan assets, so we expect the number of advisers affected by the amendment to be one quarter of the advisers with less than $25 million of assets under management, or 42 advisers (which is approximately 15 percent of all advisers relying on this exemption). We have rounded this number to 50 for purposes of our analysis. We expect that advisers that will be required to file Form ADV-W will file only a partial withdrawal because they will be registering with the states. *See supra* note 533. Compliance with the requirement to complete Form ADV-W imposes an average burden of approximately 0.25 hours for an adviser filing for partial withdrawal. *See id.*

550 *See supra* note 533.

551 50 responses on Form ADV-W x 0.25 hours = 12.5 hours.

552 12.5 hours x $67 = $837.50.

553 *See supra* note 543.

554 *See* amended rule 203A-2(d); *supra* section II.A.5.c. Several commenters suggested that the burdens of maintaining multiple state registrations can be significant. *See* Seward Letter; Shearman Letter. *See also* NEA Letter.

We estimate that, in addition to the approximately 40 advisers that rely on the exemption currently, approximately 115 will rely on the exemption as amended.[555] For purposes of the PRA, we have estimated that these advisers will incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold.[556] We further estimate that a senior operations manager will maintain the records at an hourly rate of $331, resulting in average initial and annual recordkeeping costs associated with our amendments to rule 203A-2(e) of $2,648 per adviser,[557] and total increased costs of approximately $304,520 per year.[558] Advisers newly relying on the amended exemption will also incur costs associated with completing and filing Form ADV for purposes of registration with the Commission. For purposes of the increase in our PRA burden for Form ADV, we have estimated that advisers newly registering with the Commission will incur an average amortized hour burden of

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555 Based on IARD data as of April 7, 2011, of the approximately 11,500 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule. Of the advisers that have less than $90 million of assets under management, approximately 100 currently file notice filings with 15 or more states. However, state notice filing requirements for SEC-registered advisers may differ from registration requirements because Form ADV does not distinguish between states where registration is mandatory and where registration is voluntary. In addition, we estimate that 15 advisers currently registered with 15 or more states could rely on the exemption and register with us. Thus, we estimate that approximately 155 advisers will rely on the exemption (40 currently relying on it + estimated 100 advisers eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

556 These estimates are based on an estimate that each year an investment adviser will spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain the record, for a total of 8 hours. *See infra* note 665 and accompanying text.

557 8 hours x $331 = $2,648. The $331 compensation rate used is the rate for a senior operations manager in the SIFMA Management and Earnings Report, modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

558 115 new advisers relying on the exemption x $2,648 = $304,520.

approximately 13.58 hours per year,[559] resulting in costs of approximately $3,450 per adviser[560] and total increased costs of approximately $396,750 per year.[561] Additionally, we estimate that approximately 30 of the newly registering advisers will use outside legal services, and 60 will use outside compliance consulting services, to assist them in preparing their Part 2 brochures,[562] for a cost of $132,000, and $300,000, respectively, resulting in a total non-labor cost among the newly registering advisers of $432,000.[563] The rule could also impact competition between advisers who rely on the exemption and are subject to our full regulatory program, including examinations and our rules, and state-registered advisers who do not rely on the exemption. We believe these amendments will have little, if any, effect on capital formation.

Mid-Sized Advisers

As discussed above, the Dodd-Frank Act does not explain how to determine whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers

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559 *See infra* note 695 and accompanying text.

560 We expect that the performance of this function will most likely be equally allocated between a senior compliance examiner at $235 per hour and a compliance manager at $273 per hour. *See infra* note 579. (6.79 hours x $235 = $1,596) + (6.79 hours x $273 = $1,854) = $3,450.

561 115 advisers relying on the exemption x $3,450 = $396,750.

562 We estimate that a quarter of medium-sized advisers seek the help of outside legal services and half seek the help of compliance consulting services. *See* section VI.B.2.a.iv. As discussed above, we have estimated that 115 new advisers will begin relying on the exemption, in addition to the 40 advisers that currently rely on it. *See supra* note 555. 0.25 x 115 new advisers relying on the exemption = 28.75 advisers seeking outside legal services. 0.5 x 115 new advisers relying on the exemption = 57.5 advisers seeking compliance consulting services. We have rounded these numbers to 30 and 60, respectively, for the purpose of this analysis.

563 We estimate that the initial cost related to preparation of Part 2 of Form ADV would be $4,400 for legal services and $5,000 for compliance consulting services for those medium-sized advisers who engage legal counsel or consultants. *See infra* note 729 and accompanying text. (30 advisers seeking outside legal services x $4,400 for legal services) + (60 advisers seeking compliance consulting services x $5,000 for compliance consulting services) = $132,000 for legal services + $300,000 for compliance consulting services = $432,000. The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. *See id.*

registering with the Commission, and we are providing in Form ADV an explanation of how we construe these provisions.[564] We do not, however, believe that they will generate costs independent of any costs associated with Congress' enactment of section 203A(a)(2), and will have little, if any, effect on capital formation.

2. Exempt Reporting Advisers: Sections 407 and 408

While we believe that our approach to implementing the Dodd-Frank Act's reporting provisions applicable to exempt reporting advisers will minimize costs inherent in such reporting, we acknowledge that it will impose costs on these advisers.[565] These costs include filing fees, although not significant, paid for submitting initial and annual filings through the IARD. We anticipate that filing fees, which the Commission will consider separately, will be the same as those for registered investment advisers, which currently range from $40 to $225 based on the amount of assets an adviser has under management.[566] In order to estimate the costs associated with filing fees, we assume for purposes of this analysis that exempt reporting advisers will pay a fee of $225 per initial or annual report.[567] We estimate that approximately 2,000 advisers will qualify as exempt reporting advisers pursuant to section 203(l) of the Advisers Act, as added by the Dodd-Frank Act, and rule 203(m)-1 thereunder, and will have to file Form ADV on the IARD.[568] As a result, we expect exempt reporting advisers to incur a total

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564 *See supra* section II.A.7.

565 *See* amended rule 204-1 and new rule 204-4; amended Form ADV, Part 1A; *supra* section II.B.

566 The current fee schedule for registered advisers may be found on our website at http://www.sec.gov/divisions/investment/iard/iardfee.shtml. We amended this fee schedule in December 2010. *See Order Approving Investment Adviser Registration Depository Filing Fees,* Investment Advisers Act Release No. 3126 (Dec. 22, 2010), available at http://www.sec.gov/rules/other/2010/ia-3126.pdf.

567 This is the fee applicable to registered advisers with $100 million or more in assets under management. There will be no fee for filing an other-than-annual amendment to a report.

568 *See infra* note 734. While this is an estimate of the total number of advisers that may file reports rather than register with the Commission, a number of these advisers may choose to register with

annual cost of approximately $450,000 in filing fees.[569]

In addition to filing fees, exempt reporting advisers will incur internal costs associated with collecting, reviewing, reporting, and updating a limited subset of Form ADV items in Part 1A, including Items 1, 2.B., 3, 6, 7, 10, 11 and corresponding schedules. We expect this cost to be substantially less than that incurred by registered advisers because exempt reporting advisers are not required to complete the remainder of Part 1A or Part 2 of Form ADV. The costs of completing the relevant items of Form ADV will vary from adviser to adviser, depending in large part on the number of private funds an adviser manages.

We believe, and several commenters confirmed, that the information these items require should be readily available to any adviser (particularly the identifying, private fund and control person information required by Items 1, 3, 7.B. and 10), which mitigates the costs and burdens of reporting.[570] Similarly, Item 6 requires the adviser to indicate if it engages in other specific business activities, information which we believe should also be readily available to these advisers. Item 2.B. elicits the information an exempt reporting adviser would already have gathered for purposes of determining if it is eligible for an exemption from registration under section 203(l) of the Act or rule 203(m)-1 thereunder, and as such, this item should impose few,

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the Commission rather than file reports. We cannot determine in advance the precise number of these advisers that will choose to register rather than report. Therefore, in order to avoid under-estimating the costs of these amendments, we are using the total number of potential exempt reporting advisers in our estimates.

569 2,000 exempt reporting advisers x $225 per year = $450,000. Advisers pay for initial Form ADV submissions and for annual amendments; there is no charge for an interim amendment.

570 *See* ABA Committees Letter ("We expect that most [exempt reporting advisers] will already have most of the information requested by Form ADV Part 1 readily available."); Merkl Implementing Letter (confirming that the disclosure requirements would not impose a significant burden on advisers). *See also*, with respect to private fund reporting under Item 7.B. specifically, Katten Foreign Advisers Letter ("Virtually all of the requested information would already have been provided to investors in the fund through an offering document or follow up status reports.") and NRS Letter (arguing that the expanded private fund disclosures on Schedule D would "replicate the due diligence questionnaire information....").

if any, costs to complete. Commenters who addressed Section 7.A. of Schedule D urged that we limit the reporting of related persons, which could be significant in the case of advisers that are part of a large organization.[571] Many of these commenters pointed out that in some cases the adviser and its clients have no business dealings with some affiliates and thus there is less of a chance of conflicts developing.[572] We agree and have revised the proposed item to permit an adviser to omit reporting about certain related persons in a manner that is similar to the approach suggested by a commenter.[573] We are neither reducing nor eliminating the disciplinary reporting requirements that we proposed in Item 11, and no commenters suggested that we do so.[574] Although we believe, as noted above, that the information an adviser needs to complete Section 7.B.(1) is readily available in fund offering documents, we acknowledge that this Section of Form ADV could be time-consuming to complete, particularly for an exempt reporting adviser's initial filing, depending on the number of funds the exempt reporting adviser manages. The primarily check-the-box style of this item and most of the other items exempt reporting advisers must complete, as well as some of the features of the IARD (such as drop-down boxes for common responses and the ability to pre-populate responses) should help decrease the average completion time for these advisers. Based on views expressed by some commenters,[575] we expect the changes we are adopting to Section 7.B.(1) (including the removal of some of the questions that commenters identified as most burdensome) that reduce the amount of information

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[571] *See, e.g.*, Shearman Letter.

[572] *See* IAA General Letter.

[573] *See supra* note 300 and accompanying text.

[574] Indeed, one commenter that urged us to substantially reduce the amount of information these advisers are required to report did not advocate to eliminate disciplinary reporting. Village Ventures Letter.

[575] *See supra* note 570.

required in respect of private funds[576] will also alleviate concerns that the reports require too much information or that the requirements will impose excessive burdens.[577]

For purposes of the PRA, we estimate that exempt reporting advisers, in the aggregate, will spend 16,000 hours to prepare and submit their initial reports on Form ADV.[578] Based on this estimate, we expect that exempt reporting advisers will incur costs of approximately $4,064,000 to prepare and submit their initial report on Form ADV.[579] Additionally, for PRA purposes, we estimate that exempt reporting advisers in the aggregate will spend 2,200 hours per year on amendments to their filings and on final filings.[580] Based on this estimate, we expect that exempt reporting advisers will incur costs of approximately $558,800 to prepare and submit annual amendments to their reports on Form ADV and final filings.[581] One commenter argued that these estimates should include costs of retaining outside counsel to review the disclosures.[582] We disagree. Exempt reporting advisers are only required to complete a limited subset of Part 1A of Form ADV. As noted above, this part of the form generally calls for readily available

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576 *See supra* section II.C.1. We are adopting Form ADV with several other changes from the proposal, some of which will affect the reporting by exempt reporting advisers. *See* section II.C. for details concerning these changes to Form ADV.

577 AIMA Letter; Avoca Letter; BCLBE Letter; Shearman Letter; Village Ventures Letter. A broader discussion about the costs associated with Section 7.B.(1) appears below. *See infra* section V.C.3.

578 *See infra* note 738; *infra* section VI.B.1.b.

579 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $235 and $273 per hour, respectively. (8,000 hours x $235 = $1,880,000) + (8,000 hours x $273 = 2,184,000) = $4,064,000. For an exempt reporting adviser that does not already have a senior compliance examiner or a compliance manager, we expect that a person performing a similar function would have similar hourly costs.

580 *See infra* note 744.

581 (1,100 hours x $235 = $258,500) + (1,100 hours x $273 = $300,300) = $558,800.

582 *See* BCLBE Letter.

information to be reported as approximate numerical responses, as short answers, or by checking a box. Unlike Part 2 of Form ADV, which requires free-form narrative responses, we do not believe that advisers will require outside legal advice in order to provide the factual information that Part 1A requires.[583] Commenters who asserted that our estimates were too low did not provide empirical data by which to recalculate our estimates, making it difficult to evaluate these assertions or determine the magnitude by which their estimates would differ from ours.[584] The changes we are making from the proposal will reduce the amount of information that advisers must file and result in decreased burdens for advisers from the proposal. However, in light of the general comments we received about burdens we are not reducing our burden estimates.[585]

In the Implementing Proposing Release we discussed that the reporting requirements we are adopting may result in other non-quantifiable additional costs for exempt reporting advisers. For example, the new disclosure requirements could influence the business or other decisions of exempt reporting advisers, such as whether to form additional private funds or manage private funds at all. In addition, some of the information made available to the public, such as the identification of owners of the adviser or disciplinary information, may impose costs on the

583 Certain items in Part 1A of Form ADV call for information about which an adviser may consult with outside legal counsel, such as the exemption on which the adviser relies (Item 2.B.) or the exemption on which the adviser's private fund relies (Section 7.B.(1) of Schedule D, question 4). These determinations, however, are part of the adviser's compliance burdens associated with and accounted for as a part of other regulatory requirements (*e.g.*, rule 203(m)-1) and are not, therefore, costs associated with the reporting requirements we are adopting today.

584 *See*, *e.g.*, Village Ventures Letter (asserting that the Commission's "relatively modest cost estimates... understate the true costs that will be required to assure compliance..."); AV Letter; Avoca Letter; Debevoise Letter.

585 See *supra* notes 246, 247, 262, 300, 302 and accompanying text for a discussion of these modifications. Some of the estimates provided in this section differ from those provided in the Implementing Proposing Release, but these differences reflect updated information regarding employment costs and the number of advisers subject to the reporting, not a change in the estimated time an adviser would spend on the reporting or the out-of-pocket costs an adviser would incur.

advisers and, in some cases their supervised persons or owners, including the potential loss of business to competitors, as this information was not typically made available to others previously. Commenters neither agreed nor disagreed with these costs.[586]

Several commenters argued that public reporting would be inconsistent with the intent of the Dodd-Frank Act exemptions for these advisers.[587] They did not, however, identify any specific costs associated with these concerns. As discussed above, we do not believe public reporting is inconsistent with the intent of the Dodd-Frank Act. Congress sought to protect only certain proprietary or sensitive information submitted by advisers about their private funds in reports for the assessment of systemic risk.[588]

Some commenters expressed concern that certain of the information we proposed be publicly reported also could include proprietary or competitively sensitive information regarding private funds.[589] One such commenter's competitive concerns related to such things as access to human resource talent among venture capital fund advisers, and composition of a venture capital fund's investor base, control persons and strategic relationships.[590] These commenters, however, did not identify any specific costs associated with these concerns. As discussed elsewhere in this Release, we have responded to these concerns by declining to adopt questions we had proposed

586 Several commenters argued that while the reporting may be valuable to the Commission, making the information publicly available would provide little benefit to investors, and they asserted that the benefits were insufficient to justify the costs. *See* BCLBE Letter; NRS Letter; Seward Letter.

587 Avoca Letter; ABA Committees Letter; Shearman Letter.

588 *See supra* notes 196-197 and accompanying text.

589 *See, e.g.*, MFA Letter; NVCA Letter; O'Melveny Letter. Another commenter, however, refuted these competitive concerns, stating that none of the items that exempt reporting advisers would complete would require the disclosure of proprietary or competitively sensitive information. Merkl Implementing Letter.

590 NVCA Letter. As noted above, while this information could result in competitive effects among these advisers, the effects are not unique to these advisers, and they may result in benefits. *See supra* note 200.

that commenters found most burdensome and persuaded us may likely be proprietary or competitively sensitive.[591]

Finally, some commenters expressed concern that access to this information by the general public may cause confusion because an exempt reporting adviser's information would be displayed using the same search function in the IAPD that is used to search registered advisers.[592] These commenters, however, did not identify any specific costs associated with these concerns. We are working with FINRA, our IARD contractor, to ensure that the IAPD search results distinguish between an exempt reporting adviser and a registered adviser.

Completing and filing Form ADV-H and Form ADV-NR will also impose costs on exempt reporting advisers. In the Implementing Proposing Release, we estimated that approximately two exempt reporting advisers would file Form ADV-H annually and that it would impose an average burden per response of one hour, for an increase in the total annual hour burden associated with Form ADV-H of two hours.[593] We did not receive comments on these estimates and continue to believe they are appropriate. We further estimate that for each hour required by the form, professional staff time will comprise 0.625 hours, and clerical staff time will comprise 0.375 hours. We estimate the hourly wage for a compliance manager to be $273 per hour,[594] and the hourly wage for general clerks to be $50 per hour.[595] Accordingly, we

591 *See supra* notes 238-247 and accompanying text.

592 Shearman Letter; Seward Letter. *See also supra* note 172 and accompanying text.

593 *See* Implementing Proposing Release, *supra* note 7, at sections IV.B, V.F. 2 responses x 1 hour = 2 hours.

594 Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a compliance manager is approximately $273 per hour.

595 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a general clerk is approximately $50 per hour.

estimate the average cost per response imposed on exempt reporting advisers by rule 204-4 and amended Form ADV-H will be $189,[596] for a total annual cost of $378.[597] This represents a decrease of $28 from our estimate in the Implementing Proposing Release, which is attributable to updated wage and salary information.

With regard to Form ADV-NR, we continue to estimate that exempt reporting advisers will file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[598] Thus, we estimate that the amendments will be filed by approximately three exempt reporting advisers annually,[599] imposing an annual burden of approximately three hours.[600] We further estimate that for each hour required by the form, compliance clerk time will comprise 0.75 hours and general clerk time will comprise 0.25 hours.[601] Therefore, we estimate that the amendments to Form ADV-NR will impose approximately $188 in total additional annual costs for exempt reporting advisers.[602] This represents an increase from our estimate in the Implementing Proposing Release, which is attributable to updated wage and salary information.

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596 (0.625 hours x $273) + (0.375 hours x $50) = approximately $189.

597 $189 per response x 2 responses annually = $378.

598 *See infra* text accompanying note 776.

599 0.17% (rate of filing) x 2,000 estimated exempt reporting advisers = 3 exempt reporting advisers filing Form ADV-NR.

600 3 exempt reporting advisers filing Form ADV-NR x 1 hour per Form ADV-NR = approximately 3 hours. In calculating the costs of our amendments to Form ADV-NR in the Implementing Proposing Release, we subtracted cost savings resulting from the Dodd-Frank Act's reduction in the number of total registered advisers (and the commensurate reduction in Form ADV-NR filings) from the total costs associated with completing and filing Form ADV-NR. *See* Implementing Proposing Release, *supra* note 7, at section IV.B. We now believe, however, that it is more accurate to calculate the costs of our amendments to Form ADV-NR without subtracting these savings directly attributable to the Dodd-Frank Act.

601 Data from the SIFMA Office Salaries Report, modified to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits and overhead, suggest that the cost for a General Clerk is approximately $50 per hour and cost for a Compliance Clerk is approximately $67 per hour.

602 3 hours x ((0.75 hours x $67) + (0.25 hours x $50)) = approximately $188.

3. Form ADV Amendments

The costs of completing these new and amended items will vary among advisers.[603] One-time monetary costs we expect certain current registrants to incur to complete the amendments we are adopting to Form ADV in connection with the transition filing are discussed above, but that discussion does not take into account costs we expect to be borne by (1) 7,600 current registrants with a December 31 fiscal year end that we expect to remain registered with us,[604] or (2) 700[605] advisers we expect will register with us within the next year as a result of normal annual growth of our population of registered advisers.[606] We estimate these 8,300 advisers will spend, on average, 4.5 hours to respond to the new and amended questions we are adopting today

603 We note that we do not estimate there to be costs associated with the technical amendment we are making to Form ADV-E to reflect the obligation that the accountant's report be filed electronically because those costs were addressed in the 2009 Custody Release. Staff notified advisers in November 2010 that the IARD system had been programmed to accept Form ADV-E. *See* 2009 Custody Release, *supra* note 310 at n.53 and accompanying text (establishing the requirement for Form ADV-E to be filed electronically, explaining that accountants performing surprise examinations should continue paper filing of Form ADV-E until the IARD system is programmed to accept Form ADV-E, and noting that advisers would be informed when that programming was completed).

604 *See supra* note 511.

605 *See infra* note 691.

606 Of the 9,750 advisers we estimate will remain registered or will be newly registered with us after the transition filing, the one-time monetary costs of filing Form ADV that we estimate will be borne by approximately 700 advisers with a fiscal year end other than December 31 are discussed above in section V.B.1. The one-time monetary costs that we estimate will be borne by the remaining 9,050 advisers are discussed here (8,300 discussed in this paragraph + 750 discussed in the next). For a discussion of our PRA estimate of 9,750 advisers, see note 655 below and section VI.B.2.a.i. below.

(other than the private fund reporting, which is discussed below),[607] at an aggregate cost of $9,486,900.[608]

In our PRA analysis, we also project that 750 new advisers will register with us as a result of the Dodd-Frank Act's elimination of the private adviser exemption.[609] Because this group of advisers was not formerly required to register with us, we have not previously accounted for the costs to them of completing and submitting Form ADV. As a result, rather than the incremental burden of 4.5 hours per adviser used in our estimates above, we expect that these advisers will spend the full 40.74 hours per adviser filing their initial reports on Form ADV (other than the private fund reporting, which is discussed separately below).[610] These advisers will also spend time preparing and filing interim updating amendments to the form, preparing brochure supplements and delivering codes of ethics to clients. In the aggregate, we expect that

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607 *See infra* section VI.B.1.a. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments we are adopting today would neither increase the burden associated with the other items on Form ADV, nor would they increase the external costs associated with certain Part 2 requirements.

608 We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $235 and $273 per hour, respectively. 8,300 advisers x 4.5 hours = 37,350 hours. (18,675 hours x $235 = $4,388,625) + (18,675 hours x $273 = $5,098,275) = $9,486,900.

609 *See* Implementing Proposing Release, *supra* note 7, at n.375 and accompanying text.

610 *See infra* IV.B.1. of this Release.

these 750 private fund advisers will spend 37,905 hours on these activities,[611] for a total cost of $9,627,871.[612]

Commenters that addressed burdens associated with amendments to Form ADV (other than private fund reporting discussed separately below) focused on costs associated with gathering information necessary to complete proposed Item 5.D. and Section 7.A. of Schedule D.[613] These commenters did not specifically address our estimates or provide empirical data by which to recalculate these estimates. We are making changes from the proposal that will reduce the amount of information that advisers must file and result in decreased burdens for advisers from the proposal.[614] However, in light of the general comments we received about burdens we are not reducing our burden estimates.

In addition to the costs to complete Form ADV for which we account above, some registered advisers will be required to file information regarding the private funds they advise. Specifically, filings will be required by: (i) 2,850 of the 7,600 current registrants with a December 31 fiscal year end that we expect to remain registered with us;[615] (ii) 200 of the 700 advisers we expect will register with us within the next year as a result of normal annual growth of our population of registered advisers;[616] and (iii) 750 private fund advisers registering as a

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611 750 advisers x (40.74 hours per adviser to complete entire form (except private fund reporting requirements) + (1 annual updating amendment x 6.0 hours) + (1 interim updating amendment per year x 0.5 hours) + 1 hour on new brochure supplements + 1 hour on interim amendments to brochure supplements + 1.3 hours delivering codes of ethics to clients) = 37,905 hours. *See infra* notes 679, 709, 710 and accompanying text.

612 (18,952.5 hours x $235 = $4,453,838) + (18,952.5 hours x $273 = $5,174,033) = $9,627,871. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 608.

613 *See, e.g.*, IAA General Letter; Shearman Letter.

614 *See supra* sections II.C.2 and II.C.3.

615 *See infra* note 696.

616 *See infra* note 699.

result of the elimination of the private adviser exemption. We estimate this will take 33,500 hours[617] for a total cost of $8,509,000.[618] Most of the commenters that addressed Form ADV costs focused on these private fund reporting requirements, particularly where valuation or ownership information would be required.[619] Several commenters wrote that the burden of the proposed reporting would be significant.[620] As a whole, these commenters suggested that the costs of the proposed amendments would outweigh the benefits, but only a few disagreed with the Commission's estimates of those costs, which they considered too low.[621] Although we believe, as noted above, that the information an adviser needs to complete Section 7.B.(1) is readily available in fund offering documents, we acknowledge that this Section of Form ADV could be time-consuming to complete, particularly for an adviser's initial filing, depending on the number of funds the adviser manages. The primarily check-the-box and short-answer style of Section 7.B.(1), as well as some of the features of the IARD (such as drop-down boxes for common responses and ability to pre-populate responses) should help to decrease the average completion time for these advisers. Based on views expressed by some commenters,[622] we expect these factors will alleviate concerns of other commenters, who argued that the reports

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617 *See infra* note 703.

618 (16,750 hours x $235 = $3,936,250) + (16,750 hours x $273 = $4,572,750) = $8,509,000. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 608.

619 *See* AIMA Letter; Avoca Letter; BCLBE Letter; Shearman Letter; Village Ventures Letter.

620 *See, e.g.*, AIMA Letter; AV Letter; BCLBE Letter; Debevoise Letter; Dechert Foreign Adviser Letter; Gunderson Letter; Katten Foreign Adviser Letter; NRS Letter; Seward Letter; Shearman Letter; VVL Letter. Several of these commenters were writing with respect to exempt reporting adviser reporting, but some of their comments would apply equally to registered advisers. *See supra* Section V.B.2. for a discussion of the estimated costs of reporting for exempt reporting advisers.

621 *Id.*

622 *See supra* note 570.

require too much information or that the requirements would impose significant burdens.[623] In addition, as discussed above, we are adopting Section 7.B.(1) with several changes (including the removal of some of the questions that commenters persuaded us may likely be proprietary or competitively sensitive) that reduce the amount of information required in respect of private funds.[624]

Based on the foregoing estimates, we expect that the total costs associated with the completion and submission of all of the amendments we are adopting to Form ADV, other than estimated costs above related to the transition described below,[625] therefore, are $27,623,771.[626]

In addition, we estimate for purposes of the PRA that approximately a quarter (or 350) of the 1,450 advisers estimated to register with us as a result of normal annual growth and as a result of the elimination of the private adviser exemption will use outside legal services, and half (or 725) will use outside compliance consulting services, to assist them in preparing their Part 2 brochures, for a total cost of $1,540,000, and $3,625,000, respectively, resulting in a total non-labor cost among all these newly registering advisers of $5,165,000.[627]

A few commenters objected to the amount of information required by Form ADV as a result of the amendments we proposed and suggested streamlining the form or eliminating what

623 AIMA Letter; Avoca Letter; BCLBE Letter; Shearman Letter; Village Ventures Letter.

624 *See* section II.C.1.

625 *See* section V.B.1.

626 $9,486,900 in one-time monetary costs of complying with amendments we are adopting today for current registrants and newly registering advisers as a result of normal growth + $9,627,871 in costs of completing and filing Form ADV (other than private fund reporting) for the 750 newly registering private fund advisers as a result of the elimination of the private adviser exemption + $8,509,000 in aggregate private fund reporting costs attributable to the foregoing filers = $27,623,771.

627 *See infra* note 732 an accompanying text. The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants, and it already accounts for a percentage of annual growth in our population of registered advisers. *See also infra* section VI.B.2.iv.

they saw as duplicative reporting.[628] We acknowledge some overlap in information required to be reported, but note that the two parts of Form ADV serve different purposes and that overlap in some cases may be necessary so that investors receiving a brochure are provided with full information about a practice or conflict, and that we are able to collect data on the matter for regulatory purposes. We believe that the information required by most of these items should be readily available to any adviser, and several commenters confirmed our belief.[629] The check-the-box style of most of these items, as well as some of the features of the IARD (such as drop-down boxes for common responses) should also help minimize costs by reducing the average completion time. The changes we are making from the proposal will, as a whole, reduce the amount of information that advisers must file and result in decreased burdens for advisers.[630] However, in light of the general comments we receive about burdens we are not reducing our burden estimates.

The amendments to Form ADV that we are adopting will also result in other costs, none of which commenters specifically addressed. For instance, changes to the instructions on calculating regulatory assets under management, and rule 203A-3(d), will cause some advisers to report greater assets under management than they do today and preclude some advisers from excluding certain assets from their calculation in order to remain below the new asset threshold

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628 *See* IAA General Letter (citing page 48 of the Implementing Proposing Release and stating that it "do[es] not agree that the new requirements 'should impose few additional regulatory burdens.'"). *See also* NRS Letter and Seward Letter, arguing that parts of the proposed amendments would result in duplicative reporting.

629 *See, e.g., supra* note 570.

630 *See supra* notes 245-247, 262, 286, 300, 302 and accompanying text for a discussion of these modifications. Some of the estimates provided in this section differ from those provided in the Implementing Proposing Release, but these differences reflect updated information regarding employment costs and the number of advisers subject to the reporting, not a change from the proposed estimate of time an adviser would spend on the reporting or the out of pocket costs an adviser would incur.

for registration with the Commission. The impact of these changes may result in a limited number of state-registered advisers that report assets under management of less than $30 million under the current Form ADV reporting requirements to register with us if, under the revised instructions, they would report $100 million or more in assets under management.[631]

We are also amending Form ADV to require advisers to private funds to use the market value of private fund assets, or the fair value of private fund assets where market value is unavailable, for determining regulatory assets under management.[632] Advisers to private funds that do not use fair value methodologies will likely incur costs to comply with the requirement to report the fair value of those assets on Form ADV, which could (but is not required to) include reliance on a third party or outside valuation service. We anticipate that these costs will vary, but we understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a matter of business practice.[633] Based on registered advisers' responses to Items 5.D., 7.B., and 9.C. of Form ADV,[634] we estimate that approximately 3% of registered advisers

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631 A registered investment adviser that reports more than $30 million in assets under management under the current instructions to Item 5 of Form ADV would be required to register with the Commission. These advisers would not have additional costs associated with registration as they would already be incurring those costs.

632 *See* Form ADV: Instructions for Part 1A, inst. 5.b.(4).

633 For example, an adviser to a hedge fund may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to a private equity fund may obtain valuation of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement with respect to private fund assets.

634 Item 5.D. asks advisers to identify the types of clients they have, including clients that are pooled investment vehicles. Item 7.B. asks if the adviser or its related person is a general partner in an investment-related limited partnership or manager of an investment-related limited liability company, or if the adviser advises any other "private fund." Item 9.C. asks whether an

have at least one private fund client that may not be audited.[635] These advisers therefore may incur costs to fair value their private fund assets.[636] We estimate that approximately 4,270 registered advisers have, or after registering with us will have, at least one private fund client.[637] We therefore estimate that approximately 130 registered advisers may incur costs as a result of the fair value requirement.[638] We estimated in the Implementing Proposing Release that an adviser without the internal capacity to value specific illiquid assets would obtain pricing or valuation services from an outside administrator or other service provider at a cost ranging from $250 to $75,000 annually.[639] Commenters did not address these estimates and for reasons discussed above, we continue to believe they are accurate.[640] Accordingly, we estimate that the 130 advisers would incur costs of $37,625 each on an annual basis, which is the middle of the range of estimated fair value costs, for an aggregate annual cost of $4,891,250.[641]

Requiring advisers to report whether they have $1 billion or more in assets also may have costs for advisers that are not publicly traded or otherwise do not publicly disclose the amount of

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independent public accountant audits annually the pooled investment vehicles that the adviser manages and if audited financial statements are distributed to investors in the pools.

635 A fund that is relying on the audit provision in our custody rule will have provided the fair value of its assets in its audited financial statements that are prepared in accordance with GAAP.

636 We note, however, that at least some of these advisers may currently fair value private fund assets. For instance, funds that do not prepare financial statements in accordance with GAAP (which is required to rely on an exception in our custody rule) may nonetheless use a fair value standard other than that specified in GAAP and thus may not incur any additional costs. *See supra* notes 98-99 and accompanying text (explaining that while many advisers will calculate fair value in accordance with GAAP or another international accounting standard, other advisers acting consistently and in good faith may utilize another fair valuation standard).

637 Based on IARD data as of April 7, 2011. 3,320 current SEC-registered advisers to private funds remaining registered with the SEC + 750 newly registering private fund advisers as a result of the elimination of the private adviser exemption + 200 additional advisers to private funds each year = 4,270 advisers.

638 4,270 x 0.03 = 128.1.

639 *See* Implementing Proposing Release, *supra* note 7, at n.369 and accompanying text.

640 *See supra* section II.A.3.

641 130 x $37,625 = $4,891,250.

their own assets. There may also be, as discussed below, competitive effects of this change and other of the amendments to Form ADV. We believe these changes will have little, if any, effect on capital formation.

In addition, some of the amendments to Form ADV could impose costs, including potential competitive effects, as information that may not typically be provided to others becomes publicly available. For example, for advisers that may previously have only disclosed to certain clients and prospective clients, or only upon request, information such as census data about the private funds and the amount of private fund assets that the adviser manages, disclosure of state registrations of the adviser's employees, financial industry affiliates, and the service providers to each private fund that the adviser manages could be costly. As noted above, some commenters voiced these types of concerns with respect to private fund disclosures they consider competitively sensitive or proprietary.[642] As also discussed above, we have adopted certain modifications from our proposal that are designed to address some of these concerns.[643] The competitive effects of Form ADV reporting requirements, however, could create benefits as well as costs. For instance, unregistered advisers will not incur the expense of producing and reporting publicly this information, but clients and investors may have greater confidence in advisers that provide more fulsome disclosure and are subject to our oversight.

4. Amendment to Pay to Play Rule

Our amendment to include registered municipal advisors in the definition of "regulated persons" excepted from the pay to play rule's ban on third-party solicitation may result in

642 *See supra* note 238 and accompanying text.

643 *See supra* notes 245-247 and accompanying text.

additional costs to comply with the rule.[644] Specifically, advisers that have created compliance programs based on the original "regulated person" definition, which included only registered investment advisers and broker-dealers, may have to make adjustments to those programs to account for the broadened definition. But, as explained above, our amendment will allow them greater latitude in hiring placement agents.

As discussed in section II.D.1 of this Release, we received a number of comment letters opposing our proposal to replace the exception for "regulated persons" with an exception for registered municipal advisors.[645] Among other things, commenters argued that the amendment would force persons soliciting only on behalf of affiliated investment advisers to register as municipal advisors, which they argued would subject them to regulatory requirements unrelated to pay to play practices and thus impose significant additional and unnecessary costs.[646] We are persuaded by commenters and have instead modified the definition of "regulated person" to include registered municipal advisors, which we believe is a lower-cost means to recognize this new category of registrant in our rule.

5. Advisers Previously Exempt under Section 203(b)(3)

The transition provision in rule 203-1(e) for advisers exempt under the private adviser exemption will impose costs. It will delay the public disclosure of information about these advisers on Form ADV. As such, current clients and potential clients will not have access to this

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644 *See* amended rule 206(4)-5(a)(2), (f)(9). As discussed in section V.A.4., we believe that our amendment to rule 206(4)-5 to make it apply to exempt reporting advisers and foreign private advisers will not generate new costs.

645 *See* Better Markets Letter; Debevoise Letter; Dechert General Letter; IAA Pay to Play Letter; ICI Letter; NYSBA Letter; SIFMA Letter; T. Rowe Price Letter. *But see* NRS Letter (supporting the proposal).

646 *See, e.g.*, IAA Pay to Play Letter; SIFMA Letter. *See also supra* section II.D.1.

information as quickly as they would without the transition period.[647] In addition, rule 203-1(e) will delay the deadline for these advisers to comply with all of our rules under the Advisers Act applicable to registered advisers, and thus will delay the full protection of these rules for clients and potential clients. However, we believe that providing a short transition period to effect an orderly transition to registration and full compliance for these advisers is appropriate. Furthermore, notwithstanding the transition period, these advisers continue to be subject to the Adviser's Act's antifraud provisions.[648]

VI. PAPERWORK REDUCTION ACT ANALYSIS

Certain provisions of the rules and rule amendments that the Commission is adopting today contain "collection of information" requirements within the meaning of the PRA. In the Implementing Proposing Release, the Commission solicited comment on the proposed collection of information requirements. The Commission also submitted the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The titles for the collections of information we are adopting or amending are: (i) "Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(d));"[649] (ii) "Form ADV"; (iii) "Rule 203A-5;" (iv) "Rule 0-2 and Form ADV-NR under the Investment Advisers Act of 1940;" (v) "Rule 203-2 and Form ADV-W under the Investment Advisers Act of

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647 We note, however, that the IARD system will not be updated to reflect our revisions to Form ADV, including the amendments requiring additional disclosure about private funds, until November. *See infra* note 759. Thus, even without regard to rule 203-1(e), disclosure of this information would be delayed.

648 *See, e.g.*, Advisers Act section 206. They are also subject to antifraud provisions of other federal securities laws, including rule 10b-5 under the Securities Exchange act of 1934. *See* 17 CFR 240.10b-5.

649 The current title for this collection of information is "Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(e))" which we are re-titling "Exemption for Certain Multi-State Investment Advisers (Rule 203A-2(d))" to reflect the renumbering of this provision.

1940;" (vi) "Form ADV-H;"[650] and (vii) "Rule 204-2 under the Investment Advisers Act of 1940."[651] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

While our new rules and rule amendments will impose new collection of information burdens for certain advisers and change existing burdens on advisers under our rules, the Dodd-Frank Act also will impact our total burden estimates for certain of our rules, principally by changing the number of advisers subject to these rules. Specifically, we estimate the Dodd-Frank Act's amendments to section 203A to reallocate regulatory responsibility over numerous registered advisers to the states will result in approximately 3,200 registered advisers switching from Commission to state registration.[652] At the same time, we estimate that the Dodd-Frank Act's elimination of the private adviser exemption in section 203(b)(3) of the Advisers Act will result in approximately 750 additional private fund advisers registering with the Commission.[653] Based on IARD data as of April 7, 2011, we estimate that approximately 11,500 advisers are currently registered with the Commission. We further estimate that approximately 700

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650 The current title for the collection of information on Form ADV-H is "Rule 203-3 and Form ADV-H under the Investment Advisers Act of 1940" because currently only registered advisers file Form ADV-H under rule 203-3. However, because we are proposing to amend Form ADV-H to allow exempt reporting advisers to apply for a temporary hardship exemption on Form ADV-H under rule 204-4, we are re-titling the collection of information simply "Form ADV-H."

651 We note that the PRA analysis associated with the requirement that an accountant's report be filed electronically was included in our adoption of substantive amendments to that form. Today, we are making only a technical amendment to Form ADV-E to conform to that prior rulemaking. *See* 2009 Custody Release, *supra* note 310 at section IV.C.

652 *See supra* section II.A. (discussing the Dodd-Frank Act's amendments to section 203A). Based on IARD data as of April 7, 2011, we estimate that approximately 3,200 will switch to state registration because they have assets under management of less than $90 million. This estimate includes approximately 5 advisers that will switch to state registration because they are relying on the registration of an affiliated adviser with the same principal office and place of business that will be switching to state registration. *See supra* note 422.

653 *See* Exemptions Adopting Release at section I. (discussing elimination of the private adviser exemption in section 203(b)(3)).

additional advisers register with the Commission each year.[654] Therefore, for purposes of calculating the burdens of our proposed rules and amendments under the PRA, we estimate that the number of advisers registering with the Commission after the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) become effective will be approximately 9,750.[655]

A. Rule 203A-2(d)

Rule 203A-2(d), as amended, exempts certain multi-state investment advisers from section 203A's prohibition on registration with the Commission. We have renumbered and amended the exemption to permit all investment advisers who are required to register as an investment adviser with 15 or more states to register with the Commission, rather than 30 states, as currently required.[656] An adviser relying on this exemption is required to maintain in an easily accessible place a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register for a period of not less than five years from the filing of a Form ADV relying on the rule.[657] We submitted this collection of information to OMB for review, and OMB has not yet assigned this collection a control number.

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654 Over the past several years, approximately 1,000 new advisers have registered with us annually. Due to the Dodd-Frank Act's reallocation of regulatory responsibility for advisers with assets under management of less than $100 million, we estimate that approximately 700 new advisers will register with us annually based on reducing the current growth rates by the gross reduction in the number of advisers due to the Dodd-Frank Act. (3,200 (SEC advisers withdrawing) / 11,500 (total SEC advisers)) x 1000 (number of new advisers each year) = 0.28 x 1000 = 280 (number of additional new advisers registering with the states, not the SEC). 1000 - 280 = 720. We have rounded this number to 700 for purposes of our analysis.

655 11,500 (total SEC advisers) – 3,200 (SEC advisers withdrawing) + 750 (private advisers registering with the SEC) + 700 (new SEC advisers each year) = 9,750.

656 *See* amended rule 203A-2(d).

657 *See* amended rule 203A-2(d)(3). An investment adviser relying on this exemption also will continue to be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has reviewed applicable law and concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake on Schedule D to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser will be required by the laws of fewer than 15 states to

Respondents to this collection of information will be investment advisers who would be required to register in 15 or more states absent the exemption (that rely on amended rule 203A-2(d) to register with the Commission). This collection of information is mandatory for those advisers. The records kept by investment advisers in compliance with the rule are necessary for the Commission staff to use in its examination and oversight program, and the information in these records generally will be kept confidential.[658]

The amendments to the rule that we are adopting today do not differ from our proposed amendments. Commenters did not discuss the rule's collection of information requirements, but generally agreed with our proposal to align our multi-state exemption for small advisers with the statutory exemption for mid-sized advisers.[659] A few, however, recommended a lower threshold of required state registrations for eligibility for the multi-state exemption,[660] but we have determined not to lower the threshold further in light of the Congressional determination to set the threshold at 15 states and our stated purpose to align the rule with the Dodd-Frank Act.[661]

In the Implementing Proposing Release, the Commission estimated that approximately 150 advisers would rely on the exemption.[662] As of April 7, 2011, there were approximately 40 advisers relying on the multi-state exemption.[663] Although it is difficult to determine a precise number of advisers that will rely on the exemption as amended because such reliance is entirely

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register as an investment adviser with the state. *See* amended rule 203A-2(d)(2). The increase in the PRA burden for Form ADV reflects these requirements. *See infra* section VI.B.

658 *See* section 210(b) of the Advisers Act.

659 *See* NASAA Letter; NEA Letter; NRS Letter; Pickard Letter; Seward Letter; Shearman Letter.

660 *See* NEA Letter; Seward Letter; Shearman Letter.

661 *See supra* note 136.

662 *See* Implementing Proposing Release, *supra* note 7, at n.382.

663 Based on IARD data as of April 7, 2011, of the approximately 11,500 SEC-registered advisers, 40 checked Item 2.A.(9) of Part 1A of Form ADV to indicate their basis for SEC registration under the multi-state advisers rule.

voluntary, we estimate that approximately 155 advisers will rely on the exemption.[664] These advisers will incur an average one-time initial burden of approximately 8 hours, and an average ongoing burden of approximately 8 hours per year, to keep records sufficient to demonstrate that they meet the 15-state threshold. These estimates are based on an estimate that each year an investment adviser will spend approximately 0.5 hours creating a record of its determination whether it must register as an investment adviser with each of the 15 states required to rely on the exemption, and approximately 0.5 hours to maintain these records.[665] Accordingly, the revised total initial and annual burden of the recordkeeping requirements of rule 203A-2(d) will be 1,240 hours (an additional 920 hours).[666]

B. Form ADV

Form ADV (OMB Control No. 3235-0049) is the two-part investment adviser registration and exempt adviser reporting form. Part 1 of Form ADV contains information designed for use by Commission staff, and Part 2 is the client brochure. We use the information collected on Form ADV to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or

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664 Based on IARD data as of April 7, 2011, 100 of the advisers that have less than $90 million of assets under management currently file notice filings with 15 or more states. This number may overestimate the number of advisers required to be registered with 15 or more states, and therefore eligible for the amended multi-state exemption, because notice filing requirements may differ from registration requirements. In addition, we are unable to determine the number of advisers currently registered with the states that are registered with 15 or more states that may rely on the exemption and register with us. We expect this number to be small based on the scope of business of an adviser that has less than $25 million in assets under management and because section 222(d) of the Advisers Act provides a de minimis exemption for limited state operations without registration. For purposes of this analysis, we estimate the number is 15. As a result, we estimate that approximately 155 advisers will rely on the exemption (40 currently relying on it + estimated 100 eligible based on IARD data + 15 advisers required to be registered in 15 or more states that are not registered with us today).

665 0.5 hours x 15 states = 7.5 hours + 0.5 hours = 8 hours.

666 155 advisers relying on the exemption x 8 hours = 1,240 hours. 1,240 new burden hours – 320 current burden hours = 920 additional burden hours.

retain an adviser. Rule 203-1 requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-4 requires exempt reporting advisers to file reports with the Commission by completing a limited subset of items on Form ADV. Rule 204-1 requires each registered and exempt reporting adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through the IARD. These collections of information are found at 17 CFR 275.203-1, 275.204-1, 275.204-4, and 279.1 and are mandatory. The paperwork burdens associated with rules 203-1 and 204-1 are, and the paperwork burdens associated with rule 204-4 will be, included in the approved annual burden associated with Form ADV and, thus, do not entail separate collections of information. Responses are not kept confidential. The respondents to this information collection are investment advisers registered or applying for registration with us and exempt reporting advisers.

As discussed above, in order to give effect to provisions in Title IV of the Dodd-Frank Act, we are amending Part 1A of Form ADV to reflect the new statutory threshold for registration with the Commission and to accommodate filings by exempt reporting advisers. In addition, to enhance our ability to oversee investment advisers, we are amending Part 1A of Form ADV to require advisers to provide us additional information regarding: (i) the private funds they advise; (ii) their advisory business and business practices that may present significant conflicts of interest; and (iii) their non-advisory activities and financial industry affiliations.[667] We are also adopting certain additional amendments intended to improve our ability to assess compliance risks and to enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act, which addresses certain incentive-based compensation arrangements.

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[667] *See supra* section II.C. In addition, we are adopting several clarifying or minor amendments based on frequently asked questions we receive from advisers and our experience administering the form.

The currently approved total annual burden of completing, amending, and filing Parts 1 and 2 of Form ADV is 268,457 hours.[668] The currently approved burden is based on an average total hour burden of 36.24 hours per adviser for the first year that an adviser completes Form ADV. The currently approved total annual cost burden for Form ADV is $22,775,400, consisting of costs for outside legal and consulting services associated with initial preparation of Part 2.[669]

The amendments we are adopting will increase the information requested in Part 1A of Form ADV, and we expect that this will correspondingly increase the average burden to an adviser filing Form ADV. As we explained in the Implementing Proposing Release, however, we expect that the total annual burden associated with Form ADV will experience a net decrease because the reduction in burden resulting from the decrease in the number of respondents that are registered advisers will have a greater effect on the total burden than the increase resulting from the use of the form by exempt reporting advisers and the additional information required by the amendments to the form.[670] We provided initial estimates of the revised burdens and requested comment on these estimates and our initial PRA analysis in the Implementing Proposing

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668 *See* section VI of the Part 2 Release at notes 341 and 342 and accompanying text. The approved burden is comprised of 12,658 advisers preparing an initial filing of Form ADV at 36.24 hours, which is amortized over a three-year period (the estimated period that advisers are expected to use Form ADV) for an annual burden of 152,909 hours. The burden also includes two amendments to Form ADV annually, one annual amendment and one other-than-annual amendment, for an annual burden of 87,435 hours; an annual burden of 11,658 hours to account for new brochure supplements that advisers are required to prepare; and 16,455 hours attributable to the obligation to deliver to clients codes of ethics upon request.

669 These costs are expected to vary based on the size of the adviser, and we have assumed that fewer than all advisers will use these services in connection with preparing their initial Part 2 brochures. For outside legal services, ($4,400 x 535 medium advisers) + ($3,200 x 2,370 small advisers)) + ($10,400 x 36 large advisers) = $ 10,312,400. For compliance consulting services, ($3,000 x 2,371 small advisers) + ($5,000 x 1,070 medium advisers) = $12,463,000. $10,312,400 + $12,463,000 = $22,775,400. *See* Part 2 Release, *supra* note 668, for a discussion of these estimates.

670 *See* Implementing Proposing Release, *supra* note 7, at section V.B.

Release.[671] As discussed in detail in sections II.B., II.C., V.A.2., V.A.3., V.B.2 and V.B.3. of this Release, we received a number of comments that addressed whether the amendments to the collection of information are necessary for the proper performance of our functions, whether there are ways to enhance the quality, utility, and clarity of the information to be collected, and whether we could further minimize the burden. Only a few commenters addressed the accuracy of our burden estimates for the proposed collection of information, and suggesting in general terms that our estimates were too low.[672] These commenters did not provide empirical data or suggest alternatives by which to recalculate our estimates, making it difficult to evaluate these assertions or determine the magnitude by which their estimates differ from ours.

To address these and other comments we received, we are adopting Form ADV with a number of changes that improve the clarity and utility of the information collected and reduce the amount of information required by the amendments.[673] Many of these changes include removing or re-formulating proposed questions that commenters identified as most burdensome.[674] We continue to believe that the check-the-box style of most of the Form ADV items, as well as some of the features of the IARD (such as drop-down boxes for common responses and the ability to pre-populate data), will mitigate the reporting burden, and several commenters confirmed our assumption that much of the information required by the amendments should be readily available to most advisers.[675] The changes we are making from the proposal will reduce the amount of information that advisers must file and result in decreased burdens for

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671 *Id.*

672 AIMA Letter; BCLBE Letter; Gunderson Letter; IAA General Letter. *See also supra* notes 577, 584, 613, 619 and 620.

673 *See* section II.C.

674 *See supra* notes 245-247, 262, 286, 300, 302 and accompanying text.

675 *See supra* note 570.

advisers from the proposal. However, in light of the general comments we received about burdens, we are also not reducing our burden estimates.[676]

We discuss below, in three sub-sections, the estimated revised collection of information requirements for Form ADV: first, we provide estimates for the revised and new burdens resulting from the amendments to Part 1A; second, we determine how those estimates will be reflected in the annual burdens attributable to Form ADV; and third, we calculate the total revised burdens associated with Form ADV.

1. Changes in Average Burden Estimates and New Burden Estimates

a. Estimated Change in Burden Related to Part 1A Amendments (Not Including Private Fund Reporting)

We are adopting amendments to several items in Part 1A, some that are merely technical changes or very simple in nature, and others that will require more of an adviser's time. The paperwork burdens of filing an amended Part 1A of Form ADV will, however, vary among advisers, depending on factors such as the size of the adviser, the complexity of its operations, and the number or extent of its affiliations. Although burdens will vary among advisers, we believe that the revisions to Part 1A will impose few additional burdens on advisers in collecting information because advisers should have ready access to all the information necessary to respond to the revised items in their normal course of operations. We also are working with FINRA, as our IARD contractor, to implement measures intended to minimize the burden for advisers filing the amended Form ADV on the IARD (*e.g.*, pre-populating fields and drop-down boxes for common responses). We anticipate, moreover, that the responses to many of the

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676 Some of the estimates provided in this section differ from those provided in the Implementing Proposing Release, but these differences reflect updated information regarding employment costs and the number of advisers subject to the reporting, not a change to the proposed estimate of time an adviser would spend on the reporting or the out-of-pocket costs an adviser would incur.

questions are unlikely to change from year to year, minimizing the ongoing reporting burden associated with these questions.

As we explained in the Implementing Proposing Release, in large part, the changes we are making to Part 1A of Form ADV, including those to account for the statutory increase in the threshold for Commission registration, primarily refine or expand existing questions or request information advisers already have for compliance or fund offering purposes. For instance, some of the changes to Item 5 require advisers to provide numerical responses to certain questions about their employees. An adviser likely already had this information in order to respond to those questions in the previous version of the form by checking boxes that correspond to a range of numbers. Likewise, the amendments to Item 8 require an adviser to expand on information it provided in response to Item 8 in the previous version of the form, such as whether the broker-dealers the adviser recommends or has discretion to select for client transactions are related persons of the adviser. Other questions expand upon existing requirements to elicit information advisers already have available for compliance purposes, such as whether the soft dollar benefits they reported receiving under the previous version of Item 8 qualify for the safe harbor under section 28(e) of the Exchange Act for eligible research or brokerage services. As amended, Item 2 requires an adviser to report to us its basis for registration or reporting, as already determined for compliance purposes. Other amendments to Items 5, 6 and 7 expand lists of information advisers already provided to us on the previous version of Form ADV, such as types of advisory activities the advisers perform and other types of business engaged in by advisers and their related persons. Amendments to Item 9 better align the information required to be reported with information advisers have for purposes of complying with rule 206(4)-2. Finally, we believe that several of the new questions merely require advisers to provide readily available or easily accessible information.[677]

We anticipate that other amended questions may take longer for advisers to complete, even with readily available information, such as calculating regulatory assets under management according to our revised instruction. Other new items will likely present greater burdens for some advisers but not others, depending on the nature and complexity of their businesses, such as the requirement to provide a list of the Commission file numbers of investment companies they advise or providing expanded information about related person financial industry affiliates.[678]

We estimate that these amendments, taken as a whole, will require an average of approximately 4.5 hours per adviser to complete. We have arrived at this estimate, in part, by comparing the relative complexity and availability of the information elicited by the amended items and the nature of the response required (*i.e.*, checking a box as opposed to providing a narrative response) to the current form and its approved burden. As a result, we estimate that the average total collection of information burden will increase to 40.74 hours per adviser for the first year that an adviser completes Form ADV (Part 1 and Part 2).[679]

b. New Estimated Burden Related to Private Fund Reporting Requirements

Revised Item 7.B. and Section 7.B. of Schedule D will provide us with basic census data on private funds and will permit us to conduct a more robust risk assessment of private fund

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677 For example, Item 1 requires advisers to provide contact information for their Chief Compliance Officers and report whether they have $1 billion or more in assets; Item 3 requires advisers to indicate their form of organization. *See supra* section II.C.6.

678 Advisers may, however, omit certain related persons from their Schedule D reporting requirements in accordance with our revised instruction. We expect this change from the proposal will significantly reduce burdens associated with this item. *See supra* note 300.

679 Current approved per adviser total (36.24) + estimated per adviser increase (4.5) = 40.74.

advisers for purposes of targeting our examinations. As discussed in the Implementing Proposing Release, the information will include fund data such as basic organizational, operational, and investment characteristics of the fund; the gross amount of assets held by the fund; and the fund's service providers, or gatekeepers. We believe much of this information is readily available to private fund advisers because, among other things, it is information that private fund investors commonly seek in their due diligence questionnaires or it is the kind of information that is often included in a private placement memorandum offering fund shares, and commenters confirmed our understanding.[680]

Although we understand that the required information is readily available to private fund advisers, we expect that these amendments could subject advisers, particularly those with many private funds, to a significantly increased paperwork burden. For this reason, as we explained in the Implementing Proposing Release, we have included several measures to minimize the increased burden associated with private fund reporting. First, an adviser will be permitted to exclude from its reporting on Section 7.B.(1) of Schedule D any private fund for which another adviser is filing Section 7.B.(1).[681] Second, an adviser managing a master-feeder arrangement will be permitted to submit a single Schedule D for the master fund and all of the feeder funds if separately submitted data would otherwise be substantially identical.[682] Finally, an adviser with a principal office and place of business outside the United States may omit from Section 7.B.(1)

680 *See*, with respect to private fund reporting under Item 7.B. specifically, Katten Foreign Advisers Letter ("Virtually all of the requested information would already have been provided to investors in the fund through an offering document or follow up status reports.") and NRS Letter (arguing that the expanded private fund disclosures on Schedule D would "replicate the due diligence questionnaire information...."). *See also* ABA Committees Letter ("We expect that most [exempt reporting advisers] will already have most of the information requested by Form ADV Part 1 readily available."); Merkl Implementing Letter (confirming that the disclosure requirements would not impose a significant burden on advisers). *See also supra* note 570.

681 *See supra* note 223.

682 *See supra* note 224 and accompanying text.

of Schedule D any private fund that, during the adviser's last fiscal year, was not a United States person, was not offered in the United States and was not beneficially owned by any United States person.[683] We are also working with FINRA to implement measures in the IARD intended to minimize the burden for advisers filing amended Form ADV, such as the ability to automatically pre-populate private fund service provider information provided for other funds managed by the same adviser. In addition, although we are generally expanding the information previously required in Section 7.B.(1), we have removed the requirement that advisers report the funds that their related persons manage.

Considering the changes to Item 7.B. and Section 7.B. of Schedule D as a whole, as well as our efforts to mitigate the reporting burden and to make technological upgrades to the IARD, we estimate that each adviser managing private funds will spend, on average, 1 hour per private fund to complete these questions.

c. New Estimated Burden Related to Exempt Reporting Adviser Reporting Requirements

Exempt reporting advisers are required to complete a limited number of items in Part 1A of Form ADV (consisting of Items 1, 2.B., 3, 6, 7, 10, 11 and corresponding schedules), and are not required to complete Part 2. We believe the information required by these items should be readily available to any adviser, particularly the identifying data and control person information required by Items 1, 3, and 10, and commenters agreed.[684] As we noted in the Implementing Proposing Release, the check-the-box style of most of these items, as well as some of the features of the IARD (such as drop-down boxes for common responses) should also keep the

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683 *See supra* note 225 and accompanying text.

684 *See supra* notes 570 and 680.

average completion time for these advisers to a minimum.[685] Moreover, in our staff's experience, the types of advisers that will meet the criteria for exempt reporting advisers are unlikely to have significantly large numbers of affiliations, and we do not expect that they will need to report disciplinary events at a greater rate than currently registered advisers.[686] We estimate that these items, other than Item 7.B., will take each exempt reporting adviser approximately 2 hours to complete. We anticipate that, like registered advisers, exempt reporting advisers will each spend 1 additional hour per private fund to complete Item 7.B. and Section 7.B of Schedule D.

2. Annual Burden Estimates

a. Estimated Annual Burden Applicable to All Registered Investment Advisers

i. Estimated Initial Hour Burden (Not Including Burden Applicable to Private Funds)

As a result of the transition filing discussed above,[687] we expect the total number of registered advisers responding to this collection of information will be 9,750.[688] Approximately 11,500 investment advisers are currently registered with the Commission.[689] We expect 3,200 will withdraw from registration.[690] We expect about 750 advisers who currently rely on the private adviser exemption to apply for registration with us, and we estimate that approximately

685 *See* Implementing Proposing Release, *supra* note 7, at section V.B.1.c.

686 As of April 7, 2011, approximately 13% of SEC-registered investment advisers reported a disclosure in Item 11 of Form ADV.

687 *See supra* section V.B.1.

688 *See supra* note 655.

689 Based on IARD data as of April 7, 2011.

690 As a consequence of section 410 of the Dodd-Frank Act, we estimate that approximately 3,200 advisers currently registered with the Commission will be required to withdraw their registration and register with one or more state securities authorities. *See supra* section V.B.1.

700 new advisers will register with us each year following effectiveness of the Dodd-Frank Act amendments.[691]

The estimated total annual burden applicable to these registered advisers, including new registrants, but excluding private fund reporting requirements, is 397,215 hours.[692] As discussed in the Implementing Proposing Release, we believe that most of the paperwork burden will be incurred in advisers' initial submission of the new and amended items of Part 1A of Form ADV, and that over time this burden will decrease substantially because advisers will generally only need to report updating information.[693] Amortizing this total burden over a three-year period to reflect the anticipated average period of time that advisers will use the revised form will result in an average estimated burden of 132,405 hours per year,[694] or 13.58 hours per year for each new applicant and for each currently registered adviser that will remain registered with the Commission.[695]

ii. Estimated Initial Hour Burden Applicable to All Registered Advisers to Private Funds

The amount of time that a registered adviser managing private funds will incur to complete Item 7.B. and Section 7.B. of Schedule D will vary depending on the number of private funds the adviser manages. Of the advisers currently registered with us, we estimate that approximately 2,850 advise private funds, will remain registered with us following effectiveness

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691 (3,200 (SEC advisers expected to withdraw from registration) / 11,500 (total SEC advisers)) x 1000 (average number of new advisers registered with the Commission each year) = 0.28 x 1000 = 280 (number of additional new advisers registering with the states, not the SEC). 1000 - 280 = 720. We have rounded this number to 700 for purposes of our analysis. *See also supra* note 609 and *infra* note 734.

692 40.74 per-adviser burden x 9,750 = 397,215 hours.

693 *See* Implementing Proposing Release, *supra* note 7, at section V.B.2.a.i.

694 397,215 / 3 = 132,405.

695 132,405 / 9,750 = 13.58.

of the Dodd-Frank Act amendments and have a December 31 fiscal year end.[696] Based on these advisers' Form ADV filings, we estimate that 52% of them, or approximately 1,480, currently advise an average of 3 private funds each; 43%, or approximately 1,230 advisers, currently advise an average of 10 private funds each; and the remaining 5%, or approximately 140 advisers, currently advise an average of 79 private funds each.[697] As we discussed above, we estimate that private fund advisers will spend, on average, 1 hour per private fund completing Item 7.B. and Section 7.B. of Schedule D. As a result, the private fund reporting requirements that will be applicable to registered investment advisers will add 27,800 hours to the overall annual burden applicable to registered advisers.[698]

In addition to currently registered private fund advisers, we estimate that about 200 new private fund advisers will register with us annually[699] and that 750 advisers will register with us that previously relied on the private adviser exemption. We believe that these 950 newly registering private fund advisers will, on average, be similar to the currently registered private fund advisers. However, in contrast to the currently registered advisers, this group is unlikely to

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696 IARD data as of April 7, 2011 show that 3,700 advisers indicate by reporting a fund in Schedule D, Section 7.B. that they, or a related person, advise private funds or investment-related funds. Based on IARD data, we estimate that 850 of these 3,700 advisers have a fiscal year end other than December 31 or will switch to state registration. *See supra* note 529. With respect to these 850 advisers, the burden of reporting this information is accounted for under rule 203A-5. *See infra* note 768. 3,700 – 850 = 2,850.

697 Based on IARD data as of April 7, 2011. Form ADV currently asks for an adviser to report about investment-related partnerships and limited liability companies advised by the adviser *and* its related persons. As a result, the data we have obtained from IARD over-estimates the average number of funds as a result of reporting of the same fund multiple times by affiliated registered advisers.

698 (1,480 advisers x 3 hours (3 funds x 1 hour per fund)) + (1,230 advisers x 10 hours (10 funds x 1 hour per fund)) + (140 advisers x 79 hours x 1 hour per fund)) = 4,440 + 12,300 + 11,060 = 27,800.

699 About 30% of current registrants report that they advise one or more private funds. (3,700 advisers to private funds / 11,500 registered advisers). Applying the same proportion to the 700 new registrants that we have estimated will register with us annually results in approximately 200 additional advisers to private funds each year. (700 x 0.30 = 210).

include any advisers managing a large number of private funds. For example, among the 750 advisers that currently rely on the private adviser exemption, we would not expect any of them to have more than 14 private fund clients, the most that had been allowed under the exemption provided by section 203(b)(3) of the Advisers Act. In addition, for the 200 new private fund advisers that we expect to register each year, the elimination of the private adviser exemption means that they will be subject to registration requirements even if they have only a single private fund client as long as they are not eligible for another exemption. As a result, we estimate that the average newly registering private fund adviser will (like the average currently registered private fund adviser) manage approximately 6 private funds,[700] but we do not anticipate that any subgroup of these new registrants will manage a large number of private funds (unlike the 5% of currently registered private fund advisers that we estimate manage an average of 79 private funds each). Based on these estimates, we expect that private fund reporting requirements will add 4,500 hours attributable to the 750 advisers registering because of the elimination of the private adviser exemption[701] and 1,200 hours attributable to private fund advisers registering as a result of normal growth.[702]

The total annual burden related to private fund reporting by registered advisers is 33,500 hours.[703] As we discussed in the Implementing Proposing Release, we believe that most of the paperwork burden will be incurred in connection with advisers' initial submission of private fund

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700 Approximately 65% of advisers that reported a fund in Schedule D, Section 7.B. listed five or fewer funds and 72% of advisers that registered since April 1, 2010 and reported a fund reported five or fewer private funds. The average number of private funds reported by new registrants in the past year is about 6 funds.

701 750 advisers x 6 private funds on average x 1 hour/private fund = 4,500.

702 200 advisers x 6 private funds on average x 1 hour/private fund = 1,200.

703 27,800 for existing registered advisers + 4,500 for no longer exempt advisers + 1,200 for estimated new registrants due to growth = 33,500.

data, and that over time this burden would decrease substantially because the paperwork burden will be limited to updating information.[704] Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the initial filing or re-filing of the rest of the form, results in an average estimated burden of 11,167 hours per year,[705] or 2.94 hours per year for each new private fund adviser and for each private fund adviser currently registered with the Commission.[706]

iii. Estimated Annual Burden Associated with Amendments, New Brochure Supplements and Delivery Obligations

The currently approved collection of information burden for Form ADV has three elements not discussed above: (i) the annual burden associated with annual and other amendments to Form ADV; (ii) the annual burden associated with creating new Part 2 brochure supplements for advisory employees and filing interim amendments to existing brochure supplements throughout the year; and (iii) the annual burden associated with delivering codes of ethics to clients as a result of the offer of such codes contained in the brochure. Although we do not anticipate that the amendments we are adopting to Form ADV will affect the per adviser burden imposed by these three elements, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the number of advisers subject to them, which will result in a change to the total annual burden associated with these elements of the collection of information for Form ADV.[707]

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704 *See* Implementing Proposing Release, *supra* note 7, at section V.B.2.a.ii.

705 33,500 / 3 = 11,167.

706 11,167 / (2,850 + 200 + 750) = 2.94.

707 We anticipate that the clarification we are making to the brochure supplement (Part 2B) would not affect this burden estimate. *See* note 337 and accompanying text for a discussion of this clarifying amendment.

Based on IARD data, we continue to estimate that, on average, each adviser filing Form ADV through the IARD will amend its form two times during the year.[708] On average, these consist of one interim updating amendment (at an estimated 0.5 hours per amendment) and one annual updating amendment (at an estimated 6 hours per amendment) each year. In addition, we estimate that each adviser will, on average, spend 1 hour per year making interim amendments to brochure supplements and an additional 1 hour per year to prepare new brochure supplements as required by Part 2.[709] We also expect advisers to continue to spend an average of 1.3 hours annually to meet obligations to deliver codes of ethics to clients.[710] These obligations will add 95,550 hours annually to the collection of information, consisting of 63,375 hours attributable to annual and interim updating amendments,[711] 9,750 hours attributable to interim amendments to brochure supplements,[712] 9,750 hours attributable to the creation of new brochure supplements,[713] and 12,675 hours for delivery of codes of ethics.[714]

iv. Estimated Annual Cost Burden

The currently approved collection of information burden for Form ADV has a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV. Although we do not anticipate that the amendments we are adopting to Form ADV will affect the per adviser cost burden estimates for outside legal and

708 Based on IARD data regarding the number of filings of Form ADV amendments. *See* Part 2 Release, *supra* note 67 at n.329.

709 *See* Part 2 Release, *supra* note 668 at nn.333, 336-37 and accompanying text.

710 *Id.*

711 (9,750 advisers x 0.5 hours/other than annual amendment) + (9,750 advisers x 6 hours/annual amendment) = 63,375.

712 9,750 advisers x 1 hour = 9,750.

713 9,750 advisers x 1 hour = 9,750.

714 9,750 advisers x 1.3 hours = 12,675.

compliance consulting fees, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) of the Advisers Act will result in a significant change to our estimates of the number of advisers subject to these costs. We discuss this aspect of the annual cost burden more fully below. In addition to the estimated legal and compliance consulting fees, we also anticipate that some registered advisers may incur additional outside costs related to the Form ADV amendments we are adopting today that require advisers to report the fair value of private fund assets.[715]

Advisers to private funds that do not use fair value methodologies will likely incur costs to comply with the requirement to report the fair value of those assets on Form ADV, which could (but is not required to) include reliance on a third party or outside valuation service. We anticipate that these costs will vary, but we understand that private fund advisers, including those that may not use fair value methodologies for reporting purposes, perform administrative services, including valuing assets, internally as a matter of business practice.[716] Based on registered advisers' responses to Items 5.D., 7.B., and 9.C. of Form ADV,[717] we estimate that approximately 3% of registered advisers have at least one private fund client that may not be

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715 *See* Form ADV: Instructions for Part 1A, instr. 5.b.(4).

716 For example, an adviser to a hedge fund may value fund assets for purposes of allowing new investments in the fund or redemptions by existing investors, which may be permitted on a regular basis after an initial lock-up period. An adviser to a private equity fund may obtain valuation of portfolio companies in which the fund invests in connection with financing obtained by those companies. Advisers to private funds also may value portfolio companies each time the fund makes (or considers making) a follow-on investment in the company. Private fund advisers could use these valuations as a basis for complying with the fair valuation requirement with respect to private fund assets.

717 Item 5.D. asks advisers to identify the types of clients they have, including clients that are pooled investment vehicles. Item 7.B. asks if the adviser or its related person is a general partner in an investment-related limited partnership or manager of an investment-related limited liability company, or if the adviser advises any other "private fund." Item 9.C. asks whether an independent public accountant audits annually the pooled investment vehicles that the adviser manages and if audited financial statements are distributed to investors in the pools.

audited.[718] These advisers therefore may incur costs to fair value their private fund assets.[719] As explained above, we estimate that approximately 4,270 registered advisers have, or after registering with us will have, at least one private fund client.[720] We therefore estimate that approximately 130 registered advisers may incur costs as a result of the fair value requirement.[721] We estimated in the Implementing Proposing Release that an adviser without the internal capacity to value specific illiquid assets would obtain pricing or valuation services from an outside administrator or other service provider at a cost ranging from $250 to $75,000 annually.[722] Commenters did not address these estimates, and we continue to believe they are accurate. Accordingly, we estimate that the 130 advisers would incur costs of $37,625 each on an annual basis, which is the middle of the range of estimated fair value costs, for an aggregate annual cost of $4,891,250.[723]

With respect to outside legal assistance or outside consulting services, the currently approved collection of information burden is based on an estimate that some, but not all, registered advisers will elect to obtain these services on a one-time basis to draft the new

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718 A fund that is relying on the audit provision in our custody rule will have provided the fair value of its assets in its audited financial statements that are prepared in accordance with GAAP.

719 We note, however, that at least some of these advisers may currently fair value private fund assets. For instance, funds that do not prepare financial statements in accordance with GAAP (which is required to rely on an exception in our custody rule) may nonetheless use a fair value standard other than that specified in GAAP and thus may not incur any additional costs. *See supra* notes 98-100 and accompanying text (explaining that an adviser may adopt a fair valuation standard other than GAAP or another international accounting standard that will satisfy the requirement, if developed and applied in good faith).

720 *See supra* note 637.

721 4,270 x 0.03 = 128.1.

722 *See* Implementing Proposing Release, *supra* note 7, at n.369 and accompanying text.

723 130 x $37,625 = $4,891,250.

narrative brochure for a total cost of $22,775,400.[724] By the time the amendments to Form ADV that we are adopting today become effective, substantially all registered advisers will have completed their initial filing of the narrative brochure required by our recent amendments to Part 2 of Form ADV and will have already incurred these estimated one-time costs.[725] As a result, the only respondents that we expect will incur legal and consulting costs for the initial drafting of Part 2 of Form ADV, subsequent to the effective date of the amendments to Form ADV we are adopting today, will consist of the estimated 700 new advisers that we expect to register annually and the estimated 750 advisers that will have to register as a result of the elimination of the private adviser exemption.[726]

For purposes of estimating the currently approved amount of this one-time cost, we divided advisers into three groups – small, medium and large – based on their number of employees. Different costs per adviser were assigned based on the group to which the adviser belongs.[727] We expect that the 750 newly registering private fund advisers and 700 new advisers registering annually will be medium-sized.[728] In the Part 2 Release, we estimated that the initial cost related to preparation of Part 2 of Form ADV would be $4,400 for legal services and $5,000 for compliance consulting services, in each case, for those medium-sized advisers who engaged

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724 *See* Part 2 Release, *supra* note 67, at text accompanying n.328. We estimated that a total of 2,941 advisers would elect to obtain outside legal assistance and that 3,441 advisers would elect to obtain outside consulting services.

725 *See id.* at section V.

726 *See supra* note 691 and text following note 699.

727 For purposes of this estimate, we categorize small advisers as advisers with 10 or fewer employees, medium advisers as having between 11 and 1,000 employees, and large advisers as those with 1,000 or more employees. *See* Part 2 Release, *supra* note 668, at nn.301 and 324.

728 We would not expect these advisers to be large in this sense because advisers are likely to have become subject to registration obligations before engaging 1,000 or more employees. Some of these advisers may be small, but the increase in the threshold for registration with the Commission will limit the number of small advisers registering with us.

legal counsel or consultants.[729] The currently approved burden anticipates that a quarter of medium-sized advisers would seek the help of outside legal services and half would seek the help of compliance consulting services. Accordingly, we estimate that 350 of these advisers would use outside legal services, for a total cost burden of $1,540,000,[730] and 725 advisers would use outside compliance consulting services, for a total cost burden of $3,625,000,[731] resulting in a total cost burden among all respondents of $5,165,000 for outside legal and compliance consulting fees related to drafting narrative brochures.[732]

Together, we estimate that the total cost burden among all respondents for outside legal and compliance consulting fees related to drafting narrative brochures and for third party or outside valuation services to be $10,056,250.[733]

b. Estimated Annual Burden Applicable to Exempt Reporting Advisers

i. Estimated Initial Hour Burden

Based on publications, reports, and general information publicly available from trade organizations, financial research companies, and news organizations as well as safe harbor filings with the SEC, we expect approximately 2,000 investment advisers will qualify for an exemption from registration but will be required to submit reports to us on Form ADV.[734] As we

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729 *See* Part 2 Release, *supra* note 67, at text accompanying nn.324 and 325.

730 25% x (750 private fund advisers + 700 new advisers registering annually) = approximately 350 advisers. $4,400 for legal services x 350 advisers = $1,540,000.

731 50% x (750 private fund advisers + 700 new advisers registering annually) = 725 advisers. $5,000 for consulting services x 725 advisers = $3,625,000.

732 $1,540,000 + $3,625,000 = $5,165,000.

733 $5,165,000 (legal and consulting services) + $4,891,250 (third party fair valuation services) = $10,056,250

734 This estimate was collectively derived from various sources including the National Venture Capital Association's 2010 Yearbook (http://www.nvca.org), First Research reports (http://www.firstresearch.com), Preqin reports (http://www.preqin.com), Bloomberg

explained in the Implementing Proposing Release, the paperwork burden applicable to these new exempt reporting advisers will consist of the burden attributable to completing a limited number of items in Part 1A as well as the burden attributable to the private fund reporting requirements of Item 7.B. and Section 7.B. of Schedule D.[735] We estimated the burden to complete the subset of items in Part 1A applicable to exempt reporting advisers to be 2 hours, which would result in an annual burden of approximately 4,000 hours.

As discussed above, we estimate the private fund reporting requirements of the form to be 1 hour per private fund. We assume that each exempt reporting adviser currently relies on the private adviser exemption and, therefore, has 14 or fewer private fund clients. Based on reporting by registered advisers to private funds and industry publications and reports, we expect each of these advisers, on average, advises 6 private funds.[736] Accordingly, we attribute an additional 12,000 burden hours to exempt reporting advisers' private fund reporting requirements.[737]

(http://www.bloomberg.com), the Managed Funds Association (http://www.managedfunds.org), PerTrac data (http://www.pertrac.com), and Form D data. Specific data relevant to the number or types of advisers that would be exempt reporting advisers were not available, but the information located did inform the staff to the probable number of exempt reporting advisers.

735 *See* Implementing Proposing Release, *supra* note 7, at section V.B.2.b.i.

736 *Id.* Based upon the reported general number of private funds and the estimated number of advisers to these private funds, it is estimated that each adviser advises 6 private funds on average. Approximately 2,000 exempt reporting advisers x 6 private funds/adviser = 12,000 private funds. This represents an increase from our estimate of 10,000 private funds in the Implementing Proposing Release, which is attributable to updated IARD data that indicate each private fund adviser now advises approximately 6 funds, instead of 5. *Compare supra* note 700 *with* Implementing Proposing Release, *supra* note 7, at n.406.

737 2,000 exempt reporting advisers x 6 private funds/adviser x 1 hour/private fund = 12,000.

The estimated total annual hour burden applicable to exempt reporting advisers is 16,000 hours.[738] We believe that most of the paperwork burden will be incurred in respect of the initial submission of Form ADV, and that over time this burden will decrease substantially because the paperwork burden will be limited to updating information. Amortizing this total burden imposed by Form ADV over a three-year period, as we did above with respect to the initial filing for registered advisers, results in an average burden of an estimated 5,330 hours per year,[739] or 2.67 hours per year, on average, for each exempt reporting adviser.[740]

ii. Estimated Annual Burden Associated with Amendments and Final Filings

In addition to the burdens associated with initial completion and filing of the portion of the form that exempt reporting advisers will be required to prepare, as in the Implementing Proposing Release, we estimate that, on average: (i) each exempt reporting adviser will prepare an annual updating amendment; (ii) 20% of these advisers will file an interim updating amendment; [741] and (iii) 5% of these advisers will file a final filing.[742]

With respect to an exempt reporting adviser's annual updating amendment of Form ADV, we expect that advisers will not need to spend a significant amount of time entering

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738 4,000 hours attributable to the portions of Form ADV that these advisers are required to file other than the private fund reporting + 12,000 hours attributable to private fund reporting = 16,000 hours.

739 16,000 / 3 = 5,330.

740 5,330 / 2,000 = 2.67.

741 Approximately 20% of advisers with a fiscal year end of December that filed an other-than-annual amendment changed Item 1 or 11 between April 1, 2009, and December 31, 2009 (period between annual amendment filing time).

742 Approximately 5% of advisers withdrew their SEC registrations in 2010 and did not switch to state registration, based on IARD data. We are assuming the same percentage of exempt reporting advisers will submit final reports and not simultaneously apply for registration with the Commission. Exempt reporting advisers filing a final report because they are applying for registration are not included in this count because there is no independent burden associated with making this type of final filing; they are, therefore, included in the number of advisers expected to register each year as a result of normal annual growth. *See supra* note 691.

responses into the electronic version of the form to file their annual updating amendments because the IARD will automatically pre-populate their prior responses. Based on this consideration, we estimate that the average exempt reporting adviser will spend 1 hour per year completing its annual updating amendment to Form ADV. This estimate is based on our estimate for registered advisers, but it is 85% shorter because exempt reporting advisers will be required to complete and update only a limited number of items in Part 1A of the form. We also estimate that 20% of the exempt reporting advisers will file an interim updating amendment to Items 1, 3, 10 or 11 of Form ADV,[743] and we estimate that each such amendment will require 0.5 hours. Based on the foregoing estimates, the total paperwork burden of amendments to Form ADV and final filings on Form ADV will be 2,200 hours per year for all exempt reporting advisers.[744]

3. Total Revised Burdens

The revised total annual collection of information burden for registered advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants, including private fund advisers, plus the burden associated with amendments to the form, preparing brochure supplements, and delivering codes of ethics to clients is estimated to be approximately 239,122 hours per year.[745] This represents a

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743 *See* amended Form ADV: General Instruction 4.

744 2,000 advisers x 1 hour = 2,000 hours per year for annual amendments. (2,000 advisers x 20%) x 0.5 hours = 200 hours per year for interim amendments. 200 + 2,000 = 2,200 hours. Exempt reporting advisers are not required to complete Part 2 of Form ADV and so will not incur an hour burden to prepare new brochure supplements or the cost burden that registered advisers will incur with respect to that part of the form. Exempt reporting advisers also will not be required to meet obligations to deliver codes of ethics to clients, as is required of registered advisers.

745 132,405 hours per year attributable to initial preparation of Form ADV + 11,167 hours per year attributable to initial private fund reporting requirements + 63,375 hours per year for amendments to Form ADV + 9,750 hours per year for brochure supplements for new employees + 9,750 hours per year for brochure interim amendments + 12,675 hours per year to meet code of ethics delivery obligations = 239,122 hours.

decrease of 29,335 hours from the currently approved burden.[746] This decrease is primarily attributable to the anticipated withdrawal of 3,200 advisers from SEC registration.

Registered investment advisers are also expected to incur an annual cost burden of $10,056,250, a reduction from the current approved cost burden of $22,775,400. The decrease in annual cost burden is attributable to the nature of the costs, which are one-time initial costs to draft the narrative brochure. The transition to the narrative brochure will have substantially been completed, so the newly incurred one-time costs arise solely from new registrants.

We further estimate that the total annual collection of information burden for exempt reporting advisers to file and complete the required items of Part 1A of Form ADV, including the burden associated with amendments to the form and final filings, will be 7,530 hours.[747]

Based on the foregoing, the total annual hour burden for Form ADV will decrease by 21,805 hours to 246,652.[748] Accordingly, we estimate that the blended average per adviser amortized burden for Form ADV will be 20.99 hours,[749] consisting of an average annual amortized burden of 24.52 hours for the estimated 9,750 registered advisers and 3.77 hours for the estimated 2,000 exempt reporting advisers.[750]

C. Rule 203A-5

Rule 203A-5 requires *each* investment adviser registered with us on January 1, 2012 to file an amendment to its Form ADV no later than March 30, 2012, and withdraw from

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746 Current approved burden of 268,457 hours - revised burden 239,122 hours = 29,335 decrease in hours.

747 5,330 hours per year attributable to initial preparation of Form ADV + 2,200 hours per year for amendments = 7,530 hours.

748 239,122 + 7,530 = 246,652.

749 246,652 / 11,750 = 20.99.

750 Registered advisers (239,122 / 9,750 = 24.52), exempt reporting advisers (7,530 / 2,000 = 3.77).

Commission registration by June 28, 2012, if no longer eligible.[751] The amendments to Form ADV will, among other things, require each adviser to declare whether it remains eligible for Commission registration and to report the market value of its assets under management determined within 90 days of the filing.[752] The respondents to this information collection are all investment advisers registered with the Commission on January 1, 2012. Compliance with this collection of information is mandatory, and the information collected on Form ADV is not kept confidential.

Rule 203A-5 that we are adopting today differs from our proposed rule in several respects. First, the transition period begins on January 1, 2012, not the July 21, 2011 effective date of the Dodd-Frank Act, as proposed.[753] Second, advisers will be required to file an amended Form ADV by March 30, 2012 (instead of August 20, 2011, as proposed), and mid-sized advisers no longer eligible for Commission registration will be required to withdraw by June 28, 2012 (instead of October 19, 2011, as proposed), which provides 180 days instead of the 90 days we proposed.[754] Third, we are providing additional flexibility for an adviser to choose the date by which it must calculate its assets under management that it reports on Form ADV by requiring the same 90 day period as in Form ADV today, instead of 30 days, as proposed.[755]

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751 New rule 203A-5(b)-(c). *See supra* section II.A.1. Advisers registered with us on July 21, 2011 that have at least $25 million in assets under management will be exempt from the new prohibition on Commission registration for mid-sized advisers until 2012, when the rule will require them to switch to state registration and withdraw their registration with us. *See* new rule 203A-5(a); *supra* section II.A.1., note 28.

752 *See supra* sections II.A.1. and II.A.2.

753 *See* proposed rule 203A-5(a)-(b); *supra* section II.A.1.

754 *See* proposed rule 203A-5(b)-(c); *supra* section II.A.1.

755 *See* new rule 203A-5(b); amended Form ADV: Instructions for Part 1A, instr. 5.b.(4); *supra* section II.A.1.

As noted above, we requested comment on the PRA analysis contained in the Implementing Proposing Release. Several commenters expressed general concerns about the paperwork burdens of requiring all advisers to make an additional one-time filing of Form ADV.[756] Some commenters argued that we should decrease the paperwork burden by exempting advisers unaffected by the statutory changes from the Form ADV filing requirement,[757] or only requiring advisers to report their assets under management.[758] Several commenters agreed with us that the transition should be delayed until the IARD is able to accept filings of reviewed Form ADV, instead of implementing an alternative, such as requiring interim paper filings that would increase the paperwork burdens.[759]

Changing the deadline under rule 203A-5 for advisers to re-file amended Form ADV to March 30, 2012, which coincides with most advisers' required annual updating amendment, significantly reduces the paperwork burden of rule 203A-5 by eliminating the requirement that

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756 *See, e.g.*, ICI Letter; MFA Letter; NYSBA Committee Letter; Shearman Letter.

757 ICI Letter (recommending exempting advisers that do not rely on assets under management to register with the SEC); MFA Letter (recommending exempting private fund advisers that file an initial Form ADV by July 21); NYSBA Committee Letter (recommending exempting advisers who will continue to be eligible for Commission registration and advisers relying on the section 203(b)(3) exemption that we proposed would have to register with the Commission by July 21, 2011).

758 Shearman Letter.

759 *See* NASAA Letter ("the benefits of electronic filing, including easy public access to the documents, are significant and would outweigh any disadvantages imposed by a delay in filing deadlines."); NRS Letter (urging Commission not to "regress to paper filings" which would be "a huge step into the past" and "appears to be counter to Dodd-Frank Act purposes of transparency and consistency."). *See also* Dezellem Letter (the IARD is efficient and reduces risks of misplacing paper documents and possible filing errors); NYSBA Committee Letter (the IARD is the "most efficient mechanism for advisers and exempt reporting advisers to meet their filing obligations and make such filings to the public."). FINRA informed us that the IARD will be updated to reflect the revisions to Form ADV that we are adopting today beginning in November. *See supra* section II.A.1.

these advisers incur the costs associated with a special one-time filing requirement.[760] This deadline also coincides with the filing deadline for newly registering private fund advisers, which, as one commenter points out results in "a single, comprehensive Form ADV filing to register with the Commission" instead of requiring two filings that "would be costly, inefficient and potentially confusing."[761]

We estimate that there will be approximately 3,900 respondents to this collection of information filing an amendment to Form ADV.[762] Each respondent will respond once. For purposes of the collection of information burden for Form ADV, we estimate that the amendment will take each adviser approximately 6 hours per amendment, on average,[763] and that the proposed amendments to Part 1A of Form ADV will take each adviser approximately 4.5 hours, on average, to complete.[764] We estimated that the total one-time burden for completing the proposed Form ADV amendments to be 124,425 hours, plus an additional 33,350 hours for private fund reporting, for a total of 157,775 hours.[765] As discussed above, however, the number of advisers that we estimate will complete an additional Form ADV amendment will be lower than under proposed rule 203A-5. We estimate that 700 advisers that will remain registered with the Commission after the switch will file an other-than-annual amendment, and 3,200 mid-sized

760 *See supra* note 511. *See also* CMC Letter (suggesting "timing of the transition from federal to state registration could be centered around renewals for 2012").

761 *See* MFA Letter.

762 *See supra* note 511. The PRA burden for filing Form ADV-W is part of the PRA burden submitted for Form ADV-W. *See infra* section VI.E. The Implementing Proposing Release erroneously included Form ADV-W both in the PRA burden for proposed rule 203A-5 and for Form ADV-W. *See* sections V.C. and V.E. of the Implementing Proposing Release.

763 We anticipate that the hour burden for the refiling of Form ADV for purposes of new rule 203A-5 will be the same as an adviser's annual amendment filing, which has an approved burden of 6 hours. *See supra* section VI.B.2.a.iii.

764 *See supra* sectionsVI.B.1.a.

765 *See* Implementing Proposing Release, *supra* note 7, at nn. 403, 444.

advisers will file a Form ADV amendment with us before they switch to state registration.[766] In addition, of these 3,900 registered advisers, we estimate that 850 advise one or more private funds and will have to complete the private fund reporting requirements.[767] We expect this will take 8,373 hours, and we estimate that the total one-time burden for completing the Form ADV amendments to be 52,473 hours.[768]

D. Form ADV-NR

We are making minor amendments to Form ADV-NR (OMB Control No.: 3235-0238), the form used to appoint the Secretary of the Commission as an agent for service of process for certain non-resident advisers.[769] Non-resident general partners or managing agents of SEC-registered investment advisers must make a one-time filing of Form ADV-NR with the Commission. Form ADV-NR requires these non-resident general partners or managing agents to furnish us with a written irrevocable consent and power of attorney that designates the Commission as an agent for service of process, and that stipulates and agrees that any civil suit or action against such person may be commenced by service of process on the Commission. The amendments we are adopting reflect that exempt reporting advisers will be filing reports on the IARD, and that they will use Form ADV-NR in the same way and for the same purpose as it is currently used by registered investment advisers. The collection of information is necessary for

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766 *See supra* note 511.

767 Based on IARD data as of April 7, 2011, 839 advisers out of the estimated 3,700 current SEC-registered advisers that advise private funds do not have a December fiscal year end or are expected to switch to state registration. We have rounded this number to 850 for purposes of this analysis.

768 *See supra* notes 520-522, 528-532. ((6 hours (annual amendment) + 4.5 hours (new items)) x 4,200) + ((442 advisers x 3 funds x 1 burden hour per fund) + (365 x 10 funds x 1 burden hour per fund) + (43 advisers x 79 funds x 1 burden hour per fund)) = 44,100 (burden hours for Form ADV filing excluding private fund reporting + 8,373 (burden hours for private fund reporting) = 52,473 total burden hours for Form ADV filing.

769 *See* amended Form ADV-NR; Form ADV: General Instruction 16.

us to obtain appropriate consent to permit the Commission and other parties to bring actions against non-resident partners or agents for violations of the federal securities laws. This collection of information is found at 17 CFR 279.4. The collection of information is mandatory, and the information provided in response to the collection is not kept confidential. The currently approved collection of information in Form ADV-NR is 18 hours.

In the Implementing Proposing Release, we estimated that approximately 9,150[770] investment advisers would be registered with the Commission after the Dodd-Frank Act amendments to the Advisers Act take effect and that approximately 2,000[771] exempt reporting advisers would file reports with the Commission, and that these advisers would file Form ADV-NR at the same annual rate (0.17 percent) as advisers registered with us.[772] Accordingly, we estimated that the annual aggregate information collection burden for Form ADV-NR would be 19 hours, an increase of one hour over the currently approved burden.[773] We did not receive comments on these estimates. Based on updated IARD data, we now estimate that approximately 9,750[774] investment advisers will be registered with the Commission and continue to estimate that approximately 2,000[775] exempt reporting advisers will file reports with the Commission, and that these advisers will file Form ADV-NR at an annual rate of 0.17 percent,[776] for a total of approximately 20 filings annually.[777] We continue to estimate that ADV-NR

770 *See* Implementing Proposing Release, *supra* note 7, at section V.D.

771 *See id.*

772 *See id.*

773 *See id.*

774 *See supra* note 655 and accompanying text.

775 *See supra* note 734 and accompanying text.

776 *See* Implementing Proposing Release, *supra* note 7, at n.450.

777 0.17% (rate of filing) x (9,750 estimated registered investment advisers + 2,000 estimated exempt reporting advisers) = approximately 20 Form ADV-NR filings.

requires an average of one hour to complete. Accordingly, we estimate that as a result of the amendments to Form ADV-NR and the change in the number of filers after the effectiveness of the Dodd-Frank Act, the annual aggregate information collection burden for Form ADV-NR will be 20 hours, an increase of two hours over the currently approved burden of 18 hours.[778]

E. Rule 203-2 and Form ADV-W

We are amending rule 203A-2(b), the exemption from the prohibition on registration for certain pension consultants. The amendments will increase the minimum value of plan assets which an adviser must consult from \$50 to \$200 million annually.[779] An investment adviser will have to be a pension consultant with respect to assets of plans having an aggregate value of \$200 million or more to be able to register with the Commission. Those pension consultants providing consulting services to plans of less than \$200 million will be required to file a notice of withdrawal of their registration in accordance with rule 203-2 on Form ADV-W (OMB Control No. 3235-0313). The collection of information on Form ADV-W is mandatory and is not kept confidential. The currently approved collection of information for Form ADV-W is 500 hours for 1,000 responses.

The amendments to the rule that we are adopting today do not differ from our proposed amendments. Commenters supported our proposal and did not discuss the proposal's collection of information estimates.[780] In the Implementing Proposing Release, we estimated that approximately 50 of the current advisers relying on this exemption from the prohibition on registration would no longer be eligible to rely on the exemption if adopted as proposed, and approximately 4,100 advisers also would have to withdraw their Commission registration as a

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778 20 ADV-NR filings x 1 hour per filing = 20 hours. 20 hours – 18 hours = 2 hours.

779 *See* amended rule 203A-2(a)(1).

780 NRS Letter; Pickard Letter.

result of the Dodd-Frank Act.[781] We have lowered our estimate of advisers withdrawing from Commission registration to 3,200 based on more current IARD data,[782] but we continue to estimate that 50 of the current advisers relying on this exemption from the prohibition on registration will no longer be eligible to rely on the exemption as adopted.[783]

The estimated 50 advisers no longer eligible to rely on the exemption, however, will have to file a notice of withdrawal on Form ADV-W in accordance with rule 203-2 under the Advisers Act and withdraw their registration based on the amendment to rule 203A-2(b).[784] In addition, as noted above, we estimate that approximately 3,200 advisers also will have to withdraw their Commission registration as a result of the Dodd-Frank Act. Because these advisers are registered today, we further anticipate that these advisers will be switching from SEC to state registration, and as a result will be filing a "partial" Form ADV-W. We have estimated for purposes of our current approved burden under the PRA for rule 203-2 and Form ADV-W, that a partial withdrawal imposes an average burden of approximately 0.25 hours for an adviser.[785] Thus, we estimate that the amendment to rule 203A-2(b) associated with filing Form ADV-W will generate a burden of approximately 813 additional hours[786] in addition to the approved burden of 500 hours for a total of 1,313 hours.

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781 *See* Implementing Proposing Release, *supra* note 7, at n.453 and accompanying and following text.

782 *See supra* note 510.

783 Based on IARD data as of April 7, 2011, there are 322 advisers relying on the pension consultant exemption from registration, and we estimate that approximately 15 percent will no longer be eligible to rely on the exemption as adopted. This estimate is based on our understanding that a typical pension consultant will have plan assets far in excess of the higher threshold, in light of the fact that most pension plans contain a significant amount of assets.

784 *See supra* note 549 (discussing the fact that advisers filing Form ADV-W due to our amendment to rule 203A-2(b) will likely file partial withdrawals).

785 *See supra* note 533.

786 (3,200 + 50) responses on Form ADV-W x 0.25 hours = 812.5 hours.

F. Form ADV-H

Rule 204-4(e) provides a temporary hardship exemption for an exempt reporting adviser having unanticipated technical difficulties that prevent submission of a filing to the IARD system.[787] Rule 203-3(a) provides a similar temporary hardship exemption for registered advisers that file an application on Form ADV-H (OMB Control No. 3235-0538).[788] Like rule 203-3(a), rule 204-4(e) requires advisers relying on the temporary hardship exemption to file an application on Form ADV-H in paper format no later than one business day after the filing that is the subject of the Form ADV-H was due, and submit the filing on Form ADV in electronic format with the IARD no later than seven business days after the filing was due.[789] Because we are adopting rule 204-4, respondents to the collection of information on Form ADV-H will now include exempt reporting advisers, in addition to registered advisers. The collection of information on Form ADV-H is mandatory for registered advisers and exempt reporting advisers relying on a temporary hardship exemption. The information collected on Form ADV-H is not kept confidential.

In the Implementing Proposing Release, we estimated that exempt reporting advisers would file approximately two responses to Form ADV-H annually.[790] We also estimated that Form ADV-H would impose the same average burden per response on exempt reporting advisers as it imposes on registered advisers—one hour. Thus, we estimated that rule 204-4 would result in an increase of two hours in the total hour burden associated with Form ADV-H.[791] We did not receive comments on our estimates. We continue to estimate that exempt reporting advisers will

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787 New rule 204-4(e).

788 Rule 203-3(a); 17 CFR 279.3 (Form ADV-H).

789 New rule 204-4(e).

790 *See* Implementing Proposing Release, *supra* note 7, at section V.F.

791 *See id.*

file approximately two responses to Form ADV-H annually, with each response requiring an average of one hour, for an estimated annual burden of two hours.[792] However, as discussed above, the number of registered advisers will decrease due to the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) from 11,500 to 9,750.[793] Given the reduction in registered advisers, we estimate that Form ADV-H will receive 10 annual responses from registered advisers.[794] We continue to estimate that Form ADV-H will require an average of one hour to complete, and thus estimate that the total annual burden for registered advisers to be 10 hours.[795] Thus, the total burden associated with Form ADV-H will increase one hour to 12 hours.[796]

G. Rule 204-2

Rule 204-2 (OMB Control No. 3235-0278) requires investment advisers registered, or required to be registered under section 203 of the Act, to keep certain books and records relating to their advisory business.[797] The collection of information under rule 204-2 is necessary for the Commission staff to use in its examination and oversight program, and the information is generally kept confidential.[798] The collection of information is mandatory.

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792 To estimate the currently approved total burden associated with Form ADV-H, we estimated that registered advisers file approximately 11 responses to Form ADV-H per year, which, given the then-estimated 11,850 advisers registered with the Commission, meant that approximately 1 response is filed per 1,000 advisers (11,850 registered advisers / 11 responses = approximately 1 response per 1,000 registered advisers). We estimate that approximately 2,000 exempt reporting advisers will file reports on Form ADV in accordance with rule 204-4. Thus, we estimate two responses to Form ADV-H in accordance with rule 204-4 (2,000 exempt reporting advisers x 1 response per 1000 advisers = 2 responses).

793 *See supra* note 655.

794 9,750 registered advisers x 1 response per 1,000 advisers = 9.75 responses.

795 10 responses x 1 hour = 10 hours.

796 The current approved burden is 11 hours. Our new estimate is 10 hours for registered advisers + 2 hours for exempt reporting advisers = 12 hours.

797 Rule 204-2.

798 *See* section 210(b) of the Advisers Act.

We are amending rule 204-2 to update the rule's "grandfathering provision" for investment advisers that are currently exempt from registration under the "private adviser" exemption, but will be required to register after the Dodd-Frank Act eliminates the "private adviser" exemption on July 21, 2011.[799] Upon registration, these advisers will become subject to the recordkeeping requirements of the Act, including the requirement to keep certain records relating to performance.[800] The amendment clarifies that these advisers are not obligated to keep certain performance-related records for any period when they were not registered with the Commission; however, to the extent that these advisers preserved these performance-related records even though they were not required to keep them, they must continue to preserve them.[801] Most, if not all, advisers likely gather the records and documents necessary to support the calculation of performance or rate of return as those records or documents are produced or at the time a calculation is made. Thus, we do not believe that the amendment to the grandfathering provision will reduce our current approved average annual hourly burden per adviser under rule 204-2.

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799 *See* amended rule 204-2(e)(3)(ii); section II.D.2.b. In addition, we are amending rule 204-2(e)(3)(ii) to cross-reference the new definition of "private fund" added to the Advisers Act by the Dodd-Frank Act where that term is used in rule 204-2. This amendment is technical and will not increase or decrease the collection burden on advisers. We are also rescinding rule 204-2(l) because that section was vacated by a federal appeals court in *Goldstein*.

800 *See* amended rule 204-2(a)(16).

801 *See* amended rule 204-2(e)(3)(ii) (stating, "[i]f you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, [this rule] does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under [certain sections of this rule] to the extent those books and records pertain to the performance or rate of return of such private fund (as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)), or other account you advise for any period ended prior to your registration, provided that that you continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period." (emphasis added)).

Although we do not anticipate that our amendments to rule 204-2 will affect the per adviser burden imposed by the rule, the Dodd-Frank Act's amendments to sections 203A and 203(b)(3) will change our estimates of the total annual burden associated with the rule.[802] The current approved burden for rule 204-2 is based an estimate of 11,658 registered advisers subject to rule 204-2 and an estimated average burden of 181.45 burden hours each year per adviser, for a total of 2,115,376 hours. We estimated in the Implementing Proposing Release that the Dodd-Frank Act will reduce the number of registered advisers to 9,150.[803] We did not receive comments on these estimates. However, based on updated IARD data, we now estimate that the Dodd-Frank Act will reduce the number of registered advisers to 9,750.[804] Thus, we estimate that the total burden under amended rule 204-2 will be 1,769,138 hours,[805] a reduction of 346,238 hours.[806]

The reduction in the number of advisers subject to the rule will also reduce the total non-labor cost burden of the rule. The current approved non-labor cost burden associated with rule 204-2 is $34,965,063, or an average of approximately $3,000 per adviser.[807] Due to the reduction in the number of advisers subject to rule 204-2, we estimate that the new total non-labor cost burden will be $29,250,000,[808] a reduction of $5,715,063.[809]

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

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802 Exempt reporting advisers are not subject to rule 204-2, and therefore there is no offsetting increase in the number of advisers subject to the rule.

803 *See* Implementing Proposing Release, *supra* note 7, at n.377 and accompanying text.

804 *See supra* note 655 and accompanying text.

805 9,750 registered advisers x 181.45 hours = approximately 1,769,138.

806 2,115,376 hours – 1,769,138 hours = 346,238 hours.

807 $34,965,063 / 11,658 advisers = approximately $3,000.

808 9,750 x $3,000 = $29,250,000.

809 $34,965,063 - $29,250,000 = $5,715,063.

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA"), in accordance with section 4(a) of the Regulatory Flexibility Act, regarding the rules and rule amendments we are adopting today to give effect to the Dodd-Frank Act's amendments to the Advisers Act.[810] It relates to new rules 203A-5 and 204-4, amendments to rules 0-7, 203-1, 203A-1, 203A-2, 203A-3, 203A-4, 204-1, 204-2, 206(4)-5, 222-1, 222-2, and amendments to Form ADV, Form ADV-NR and Form ADV-H under the Advisers Act.[811] We prepared an Initial Regulatory Flexibility Analysis ("IRFA") in conjunction with the Implementing Proposing Release in November 2010.[812]

A. Need for and Objectives of the New Rules and Rule Amendments

The new rules and rule amendments are necessary to give effect to provisions of the Dodd-Frank Act which, among other things, amend certain provisions of the Advisers Act, and to respond to a number of other changes made by the Dodd-Frank Act, including the Commission's pay to play rule. In addition, in light of our increased responsibility for oversight of private funds, we are requiring advisers to those funds to provide us with additional information about the operation of those funds, which will permit us to better oversee those advisers by focusing our examination and enforcement resources on those advisers to private funds that appear to present greater compliance risks. We also are requiring all registered advisers to provide us with additional information on their operations to allow us to more efficiently allocate our examination resources, to better prepare for on-site examinations, and to provide us with a better understanding of the investment advisory industry to assist our

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810 5 U.S.C. 604(a).

811 We note that the FRFA analysis associated with the requirement that an accountant's report be filed electronically was included in our adoption of substantive amendments to Form ADV-E. Today, we are making only a technical amendment to Form ADV-E to conform to that prior rulemaking. *See* 2009 Custody Release, *supra* note 310, at section VI.

812 *See* Implementing Proposing Release, *supra* note 7, at section VI.

evaluation of the implications of policy choices we must make in administering the Advisers Act.

Specifically, the new rules and rule amendments give effect to provisions of Title IV of the Dodd-Frank Act that: (i) reallocate responsibility for oversight of investment advisers by delegating generally to the states responsibility over certain mid-sized advisers; (ii) repeal the "private adviser" exemption contained in section 203(b)(3) of the Advisers Act; and (iii) provide for reporting by advisers to certain types of private funds that are exempt from registration.[813] New rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 are intended to provide us a means of identifying advisers that must transition to state regulation, clarify the application of the new statutory provisions under the Dodd-Frank Act, and extend certain of the exemptions we have adopted under section 203A of the Act to mid-sized advisers. Rule 203-1(e) is intended to provide an orderly transition to registration for advisers that previously relied on the "private adviser" exemption in section 203(b)(3) of the Advisers Act. New rule 204-4 and amendments to rule 204-1 are intended to require exempt reporting advisers to submit, and to update periodically, reports to us by completing several items on Form ADV. The amendments to rule 204-2 are intended to account for the Dodd-Frank Act's elimination of the "private adviser" exemption under section 203(b)(3) of the Advisers Act and its addition of a definition of "private fund" to the Advisers Act.[814] The amendments to Form ADV will permit the form to serve as a reporting, as well as a registration, form and to specify the seven items exempt reporting advisers must complete. The amendments to Form ADV also will provide additional information on the operations of registered investment advisers. The amendments to Forms

813 *See supra* section I.

814 *See supra* section II.D.2.b. As discussed above, we are also rescinding rule 204-2(l), which was vacated by the federal appeals court in *Goldstein*.

ADV-NR and ADV-H will revise the forms for use by exempt reporting advisers. Additionally, we are amending the Advisers Act pay to play rule, rule 206(4)-5, to make it apply both to exempt reporting advisers and foreign private advisers, thereby preventing the unintended narrowing of the application of the rule resulting from the repeal of the "private adviser" exemption.[815] Furthermore, we are amending the rule to add the new "municipal advisor" category of registrant created by the Dodd-Frank Act to the categories of registered entities – referred to as "regulated persons" – excepted from the rule's prohibition on advisers paying third parties to solicit government entities.[816]

B. Significant Issues Raised by Public Comment

In the Implementing Proposing Release, we requested comment on the IRFA. In particular, we sought comment on the number of small entities, particularly small advisers, to which the new rules and rule amendments would apply and the effect on those entities, including whether the effects would be economically significant. None of the comment letters we received specifically addressed the IRFA. A couple of commenters made specific comments about the proposed rule and rule amendments' impact on smaller advisers, generally. In response to a question in the Implementing Proposing Release, one commenter stated that a shortened deadline, from 90 to 60 days, for filing an annual update to Form ADV would be particularly burdensome on small advisers because they have limited resources.[817] As discussed above, in light of this and similar concerns raised by other commenters, we are not adopting a requirement to accelerate the annual updating amendment deadline.[818] Another commenter asserted that we

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815 *See* amended rule 206(4)-5; *supra* section II.D.1.

816 *See id.*

817 Pickard Letter.

818 *See supra* section II.C. 7.

should retain the rule 203A-4 safe harbor for state-registered advisers that have a reasonable belief that they are prohibited from registration with the Commission as there has been, and continues to be, confusion among small advisers in calculating assets under management.[819] We have not retained the safe harbor, which, as we explain above, was designed for smaller advisory businesses (with assets under management of less than $30 million) that may not employ the same tools or otherwise have a need to calculate assets as precisely as advisers with greater assets under management.[820] Moreover, such a safe harbor would no longer apply to small advisers as it would be used, if at all, by advisers managing close to the new $100 million threshold for SEC registration and not the $30 million threshold that existed prior to the Dodd-Frank amendments to the Advisers Act.

C. Small Entities Subject to Rules and Rule Amendments

In developing these new rules and rule amendments, we have considered their potential impact on small entities to which they will apply. The rules and rule amendments will affect all advisers registered with the Commission and exempt reporting advisers, including small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[821]

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[819] NRS Letter.

[820] *See supra* section II.A.6.

[821] Rule 0-7(a) [17 CFR 275.0-7(a)].

Our rule and form amendments will not affect most advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with us. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators.[822] We estimate that as of April 7, 2011, approximately 570 advisers that were small advisers were registered with the Commission.[823] Because these advisers are registered, they will be subject to new rule 203A-5 and amendments to rules 0-7, 203-1, 204-2, 203A-1, 203A-2, 203A-3, and 203A-4, and Forms ADV and ADV-NR. In addition, we estimate that, due to the Dodd-Frank Act's elimination of the "private adviser" exemption in section 203(b)(3), an additional two small advisers will become subject to these rules.[824] Further, as a result of the amendments to rule 203A-2, we estimate that 15 additional multi-state small advisers will register with us and be subject to these rules,[825] and 18 pension consultants that are small advisers will be required to withdraw from registration with us and will no longer be subject to these rules.[826] We estimate

822 *See supra* section II.A.7.a.

823 Based on IARD data as of April 7, 2011, 572 advisers registered with the Commission were small advisers. We have rounded this number to 570 for purposes of this analysis.

824 We believe that the only small advisers that would become subject to registration as a result of the elimination of the private adviser exemption in section 203(b)(3) would be advisers to private funds that maintain their principal office and place of business in Wyoming. Based on IARD data as of April 7, 2011, we estimate that 28 SEC-registered small advisers are required to be registered with us because they have a principal office and place of business in Wyoming, which is 0.2% of all SEC-registered advisers (28 / 11,500 SEC-registered advisers = approximately 0.2%). We estimate that a similar proportion of the approximately 750 advisers to private funds that will register with the Commission due to the elimination of the private adviser exemption in section 203(b)(3) would be Wyoming-based small advisers. As a result, we estimate that approximately two small advisers to private funds will register with the Commission (750 private fund advisers x 0.2% = approximately two).

825 *See supra* note 555.

826 Based on IARD data as of April 7, 2011, 118 of the advisers that would be considered small advisers rely on the pension consultant exemption from registration. We estimate that approximately 15%, or 18, of these advisers would no longer be eligible to rely on the exemption

that four exempt reporting advisers that are small advisers will be subject to rule 204-4, and the amendments to rule 204-1, Form ADV, Form ADV-NR and Form ADV-H to give effect to the Dodd-Frank Act's reporting requirements by exempt reporting advisers.[827] We also estimate that four exempt reporting advisers that are small advisers will be subject to the amendments to rule 206(4)-5. Finally, all investment advisers, whether they are small advisers or not, will be subject to the technical amendments to rules 222-1 and 222-2. The small advisers subject to these amendments include approximately four exempt reporting advisers and approximately 14,600 state-registered advisers.[828]

as amended. This ratio is consistent with our estimate for the PRA burden. *See supra* section VI.E. and note 783.

827 The only small adviser exempt reporting advisers that would be subject to the rule and amendments would be exempt reporting advisers that maintain their principal office and place of business in Wyoming. The current practical effect of section 203A(a)(1) is to prohibit U.S. advisers with less than $25 million in assets under management from registering with the Commission *unless* they maintain their principal office or place of business in Wyoming. *See* NSMIA Adopting Release, *supra* note 17, at section II.E. Currently, all U.S. states except Wyoming require certain investment advisers to register. See Transition Rule for Ohio Investment Advisers, Investment Advisers Act Release No. 1794, n. 4 (Mar. 25, 1999) [64 FR 15680 (Apr. 1, 1999)]. New rule 204-4 requires an adviser relying on an exemption under new sections 203(l) or (m) of the Advisers Act to complete and file reports on Form ADV. *See* new rule 204-4; *supra* section II.B.1. The exemptions from registration in sections 203(l) and (m) apply to advisers solely to venture capital funds and advisers solely to private funds with less than $150 million in assets under management, respectively. Small Wyoming-based advisers to venture capital funds or private funds may be required to register with the Commission but for the exemptions in section 203(l) or (m). Thus, these advisers would be subject to rule 204-4 and the amendments to rule 204-1, Form ADV, and Form ADV-H to give effect to the Dodd-Frank Act's mandate for reporting by exempt reporting advisers. Assuming that the proportion of registered Wyoming-based small advisers to registered advisers is similar to the proportion of small Wyoming-based exempt reporting advisers to exempt reporting advisers generally, we estimate that approximately four exempt reporting advisers that are small advisers would be subject to rule 204-4 and the amendments to rule 204-1, Form ADV, and Form ADV-H (2,000 exempt reporting advisers x 0.2% = four small Wyoming-based exempt reporting advisers).

828 Based on IARD data as of January 1, 2011, we estimate that there were approximately 14,600 state-registered advisers. Because section 203A currently precludes most advisers with less than $25 million in assets under management from registering with the Commission, we assume that nearly all of the 14,600 state-registered advisers are small advisers. Therefore, 14,600 small advisers (registered with the states as of January 1, 2011) + 18 small advisers (registering with the states due to the amendment to the pension consultant exemption in rule 203A-2(b)) – 2 small advisers (registering with the Commission due to elimination of the private adviser exemption in

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

The rules and rule amendments we are adopting today impose certain reporting, recordkeeping, and compliance requirements on advisers, including small advisers. The rules and amendments require all of the small advisers registered with us to file an amended Form ADV, require some to file Form ADV-W, and require some to file reports as exempt reporting advisers. The amendments also cause the advisers to be subject to the existing recordkeeping and compliance requirements for SEC-registered advisers. These requirements and the burdens on small advisers are discussed below.[829]

Transition to State Registration

Rule 203A-5 imposes costs on all investment advisers, including small advisers, by requiring *each* investment adviser registered with us on January 1, 2012 to file an amendment to its Form ADV no later than March 30, 2012, and withdraw from Commission registration by June 28, 2012, if no longer eligible.[830] We estimate that all of the 570 small advisers currently registered with the Commission will file Form ADV, but none will withdraw registration because the Dodd-Frank Act does not change the eligibility requirements for small advisers registered with us since they already rely on one or more of the exemptions from the prohibition on registration.[831]

Switching Between State and Commission Registration

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section 203(b)(3)) – 15 small advisers (de-registering with the states and registering with the Commission due to the amendment to the multi-state adviser exemption in rule 203A-2(e)) = approximately 14,600 state-registered advisers that are small advisers.

829 *Supra* sections I. through II. describe these requirements in more detail.

830 New rule 203A-5(b)-(c). *See supra* section II.A.1.

831 *See* section 410 of the Dodd-Frank Act; rule 203A-2.

The amendments to rule 203A-1 eliminate the $5 million buffer in current rule 203A-1(a), which permits an adviser to register with the Commission if the adviser has between $25 million and $30 million of assets under management, and replaces it with a similar buffer for mid-sized advisers with assets under management of close to $100 million.[832] By definition, a small adviser under the Advisers Act has less than $25 million in assets under management; as such, these amendments should have no impact on small advisers.[833]

Exemptions from the Prohibition on Registration with the Commission

The amendments we are adopting to two of the three exemptions from the prohibition on registration in rule 203A-2 will cause small advisers to be subject to new reporting, recordkeeping, and other compliance requirements.[834] The amendment to the exemption from the prohibition on registration available to pension consultants in rule 203A-2(b) will increase the minimum value of plan assets on which an adviser must consult from $50 million to $200 million.[835] We estimate that this may cause approximately 18 small adviser pension consultants to be required to withdraw from registration with us by filing Form ADV-W and thus no longer be subject to Commission rules.[836] These advisers will likely need to register with one or more states, and comply with the states' recordkeeping and other regulatory requirements. These additional costs will have a negative impact on competition for these advisers compared to

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832 *See* amended rule 203A-1; *supra* section II.A.4.

833 *See* rule 0-7(a)(1).

834 *See* amended rule 203A-2; *supra* section II.A.5. The elimination of the exemption from the prohibition on Commission registration for NRSROs in rule 203A-2(a) will not affect small advisers because, based on IARD data as of April 7, 2011, none of the advisers registered with us relies on the exemption.

835 We also are renumbering the rule as rule 203A-2(a). *See* amended rule 203A-2(a); *supra* section II.A.5.b.

836 *See supra* note 826 and accompanying text.

pension consultants with more than $200 million of plan assets that will remain registered with the Commission.

The amendment to the multi-state adviser exemption in rule 203A-2(e) will permit all investment advisers who are required to register as an investment adviser with 15 or more states to register with the Commission, rather than 30 states, as currently required.[837] An adviser relying on this exemption will continue to report certain information on Form ADV[838] and maintain a record of the states in which the investment adviser has determined it would, but for the exemption, be required to register. This will promote competition by making the standards for the multi-state exemption consistent for small and mid-sized advisers. We estimate that, in addition to the approximately 19 small advisers that rely on the exemption currently,[839] approximately 15 will begin relying on the exemption, as amended.[840] Advisers newly relying on the amended exemption will incur costs associated with completing and filing Form ADV for purposes of registration with the Commission, and all of the advisers relying on the exemption will incur the costs associated with keeping records sufficient to demonstrate that they would be required to register with 15 or more states. In addition, these advisers will incur costs of

[837] We also are renumbering the rule as rule 203A-2(d). *See* amended rule 203A-2(d); *supra* section II.A.5.c.

[838] Advisers will be required to: (i) include a representation on Schedule D of Form ADV that the investment adviser has concluded that it must register as an investment adviser with 15 or more states; and (ii) undertake to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 states to register as an investment adviser with those states. *See* amended rule 203A-2(d)(2).

[839] Based on IARD data as of April 7, 2011, 19 advisers checked Item 12 of Part 1A of Form ADV to indicate that they are small advisers and checked Item 2.A.(9) to indicate their basis for SEC registration under the multi-state rule.

[840] *See supra* note 555.

complying with the Advisers Act and our rules, but they may see an absolute reduction in compliance costs by registering with the Commission instead of 15 or more states.[841]

Elimination of Safe Harbor

Eliminating rule 203A-4, which has provided a safe harbor from Commission registration for an investment adviser that is registered with state securities authorities based on a reasonable belief that it is prohibited from registering with the Commission because it does not have at least $30 million of assets under management, will not create new requirements for small advisers.[842] These advisers will not have at least $30 million of assets under management, and advisers have not, in our experience, relied on this safe harbor.

Mid-Sized Advisers

Providing in instructions to Form ADV an explanation of whether a mid-sized adviser is "required to be registered" or is "subject to examination" by a particular state securities authority for purposes of section 203A(a)(2)'s prohibition on mid-sized advisers from registering with the Commission will not create new reporting requirements for small advisers.[843] The mid-sized adviser requirements will only apply to advisers with assets under management between $25 million and $100 million and therefore will not apply to small advisers.

Exempt Reporting Advisers

Rule 204-4 and the amendments to rules 204-1, Form ADV, and Form ADV-H require exempt reporting advisers to file reports with the Commission electronically on Form ADV and impose reporting requirements on an estimated four small advisers.[844] As discussed above, we

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[841] *See supra* section II.A.5.c., note 543 and accompanying text.

[842] Rule 203A-4. *See supra* section II.A.6.

[843] *See* amended Form ADV: Instructions for Part 1A, instr. 2.b.; *supra* section II.A.7.

[844] *See supra* section II.B. and note 827.

estimate that completing and filing Form ADV will cost $2,032 for each exempt reporting adviser.[845] In addition, small exempt reporting advisers would be required to pay an estimated filing fee of $225 annually,[846] for a total of $900 for the estimated four small exempt reporting advisers.[847] Finally, under rule 204-4 exempt reporting advisers that seek a temporary hardship exemption from electronic filing must complete and file Form ADV-H.[848] To the extent any of the four small exempt reporting advisers file Form ADV-H, we have estimated that it would require one burden hour at a total cost of $189.[849]

Amendments to Form ADV

The amendments to Form ADV that we are adopting today will require registered advisers to report information that is different from, or in addition to, what is currently required. Approximately 570 currently registered small advisers, and two small advisers currently relying on the private adviser exemption that we expect will register with us, will be subject to these requirements.[850] We expect these 570 advisers will spend, on average, 4.5 hours to respond to the new and amended questions on Form ADV, other than the private fund reporting requirements.[851] We expect the aggregate cost associated with this process will be $651,511.[852]

845 *See supra* note 579 and accompanying text. $4,064,000 / 2,000 = $2,032.

846 *See supra* notes 567-568 and accompanying text (discussing the potential filing fee).

847 $225 x 4 small exempt reporting advisers = $900.

848 New rule 204-4(e).

849 *See supra* note 596 and accompanying text.

850 *See supra* notes 823 and 824 and accompanying text.

851 *See supra* text preceding note 679. We are calculating costs only of the increased burden because we have previously assessed the costs of the other items of Form ADV for registered advisers and for new advisers attributed to annual growth. The amendments to Form ADV increase neither the burden associated with these items on Form ADV, nor the external costs associated with certain Part 2 requirements.

852 We expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA Management and Earnings Report, modified to account for an 1,800-hour work-year and multiplied by 5.35 to

The two anticipated newly registering advisers will spend, in the aggregate, about 101 hours total to complete the form (Part 1 except for the private fund reporting requirements, and Part 2) as well as to amend the form periodically, to prepare brochure supplements, and to deliver codes of ethics to clients,[853] for a total cost of $25,655.[854] In addition, of these approximately 572 registered advisers, we estimate that 50 advise one or more private funds and will have to complete the private fund reporting requirements we are adopting today.[855] We expect this will take 150 hours,[856] in the aggregate, for a total cost of $38,100.[857] The total estimated labor costs associated with our Form ADV amendments that we expect will be borne by small advisers, therefore, are $715,266. Additionally, we estimate that one of the newly registering advisers will

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account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $235 and $273 per hour, respectively. 570 advisers x 4.5 hours = 2,565 hours. (1,282.5 hours x $235 = $301,388) + (1,282.5 hours x $273 = $350,123) = $651,511.

853 2 advisers x (40.74 hours per adviser to complete entire form (except private fund reporting requirements)) + (1 annual updating amendment x 6.0 hours) + (1 interim updating amendment per year x 0.5 hours) + (1 hour on new brochure supplements) + (1 hour on interim amendments to brochure supplements) + (1.3 hours delivering codes of ethics to clients)) = 101 hours. *See supra* notes 679, 709, 710 and accompanying text.

854 (50.5 hours x $235 = $11,868) + (50.5 hours x $273 = $13,787) = $25,655. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 618.

855 Based on IARD data as of April 7, 2011. Form ADV currently asks an adviser to report about investment-related partnerships and limited liability companies advised by the adviser *and* its related persons. As a result, the data we have obtained from IARD over-estimates the average number of funds as a result of reporting of the same fund multiple times by affiliated registered advisers. We note the decrease in the estimated number of small advisers to private funds in the Implementing Proposing Release is primarily attributable to an increase in these advisers' assets under management, rendering them no longer "small" for purposes of FRFA. *See* Implementing Proposing Release, *supra* note 7 at n.516 and accompanying text.

856 We expect these advisers are likely to advise 3 funds each. *See* text accompanying note 698. We estimated above that private fund reporting would take an adviser approximately 1 hour per fund to complete. 50 advisers x 3 hours = 150 hours.

857 (75 hours x $235 = $17,625) + (75 hours x $273 = $20,475) = $38,100. As noted above, we expect that the performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. *See supra* note 522.

use outside legal services to assist them in preparing their Part 2 brochure, for a total non-labor cost of $3,200.[858]

Amendments to Pay to Play Rule

Our amendment to the pay to play rule to make it apply to exempt reporting advisers and foreign private advisers will not create new reporting, recordkeeping, or other compliance requirements for these advisers.[859] Rather, we are adopting this amendment to assure that the rule continues to apply to these advisers and to prevent the unintended narrowing of the rule.[860] Our amendment to the pay to play rule to add registered municipal advisors to the definition of "regulated persons" (*i.e.*, those excepted from the rule's ban on third-party solicitation) may create new recordkeeping and compliance requirements on investment advisers that are small advisers subject to the rule to the extent that they have to verify and document that persons that they hire to solicit government entities are indeed registered municipal advisors, if these solicitors do not otherwise meet the "regulated person" definition.[861]

Other Amendments

Our amendments to rule 204-2's grandfathering provision are meant to assure that private fund advisers that are required to register as a result of the Dodd-Frank Act's elimination of the private fund exemption in section 203(b)(3) will not face a retroactively imposed recordkeeping requirement.[862] We are also making a technical amendment to rule 204-2(e)(3)(ii) to a cross-

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858 The currently approved burden associated with Form ADV already accounts for similar estimated costs to be incurred by current registrants. The non-labor costs for Form ADV are based on an estimate that 50% of small advisers will retain either legal services (at $3,200) or compliance consulting services (at $3,000) to assist in the preparation of Form ADV. *See supra* notes 668 and 669 and accompanying text.

859 *See supra* section II.D.1 (discussing this amendment).

860 *See id.*

861 *See id.*

862 *See supra* section II.D.2.b.

reference to the new definition of a private fund in section 202(a)(29) of the Advisers Act.[863] These amendments will not create reporting, recordkeeping, and other compliance requirements for small advisers independent of the reporting, recordkeeping, and other compliance requirements imposed by current rule 204-2.[864]

We do not believe that our technical amendments to rules 0-7 and 222-1 will impose reporting, recordkeeping, and other compliance requirements on small advisers. Our amendment to rule 203-1 will not impose reporting, recordkeeping, and other compliance requirements on small advisers. Rather, it delays reporting, recordkeeping, and other compliance requirements on such advisers to the extent that they currently rely on the "private adviser" exemption in section 203(b)(3).[865] Because our amendments to rule 222-2 will require advisers to count clients from whom they do not receive compensation for purposes of the national *de minimis* standard, some small advisers may be required to register with one or more states, and comply with the states' recordkeeping and other regulatory requirements.[866]

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small advisers. In considering whether to adopt the new rules and rule amendments, the Commission considered the following alternatives: (i) the establishment of differing

863 *See id.*

864 The Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3) may require additional small advisers to register with the Commission. Therefore, these small advisers would become subject to rule 204-2 with its reporting, recordkeeping, and other compliance burdens. However, subjecting these entities to rule 204-2 is a function of the Dodd-Frank Act's removal of the private adviser exemption in section 203(b)(3), not our amendments to rule 204-2.

865 *See supra* section III.B.2.

866 *See supra* section II.D.2.e (discussing the amendments to rule 222-2).

compliance or reporting requirements or timetables that take into account the resources available to small advisers; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rules for such small advisers; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rules, or any part thereof, for such small advisers.

Regarding the first and fourth alternatives, we do not believe that differing compliance or reporting requirements or an exemption from coverage of the new rules or rule amendments, or any part thereof, for small advisers would be appropriate or consistent with investor protection or with Congress's mandate in the Dodd-Frank Act, to the extent the new rule or amendment is being adopted due to a Congressional mandate. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small advisory firms, it would be inconsistent with the purposes of the Act to specify different requirements for small advisers under the new rules and amendments unless expressly required to do so by Congress.

Regarding the second alternative, rule 203A-5 will enable small advisers to easily and efficiently identify whether they are subject to our regulatory authority after the Dodd-Frank Act's amendment to section 203A becomes effective, and will also help minimize any potential uncertainty about the effects of the Dodd-Frank Act on their registration status by providing a simple, efficient means of determining their post-Dodd-Frank registration status as of a specific date. The amendments to rule 203A-1 eliminate the $5 million buffer because it seems unnecessary in light of Congress's determination generally to require most advisers having between $30 million and $100 million of assets under management to be registered with the states,[867] and makes the registration requirements for advisers with assets under management

[867] *See supra* note 426 and accompanying text.

between $25 million and $30 million uniform with the requirements for advisers with assets under management between $30 million and $100 million. The buffer for advisers with close to $100 million of assets under management will prevent advisers from frequently having to switch to and from Commission registration due to market fluctuations and will eliminate the additional associated costs they would therefore incur.[868] Amending the multi-state adviser exemption in rule 203A-2(e) also will consolidate and simplify compliance for small advisers by aligning the rule with the multi-state exemption Congress built into the mid-sized adviser provision under section 410 of the Dodd-Frank Act and by requiring one standard for advisers relying on the exemption.[869] This amendment also will reduce the compliance burdens on advisers required to be registered with at least 15 states, but less than 30, by allowing them to register with a single securities regulator—the Commission. Furthermore, requiring the use of an existing form, Form ADV, and an existing filing system, the IARD, for reporting and registration purposes will clarify and simplify the processes of registering and/or reporting for small advisers because: (i) all of the information collection requirements for both registration and reporting will be consolidated in a single form; (ii) a small exempt reporting adviser will be able to use the same form and filing system both for reporting and for purposes of registering with one or more state securities authorities; and (iii) a small exempt reporting adviser may find that it can no longer

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868 *See supra* note 427 and accompanying text.

869 *See* amended rule 203A-2(d); *supra* section V.A.1. Under rule 203A-2(e), the prohibition on registration with the Commission does not apply to an investment adviser that is required to register with 30 or more states. Once registered with the Commission, the adviser remains eligible for Commission registration as long as it would be obligated, absent the exemption, to register with at least 25 states. We are amending rule 203A-2(e) to permit all investment advisers required to register as an investment adviser with 15 or more states to register with the Commission.

rely on an exemption from registration with the Commission and will be able to register simply by filing an amendment to its current Form ADV to apply for registration.[870]

Regarding the third alternative, we do not consider using performance rather than design standards to be consistent with Congress's mandate in the Dodd-Frank Act.

VIII. EFFECTS ON COMPETITION, EFFICIENCY AND CAPITAL FORMATION

The Commission is adopting certain new rules and amending others pursuant to its authority under sections 204(a) and 206A of the Advisers Act,[871] and sections 23(a) and 28(e)(2) of the Exchange Act.[872] Section 204(a) of the Advisers Act and section 28(e)(2) of the Exchange Act require the Commission, when engaging in rulemaking under the authority provided in those sections, to consider whether the rule is "necessary or appropriate in the public interest or for the protection of investors."[873] Section 202(c) of the Advisers Act requires that whenever the Commission is engaged in rulemaking and is required, pursuant to the Advisers Act, to consider or determine whether an action is necessary or appropriate in the public interest, the Commission must also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[874] Section 3(f) of the Exchange Act imposes the same requirements on the Commission's Exchange Act rulemakings.[875] Section 23(a) of the Exchange Act requires the Commission, in adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and prohibits the Commission from

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[870] *See supra* section II.C.

[871] 15 U.S.C. 80b-4(a), 80b-6A.

[872] 15 U.S.C. 78w(a) and 78bb(e)(2).

[873] 15 U.S.C. 80b-4(a) and 78bb(e)(2).

[874] 15 U.S.C. 80b-2(c).

[875] 15 U.S.C. 78c(f).

adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[876]

The Commission is adopting rule 204-4 and amending rules 203-1, 204-1, and 204-2 and Forms ADV, ADV-NR, and ADV-H.[877] The new rule and rule amendments are designed to give effect to provisions of Title IV of the Dodd-Frank Act.[878] We are adopting new rule 204-4 to require exempt reporting advisers to file reports with the Commission electronically on Form ADV.[879] We are adopting amendments to Form ADV to improve our risk-assessment capabilities and so that it can serve the dual purpose of an SEC reporting form for exempt reporting advisers and, as it is used today, a registration form for both state and SEC-registered firms.[880] In addition to requiring that exempt reporting advisers use Form ADV, rule 204-4 will require these advisers to submit reports through the IARD and to pay a filing fee.[881] We are also amending rule 204-1, which addresses when and how advisers must amend their Form ADV, to add a requirement that exempt reporting advisers file updating amendments to reports filed on

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876 15 U.S.C. 78w(a)(2).

877 In contrast, we are adopting new rule 203A-5 and amendments to rules 203A-1, 203A-2, 203A-3, and 203A-4 pursuant to our authority set forth in sections 203A(a)(2), 203A(c) and 211(a), amendments to rules 0-7, 222-1, and 222-2 pursuant to our authority set forth in section 211(a), and amendments to rule 206(4)-5 pursuant to our authority set forth in sections 206(4) and 211(a). For a discussion of the effects of this new rule and rule amendments on competition, efficiency, and capital formation, see *supra* sections V., VI., and VII. We note that our analysis of the effects on competition, efficiency, and capital formation associated with the requirement that an accountant's report be filed electronically was included in our adoption of substantive amendments to that form. Today, we are making only a technical amendment to Form ADV-E to conform to that prior rulemaking. *See* 2009 Custody Release, *supra* note 310 at section VII.

878 For a discussion of the overall objectives of our rules and rule amendments, see *supra* section I.

879 New rule 204-4. *See supra* section II.B.1.

880 *See supra* sections II.B. and II.C.

881 New rule 204-4(b). New rule 204-4(e) also allows exempt reporting advisers having unanticipated technical difficulties that prevent submission of a filing to the IARD system to request a temporary hardship exemption from electronic filing requirements by filing Form ADV-H. We are also adopting technical amendments to Form ADV-H for this purpose.

Form ADV.[882] Finally, we are amending rule 203-1 to allow an adviser that was relying on, and was permitted to rely on, the "private adviser" exemption in section 203(b)(3) on July 20, 2011, to delay registering with the Commission until March 30, 2012.[883]

In the Implementing Proposing Release, we solicited comment on whether the proposed rule and rule amendments would, if adopted, promote efficiency, competition, and capital formation. We further encouraged commenters to provide empirical data to support their views. We did not receive any empirical data in this regard concerning the proposed amendments. We received some comments, addressing competition and efficiency generally, which are addressed below.

A. Exempt Reporting Adviser Reporting Requirements

The Dodd-Frank Act provides for the Commission to require reporting by exempt reporting advisers, but it does not indicate the information we should collect or the filing method by which it should be collected. Our choices, in adopting rule 204-4 to require these advisers to complete a subset of items contained in Form ADV and to file through the IARD, and in amending rule 204-1 to impose periodic updating requirements of those filings, will impose costs on exempt reporting advisers.[884] However, as we asserted in the Implementing Proposing Release, our choices also will create efficiencies that benefit both us and filers by taking advantage of an established and proven adviser filing system and avoiding the expense and delay of developing a new form and filing system. Commenters widely agreed with us,[885] with one

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882 *See* amended rule 204-1; *supra* section II.B.3.

883 *See* amended rule 203-1(e); *supra* section III.B.2.

884 For a discussion of the costs of the reporting obligations we are applying to exempt reporting advisers, see section V.B.2.

885 Two commenters urged that we create a separate reporting system. Merkl Implementing Letter; Seward Letter. *See also* Shearman Letter (making arguments regarding the potential for investor confusion, but not advocating use of a different form or reporting system). However, as we stated

stating that, in its view, there is "no reason to create a new form or filing system when the existing ones have been designed for use by advisers and are suitable for that purpose."[886] In addition, because an exempt reporting adviser may be required to register on Form ADV with one or more state securities authorities, use of the existing form and filing system (which is shared with the states) should reduce regulatory burdens for them because they can satisfy multiple filing obligations through a uniform reporting instrument.[887] Several commenters agreed and also expressed the view that use of Form ADV and the IARD for exempt reporting advisers would be efficient, because the system is familiar to many advisers.[888] Similarly, commenters agreed with our expectation that regulatory burdens would be diminished for an exempt reporting adviser that later finds it can no longer rely on an exemption and would be required to register with us because the adviser would simply file an amendment to its current Form ADV to apply for Commission registration.[889] Finally, certain items in Form ADV Part 1 are also linked to Form BD, which would create efficiencies if the exempt reporting adviser were to apply for broker-dealer registration.

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above, the expense and delay of developing a system with adequate functionality, which neither commenter addressed, argues against these commenters' recommendations for a new form and electronic filing system. *See supra* section II.B.1.

886 ABA Committees Letter. *See also* AFL-CIO Letter; NRS Letter; Better Markets Letter; NASAA Letter; ABA Committees Letter. We anticipate that the IARD's ability to pre-populate prior responses and allow drop-down boxes for common responses will also save time for advisers.

887 *See supra* note 170 and accompanying text.

888 *See* Better Markets Letter; NRS Letter; NASAA Letter. Responding to our request for comment regarding the possible use of EDGAR in place of the IARD, one commenter argued that "[s]uch an approach would be confusing and burdensome for any adviser that transitions between [exempt reporting adviser] and Commission-registered status." ABA Committees Letter.

889 *See* ABA Committees Letter; Better Markets Letter; NRS Letter; NASAA Letter. Form ADV, as amended, permits an adviser to transition from filing reports with us to applying for registration under the Act by simply amending its Form ADV; the adviser would check the box to indicate it is filing an initial application for registration, complete the items it did not have to answer as an exempt reporting adviser, and update the pre-populated items that it already has on file. *See* amended Form ADV: General Instruction 15 (providing procedural guidance to advisers that no longer meet the definition of exempt reporting adviser).

Using Form ADV and the IARD also will enable investors to access information on our website that may have previously been unavailable or not easily attainable, such as whether a prospective exempt reporting adviser has reported disciplinary events and whether its relationships with affiliates present conflicts of interest or potential efficiencies. Indeed, commenters indicated that an investor would be better able to perform due diligence if the information was made available to the public,[890] and could make an informed decision regarding the integrity of a prospective adviser if he or she were able to review the disciplinary history of the exempt reporting adviser and its employees.[891] As we asserted in the Implementing Proposing Release, public access to this information, which may previously have been undisclosed, may promote competition to the extent that it will allow private fund investors to make informed decisions about these advisers, avoiding the burdens and costs associated with selling private funds to switch advisers at a later date, and thereby potentially creating efficiency gains in the marketplace and enhancing allocative efficiency of client assets among investment advisers.[892] The availability of disciplinary information, in particular, about these advisers and their supervised persons may also enhance competition if, for example, firms and personnel with better disciplinary records outcompete those with worse records. Greater competition among advisers may, in turn, benefit clients. Access to the information we are requiring exempt reporting advisers to report may also increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets. This may enhance capital formation by making more assets available for investment and enhancing the allocation of capital generally.

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890 Merkl Implementing Letter.

891 CII Letter.

892 *See* Implementing Proposing Release, *supra* note 7, at section VII.A.

Several commenters, however, stated that public availability of the information we proposed to be reported would impose costs on advisers (and in some cases their supervised persons or owners) including the potential loss of business to competitors, as the information was not typically made available to others previously and may not be required of unregistered competitors.[893] Some commenters expressed concerns that some of the information we proposed to require also could include proprietary or competitively sensitive information regarding private funds.[894] We have responded to some of these concerns by declining to adopt certain questions that commenters suggested could require particularly proprietary or competitively sensitive information, such as certain data about beneficial owners.[895] Nonetheless, as discussed above in greater detail, based on section 210 of the Act, which presumes reports submitted to us by advisers will be publicly available, together with the Freedom of Information Act, which generally supports disclosure of such documents, we decline to deny the public access to all of this information at this time.[896]

Finally, to the extent that the information we collect and the filing method by which we collect it impose costs on exempt reporting advisers that are then passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. As

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893 *See* BCLBE Letter; NRS Letter; Seward Letter (claiming that the reporting may be valuable to the Commission, but making the information publicly available would provide little benefit to investors, and asserting that the benefits were insufficient to justify the costs).

894 *See, e.g.*, MFA Letter; NVCA Letter; O'Melveny Letter. Another commenter, however, refuted these competitive concerns, stating that none of the items that exempt reporting advisers would complete would require the disclosure of proprietary or competitively sensitive information. Merkl Implementing Letter.

895 *See supra* notes 245-247 and accompanying text.

896 *See supra* section II.B.3.

we acknowledged in the Implementing Proposing Release, this may result in inefficiencies in the market for advisory services and hinder capital formation.[897]

B. Risk-Assessment Amendments to Form ADV

The amendments to Form ADV we are adopting today are designed to improve advisers' disclosure of their business practices (particularly those relating to advising private funds), non-advisory activities, financial industry affiliations, and conflicts of interest. Private fund reporting, in particular, will benefit private fund investors and other market participants and will provide us and other policy makers with better data. Better data will enhance our ability to form and frame regulatory policies regarding the private fund industry and fund advisers and to evaluate the effect of our policies and programs on this industry. Private fund reporting will provide us with important information about this rapidly growing segment of the U.S. financial system. Additionally, data about which advisers have $1 billion or more in total balance sheet assets will enable us to identify the advisers that are covered by section 956 of the Dodd-Frank Act, which addresses certain incentive-based compensation arrangements.

As acknowledged above with respect to exempt reporting advisers, there may also be a competitive impact among registered investment advisers as a result of the collection of the additional information on Form ADV in connection with the amendments we are adopting today. We raised several examples of competitive impacts in the Implementing Proposing Release.[898] For instance, information regarding the amount of assets under management by specific types of clients could be used by competitors when marketing their own advisory services.[899] We are adopting a modified version of this item as it was proposed, which we expect will alleviate

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897 *See* Implementing Proposing Release, *supra* note 7, at section VII.A.

898 *See id.* at section VII.B.

899 *See supra* section II.C.2. (discussing Item 5.D.(2)).

commenters' concerns about the costs and burdens of the proposed item,[900] but which we do not expect will alter this competitive impact. Another example we noted in the Implementing Proposing Release includes the information concerning private funds that registered and exempt reporting advisers are required to submit on Form ADV, which could assist private fund investors in assessing investment choices or screening funds based on certain parameters, such as the identification of certain fund service providers or gatekeepers. Amendments we are adopting to Form ADV will not prevent this information from being used by other financial service providers (such as banks or broker-dealers) that do not provide similar information publicly.

We continue to believe that increased competition among investment advisers (both exempt reporting and registered) and other financial service providers will result in capital being allocated more efficiently, benefiting clients and certain advisers. Commenters did not address the above examples or provide empirical data about the competitive effects of the proposal.

Finally, as noted above and in the Implementing Proposing Release, better disclosure may increase clients' and prospective clients' trust in investment advisers, which may encourage them to seek professional investment advice and encourage them to invest their financial assets.[901] This also may enhance capital formation by making more assets available for investment and enhancing the allocation of capital generally. On the other hand, if the rule amendments we are adopting increase costs for investment advisers and these cost increases are passed on to clients, this may deter clients from seeking professional investment advice and investing their financial assets. This may result in inefficiencies in the market for advisory services and hinder capital formation.

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900 *See id. See* IAA General Letter.

901 *See* Implementing Proposing Release, *supra* note 7, at section VII.B.

C. Other Amendments

Finally, we are amending rule 203-1 to allow an adviser that was relying on, and was permitted to rely on, the "private adviser" exemption in section 203(b)(3) on July 20, 2011, to delay registering with the Commission until March 30, 2012. We believe that this temporary extension of the registration deadline will assure an orderly transition to registration and thus will promote efficiency. We believe that this temporary extension will have minimal, if any, effects on competition or capital formation.

We are also amending rule 204-2 to cross-reference the new definition of private fund and add a grandfathering provision relieving firms that were exempt from registration prior to the effectiveness of the Dodd-Frank Act's elimination of the "private adviser" exemption from certain recordkeeping obligations applicable to registered advisers.[902] Finally, we are amending Forms ADV-NR and Form ADV-H to provide for their use by exempt reporting advisers. The amendments to rule 204-2, Form ADV-NR, and Form ADV-H are technical in nature. We do not anticipate that they will have any bearing on efficiency, competition, or capital formation.

IX. STATUTORY AUTHORITY

The Commission is removing rules 202(a)(11)-1, 203(b)(3)-1, and 203(b)(3)-2 under the Investment Advisers Act of 1940 pursuant to the authority set forth in section 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-11(a)], adopting new rule 203A-5 and amendments to rules 203A-2, 203A-3, and 203A-4 under the Advisers Act pursuant to the authority set forth in sections 203A(c) and 211(a) of the Advisers Act [15 U.S.C. 80b-3A(c) and 80b-11(a)]; amendments to rule 203A-1 under the Advisers Act pursuant to the authority set forth in sections 203A(a)(2)(B)(ii) (as amended by section 410 of the Dodd-Frank Act), 203A(c),

[902] *See supra* section II.D.2.b.

and 211(a) of the Advisers Act [15 U.S.C. 80b-3A(a)(2)(B)(ii), 80b-3A(c), and 80b-11(a)]; amendments to rule 203-1 under the Advisers Act pursuant to the authority set forth in section 206A of the Advisers Act [15 U.S.C. 80b-6A]; new rule 204-4 and amendments to rules 204-1 and 204-2 under the Advisers Act pursuant to the authority set forth in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)]; amendments to rule 206(4)-5 under the Advisers Act pursuant to authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]; amendments to rules 0-7, 222-1, and 222-2 under the Advisers Act pursuant to authority set forth in section 211(a) of the Advisers Act [15 U.S.C. 80b-11(a)]; and to amend Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Exchange Act [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-NR under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], section 23(a) of the Exchange Act [15 U.S.C. 78w(a)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 77sss(a)], section 38(a) of the Investment Company Act [15 U.S.C. 78a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]; Form ADV-H pursuant to the authority set forth in sections 203(c)(1), 204, and 211(a) of the Advisers Act [15 U.S.C. 80b-3(c)(1), 80b-4, 80b-11(a)]; and Form ADV-E pursuant to authority set forth in sections 204, 206(4), and 211(a) of the Advisers Act [15 U.S.C. 80b-4, 80b-6(4), and 80b-11(a)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities.

TEXT OF RULE AND FORM AMENDMENTS

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

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 is amended by revising the general authority and by adding authority for sections 275.203A-3, 275.203A-5, 275.204-1 and 275.204-4 in numerical order to read as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

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Section 275.203A-3 is also issued under 15 U.S.C. 80b-3a.

Section 275.203A-5 is also issued under 15 U.S.C. 80b-3a.

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Section 275.204-1 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

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Section 275.204-4 is also issued under sec. 407 and 408, Pub. L. 111-203, 124 Stat. 1376.

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2. Section 275.0-7 is amended by revising the reference to "Section 203A(a)(2)" in paragraph (a)(1) to read "Section 203A(a)(3)."

3. Section 275.202(a)(11)-1 is removed.

4. Section 275.203-1 is amended by adding paragraph (e) to read as follows:

§ 275.203-1 Application for investment adviser registration.

* * * * *

(e) *"Private Adviser" Transition Rule.* If you are exempt from registration with the Commission as an investment adviser under, and are not registered in reliance on, section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)) on July 20, 2011, you are exempt from registration with the Commission as an investment adviser until March 30, 2012, provided that you:

(1) During the course of the preceding twelve months, have had fewer than fifteen clients; and

(2) Neither hold yourself out generally to the public as an investment adviser nor act as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), or a company which has elected to be a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-54) and has not withdrawn its election.

5. Section 275.203(b)(3)-1 is removed.

6. Section 275.203(b)(3)-2 is removed.

7. Section 275.203A-1 is revised to read as follows:

§ 275.203A-1 Eligibility for SEC registration; Switching to or from SEC registration.

(a) *Eligibility for SEC registration of mid-sized investment advisers*—If you are an investment adviser described in section 203A(a)(2)(B) of the Act (15 U.S.C. 80b-3a(a)(2)(B)):

(1) *Threshold for SEC registration and registration buffer.* You may, but are not required to register with the Commission if you have assets under management of at least $100,000,000 but less than $110,000,000, and you need not withdraw your registration unless you have less than $90,000,000 of assets under management.

(2) *Exceptions*. This paragraph (a) does not apply if:

(i) You are an investment adviser to an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a) or to a company which has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940 (15 U.S.C. 80a-54), and has not withdrawn the election; or

(ii) You are eligible for an exemption described in § 275.203A-2 of this chapter.

(b) *Switching to or from SEC registration—*

(1) *State-registered advisers—switching to SEC registration.* If you are registered with a state securities authority, you must apply for registration with the Commission within 90 days of filing an annual updating amendment to your Form ADV reporting that you are eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)).

(2) *SEC-registered advisers—switching to State registration.* If you are registered with the Commission and file an annual updating amendment to your Form ADV reporting that you are not eligible for SEC registration and are not relying on an exemption from registration under sections 203(l) or 203(m) of the Act (15 U.S.C. 80b-3(l), (m)), you must file Form ADV-W (17 CFR 279.2) to withdraw your SEC registration within 180 days of your fiscal year end (unless you then are eligible for SEC registration). During this period while you are registered with both the Commission and one or more state securities authorities, the Act and applicable State law will apply to your advisory activities.

8. Section 275.203A-2 is amended by:

a. Removing paragraph (a);

b. Redesignating paragraphs (b) through (f) as paragraphs (a) through (e);

c. Revising newly designated paragraph (a)(1);

d. Revising the reference to "paragraph (b) of this section" in newly designated paragraph (a)(2) to read "paragraph (a) of this section";

e. Revising newly designated paragraph (c)(1);

f. Revising newly designated paragraph (d)(1);

g. Further redesignating newly designated paragraphs (d)(2) and (d)(3) as paragraphs (d)(2)(i) and (d)(2)(ii);

h. Adding new introductory text to paragraph (d)(2) and revising newly designated paragraphs (d)(2)(i) and (d)(2)(ii);

i. Further redesignating newly designated paragraph (d)(4) as paragraph (d)(3);

j. Revising the reference to "paragraph (f) of this section" in newly designated paragraphs (e)(1)(ii), (e)(1)(iii), and (e)(2) to read "paragraph (e) of this section";

k. Revising the reference to "paragraph (f)(1)(i) of this section" in newly designated paragraphs (e)(1)(ii) and (e)(3) to read "paragraph (e)(1)(i) of this section";

l. Revising the reference to "paragraph (c) of this section" in newly designated paragraph (e)(1)(iii) to read "paragraph (b) of this section"; and

m. Revising the reference "§ 275.203(b)(3)-1" in newly designated paragraph (e)(3) to read "§ 275.202(a)(30)-1".

The revisions and additions read as follows:

§ 275.203A-2 Exemptions from prohibition on Commission registration.

(a) *Pension Consultants.* (1) An investment adviser that is a "pension consultant," as defined in this section, with respect to assets of plans having an aggregate value of at least $200,000,000.

* * * * *

(c) * * *

(1) Immediately before it registers with the Commission, is not registered or required to be registered with the Commission or a state securities authority of any State and has a reasonable expectation that it would be eligible to register with the Commission within 120 days after the date the investment adviser's registration with the Commission becomes effective;

* * * * *

(d) * * *

(1) Upon submission of its application for registration with the Commission, is required by the laws of 15 or more States to register as an investment adviser with the state securities authority in the respective States, and thereafter would, but for this section, be required by the laws of at least 15 States to register as an investment adviser with the state securities authority in the respective States;

(2) Elects to rely on paragraph (d) of this section by:

(i) Indicating on Schedule D of its Form ADV that the investment adviser has reviewed the applicable State and federal laws and has concluded that, in the case of an application for registration with the Commission, it is required by the laws of 15 or more States to register as an investment adviser with the state securities authorities in the respective States or, in the case of an amendment to Form ADV, it would be required by the laws of at least 15 States to register as an investment adviser with the state securities authorities in the respective States, within 90 days prior to the date of filing Form ADV; and

(ii) Undertaking on Schedule D of its Form ADV to withdraw from registration with the Commission if the adviser indicates on an annual updating amendment to Form ADV that the investment adviser would be required by the laws of fewer than 15 States to register as an investment adviser with the state securities authority in the respective States, and that the investment adviser would be prohibited by section 203A(a) of the Act (15 U.S.C. 80b–3a(a)) from registering with the Commission, by filing a completed Form ADV-W within 180 days of the adviser's fiscal year end (unless the adviser then is eligible for SEC registration); and

* * * * *

9. Section 275.203A-3 is amended by revising paragraph (a)(4) and adding paragraphs (d) and (e) to read as follows:

§ 275.203A-3 Definitions.

* * * * *

(a) * * *

(4) Supervised persons may rely on the definition of "client" in §275.202(a)(30)–1 to identify clients for purposes of paragraph (a)(1) of this section, except that supervised persons need not count clients that are not residents of the United States.

* * * * *

(d) *Assets under management.* Determine "assets under management" by calculating the securities portfolios with respect to which an investment adviser provides continuous and regular supervisory or management services as reported on the investment adviser's Form ADV (17 CFR 279.1).

(e) *State securities authority.* "State securities authority" means the securities commissioner or commission (or any agency, office or officer performing like functions) of any State.

10. Section 275.203A-4 is removed and reserved.

11. Section 275.203A-5 is added to read as follows:

§ 275.203A-5 Transition rules.

(a) *Temporary exemption from prohibition on Commission registration for mid-sized investment advisers.* Until January 1, 2012, the prohibition of section 203A(a)(2) of the Act (15 U.S.C. 80b–3a(a)(2)) does not apply to an investment adviser registered with the Commission on July 21, 2011.

(b) *SEC-registered advisers—Form ADV filing.* Every investment adviser registered with the Commission on January 1, 2012 shall file an amendment to Form ADV (17 CFR 279.1) no later than March 30, 2012 and shall determine its assets under management based on the current market value of the assets as determined within 90 days prior to the date of filing the Form ADV.

(c) *Mid-sized investment advisers—withdrawing from Commission registration.*

(1) If an investment adviser registered with the Commission on January 1, 2012 would be prohibited from registering with the Commission under section 203A(a)(2) of the Act (15 U.S.C. 80b-3a(a)(2)), and is not otherwise exempted by § 275.203A-2 from such prohibition, such investment adviser shall withdraw from registration with the Commission by filing Form ADV-W (17 CFR 279.2) no later than June 28, 2012. During this period while an investment adviser is registered with both the Commission and one or more state securities authorities, the Act and applicable State law will apply to the investment adviser's advisory activities.

(2) If, prior to the effective date of the withdrawal from registration of an investment adviser on Form ADV-W, the Commission has instituted a proceeding pursuant to section 203(e) of the Act (15 U.S.C. 80b-3(e)) to suspend or revoke registration, or pursuant to section 203(h) of the Act (15 U.S.C. 80b-3(h)) to impose terms or conditions upon withdrawal, the withdrawal

from registration shall not become effective except at such time and upon such terms and conditions as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

12. Section 275.204-1 is amended by revising the heading, paragraphs (b) and (c) to read as follows:

§ 275.204-1 Amendments to Form ADV.

* * * * *

(b) Electronic filing of amendments.

(1) Subject to paragraph (c), you must file all amendments to Part 1A of Form ADV and Part 2A of Form ADV electronically with the IARD, unless you have received a continuing hardship exemption under §275.203-3. You are not required to file with the Commission amendments to brochure supplements required by Part 2B of Form ADV.

(2) If you have received a continuing hardship exemption under §275.203-3, you must, when you are required to amend your Form ADV, file a completed Part 1A and Part 2A of Form ADV on paper with the SEC by mailing it to FINRA.

Note to paragraphs (a) and (b): Information on how to file with the IARD is available on our website at www.sec.gov/iard. For the annual updating amendment: summaries of material changes that are not included in the adviser's brochure must be filed with the Commission as an exhibit to Part 2A in the same electronic file; and if you are not required to prepare a brochure, a summary of material changes, or an annual updating amendment to your brochure, you are not required to file them with the Commission. See the instructions for Part 2A of Form ADV.

(c) Transition to electronic filing. If you are required to file a brochure and your fiscal year ends on or after December 31, 2010, you must amend your Form ADV by electronically filing with the IARD one or more brochures that satisfy the requirements of Part 2A of Form ADV (as amended effective October 12, 2010) as part of the next annual updating amendment that you are required to file.

* * * * *

13. Section 275.204-2 is amended by:

a. Removing paragraph (l);

b. In paragraph (a)(14)(ii), revising the reference to "assets under management" to read "regulatory assets under management"; and

c. Revising paragraph (e)(3)(ii) to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers.

* * * * *

(e) * * *

(3) * * *

(ii) *Transition rule*. If you are an investment adviser that was, prior to July 21, 2011, exempt from registration under section 203(b)(3) of the Act (15 U.S.C. 80b-3(b)(3)), as in effect on July 20, 2011, paragraph (e)(3)(i) of this section does not require you to maintain or preserve books and records that would otherwise be required to be maintained or preserved under the provisions of paragraph (a)(16) of this section to the extent those books and records pertain to the performance or rate of return of such private fund (as defined in section 202(a)(29) of the Act (15 U.S.C. 80b-2(a)(29)), or other account you advise for any period ended prior to your registration, provided that you continue to preserve any books and records in your possession that pertain to the performance or rate of return of such private fund or other account for such period.

* * * * *

14. Section 275.204-4 is added to read as follows:

§ 275.204-4 Reporting by exempt reporting advisers.

(a) *Exempt reporting advisers.* If you are an investment adviser relying on the exemption from registering with the Commission under section 203(l) or (m) of the Act (15 U.S.C. 80b-3(l) or 80b-3(m)), you must complete and file reports on Form ADV (17 CFR 279.1) by following the instructions in the Form, which specify the information that an exempt reporting adviser must provide.

(b) *Electronic filing.* You must file Form ADV electronically with the Investment Adviser Registration Depository (IARD) unless you have received a hardship exemption under paragraph (e) of this section.

Note to paragraph (b): Information on how to file with the IARD is available on the Commission's website at http://www.sec.gov/iard.

(c) *When filed.* Each Form ADV is considered filed with the Commission upon acceptance by the IARD.

(d) *Filing fees.* You must pay FINRA (the operator of the IARD) a filing fee. The Commission has approved the amount of the filing fee. No portion of the filing fee is refundable. Your completed Form ADV will not be accepted by FINRA, and thus will not be considered filed with the Commission, until you have paid the filing fee.

(e) *Temporary hardship exemption.*

(1) *Eligibility for exemption.* If you have unanticipated technical difficulties that prevent submission of a filing to the IARD, you may request a temporary hardship exemption from the requirements of this chapter to file electronically.

(2) *Application procedures*. To request a temporary hardship exemption, you must:

(i) File Form ADV-H (17 CFR 279.3) in paper format no later than one business day after the filing that is the subject of the ADV-H was due; and

(ii) Submit the filing that is the subject of the Form ADV-H in electronic format with the IARD no later than seven business days after the filing was due.

(3) *Effective date – upon filing*. The temporary hardship exemption will be granted when you file a completed Form ADV-H.

(f) *Final report*. You must file a final report in accordance with instructions in Form ADV when:

(1) You cease operation as an investment adviser;

(2) You no longer meet the definition of exempt reporting adviser under paragraph (a); or

(3) You apply for registration with the Commission.

Note to paragraph (f): You do not have to pay a filing fee to file a final report on Form ADV through the IARD.

15. Section 275.206(4)-5 is amended by:

a. In paragraph (f)(2)(i), removing the term "individual" and adding in its place the term "person"; and

b. Revising paragraphs (a)(1), (a)(2) introductory text, (a)(2)(i), (d), and (f)(9) to read as follows:

§ 275.206(4)-5 Political contributions by certain investment advisers.

(a) * * *

(1) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, as defined in section 275.204-4(a), to provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made); and

(2) For any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates:

(i) To provide or agree to provide, directly or indirectly, payment to any person to solicit a government entity for investment advisory services on behalf of such investment adviser unless such person is:

(A) A regulated person; or

(B) An executive officer, general partner, managing member (or, in each case, a person with a similar status or function), or employee of the investment adviser; and

* * * * *

(d) <u>Further prohibition</u>. As a means reasonably designed to prevent fraudulent, deceptive or manipulative acts, practices, or courses of business within the meaning of section 206(4) of Advisers Act (15 U.S.C. 80b-6(4)), it shall be unlawful for any investment adviser registered (or required to be registered) with the Commission, or unregistered in reliance on the exemption available under section 203(b)(3) of the Advisers Act (15 U.S.C. 80b-3(b)(3)), or that is an exempt reporting adviser, or any of the investment adviser's covered associates to do anything indirectly which, if done directly, would result in a violation of this section.

* * * * *

(f) * * *

(9) Regulated person means:

(i) An investment adviser registered with the Commission that has not, and whose covered associates have not, within two years of soliciting a government entity:

(A) Made a contribution to an official of that government entity, other than as described in paragraph (b)(1) of this section; and

(B) Coordinated or solicited any person or political action committee to make any contribution or payment described in paragraphs (a)(2)(ii)(A) and (B) of this section;

(ii) A "broker," as defined in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)) or a "dealer," as defined in section 3(a)(5) of that Act (15 U.S.C. 78c(a)(5)), that is registered with the Commission, and is a member of a national securities association registered under 15A of that Act (15 U.S.C. 78o-3), provided that:

(A) The rules of the association prohibit members from engaging in distribution or solicitation activities if certain political contributions have been made; and

(B) The Commission, by order, finds that such rules impose substantially equivalent or more stringent restrictions on broker-dealers than this section imposes on investment advisers and that such rules are consistent with the objectives of this section; and

(iii) A "municipal advisor" registered with the Commission under section 15B of the Exchange Act and subject to rules of the Municipal Securities Rulemaking Board, provided that:

(A) Such rules prohibit municipal advisors from engaging in distribution or solicitation activities if certain political contributions have been made; and

(B) The Commission, by order, finds that such rules impose substantially equivalent or more stringent restrictions on municipal advisors than this section imposes on investment advisers and that such rules are consistent with the objectives of this section.

* * * * *

16. Section 275.222-1 is amended by revising the phrase "Principal place of business" to read "Principal office and place of business" in both the heading and the first sentence of paragraph (b).

17. Section 275.222-2 is revised to read as follows:

§ 275.222-2 Definition of "client" for purposes of the national de minimis standard.

For purposes of section 222(d)(2) of the Act (15 U.S.C. 80b-18a(d)(2)), an investment adviser may rely upon the definition of "client" provided by § 275.202(a)(30)-1, without giving regard to paragraph (b)(4) of that section.

PART 279 -- FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

18. The authority citation for Part 279 continues to read as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b.

§ 279.1 [Amended]

19. Form ADV [referenced in § 279.1] is amended by:

a. In the instructions to the form, revising the section entitled "Form ADV: General Instructions." The revised version of Form ADV: General Instructions is attached as Appendix A;

b. In the instructions to the form, revising the section entitled "Form ADV: Instructions for Part 1A." The revised version of Form ADV: Instructions for Part 1A is attached as Appendix B;

c. In the instructions to the form, revising the section entitled "Form ADV: Glossary of Terms." The revised version of Form ADV: Glossary of Terms is attached as Appendix C;

d. In the form, revising Part 1A. The revised version of Form ADV, Part 1A is attached as Appendix D;

e. In the form, revising the reference to "proceeding" in Item 3.D. of Part 2B to read "hearing or formal adjudication";

f. In the form, revising the reference to "assets under management" in the Note to Item 4.E of Part 2A to read "regulatory assets under management"; and

g. In the form, revising the section entitled "Form ADV: Domestic Investment Adviser Execution Page." The revised version of Form ADV: Domestic Investment Adviser Execution Page is attached as Appendix E.

The revisions read as follows:

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

* * * * *

Form ADV: Part 2B

* * *

Item 3. * * *

D. Any other hearing or formal adjudication in which a professional attainment, designation, or license of the supervised person was revoked or suspended because of a violation of rules relating to professional conduct. If the supervised person resigned (or otherwise relinquished the attainment, designation, or license) in anticipation of such a hearing or formal adjudication (and the adviser knows, or should have known, of such resignation or relinquishment), disclose the event.

* * * * *

§ 279.3 [Amended]

20. Form ADV-H [referenced in § 279.3] is amended by revising the form. The revised version of Form ADV-H is attached as Appendix F.

Note: The text of Form ADV-H does not and the amendments will not appear in the Code of Federal Regulations.

§ 279.4 [Amended]

21. Form ADV-NR [referenced in § 279.4] is amended by revising the form. The revised version of Form ADV-NR is attached as Appendix G.

Note: The text of Form ADV-NR does not and the amendments will not appear in the Code of Federal Regulations.

§ 279.8 [Amended]

22. Form ADV-E [referenced in § 279.4] is amended by revising the form. The revised version of Form ADV-E is attached as Appendix H.

Note: The text of Form ADV-E does not and the amendments will not appear in the Code of Federal Regulations.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy

Secretary

June 22, 2011

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT FORM BY EXEMPT REPORTING ADVISERS**

Form ADV: General Instructions

Read these instructions carefully before filing Form ADV. Failure to follow these instructions, properly complete the form, or pay all required fees may result in your application or report being delayed or rejected.

In these instructions and in Form ADV, "you" means the investment adviser (i.e., the advisory firm). If you are a "separately identifiable department or division" (SID) of a bank, "you" means the SID, rather than your bank, unless the instructions or the form provide otherwise. Terms that appear in *italics* are defined in the Glossary of Terms to Form ADV.

Special One-Time Dodd-Frank Transition Filing for SEC-Registered Advisers:

- Form ADV amendment: If you are a mid-sized adviser registered with us on July 21, 2011 you must maintain your SEC registration and comply with the Advisers Act until January 1, 2012, unless you file a "full withdrawal" on Form ADV-W to withdraw from registration in all of the jurisdictions with which you are registered (or have an application for registration pending). See Advisers Act sections 203 and 203A(a)(2); SEC rule 203A-5(a). For example, you may file Form ADV-W and withdraw your registration with us and any *state securities authorities* before January 1, 2012 because you are exempt from registration under section 203 of the Act and state securities laws or are no longer in business, but you may not switch to state registration until after January 1, 2012.

  If you are registered or have an application for registration pending with the SEC on January 1, 2012, you must file an amendment to Form ADV no later than March 30, 2012. File an *annual updating amendment* if your annual amendment is due during this period, or file an other-than-annual amendment. See SEC rule 204-1. You must update your responses to all items and corresponding sections of Schedules A, B, C and D, including the reporting of your regulatory assets under management determined within 90 days of the filing. See SEC rule 203A-5(b). If you are no longer eligible for Commission registration, you must mark Item 2.A.(13) of Form ADV, Part 1A. You should amend your *brochure* if any information has become materially inaccurate. See Form ADV, Part 2A, Instructions 4 and 6.

- Form ADV-W filing: If you are no longer eligible for Commission registration, you must withdraw your Commission registration by filing Form ADV-W no later than June 28, 2012. See SEC rule 203A-5(c)(1). You should consult state law or the *state securities authority* for the states in which you are "doing business" as soon as possible to determine if you are required to register in these states and to begin the registration process. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b)(2).

Failure to amend your Form ADV or file Form ADV-W, as required by this instruction, is a violation of SEC rules and could lead to your registration being revoked.

1. Where can I get more information on Form ADV, electronic filing, and the IARD?

The SEC provides information about its rules and the Advisers Act on its website: <http://www.sec.gov/iard>.

NASAA provides information about state investment adviser laws and state rules, and how to contact a *state securities authority*, on its website: <http://www.nasaa.org>.

FINRA provides information about the IARD and electronic filing on the IARD website: <http://www.iard.com>.

2. What is Form ADV used for?

Investment advisers use Form ADV to:

- Register with the Securities and Exchange Commission
- Register with one or more *state securities authorities*
- Amend those registrations;

- Report to the SEC as an *exempt reporting adviser*
- Report to one or more *state securities authorities* as an *exempt reporting adviser*
- Amend those reports; and
- Submit a final report as an *exempt reporting adviser*

3. How is Form ADV organized?

Form ADV contains four parts:

- Part 1A asks a number of questions about you, your business practices, the *persons* who own and *control* you, and the *persons* who provide investment advice on your behalf.
  - All advisers registering with the SEC or any of the *state securities authorities* must complete Part 1A.
  - *Exempt reporting advisers* (that are not also registering with any *state securities authority*) must complete only the following Items of Part 1A: 1, 2, 3, 6, 7, 10, and 11, as well as corresponding schedules. *Exempt reporting advisers* that are registering with any *state securities authority* must complete all of Form ADV.

Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.

- Schedule A asks for information about your direct owners and executive officers.
- Schedule B asks for information about your indirect owners.
- Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 16).
- Schedule D asks for additional information for certain items in Part 1A.
- Disclosure Reporting Pages (or DRPs) are schedules that ask for details about disciplinary events involving you or your *advisory affiliates*.

- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for SEC registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B.)

- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

4. When am I required to update my Form ADV?

- SEC- and State-Registered Advisers:

  - Annual updating amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items, including corresponding sections of Schedules A, B, C, and D. You must submit your summary of material changes required by Item 2 of Part 2A either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.

  - Other-than-annual amendments: In addition to your *annual updating amendment*, if you are registered with the SEC or a *state securities authority*, you must amend your Form ADV, including corresponding sections of Schedules A, B, C, and D, by filing additional amendments (other-than-annual amendments) promptly if:

    - information you provided in response to Items 1, 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B becomes inaccurate in any way;

- information you provided in response to Items 4, 8, or 10 of Part 1A or Item 2.G. of Part 1B becomes materially inaccurate; or
- information you provided in your *brochure* becomes materially inaccurate (see note below for exceptions)

Notes: Part 1: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 9.F., or 12 of Part 1A or Items 2.H. or 2.J. of Part 1B even if your responses to those items have become inaccurate.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate. If you are submitting an other-than-annual amendment to your *brochure*, you are not required to update your summary of material changes as required by Item 2. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment.

- If you are an SEC-registered adviser, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.
- If you are a state-registered adviser, you are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities* through IARD.

- Exempt reporting advisers:
  - Annual Updating Amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all required items, including corresponding sections of Schedules A, B, C and D.
  - Other-than-Annual Amendments: In addition to your *annual updating amendment*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) promptly if:
    - information you provided in response to Items 1, 3, or 11 becomes inaccurate in any way; or

- information you provided in response to Item 10 becomes materially inaccurate.

Failure to update your Form ADV, as required by this instruction, is a violation of SEC rules or similar state rules and could lead to your registration being revoked.

5. **Part 2 of Form ADV was amended recently. When do I have to comply with the new requirements?**

If you are applying for registration with the SEC: As of January 1, 2011, every application for registration must include a narrative *brochure* prepared in accordance with the requirements of (amended) Part 2A of Form ADV. See SEC rule 203-1. The SEC will no longer accept any application that does not include a *brochure*(s) that satisfies the requirements of (amended) Part 2 of Form ADV.

If you already are registered with the SEC: Until you file your first *annual updating amendment* for your fiscal year that ended on or after December 31, 2010, you may (but are not required to) submit a narrative *brochure* that meets the requirements of (amended) Part 2A of Form ADV. If you do not do this, you must continue to comply with the requirements for preparing, delivering, and offering "old" Part II of Form ADV. Your first *annual updating amendment* must contain a narrative *brochure* that meets the requirements of (amended) Part 2A of Form ADV.

Note: Until you are required to meet the requirements of (amended) Part 2, you can satisfy the requirements related to "old" Part II by updating the information in your "old" Part II whenever it becomes materially inaccurate. You must deliver "old" Part II or a *brochure* containing at least the information contained in "old" Part II to prospective *clients* and annually offer it to current *clients*. You are not required to file "old" Part II with the SEC, but you must keep a copy in your files, and provide it to the SEC staff upon request.

If you are applying for registration or are registered with one or more *state securities authorities*, contact the appropriate *state securities authorities* or check <http://www.nasaa.org> for more information about the implementation deadline for the amended Part 2.

6. **Where do I sign my Form ADV application or amendment?**

You must sign the appropriate Execution Page. There are three Execution Pages at the end of the form. Your initial application, your initial report (in the case of an *exempt reporting adviser*), and all amendments to Form ADV must include at least one Execution Page.

- If you are applying for or are amending your SEC registration, or if you are reporting as an *exempt reporting adviser* or amending your report, you must sign and submit either a:
  - Domestic Investment Adviser Execution Page, if you (the advisory firm) are a resident of the United States; or

- *Non-Resident* Investment Adviser Execution Page, if you (the advisory firm) are not a resident of the United States.

- If you are applying for or are amending your registration with a *state securities authority*, you must sign and submit the State-Registered Investment Adviser Execution Page.

7. Who must sign my Form ADV or amendment?

The individual who signs the form depends upon your form of organization:

- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For a "separately identifiable department or division" (SID) of a bank, a principal officer of your bank who is directly engaged in the management, direction, or supervision of your investment advisory activities.
- For all others, an authorized individual who participates in managing or directing your affairs.

The signature does not have to be notarized, and in the case of an electronic filing, should be a typed name.

8. How do I file my Form ADV?

Complete Form ADV electronically using the Investment Adviser Registration Depository (IARD) if:

- You are filing with the SEC (and submitting *notice filings* to any of the *state securities authorities*), or

- You are filing with a *state securities authority* that requires or permits advisers to submit Form ADV through the IARD.

  Note: SEC rules require advisers that are registered or applying for registration with the SEC, or that are reporting to the SEC as an *exempt reporting adviser*, to file electronically through the IARD system. See SEC rules 203-1 and 204-4.

To file electronically, go to the IARD website (<www.iard.com>), which contains detailed instructions for advisers to follow when filing through the IARD.

Complete Form ADV (Paper Version) on paper if:

- You are filing with the SEC or a *state securities authority* that requires electronic filing, but you have been granted a continuing hardship exemption. Hardship exemptions are described in Instruction 17.

- You are filing with a *state securities authority* that permits (but does not require) electronic filing and you do not file electronically.

9. **How do I get started filing electronically?**

First, obtain a copy of the IARD Entitlement Package from the following website: <http://www.iard.com/GetStarted.asp>. Second, request access to the IARD system for your firm by completing and submitting the IARD Entitlement Package. The IARD Entitlement Package must be submitted on paper. Mail the forms to: FINRA Entitlement Group, P.O. Box 9495, Gaithersburg, MD 20898-9495.

When FINRA receives your Entitlement Package, they will assign a *CRD* number (identification number for your firm) and a user I.D. code and password (identification number and system password for the individual(s) who will submit Form ADV filings for your firm). Your firm may request an I.D. code and password for more than one individual. FINRA also will create a financial account for you from which the IARD will deduct filing fees and any state fees you are required to pay. If you already have a *CRD* account with FINRA, it will also serve as your IARD account; a separate account will not be established.

Once you receive your *CRD* number, user I.D. code and password, and you have funded your account, you are ready to file electronically.

Questions regarding the Entitlement Process should be addressed to FINRA at 240.386.4848.

10. **If I am applying for registration with the SEC, or amending my SEC registration, how do I make *notice filings* with the *state securities authorities*?**

If you are applying for registration with the SEC or are amending your SEC registration, one or more *state securities authorities* may require you to provide them with copies of your SEC filings. We call these filings "*notice filings*." Your *notice filings* will be sent electronically to the states that you check on Item 2.C. of Part 1A. The *state securities authorities* to which you send *notice filings* may charge fees, which will be deducted from the account you establish with FINRA. To determine which *state securities authorities* require SEC-registered advisers to submit *notice filings* and to pay fees, consult the relevant state investment adviser law or *state securities authority*. See General Instruction 1.

If you are granted a continuing hardship exemption to file Form ADV on paper, FINRA will enter your filing into the IARD and your *notice filings* will be sent electronically to the *state securities authorities* that you check on Item 2.C. of Part 1A.

11. **I am registered with a state. When must I switch to SEC registration?**

If at the time of your *annual updating amendment* you meet at least one of the requirements for SEC registration in Item 2.A.(1) to (12) of Part 1A, you must register with the SEC within 90 days after you file the *annual updating amendment*. Once you register with the SEC, you are subject to SEC regulation, regardless of whether you remain registered with one or more states. See SEC rule 203A-1(b)(2). Each of your *investment adviser representatives*, however, may be subject to registration in those states in which the representative has a place of business. See Advisers Act section 203A(b)(1); SEC rule 203A-3(a). For additional information, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

12. I am registered with the SEC. When must I switch to registration with a *state securities authority*?

If you check box 13 in Item 2.A. of Part 1A to report on your *annual updating amendment* that you are no longer eligible to register with the SEC, you must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. See SEC rule 203A-1(b)(2). You should consult state law or the *state securities authority* for the states in which you are "doing business" to determine if you are required to register in these states. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b)(2).

13. I am an *exempt reporting adviser*. When must I submit my first report on Form ADV?

- <u>All exempt reporting advisers:</u>
You must submit your initial Form ADV filing within 60 days of relying on the exemption from registration under either section 203(l) of the Advisers Act as an adviser solely to one or more venture capital funds or section 203(m) of the Advisers Act because you act solely as an adviser to private funds and have assets under management in the United States of less than $150 million.

- <u>Additional instruction for advisers switching from being registered to being exempt reporting advisers:</u>
If you are currently registered as an investment adviser (or have an application for registration pending) with the SEC or with a *state securities authority*, you must file a Form ADV-W to withdraw from registration in the jurisdictions where you are switching. You must submit the Form ADV-W <u>before</u> submitting your first report as an exempt reporting adviser.

14. I am an *exempt reporting adviser*. Is it possible that I might be required to also register with or submit a report to a *state securities authority*?

Yes, you may be required to register with or submit a report to one or more *state securities authorities*. If you are required to register with one or more *state securities authorities*, you must complete all of Form ADV. See General Instruction 3. If you are required to submit a report to one or more *state securities authorities*, check the box(es) in Item 2.C. of Part 1A next to the state(s) you would like to receive the report. Each of your *investment adviser representatives* may also be subject to registration requirements. For additional information about the requirements that may apply to you, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

15. What do I do if I no longer meet the definition of an "*exempt reporting adviser*"?

- Advisers Switching to SEC Registration:

    - You may no longer be an *exempt reporting adviser* and may be required to register with the SEC if you wish to continue doing business as an investment adviser. For example, you may be relying on section 203(l) and wish to accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)-1, or you may have been relying on SEC rule 203(m)-1 and reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more.

        - If you are relying on section 203(l), unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)-1 before the SEC approves your application for registration. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing.

        - If you were relying on SEC rule 203(m)-1 and you reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more, you must register with the SEC unless you qualify for another exemption. If you have complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, you have up to 90 days after filing your *annual updating amendment* to apply for SEC registration, and you may continue doing business as a *private fund* adviser during this time. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing. Unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a *private fund* during this transition period before the SEC approves your application for registration, and you must comply with all SEC reporting requirements applicable to an *exempt reporting adviser* as such during this 90-day transition period. If you have not complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, this 90-day transition period is not available to you. Therefore, if the transition period is not available to you, and you do not qualify for another exemption, your application for registration must be approved by the SEC before you meet or exceed SEC rule 203(m)-1's $150 million asset threshold.

- You will be deemed in compliance with the Form ADV filing and reporting requirements until the SEC approves or denies your application. If your application is approved, you will be able to continue business as a registered adviser.

- If you register with the SEC, you may be subject to state *notice filing* requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

Note: If you are relying on SEC rule 203(m)-1 and you accept a *client* that is not a *private fund*, you will lose the exemption provided by SEC rule 203(m)-1 immediately. To avoid this result, you should apply for SEC registration in advance so that the SEC has approved your registration before you accept a *client* that is not a *private fund.*

The 90-day transition period described above also applies to investment advisers with their *principal offices and places of business* outside of the United States with respect to their *clients* who are *United States persons* (*e.g.*, the adviser would not be eligible for the 90-day transition period if it accepted a *client* that is a *United States person* and is not a *private fund*).

- Advisers Not Switching to SEC Registration:

  - You may no longer be an *exempt reporting adviser* but may not be required to register with the SEC or may be prohibited from doing so. For example, you may cease to do business as an investment adviser, become eligible for an exemption that does not require reporting, or be ineligible for SEC registration. In this case, you must submit a final report as an *exempt reporting adviser* to update only Item 1 of Part 1A of Form ADV.

  - You may be subject to state registration requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

16. Are there filing fees?

Yes. These fees go to support and maintain the IARD. The IARD filing fees are in addition to any registration or other fee that may be required by state law. You must pay an IARD filing fee for your initial application, your initial report, and each *annual updating amendment*. There is no filing fee for an other-than-annual amendment, a final report as an *exempt reporting adviser*, or Form ADV-W. The IARD filing fee schedule is published at <http://www.sec.gov/iard>; <http://www.nasaa.org>; and <http://www.iard.com>.

If you are submitting a paper filing under a continuing hardship exemption (see Instruction 17), you are required to pay an additional fee. The amount of the additional fee depends on whether you are filing Form ADV or Form ADV-W. (There is no additional fee for filings made on Form ADV-W.) The hardship filing fee schedule is available by contacting FINRA at 240.386.4848.

17. What if I am not able to file electronically?

If you are required to file electronically but cannot do so, you may be eligible for one of two types of hardship exemptions from the electronic filing requirements.

- A **temporary hardship exemption** is available if you file electronically, but you encounter unexpected difficulties that prevent you from making a timely filing with the IARD, such as a computer malfunction or electrical outage. This exemption does not permit you to file on paper; instead, it extends the deadline for an electronic filing for seven business days. See SEC rules 203-3(a) and 204-4(e).

- A **continuing hardship exemption** may be granted if you are a small business and you can demonstrate that filing electronically would impose an undue hardship. You are a small business, and may be eligible for a continuing hardship exemption, if you are required to answer Item 12 of Part 1A (because you have assets under management of less than $25 million) and you are able to respond "no" to each question in Item 12. See SEC rule 0-7.

  If you have been granted a continuing hardship exemption, you must complete and submit the paper version of Form ADV to FINRA. FINRA will enter your responses into the IARD. As discussed in General Instruction 16, FINRA will charge you a fee to reimburse it for the expense of data entry.

18. I am eligible to file on paper. How do I make a paper filing?

When filing on paper, you must:

- Type all of your responses.
- Include your name (the same name you provide in response to Item 1.A. of Part 1A) and the date on every page.
- If you are amending your Form ADV:
  - complete page 1 and circle the number of any item for which you are changing your response.
  - include your SEC 801-number (if you have one), or your 802-number (if you have one), and your CRD number (if you have one) on every page.
  - complete the amended item in full and circle the number of the item for which you are changing your response.
  - to amend Schedule A or Schedule B, complete and submit Schedule C.

Where you submit your paper filing depends on why you are eligible to file on paper:

- If you are filing on paper because you have been granted a continuing hardship exemption, submit one manually signed Form ADV and one copy to: IARD Document Processing, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

  If you complete Form ADV on paper and submit it to FINRA but you do not have a continuing hardship exemption, the submission will be returned to you.

- If you are filing on paper because a state in which you are registered or in which you are applying for registration allows you to submit paper instead of electronic filings, submit one manually signed Form ADV and one copy to the appropriate *state securities authorities*.

19. Who is required to file Form ADV-NR?

Every *non-resident* general partner and *managing agent* of all SEC-registered advisers and *exempt reporting advisers*, whether or not the adviser is resident in the United States, must file Form ADV-NR in connection with the adviser's initial application or report. A general partner or *managing agent* of an SEC-registered adviser or *exempt reporting adviser* who becomes a *non-resident* after the adviser's initial application or report has been submitted must file Form ADV-NR within 30 days. Form ADV-NR must be filed on paper (it cannot be filed electronically).

Submit Form ADV-NR to the SEC at the following address:

> Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549;
> Attn: Branch of Registrations and Examinations.

Failure to file Form ADV-NR promptly may delay SEC consideration of your initial application.

Federal Information Law and Requirements

Sections 203 and 204 of the Advisers Act [15 U.S.C. §§ 80b-3 and 80b-4] authorize the SEC to collect the information required by Form ADV. The SEC collects the information for regulatory purposes, such as deciding whether to grant registration. Filing Form ADV is mandatory for advisers who are required to register with the SEC and for *exempt reporting advisers*. The SEC maintains the information submitted on this form and makes it publicly available. The SEC may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17.

SEC's Collection of Information

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Advisers Act authorizes the

SEC to collect the information on Form ADV from investment advisers. See 15 U.S.C. §§ 80b-3 and 80b-4. Filing the form is mandatory.

The form enables the SEC to register investment advisers and to obtain information from and about *exempt reporting advisers*. Every applicant for registration with the SEC as an adviser, and every *exempt reporting adviser*, must file the form. See 17 C.F.R. § 275.203-1 and 204-4. By accepting a form, however, the SEC does not make a finding that it has been completed or submitted correctly. The form is filed annually by every adviser, no later than 90 days after the end of its fiscal year, to amend its registration or its report. It is also filed promptly during the year to reflect material changes. See 17 C.F.R. § 275.204-1. The SEC maintains the information on the form and makes it publicly available through the IARD.

Anyone may send the SEC comments on the accuracy of the burden estimate on page 1 of the form, as well as suggestions for reducing the burden. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507.

The information contained in the form is part of a system of records subject to the Privacy Act of 1974, as amended. The SEC has published in the Federal Register the Privacy Act System of Records Notice for these records.

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

Form ADV: Instructions for Part 1A

These instructions explain how to complete certain items in Part 1A of Form ADV.

1. Item 1: Identifying Information

a. **Separately Identifiable Department or Division of a Bank.** If you are a "separately identifiable department or division" (SID) of a bank, answer Item 1.A. with the full legal name of your bank, and answer Item 1.B. with your own name (the name of the department or division) and all names under which you conduct your advisory business. In addition, your *principal office and place of business* in Item 1.F. should be the principal office at which you conduct your advisory business. In response to Item 1.I., the website addresses you list on Schedule D should be sites that provide information about your own activities, rather than general information about your bank.

b. **Item 1.O.: Assets.** For purposes of Item 1.O. only, "assets" refers to your total assets, rather than the assets you manage on behalf of clients. Determine your total assets using the total assets shown on the balance sheet for your most recent fiscal year end.

2. Item 2: SEC Registration and SEC Report by *Exempt Reporting Advisers*

If you are registered or applying for registration with the SEC, you must indicate in Item 2.A. why you are eligible to register with the SEC by checking at least one of the boxes.

a. **Item 2.A.(1): Adviser with Regulatory Assets Under Management of $100 Million or More.** You may check box 1 only if your response to Item 5.F.(2)(c) is $100 million or more, or you are filing an *annual updating amendment* with the SEC and your response to Item 5.F.(2)(c) is $90 million or more. While you may register with the SEC if your regulatory assets under management are at least $100 million but less than $110 million, you must register with the SEC if your regulatory assets under management are $110 million or more. If you are a SEC-registered adviser, you may remain registered with the SEC if your regulatory assets under management are $90 million or more. See SEC rule 203A-1(a). Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

If you are a state-registered adviser and you report on your *annual updating amendment* that your regulatory assets under management increased to $100 million or more, you may register with the SEC. If your regulatory assets under management increased to $110 million or more, you must register with the SEC within 90 days after you file that *annual* *updating amendment.* See SEC rule 203A-1(b)(1) and Form ADV General Instruction 11.

b. **Item 2.A.(2): Mid-Sized Adviser.** You may check box 2 only if your response to Item 5.F(2)(c) is $25 million or more but less than $100 million, and you satisfy one of the requirements below. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

You must register with the SEC if you meet at least one of the following requirements:

- You are not required to be registered as an investment adviser with the *state securities authority* of the state where you maintain your *principal office and place of business* pursuant to that state's investment adviser laws. If you are exempt from registration with that state or are excluded from the definition of investment adviser in that state, you must register with the SEC. You should consult the investment adviser laws or the *state securities authority* for the particular state in which you maintain your *principal office and place of business* to determine if you are required to register in that state. See General Instruction 1.

- You are not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business.* To determine whether such *state securities authority* does not conduct such examinations, see: http://www.sec.gov/divisions/investment/midsizedadviserinfo.htm.

See section 203A(a)(2) of the Advisers Act.

c. **Item 2.A.(5): Adviser to an Investment Company.** You may check box 5 only if you currently provide advisory services under an investment advisory contract to an investment company registered under the Investment Company Act of 1940 and the investment company is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See sections 203A(a)(1)(B) and 203A(a)(2)(A) of the Advisers Act. Advising investors about the merits of investing in mutual funds or recommending particular mutual funds does not make you eligible to check this box.

d. **Item 2.A.(6): Adviser to a Business Development Company.** You may check box 6 only if your response to Item 5.F.(2)(c) is $25 million or more of regulatory assets under management, and you currently provide advisory services under an investment advisory contract to a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, that has not withdrawn the election, and that is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See section 203A(a)(2)(A) of the Advisers Act. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

e. **Item 2.A.(7): Pension Consultant.** You may check box 7 only if you are eligible for the pension consultant exemption from the prohibition on SEC registration.

- You are eligible for this exemption if you provided investment advice to employee benefit plans, governmental plans, or church plans with respect to assets having an aggregate value of $200 million or more during the 12-month period that ended within 90 days of filing this Form ADV. You are not eligible for this exemption if you only advise plan participants on allocating their investments within their pension plans. See SEC rule 203A-2(a).

- To calculate the value of assets for purposes of this exemption, aggregate the assets of the plans for which you provided advisory services at the end of the 12-month period. If you provided advisory services to other plans during the 12-month period, but your employment or contract terminated before the end of the 12-month period, you also may include the value of those assets.

f. **Item 2.A.(8): Related Adviser.** You may check box 8 only if you are eligible for the related adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(b). You are eligible for this exemption if you *control*, are *controlled* by, or are under common *control* with an investment adviser that is registered with the SEC, and you have the same *principal office and place of business* as that other investment adviser. Note that you may not rely on the SEC registration of an Internet adviser under rule 203A-2(e) in establishing eligibility for this exemption. See SEC rule 203A-2(e)(1)(iii). If you check box 8, you also must complete Section 2.A.(8) of Schedule D.

g. **Item 2.A.(9): Newly-Formed Adviser.** You may check box 9 only if you are eligible for the newly-formed-adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(c). You are eligible for this exemption if:

- immediately before you file your application for registration with the SEC, you were not registered or required to be registered with the SEC or a *state securities authority;* and

- at the time of your formation, you have a reasonable expectation that within 120 days of registration you will be eligible for SEC registration.

If you check box 9, you also must complete Section 2.A.(9) of Schedule D.

You must file an amendment to Part 1A of your Form ADV that updates your response to Item 2.A. within 120 days after the SEC declares your registration effective. You may not check box 9 on your amendment; since this exemption is available only if you are not registered, you may not "re-rely" on this exemption. If you indicate on that amendment (by checking box 13) that you are not eligible to register with the SEC, you also must file a Form ADV-W to withdraw your SEC registration no later than 120 days after your registration was declared effective. You should contact the appropriate *state securities authority* to determine how long it may take to become state-registered sufficiently in advance of when you are required to file Form ADV-W to withdraw from SEC registration.

Note: If you expect to be eligible for SEC registration because of the amount of your regulatory assets under management, that amount must be $100 million or more no later than 120 days after your registration is declared effective.

h. **Item 2.A.(10): Multi-State Adviser.** You may check box 10 only if you are eligible for the multi-state adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(d). You are eligible for this exemption if you are required to register as an investment adviser with the *state securities authorities* of 15 or more states. If you check box 10, you must complete Section 2.A.(10) of Schedule D. You must complete Section 2.A.(10) of Schedule D in each *annual updating amendment* you submit.

If you check box 10, you also must:

- create and maintain a list of the *states* in which, but for this exemption, you would be required to register;
- update this list each time you submit an *annual updating amendment* in which you continue to represent that you are eligible for this exemption; and
- maintain the list in an easily accessible place for a period of not less than five years from each date on which you indicate that you are eligible for the exemption.

If, at the time you file your *annual updating amendment*, you are required to register in less than 15 *states* and you are not otherwise eligible to register with the SEC, you must check box 13 in Item 2.A. You also must file a Form ADV-W to withdraw your SEC registration. See Part 1A Instruction 2.j.

i. **Item 2.A.(11): Internet Adviser.** You may check box 11 only if you are eligible for the Internet adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(e). You are eligible for this exemption if:

- you provide investment advice to your *clients* through an interactive website. An interactive website means a website in which computer software-based models or applications provide investment advice based on personal information each *client* submits through the website. Other forms of online or Internet investment advice do not qualify for this exemption;

- you provide investment advice to all of your *clients* exclusively through the interactive website, except that you may provide investment advice to fewer than 15 *clients* through other means during the previous 12 months; and

- you maintain a record demonstrating that you provide investment advice to your *clients* exclusively through an interactive website in accordance with these limits.

j. **Item 2.A.(13): Adviser No Longer Eligible to Remain Registered with the SEC.** You must check box 13 if:

- you are registered with the SEC;
- you are filing an *annual updating amendment* to Form ADV in which you indicate in response to Item 5.F.(2)(c) that you have regulatory assets under management of less than $90 million; and
- you are not eligible to check any other box (other than box 13) in Item 2.A. (and are therefore no longer eligible to remain registered with the SEC).

You must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. Until you file your Form ADV-W, you will remain subject to SEC regulation, and you also will be subject to regulation in the *states* in which you register. See SEC rule 203A-1(b)(2).

k. **Item 2.B.: Reporting by *Exempt Reporting Advisers*.** You may check box 2.B.(1) only if you qualify for the exemption from SEC registration as an adviser solely to one or more venture capital funds. See SEC rule 203(l)-1. You may check box 2.B.(2) only if you qualify for the exemption from SEC registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million. See SEC rule 203(m)-1. You may check both boxes to indicate that you qualify for both exemptions. You should check box 2.B.(3) if you act solely as an adviser to *private funds* but you are no longer eligible to check box 2.B.(2) because you have assets under management in the United States of $150 million or more. If you check box 2.B.(2) or (3), you also must complete Section 2.B. of Schedule D.

3. Item 3: Form of Organization

If you are a "separately identifiable department or division" (SID) of a bank, answer Item 3.A. by checking "other." In the space provided, specify that you are a "SID of" and indicate the form of organization of your bank. Answer Items 3.B. and 3.C. with information about your bank.

4. Item 4: Successions

a. **Succession of an SEC-Registered Adviser.** If you (1) have taken over the business of an investment adviser or (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under the Advisers Act. There are different ways to fulfill these obligations. You may rely on the registration provisions discussed in the General Instructions, or you may be able to rely on special registration provisions for "successors" to SEC-registered advisers, which may ease the transition to the successor adviser's registration.

To determine if you may rely on these provisions, review "Registration of Successors to Broker-Dealers and Investment Advisers," Investment Advisers Act Release No. 1357 (Dec. 28, 1992). If you have taken over an adviser, follow Part 1A Instruction 4.a(1), Succession by Application. If you have changed your structure or legal status, follow Part 1A Instruction 4.a(2), Succession by Amendment. If either (1) you are a "separately identifiable department or division" (SID) of a bank that is currently registered as an investment adviser, and you are taking over your bank's advisory business; or (2) you are a SID currently registered as an investment adviser, and your bank is taking over your advisory business, then follow Part 1A Instruction 4.a(1), Succession by Application.

(1) **Succession by Application.** If you are not registered with the SEC as an adviser, and you are acquiring or assuming substantially all of the assets and liabilities of the advisory business of an SEC-registered adviser, file a new application for registration on Form ADV. You will receive new registration numbers. You must file the new application within 30 days after the succession. On the application, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D.

Until the SEC declares your new registration effective, you may rely on the registration of the adviser you are acquiring, but only if the adviser you are acquiring is no longer conducting advisory activities. Once your new registration is effective, a Form ADV-W must be filed with the SEC to withdraw the registration of the acquired adviser.

(2) **Succession by Amendment.** If you are a new investment adviser formed solely as a result of a change in form of organization, a reorganization, or a change in the composition of a partnership, and there has been no practical change in *control* or management, you may amend the registration of the registered investment adviser to reflect these changes rather than file a new application. You will keep the same registration numbers, and you should not file a Form ADV-W. On the amendment, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D. You must submit the amendment within 30 days after the change or reorganization.

b. **Succession of a State-Registered Adviser.** If you (1) have taken over the business of an investment adviser or (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under state investment adviser laws. There may be different ways to fulfill these obligations. You should contact each state in which you are registered to determine that state's requirements for successor registration. See Form ADV General Instruction 1.

5. **Item 5: Information About Your Advisory Business**

   a. **Newly-Formed Advisers:** Several questions in Item 5 that ask about your advisory business assume that you have been operating your advisory business for some time. Your response to these questions should reflect your current advisory business (i.e., at the time you file your Form ADV), with the following exceptions:

      - base your response to Item 5.E. on the types of compensation you expect to accept;
      - base your response to Item 5.G. and Item 5.J. on the types of advisory services you expect to provide during the next year; and
      - skip Item 5.H.

   b. **Item 5.F: Calculating Your Regulatory Assets Under Management.** In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or management services as of the date of filing this Form ADV.

      (1) **Securities Portfolios.** An account is a securities portfolio if at least 50% of the total value of the account consists of securities. For purposes of this 50% test, you may treat cash and cash equivalents (i.e., bank deposits, certificates of deposit, bankers acceptances, and similar bank instruments) as securities. You must include securities portfolios that are:

      (a) your family or proprietary accounts;

      (b) accounts for which you receive no compensation for your services; and

      (c) accounts of *clients* who are not *United States persons*.

      For purposes of this definition, treat all of the assets of a *private fund* as a securities portfolio, regardless of the nature of such assets. For accounts of *private funds*, moreover, include in the securities portfolio any uncalled commitment pursuant to which a *person* is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

      (2) **Value of Portfolio.** Include the entire value of each securities portfolio for which you provide continuous and regular supervisory or management services. If you provide

continuous and regular supervisory or management services for only a portion of a securities portfolio, include as regulatory assets under management only that portion of the securities portfolio for which you provide such services. Exclude, for example, the portion of an account:

(a) under management by another *person*; or

(b) that consists of real estate or businesses whose operations you "manage" on behalf of a *client* but not as an investment.

Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities.

(3) **Continuous and Regular Supervisory or Management Services.**

General Criteria. You provide continuous and regular supervisory or management services with respect to an account if:

(a) you have *discretionary authority* over and provide ongoing supervisory or management services with respect to the account; or

(b) you do not have *discretionary authority* over the account, but you have ongoing responsibility to select or make recommendations, based upon the needs of the *client*, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the *client*, you are responsible for arranging or effecting the purchase or sale.

Factors. You should consider the following factors in evaluating whether you provide continuous and regular supervisory or management services to an account.

(a) **Terms of the advisory contract.** If you agree in an advisory contract to provide ongoing management services, this suggests that you provide these services for the account. Other provisions in the contract, or your actual management practices, however, may suggest otherwise.

(b) **Form of compensation.** If you are compensated based on the average value of the *client's* assets you manage over a specified period of time, that suggests that you provide continuous and regular supervisory or management services for the account. If you receive compensation in a manner similar to either of the following, that suggests you do not provide continuous and regular supervisory or management services for the account --

(i) you are compensated based upon the time spent with a *client* during a *client* visit; or

(ii) you are paid a retainer based on a percentage of assets covered by a financial plan.

(c) **Management practices.** The extent to which you actively manage assets or provide advice bears on whether the services you provide are continuous and regular supervisory or management services. The fact that you make infrequent trades (e.g., based on a "buy and hold" strategy) does not mean your services are not "continuous and regular."

Examples. You <u>may</u> provide continuous and regular supervisory or management services for an account if you:

(a) have *discretionary authority* to allocate *client* assets among various mutual funds;

(b) do not have *discretionary authority*, but provide the same allocation services, and satisfy the criteria set forth in Instruction 5.b.(3);

(c) allocate assets among other managers (a "manager of managers"), but only if you have *discretionary authority* to hire and fire managers and reallocate assets among them; or

(d) you are a broker-dealer and treat the account as a brokerage account, but only if you have *discretionary authority* over the account.

You <u>do</u> <u>not</u> provide continuous and regular supervisory or management services for an account if you:

(a) provide market timing recommendations (i.e., to buy or sell), but have no ongoing management responsibilities;

(b) provide only *impersonal investment advice* (e.g., market newsletters);

(c) make an initial asset allocation, without continuous and regular monitoring and reallocation; or

(d) provide advice on an intermittent or periodic basis (such as upon *client* request, in response to a market event, or on a specific date (e.g., the account is reviewed and adjusted quarterly)).

(4) **Value of Regulatory Assets Under Management**. Determine your regulatory assets under management based on the current market value of the assets as determined within 90 days prior to the date of filing this Form ADV. Determine market value using the same method you used to report account values to *clients* or to calculate fees for investment advisory services.

In the case of a *private fund*, determine the current market value (or fair value) of the *private fund*'s assets and the contractual amount of any uncalled commitment pursuant to which a person is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

(5) **Example.** This is an example of the method of determining whether an account of a *client* other than a *private fund* may be included as regulatory assets under management.

The *client's* portfolio consists of the following:

\$ 6,000,000	stocks and bonds
\$ 1,000,000	cash and cash equivalents
\$ 3,000,000	non-securities (collectibles, commodities, real estate, etc.)
\$10,000,000	Total Assets

First, is the account a securities portfolio? The account is a securities portfolio because securities as well as cash and cash equivalents (which you have chosen to include as securities) (\$6,000,000 + \$1,000,000 = \$7,000,000) comprise at least 50% of the value of the account (here, 70%). (See Instruction 5.b(1)).

Second, does the account receive continuous and regular supervisory or management services? The entire account is managed on a *discretionary* basis and is provided ongoing supervisory and management services, and therefore receives continuous and regular supervisory or management services. (See Instruction 5.b.(3)).

Third, what is the entire value of the account? The entire value of the account (\$10,000,000) is included in the calculation of the adviser's total regulatory assets under management.

6. Item 7: Financial Industry Affiliations and Private Fund Reporting

Item 7.B. and Section 7.B. of Schedule D ask questions about the *private funds* that you advise. You are required to complete a Section 7.B.(1) of Schedule D for each *private fund* that you advise, except in certain circumstances described under Item 7.B. and below.

a. If your *principal office and place of business* is outside the United States, for purposes of Item 7 and Section 7.B. of Schedule D you may disregard any *private fund* that, during your last fiscal year, was not a *United States person*, was not offered in the United States, and was not beneficially owned by any *United States person*.

b. When filing Section 7.B.(1) of Schedule D for a *private fund*, you must acquire an identification number for the fund by logging onto the IARD website and using the private fund identification number generator. You must continue to use the same identification number whenever you amend Section 7.B.(1) for that fund. If you file a Section 7.B.(1) for a *private fund* for which an identification number has already been acquired by another adviser, you must not acquire a new identification number, but must instead utilize the existing number. If you choose to complete a single Section 7.B.(1) for a master-feeder arrangement under instruction 6.d. below, you must acquire an identification number also for each feeder fund.

c. If any *private fund* has issued two or more series (or classes) of equity interests whose values are determined with respect to separate portfolios of securities and other assets, then each such series (or class) should be regarded as a separate *private fund*. In Section 7.B.(1) and 7.B.(2) of Schedule D, next to the name of the *private fund*, list the name and identification number of the specific series (or class) for which you are filing the sections. This only applies with respect to series (or classes) that you manage as if they were separate funds and not a fund's side pockets or similar arrangements.

d. In the case of a master-feeder arrangement (see questions 6-7 of Section 7.B.(1) of Schedule D), instead of completing a Section 7.B.(1) for each of the master fund and each feeder fund, you may complete a single Section 7.B.(1) for the master-feeder arrangement under the name of the master fund if the answers to questions 8, 10, 21 and 23 through 28 are the same for all of the feeder funds (or, in the case of questions 24 and 25, if the feeder funds do not use a prime broker or custodian). If you choose to complete a single Section 7.B.(1), you should disregard the feeder funds, except for the following:

   (1) **Question 11**: State the gross assets for the master-feeder arrangement as a whole.

   (2) **Question 12**: List the lowest minimum investment commitment applicable to any of the master fund and the feeder funds.

   (3) **Questions 13-16**: Answer by aggregating all investors in the master-feeder arrangement (but do not count the feeder funds themselves as investors).

   (4) **Questions 19-20**: For purposes of these questions, the *private fund* means any of the master fund or the feeder funds. In answering the questions, moreover, disregard the feeder funds' investment in the master fund.

   (5) **Question 22**: List all of the Form D SEC file numbers of any of the master fund and feeder funds.

e. Additional Instructions:

   (1) **Question 9: Investment in Registered Investment Companies:** For purposes of this question, disregard any open-end management investment company regulated as a money market fund under rule 2a-7 under the Investment Company Act if the *private fund* invests in such a company in reliance on rule 12d1-1 under the same Act.

(2) **Question 10: Type of *Private Fund*:** For purposes of this question, the following definitions apply:

"Hedge fund" means any *private fund* (other than a securitized asset fund):

(a) with respect to which one or more investment advisers (or related persons of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses);

(b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or

(c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration).

A commodity pool is categorized as a hedge fund solely for purposes of this question. For purposes of this definition, do not net long and short positions. Include any borrowings or notional exposure of another person that are guaranteed by the *private fund* or that the *private fund* may otherwise be obligated to satisfy.

"Liquidity fund" means any *private fund* that seeks to generate income by investing in a portfolio of short-term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors.

"Private equity fund" means any *private fund* that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund, or venture capital fund and does not provide investors with redemption rights in the ordinary course.

"Real estate fund" means any *private fund* that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course, and that invests primarily in real estate and real estate related assets.

"Securitized asset fund" means any *private fund* whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders.

"Venture capital fund" means any *private fund* meeting the definition of venture capital fund in rule 203(l)-1 under the Advisers Act.

"Other *private fund*" means any *private fund* that is not a hedge fund, liquidity fund, private equity fund, real estate fund, securitized asset fund, or venture capital fund.

(3) **Question 11: Gross Assets.** Report the assets of the *private fund* that you would include in calculating your regulatory assets under management according to instruction 5.b above.

(4) **Questions 19-20: Other clients' investments:** For purposes of these questions, disregard any feeder fund's investment in its master fund. (*See* questions 6-7 for the definition of "master fund" and "feeder fund.")

7. Item 10: *Control Persons*

If you are a "separately identifiable department or division" (SID) of a bank, identify on Schedule A your bank's executive officers who are directly engaged in managing, directing, or supervising your investment advisory activities, and list any other *persons* designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities, including supervising *employees* performing investment advisory activities.

8. Additional Information.

If you believe your response to an item in Form ADV Part 1A requires further explanation, or if you wish to provide additional information, you may do so on Schedule D, in the Miscellaneous section. Completion of this section is optional.

GLOSSARY OF TERMS

1. **Advisory Affiliate:** Your advisory affiliates are (1) all of your officers, partners, or directors (or any ***person*** performing similar functions); (2) all ***persons*** directly or indirectly ***controlling*** or ***controlled*** by you; and (3) all of your current ***employees*** (other than ***employees*** performing only clerical, administrative, support or similar functions).

   If you are a "separately identifiable department or division" (SID) of a bank, your ***advisory affiliates*** are: (1) all of your bank's ***employees*** who perform your investment advisory activities (other than clerical or administrative ***employees***); (2) all ***persons*** designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities (including supervising the ***employees*** who perform investment advisory activities); (3) all ***persons*** who directly or indirectly ***control*** your bank, and all ***persons*** whom you ***control*** in connection with your investment advisory activities; and (4) all other ***persons*** who directly manage any of your investment advisory activities (including directing, supervising or performing your advisory activities), all ***persons*** who directly or indirectly ***control*** those management functions, and all ***persons*** whom you ***control*** in connection with those management functions. *[Used in: Part 1A, Items 7, 11, DRPs; Part 1B, Item 2]*

2. **Annual Updating Amendment:** Within 90 days after your firm's fiscal year end, your firm must file an "annual updating amendment," which is an amendment to your firm's Form ADV that reaffirms the eligibility information contained in Item 2 of Part 1A and updates the responses to any other item for which the information is no longer accurate. *[Used in: General Instructions; Part 1A Instructions, Introductory Text, Item 2; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

3. **Brochure:** A written disclosure statement that you must provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2]*

4. **Brochure Supplement:** A written disclosure statement containing information about certain of your ***supervised persons*** that your firm is required by Part 2B of Form ADV to provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2B. *[Used in: General Instructions; Used throughout Part 2]*

5. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs]*

6. **Client:** Any of your firm's investment advisory clients. This term includes clients from which your firm receives no compensation, such as family members of your supervised persons. If your firm also provides other services (*e.g.*, accounting services), this term does not include clients that are not investment advisory clients. *[Used throughout Form ADV and Form ADV-W]*

7. **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 your firm's officers, partners, or directors exercising executive responsibility (or ***persons*** having similar status or functions) is presumed to control your firm.

   - 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.

   [Used in: General Instructions; Part 1A, Instructions, Items 2, 7, 10, 11, 12, Schedules A, B, C, D; DRPs]

8. **Custody:** Holding, directly or indirectly, client funds or securities, or having any authority to obtain possession of them. You have custody if a ***related person*** holds, directly or indirectly, client funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to clients. Custody includes:

   - Possession of client funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly, but in any case within three business days of receiving them;

   - Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw client funds or securities maintained with a custodian upon your instruction to the custodian; and

   - Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your supervised person legal ownership of or access to client funds or securities. *[Used in: Part 1A, Item 9; Part 1B, Instructions, Item 2; Part 2A, Items 15, 18]*

9. **Discretionary Authority or Discretionary Basis:** Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the ***client***. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the ***client***. *[Used in: Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; Part 2B, Instructions]*

10. **Employee:** This term includes an independent contractor who performs advisory functions on your behalf. *[Used in: Part 1A, Instructions, Items 1, 5, 11; Part 2B, Instructions]*

11. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining ***order***. *[Used in: Part 1A, Item 11; DRPs]*

12. **Exempt Reporting Adviser:** An investment adviser that qualifies for the exemption from registration under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m)-1 of the Advisers Act because it is an adviser solely to ***private funds*** and has assets under management in the United States of less than $150 million. *[Used in: Throughout Part 1A; General Instructions; Form ADV-H; Form ADV-NR]*

13. **Felony:** For jurisdictions that do not differentiate between a felony and a ***misdemeanor***, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

14. **FINRA CRD** or **CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. *[Used in: General Instructions, Part 1A, Item 1, Schedules A, B, C, D, DRPs; Form ADV-W, Item 1]*

15. **Foreign Financial Regulatory Authority:** This term includes (1) a foreign securities authority; (2) another governmental body or foreign equivalent of a ***self-regulatory organization*** empowered by a foreign government to administer or enforce its laws relating to the regulation of ***investment-related*** activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above. *[Used in: Part 1A, Items 1, 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

16. **Found:** This term includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters. *[Used in: Part 1A, Item 11; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

17. **Government Entity:** Any state or political subdivision of a state, including (i) any agency, authority, or instrumentality of the state or political subdivision; (ii) a plan or pool of assets ***controlled*** by the state or political subdivision or any agency, authority, or instrumentality thereof; and (iii) any officer, agent, or employee of the state or political subdivision or any agency, authority, or instrumentality thereof, acting in their official capacity. *[Used in: Part 1A, Item 5]*

18. **High Net Worth Individual:** An individual who is a "qualified client" under rule 205-3 of the Advisers Act or who is a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. *[Used in: Part 1A, Item 5; Schedule D]*

19. **Home State:** If your firm is registered with a ***state securities authority***, your firm's "home state" is the state where it maintains its ***principal office and place of business***. *[Used in: Part 1B, Instructions]*

20. **Impersonal Investment Advice:** Investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts. *[Used in: Part 1A, Instructions; Part 2A, Instructions; Part 2B, Instructions]*

21. **Independent Public Accountant:** A public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR 210.2-01(b) and (c)). *[Used in: Item 9; Schedule D]*

22. **Investment Adviser Representative:** *Any of your firm's **supervised persons** (except* those that provide only ***impersonal investment advice***) is an investment adviser representative, if --

   - the ***supervised person*** regularly solicits, meets with, or otherwise communicates with your firm's ***clients***,

   - the ***supervised person*** has more than five ***clients*** who are natural persons and not ***high net worth individuals***, and

   - more than ten percent of the ***supervised person's*** clients are natural persons and not ***high net worth individuals.***

NOTE: If your firm is registered with the ***state securities authorities*** and not the SEC, your firm may be subject to a different state definition of "investment adviser representative." Investment adviser representatives of SEC-registered advisers may be required to register in each state in which they have a place of business.

[Used in: General Instructions; Part 1A, Item 7; Part 2B, Item 1]

23. **Investment-Related:** Activities that pertain to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with an investment adviser, broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, futures sponsor, bank, or savings association). *[Used in: Part 1A, Items, 7, 11, DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3, 4 and 7]*

24. **Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. *[Used in: Part 1A, Item 11; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

25. **Legal Entity Identifier:** A "legal entity identifier" assigned by or on behalf of an internationally recognized standards setting body and required for reporting purposes by the U.S. Department of the Treasury's Office of Financial Research or a financial regulator.

26. **Management Persons:** Anyone with the power to exercise, directly or indirectly, a ***controlling*** influence over your firm's management or policies, or to determine the general investment advice given to the ***clients*** of your firm.

    Generally, all of the following are management persons:

    - Your firm's principal executive officers, such as your chief executive officer, chief financial officer, chief operations officer, chief legal officer, and chief compliance officer; your directors, general partners, or trustees; and other individuals with similar status or performing similar functions;

    - The members of your firm's investment committee or group that determines general investment advice to be given to ***clients***; and

    - If your firm does not have an investment committee or group, the individuals who determine general investment advice provided to ***clients*** (if there are more than five people, you may limit your firm's response to their supervisors).

    [Used in: Part 1B, Item 2; Part 2A, Items 9, 10 and 19]

27. **Managing Agent:** A managing agent of an investment adviser is any ***person***, including a trustee, who directs or manages (or who participates in directing or managing) the affairs of any unincorporated organization or association that is not a partnership. *[Used in: General Instructions; Form ADV-NR; Form ADV-W, Item 8]*

28. **Minor Rule Violation:** A violation of a ***self-regulatory organization*** rule that has been designated as "minor" pursuant to a plan approved by the SEC. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less,

and if the sanctioned ***person*** does not contest the fine. (Check with the appropriate ***self-regulatory organization*** to determine if a particular rule violation has been designated as "minor" for these purposes.) *[Used in: Part 1A, Item 11]*

29. **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. The term also includes a special court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

30. **Non-Resident:** (a) an individual who resides in any place not subject to the jurisdiction of the United States; (b) a corporation incorporated in or that has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States; and (c) a partnership or other unincorporated organization or association that is formed in or has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States. *[Used in: General Instructions; Form ADV-NR]*

31. **Notice Filing:** SEC-registered advisers may have to provide ***state securities authorities*** with copies of documents that are filed with the SEC. These filings are referred to as "notice filings." *[Used in: General Instructions; Part 1A, Item 2; Execution Page(s); Form ADV-W]*

32. **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. *[Used in: Part 1A, Items 2 and 11; Schedule D; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

33. **Performance-Based Fee:** An investment advisory fee based on a share of capital gains on, or capital appreciation of, ***client*** assets. A fee that is based upon a percentage of assets that you manage is not a performance-based fee. *[Used in: Part 1A, Item 5; Part 2A, Items 6 and 19]*

34. **Person:** A natural person (an individual) or a company. A company includes any partnership, corporation, trust, limited liability company ("LLC"), limited liability partnership ("LLP"), sole proprietorship, or other organization. *[Used throughout Form ADV and Form ADV-W]*

35. **Principal Office and Place of Business:** Your firm's executive office from which your firm's officers, partners, or managers direct, ***control***, and coordinate the activities of your firm. *[Used in: Part 1A, Instructions, Items 1 and 2; Schedule D; Form ADV-W, Item 1]*

36. **Private Fund:** An issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act. *[Used in: Part 1A, Items 2, 5, 7, and 9; Schedule D; General Instructions; Part 1A, Instructions]*

37. **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, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

38. **Related Person:** Any ***advisory affiliate*** and any ***person*** that is under common ***control*** with your firm. *[Used in: Part 1A, Items 7, 8, 9; Schedule D; Form ADV-W, Item 3; Part 2A, Items 10, 11, 12, 14; Part 2A, Appendix 1, Item 6]*

39. **Self-Regulatory Organization** or **SRO:** Any national securities or commodities exchange, registered securities association, or registered clearing agency. For example, the Chicago Board of Trade ("CBOT"), FINRA and New York Stock Exchange ("NYSE") are self-regulatory organizations. *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

40. **Sponsor:** A sponsor of a ***wrap fee program*** sponsors, organizes, or administers the program or selects, or provides advice to ***clients*** regarding the selection of, other investment advisers in the program. *[Used in: Part 1A, Item 5; Schedule D; Part 2A, Instructions, Appendix 1 Instructions]*

41. **State Securities Authority:** The securities commissioner or commission (or any agency, office or officer performing like functions) of any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. *[Used throughout Form ADV]*

42. **Supervised Person:** Any of your officers, partners, directors (or other ***persons*** occupying a similar status or performing similar functions), or ***employees***, or any other ***person*** who provides investment advice on your behalf and is subject to your supervision or ***control***. *[Used throughout Part 2]*

43. **United States person:** This term has the same meaning as in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States. *[Used in: Part 1A, Instructions; Item 5; Schedule D]*

44. **Wrap Brochure** or **Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** must provide to each of their ***wrap fee program clients***. *[Used in: Part 2, General Instructions; Used throughout Part 2A, Appendix 1]*

45. **Wrap Fee Program:** Any advisory program under which a specified fee or fees not based directly upon transactions in a ***client's*** account is charged for investment advisory services

(which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of ***client*** transactions. *[Used in: Part 1, Item 5; Schedule D; Part 2A, Instructions, Item 4, used throughout Appendix 1; Part 2B, Instructions]*

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

PART 1A

WARNING: Complete this form truthfully. False statements or omissions may result in denial of your application, revocation of your registration, or criminal prosecution. You must keep this form updated by filing periodic amendments. See Form ADV General Instruction 4.

Check the box that indicates what you would like to do (check all that apply):

SEC or State Registration:
☐ Submit an initial application to register as an investment adviser with the SEC.
☐ Submit an initial application to register as an investment adviser with one or more states.
☐ Submit an *annual updating amendment* to your registration for your fiscal year ended ________.
☐ Submit an other-than-annual amendment to your registration.

SEC or State Report by *Exempt Reporting Advisers*:
☐ Submit an initial report to the SEC.
☐ Submit a report to one or more *state securities authorities*.
☐ Submit an *annual updating amendment* to your report for your fiscal year ended ________.
☐ Submit an other-than-annual amendment to your report.
☐ Submit a final report.

Item 1 Identifying Information

Responses to this Item tell us who you are, where you are doing business, and how we can contact you.

A. Your full legal name (if you are a sole proprietor, your last, first, and middle names):

____

B. Name under which you primarily conduct your advisory business, if different from Item 1.A.

____

List on Section 1.B. of Schedule D any additional names under which you conduct your advisory business.

C. If this filing is reporting a change in your legal name (Item 1.A.) or primary business name (Item 1.B.), enter the new name and specify whether the name change is of ☐ your legal name or ☐ your primary business name:

____

D. (1) If you are registered with the SEC as an investment adviser, your SEC file number: 801-__________

(2) If you report to the SEC as an *exempt reporting adviser*, your SEC file number: 802-__________

E. If you have a number ("*CRD* Number") assigned by the *FINRA's CRD* system or by the IARD system, your *CRD* number: __________

If your firm does not have a CRD number, skip this Item 1.E. Do not provide the CRD number of one of your officers, employees, or affiliates.

F. *Principal Office and Place of Business*

(1) Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

List on Section 1.F. of Schedule D any office, other than your principal office and place of business, at which you conduct investment advisory business. If you are applying for registration, or are registered, with one or more state securities authorities, you must list all of your offices in the state or states to which you are applying for registration or with whom you are registered. If you are applying for SEC registration, if you are registered only with the SEC, or if you are reporting to the SEC as an exempt reporting adviser, list the largest five offices in terms of numbers of employees.

(2) Days of week that you normally conduct business at your *principal office and place of business*:

☐ Monday - Friday ☐ Other: ____________________

Normal business hours at this location: ____________________

(3) Telephone number at this location: ____________________
(area code) (telephone number)

(4) Facsimile number at this location: ____________________
(area code) (facsimile number)

G. Mailing address, if different from your *principal office and place of business* address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

H. If you are a sole proprietor, state your full residence address, if different from your *principal office and place of business* address in Item 1.F.:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

I. Do you have one or more websites? Yes ☐ No ☐

If "yes," list all website addresses on Section 1.I. of Schedule D. If a website address serves as a portal through which to access other information you have published on the web, you may list the portal without listing addresses for all of the other information. Some advisers may need to list more than one portal address. Do not provide individual electronic mail (e-mail) addresses in response to this Item.

J. Provide the name and contact information of your Chief Compliance Officer: If you are an *exempt reporting adviser*, you must provide the contact information for your Chief Compliance Officer, if you have one. If not, you must complete Item 1.K. below.

____
(name)

____
(other titles, if any)

____________ ____________
(area code) (telephone number) (area code) (facsimile number)

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

____
(electronic mail (e-mail) address, if Chief Compliance Officer has one)

K. Additional Regulatory Contact Person: If a person other than the Chief Compliance Officer is authorized to receive information and respond to questions about this Form ADV, you may provide that information here.

____
(name)

____
(titles)

____________ ____________
(area code) (telephone number) (area code) (facsimile number)

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

____
(electronic mail (e-mail) address, if contact person has one)

L. Do you maintain some or all of the books and records you are required to keep under Section 204 of the Advisers Act, or similar state law, somewhere other than your *principal office and place of business*?

Yes ☐ No ☐

If "yes," complete Section 1.L. of Schedule D.

M. Are you registered with a *foreign financial regulatory authority*? Yes ☐ No ☐

Answer "no" if you are not registered with a foreign financial regulatory authority, even if you have an affiliate that is registered with a foreign financial regulatory authority. If "yes," complete Section 1.M. of Schedule D.

N. Are you a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934?

Yes ☐ No ☐

If "yes," provide your CIK number (Central Index Key number that the SEC assigns to each public reporting company): ____________________

O. Did you have $1 billion or more in assets on the last day of your most recent fiscal year?

Yes ☐ No ☐

P. Provide your *Legal Entity Identifier* if you have one: ____________________

A *legal entity identifier* is a unique number that companies use to identify each other in the financial marketplace. In the first half of 2011, the *legal entity identifier* standard was still in development. You may not have a *legal entity identifier*.

Item 2

SEC Registration

Responses to this Item help us (and you) determine whether you are eligible to register with the SEC. Complete this Item 2.A. only if you are applying for SEC registration or submitting an *annual updating amendment* to your SEC registration.

A. To register (or remain registered) with the SEC, you must check **at least one** of the Items 2.A.(1) through 2.A.(12), below. If you are submitting an *annual updating amendment* to your SEC registration and you are no longer eligible to register with the SEC, check Item 2.A.(13). Part 1A Instruction 2 provides information to help you determine whether you may affirmatively respond to each of these items.

You (the adviser):

☐ (1) are a **large advisory firm** that either:

(a) has regulatory assets under management of $100 million (in U.S. dollars) or more, or

(b) has regulatory assets under management of $90 million (in U.S. dollars) or more at the time of filing its most recent *annual updating amendment* and is registered with the SEC;

☐ (2) are a **mid-sized advisory firm** that has regulatory assets under management of $25 million (in U.S. dollars) or more but less than $100 million (in U.S. dollars) and you are either:

(a) not required to be registered as an adviser with the *state securities authority* of the state where you maintain your *principal office and place of business*, or

(b) not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*;

*Click **HERE** for a list of states in which an investment adviser, if registered, would not be subject to examination by the state securities authority.*

☐ (3) have your *principal office and place of business* **in Wyoming** (which does not regulate advisers);

☐ (4) have your *principal office and place of business* **outside the United States**;

☐ (5) are **an investment adviser (or sub-adviser) to an investment company** registered under the Investment Company Act of 1940;

☐ (6) are **an investment adviser to a company which has elected to be a business development company** pursuant to section 54 of the Investment Company Act of 1940 and has not withdrawn the election, and you have at least $25 million of regulatory assets under management;

☐ (7) are a **pension consultant** with respect to assets of plans having an aggregate value of at least $200,000,000 that qualifies for the exemption in rule 203A-2(a);

☐ (8) are a **related adviser** under rule 203A-2(b) that *controls*, is *controlled* by, or is under common *control* with, an investment adviser that is registered with the SEC, and your *principal office and place of business* is the same as the registered adviser;

If you check this box, complete Section 2.A.(8) of Schedule D.

☐ (9) are a **newly formed adviser** relying on rule 203A-2(c) because you expect to be eligible for SEC registration within 120 days;

If you check this box, complete Section 2.A.(9) of Schedule D.

☐ (10) are a **multi-state adviser** that is required to register in 15 or more states and is relying on rule 203A-2(d);

If you check this box, complete Section 2.A.(10) of Schedule D.

☐ (11) are an **Internet adviser** relying on rule 203A-2(e);

☐ (12) have **received an SEC order** exempting you from the prohibition against registration with the SEC;

If you check this box, complete Section 2.A.(12) of Schedule D.

☐ (13) are **no longer eligible** to remain registered with the SEC.

SEC Reporting by *Exempt Reporting Advisers*

B. Complete this Item 2.B. only if you are reporting to the SEC as an *exempt reporting adviser*. Check all that apply. You:

☐ (1) qualify for the exemption from registration as an adviser solely to one or more venture capital funds;

☐ (2) qualify for the exemption from registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million;

☐ (3) act solely as an adviser to *private funds* but you are no longer eligible to check box 2.B.(2) because you have assets under management in the United States of $150 million or more.

If you check box (2) or (3), complete Section 2.B. of Schedule D.

State Securities Authority Notice Filings and State Reporting by *Exempt Reporting Advisers*

C. Under state laws, SEC-registered advisers may be required to provide to *state securities authorities* a copy of the Form ADV and any amendments they file with the SEC. These are called *notice filings*. In addition, *exempt reporting advisers* may be required to provide *state securities authorities* with a copy of reports and any amendments they file with the SEC. If this is an initial application or report, check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to direct your *notice filings* or reports to additional state(s), check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to your registration to stop your *notice filings* or reports from going to state(s) that currently receive them, uncheck the box(es) next to those state(s).

☐ AL	☐ CT	☐ HI	☐ KY	☐ MN	☐ NH	☐ OH	☐ SC	☐ VI
☐ AK	☐ DE	☐ ID	☐ LA	☐ MS	☐ NJ	☐ OK	☐ SD	☐ VA
☐ AZ	☐ DC	☐ IL	☐ ME	☐ MO	☐ NM	☐ OR	☐ TN	☐ WA
☐ AR	☐ FL	☐ IN	☐ MD	☐ MT	☐ NY	☐ PA	☐ TX	☐ WV
☐ CA	☐ GA	☐ IA	☐ MA	☐ NE	☐ NC	☐ PR	☐ UT	☐ WI
☐ CO	☐ GU	☐ KS	☐ MI	☐ NV	☐ ND	☐ RI	☐ VT	

If you are amending your registration to stop your notice filings or reports from going to a state that currently receives them and you do not want to pay that state's notice filing or report filing fee for the coming year, your amendment must be filed before the end of the year (December 31).

Item 3 Form of Organization

A. How are you organized?

☐ Corporation ☐ Sole Proprietorship ☐ Limited Liability Partnership (LLP)
☐ Partnership ☐ Limited Liability Company (LLC) ☐ Limited Partnership (LP)
☐ Other (specify):____________________

If you are changing your response to this Item, see Part 1A Instruction 4.

B. In what month does your fiscal year end each year? __________

C. Under the laws of what state or country are you organized? __________

If you are a partnership, provide the name of the state or country under whose laws your partnership was formed. If you are a sole proprietor, provide the name of the state or country where you reside.

If you are changing your response to this Item, see Part 1A Instruction 4.

Item 4 Successions

A. Are you, at the time of this filing, succeeding to the business of a registered investment adviser?

☐ Yes ☐ No

If "yes," complete Item 4.B. and Section 4 of Schedule D.

B. Date of Succession: ________________ (mm/dd/yyyy)

If you have already reported this succession on a previous Form ADV filing, do not report the succession again. Instead, check "No." See Part 1A Instruction 4.

Item 5 Information About Your Advisory Business

Responses to this Item help us understand your business, assist us in preparing for on-site examinations, and provide us with data we use when making regulatory policy. Part 1A Instruction 5.a. provides additional guidance to newly formed advisers for completing this Item 5.

<u>Employees</u>

If you are organized as a sole proprietorship, include yourself as an employee in your responses to Item 5.A and Items 5.B.(1), (2), (3), (4), and (5). If an employee performs more than one function, you should count that employee in each of your responses to Items 5.B.(1), (2), (3), (4) and (5).

A. Approximately how many *employees* do you have? Include full- and part-time *employees* but do not include any clerical workers.

____

B.

(1) Approximately how many of the *employees* reported in 5.A. perform investment advisory functions (including research)?

____

(2) Approximately how many of the *employees* reported in 5.A. are registered representatives of a broker-dealer?

____

(3) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives*?

____

(4) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives* for an investment adviser other than you?

____

(5) Approximately how many of the *employees* reported in 5.A. are licensed agents of an insurance company or agency?

____

(6) Approximately how many firms or other *persons* solicit advisory *clients* on your behalf? ________

In your response to Item 5.B.(6), do not count any of your employees and count a firm only once – do not count each of the firm's employees that solicit on your behalf.

Clients

In your responses to Items 5.C. and 5.D. do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

C. (1) To approximately how many *clients* did you provide investment advisory services during your most recently completed fiscal year?

☐ 0 ☐ 1-10 ☐ 11-25 ☐ 26-100

If more than 100, how many? ______ (round to the nearest 100)

(2) Approximately what percentage of your *clients* are non-*United States persons*? ______%

D. *For purposes of this Item 5.D., the category "individuals" includes trusts, estates, and 401(k) plans and IRAs of individuals and their family members, but does not include businesses organized as sole proprietorships.*
The category "business development companies" consists of companies that have made an election pursuant to section 54 of the Investment Company Act of 1940. Unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940, check "None" in response to Item 5.D.(1)(d) and do not check any of the boxes in response to Item 5.D.(2)(d).

(1) What types of *clients* do you have? Indicate the approximate percentage that each type of *client* comprises of your total number of *clients*. If a *client* fits into more than one category, check all that apply.

	None	Up to 10%	11-25%	26-50%	51-75%	76-99%	100%
(a) Individuals (other than *high net worth individuals*)	☐	☐	☐	☐	☐	☐	☐
(b) *High net worth individuals*	☐	☐	☐	☐	☐	☐	☐
(c) Banking or thrift institutions	☐	☐	☐	☐	☐	☐	☐
(d) Investment companies	☐	☐	☐	☐	☐	☐	☐
(e) Business development companies	☐	☐	☐	☐	☐	☐	☐
(f) Pooled investment vehicles (other than investment companies)	☐	☐	☐	☐	☐	☐	☐
(g) Pension and profit sharing plans (but not the plan participants)	☐	☐	☐	☐	☐	☐	☐
(h) Charitable organizations	☐	☐	☐	☐	☐	☐	☐
(i) Corporations or other businesses not listed above	☐	☐	☐	☐	☐	☐	☐
(j) State or municipal *government entities*	☐	☐	☐	☐	☐	☐	☐
(k) Other investment advisers	☐	☐	☐	☐	☐	☐	☐
(l) Insurance companies	☐	☐	☐	☐	☐	☐	☐

(m) Other: ________ ☐ ☐ ☐ ☐ ☐ ☐ ☐

(2) Indicate the approximate amount of your regulatory assets under management (reported in Item 5.F. below) attributable to each of the following type of *client*. If a *client* fits into more than one category, check all that apply.

	None	Up to 25%	Up to 50%	Up to 75%	>75%
(a) Individuals (other than *high net worth individuals*)	☐	☐	☐	☐	☐
(b) *High net worth individuals*	☐	☐	☐	☐	☐
(c) Banking or thrift institutions	☐	☐	☐	☐	☐
(d) Investment companies	☐	☐	☐	☐	☐
(e) Business development companies	☐	☐	☐	☐	☐
(f) Pooled investment vehicles (other than investment companies)	☐	☐	☐	☐	☐
(g) Pension and profit sharing plans (but not the plan participants)	☐	☐	☐	☐	☐
(h) Charitable organizations	☐	☐	☐	☐	☐
(i) Corporations or other businesses not listed above	☐	☐	☐	☐	☐
(j) State or municipal *government entities*	☐	☐	☐	☐	☐
(k) Other investment advisers	☐	☐	☐	☐	☐
(l) Insurance companies	☐	☐	☐	☐	☐
(m) Other: ________	☐	☐	☐	☐	☐

Compensation Arrangements

E. You are compensated for your investment advisory services by (check all that apply):

☐ (1) A percentage of assets under your management
☐ (2) Hourly charges
☐ (3) Subscription fees (for a newsletter or periodical)
☐ (4) Fixed fees (other than subscription fees)
☐ (5) Commissions
☐ (6) *Performance-based fees*
☐ (7) Other (specify): ________

Regulatory Assets Under Management

F. (1) Do you provide continuous and regular supervisory or management services to securities portfolios? ☐ Yes ☐ No

(2) If yes, what is the amount of your regulatory assets under management and total number of accounts?

	U.S. Dollar Amount	Total Number of Accounts
Discretionary:	(a) $________.00	(d) ________

Non-Discretionary: (b) $______.00 (e) ______

Total: (c) $______.00 (f) ______

Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management. You must follow these instructions carefully when completing this Item.

Advisory Activities

G. What type(s) of advisory services do you provide? Check all that apply.

- ☐ (1) Financial planning services
- ☐ (2) Portfolio management for individuals and/or small businesses
- ☐ (3) Portfolio management for investment companies (as well as "business development companies" that have made an election pursuant to section 54 of the Investment Company Act of 1940)
- ☐ (4) Portfolio management for pooled investment vehicles (other than investment companies)
- ☐ (5) Portfolio management for businesses (other than small businesses) or institutional *clients* (other than registered investment companies and other pooled investment vehicles)
- ☐ (6) Pension consulting services
- ☐ (7) Selection of other advisers (including *private fund* managers)
- ☐ (8) Publication of periodicals or newsletters
- ☐ (9) Security ratings or pricing services
- ☐ (10) Market timing services
- ☐ (11) Educational seminars/workshops
- ☐ (12) Other (specify): ______

Do not check Item 5.G.(3) unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940, including as a subadviser. If you check Item 5.G.(3), report the 811 or 814 number of the investment company or investment companies to which you provide advice in Section 5.G. of Schedule D.

H. If you provide financial planning services, to how many *clients* did you provide these services during your last fiscal year?

☐ 0 ☐ 1-10 ☐ 11-25 ☐ 26-50 ☐ 51-100 ☐ 101-250 ☐ 251 – 500
☐ More than 500 If more than 500, how many? ______ (round to the nearest 500)

In your responses to this Item 5.H., do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

I. If you participate in a *wrap fee program*, do you (check all that apply):

- ☐ (1) *sponsor* the *wrap fee program*?
- ☐ (2) act as a portfolio manager for the *wrap fee program*?

If you are a portfolio manager for a wrap fee program, list the names of the programs and their sponsors in Section 5.I.(2) of Schedule D.

If your involvement in a wrap fee program is limited to recommending wrap fee programs to your clients, or you advise a mutual fund that is offered through a wrap fee program, do not check either Item 5.I.(1) or 5.I(2).

J. In response to Item 4.B. of Part 2A of Form ADV, do you indicate that you provide investment advice only with respect to limited types of investments? ☐ Yes ☐ No

Item 6 Other Business Activities

In this Item, we request information about your firm's other business activities.

A. You are actively engaged in business as a (check all that apply):

☐ (1) broker-dealer (registered or unregistered)
☐ (2) registered representative of a broker-dealer
☐ (3) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
☐ (4) futures commission merchant
☐ (5) real estate broker, dealer, or agent
☐ (6) insurance broker or agent
☐ (7) bank (including a separately identifiable department or division of a bank)
☐ (8) trust company
☐ (9) registered municipal advisor
☐ (10) registered security-based swap dealer
☐ (11) major security-based swap participant
☐ (12) accountant or accounting firm
☐ (13) lawyer or law firm
☐ (14) other financial product salesperson (specify): ________________

If you engage in other business using a name that is different from the names reported in Items 1.A. or 1.B, complete Section 6.A. of Schedule D.

B. (1) Are you actively engaged in any other business not listed in Item 6.A. (other than giving investment advice)? ☐ Yes ☐ No

(2) If yes, is this other business your primary business? ☐ Yes ☐ No

If "yes," describe this other business on Section 6.B.(2) of Schedule D, and if you engage in this business under a different name, provide that name.

(3) Do you sell products or provide services other than investment advice to your advisory *clients*?
☐ Yes ☐ No

If "yes," describe this other business on Section 6.B.(3) of Schedule D, and if you engage in this business under a different name, provide that name.

Item 7 Financial Industry Affiliations and *Private Fund* Reporting

In this Item, we request information about your financial industry affiliations and activities. This information identifies areas in which conflicts of interest may occur between you and your *clients*.

A. This part of Item 7 requires you to provide information about you and your *related persons*, including foreign affiliates. Your *related persons* are all of your *advisory affiliates* and any *person* that is under common *control* with you.

You have a *related person* that is a (check all that apply):

☐ (1) broker-dealer, municipal securities dealer, or government securities broker or dealer (registered or unregistered)

- ☐ (2) other investment adviser (including financial planners)
- ☐ (3) registered municipal advisor
- ☐ (4) registered security-based swap dealer
- ☐ (5) major security-based swap participant
- ☐ (6) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (7) futures commission merchant
- ☐ (8) banking or thrift institution
- ☐ (9) trust company
- ☐ (10) accountant or accounting firm
- ☐ (11) lawyer or law firm
- ☐ (12) insurance company or agency
- ☐ (13) pension consultant
- ☐ (14) real estate broker or dealer
- ☐ (15) sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles
- ☐ (16) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

For each related person, including foreign affiliates that may not be registered or required to be registered in the United States, complete Section 7.A. of Schedule D.

You do not need to complete Section 7.A. of Schedule D for any related person if: (1) you have no business dealings with the related person in connection with advisory services you provide to your clients; (2) you do not conduct shared operations with the related person; (3) you do not refer clients or business to the related person, and the related person does not refer prospective clients or business to you; (4) you do not share supervised persons or premises with the related person; and (5) you have no reason to believe that your relationship with the related person otherwise creates a conflict of interest with your clients.

You must complete Section 7.A. of Schedule D for each related person acting as qualified custodian in connection with advisory services you provide to your clients (other than any mutual fund transfer agent pursuant to rule 206(4)-2(b)(1)), regardless of whether you have determined the related person to be operationally independent under rule 206(4)-2 of the Advisers Act.

B. Are you an adviser to any *private fund*? ☐ Yes ☐ No

If "yes," then for each private fund that you advise, you must complete a Section 7.B.(1) of Schedule D, except in certain circumstances described in the next sentence and in Instruction 6 of the Instructions to Part 1A. If another adviser reports this information with respect to any such private fund in Section 7.B.(1) of Schedule D of its Form ADV (e.g., if you are a subadviser), do not complete Section 7.B.(1) of Schedule D with respect to that private fund. You must, instead, complete Section 7.B.(2) of Schedule D.

In either case, if you seek to preserve the anonymity of a private fund client by maintaining its identity in your books and records in numerical or alphabetical code, or similar designation, pursuant to rule 204-2(d), you may identify the private fund in Section 7.B.(1) or 7.B.(2) of Schedule D using the same code or designation in place of the fund's name.

Item 8 Participation or Interest in *Client* Transactions

In this Item, we request information about your participation and interest in your *clients'* transactions. This information identifies additional areas in which conflicts of interest may occur between you and your *clients*.

Like Item 7, Item 8 requires you to provide information about you and your *related persons*, including foreign affiliates.

Proprietary Interest in *Client* Transactions

	Yes	No
A. Do you or any *related person*:		
(1) buy securities for yourself from advisory *clients*, or sell securities you own to advisory *clients* (principal transactions)?	☐	☐
(2) buy or sell for yourself securities (other than shares of mutual funds) that you also recommend to advisory *clients*?	☐	☐
(3) recommend securities (or other investment products) to advisory *clients* in which you or any *related person* has some other proprietary (ownership) interest (other than those mentioned in Items 8.A.(1) or (2))?	☐	☐

Sales Interest in *Client* Transactions

	Yes	No
B. Do you or any *related person*:		
(1) as a broker-dealer or registered representative of a broker-dealer, execute securities trades for brokerage customers in which advisory *client* securities are sold to or bought from the brokerage customer (agency cross transactions)?	☐	☐
(2) recommend purchase of securities to advisory *clients* for which you or any *related person* serves as underwriter, general or managing partner, or purchaser representative?	☐	☐
(3) recommend purchase or sale of securities to advisory *clients* for which you or any *related person* has any other sales interest (other than the receipt of sales commissions as a broker or registered representative of a broker-dealer)?	☐	☐

Investment or Brokerage Discretion

	Yes	No
C. Do you or any *related person* have *discretionary authority* to determine the:		
(1) securities to be bought or sold for a *client's* account?	☐	☐
(2) amount of securities to be bought or sold for a *client's* account?	☐	☐
(3) broker or dealer to be used for a purchase or sale of securities for a *client's* account?	☐	☐
(4) commission rates to be paid to a broker or dealer for a *client's* securities transactions?	☐	☐

	Yes	No
D. If you answer "yes" to C.(3) above, are any of the brokers or dealers *related persons*?	☐	☐
E. Do you or any *related person* recommend brokers or dealers to *clients*?	☐	☐

F. If you answer "yes" to E above, are any of the brokers or dealers *related persons*? ☐ ☐

G. (1) Do you or any *related person* receive research or other products or services other than execution from a broker-dealer or a third party ("soft dollar benefits") in connection with *client* securities transactions? ☐ ☐

(2) If "yes" to G.(1) above, are all the "soft dollar benefits" you or any *related persons* receive eligible "research or brokerage services" under section 28(e) of the Securities Exchange Act of 1934? ☐ ☐

H. Do you or any *related person*, directly or indirectly, compensate any *person* for *client* referrals? ☐ ☐

I. Do you or any *related person*, directly or indirectly, receive compensation from any *person* for *client* referrals? ☐ ☐

In responding to Items 8.H and 8.I., consider all cash and non-cash compensation that you or a related person gave to (in answering Item 8.H) or received from (in answering Item 8.I) any person in exchange for client referrals, including any bonus that is based, at least in part, on the number or amount of client referrals.

Item 9 Custody

In this Item, we ask you whether you or a *related person* has *custody* of *client* (other than *clients* that are investment companies registered under the Investment Company Act of 1940) assets and about your custodial practices.

A. (1) Do you have *custody* of any advisory *clients'*:

	Yes	No
(a) cash or bank accounts?	☐	☐
(b) securities?	☐	☐

If you are registering or registered with the SEC, answer "No" to Item 9.A.(1)(a) and (b) if you have custody solely because (i) you deduct your advisory fees directly from your clients' accounts, or (ii) a related person has custody of client assets in connection with advisory services you provide to clients, but you have overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)-(2)(d)(5)) from the related person.

(2) If you checked "yes" to Item 9.A.(1)(a) or (b), what is the approximate amount of *client* funds and securities and total number of *clients* for which you have *custody*:

U.S. Dollar Amount	Total Number of *Clients*
(a) $__________	(b) __________

If you are registering or registered with the SEC and you have custody solely because you deduct your advisory fees directly from your clients' accounts, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). If your related person has custody of client assets in connection with advisory services you provide to clients, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). Instead, include that information in your response to Item 9.B.(2).

B. (1) In connection with advisory services you provide to *clients*, do any of your *related persons* have *custody* of any of your advisory *clients'*:

	Yes	No
(a) cash or bank accounts?	☐	☐
(b) securities?	☐	☐

You are required to answer this item regardless of how you answered Item 9.A.(1)(a) or (b).

(2) If you checked "yes" to Item 9.B.(1)(a) or (b), what is the approximate amount of *client* funds and securities and total number of *clients* for which your *related persons* have *custody*:

U.S. Dollar Amount — Total Number of *Clients*

(a) $________ (b) ________

C. If you or your *related persons* have *custody* of *client* funds or securities in connection with advisory services you provide to *clients*, check all the following that apply:

☐ (1) A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.

☐ (2) An *independent public accountant* audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.

☐ (3) An *independent public accountant* conducts an annual surprise examination of *client* funds and securities.

☐ (4) An *independent public accountant* prepares an internal control report with respect to custodial services when you or your *related persons* are qualified custodians for *client* funds and securities.

If you checked Item 9.C.(2), C.(3) or C.(4), list in Section 9.C. of Schedule D the accountants that are engaged to perform the audit or examination or prepare an internal control report. (If you checked Item 9.C.(2), you do not have to list auditor information in Section 9.C. of Schedule D if you already provided this information with respect to the private funds you advise in Section 7.B.(1) of Schedule D).

D. Do you or your *related person(s)* act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*?

	Yes	No
(1) you act as a qualified custodian	☐	☐
(2) your *related person(s)* act as qualified custodian(s)	☐	☐

If you checked "yes" to Item 9.D.(2), all related persons that act as qualified custodians (other than any mutual fund transfer agent pursuant to rule 206(4)-2(b)(1)) must be identified in Section 7.A. of Schedule D, regardless of whether you have determined the related person to be operationally independent under rule 206(4)-2 of the Advisers Act.

E. If you are filing your *annual updating amendment* and you were subject to a surprise examination by an *independent public accountant* during your last fiscal year, provide the date (MM/YYYY) the examination commenced: ________

F. If you or your *related persons* have *custody* of *client* funds or securities, how many *persons*, including, but not limited to, you and your *related persons*, act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*? __________

Item 10 Control Persons

In this Item, we ask you to identify every *person* that, directly or indirectly, *controls* you.

If you are submitting an initial application or report, you must complete Schedule A and Schedule B. Schedule A asks for information about your direct owners and executive officers. Schedule B asks for information about your indirect owners. If this is an amendment and you are updating information you reported on either Schedule A or Schedule B (or both) that you filed with your initial application or report, you must complete Schedule C.

A. Does any *person* not named in Item 1.A. or Schedules A, B, or C, directly or indirectly, *control* your management or policies? ☐ Yes ☐ No.

If yes, complete Section 10.A. of Schedule D.

B. If any *person* named in Schedules A, B, or C or in Section 10.A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, please complete Section 10.B. of Schedule D.

Item 11 Disclosure Information

In this Item, we ask for information about your disciplinary history and the disciplinary history of all your *advisory affiliates*. We use this information to determine whether to grant your application for registration, to decide whether to revoke your registration or to place limitations on your activities as an investment adviser, and to identify potential problem areas to focus on during our on-site examinations. One event may result in "yes" answers to more than one of the questions below.

Your *advisory affiliates* are: (1) all of your current *employees* (other than *employees* performing only clerical, administrative, support or similar functions); (2) all of your officers, partners, or directors (or any *person* performing similar functions); and (3) all *persons* directly or indirectly *controlling* you or *controlled* by you. If you are a "separately identifiable department or division" (SID) of a bank, see the Glossary of Terms to determine who your *advisory affiliates* are.

If you are registered or registering with the SEC or if you are an exempt reporting adviser, you may limit your disclosure of any event listed in Item 11 to ten years following the date of the event. If you are registered or registering with a state, you must respond to the questions as posed; you may, therefore, limit your disclosure to ten years following the date of an event only in responding to Items 11.A.(1), 11.A.(2), 11.B.(1), 11.B.(2), 11.D.(4), and 11.H(1)(a). For purposes of calculating this ten-year period, the date of an event is the date the final order, judgment, or decree was entered, or the date any rights of appeal from preliminary orders, judgments, or decrees lapsed.

You must complete the appropriate Disclosure Reporting Page ("DRP") for "yes" answers to the questions in this Item 11.

	Yes	No
Do any of the events below involve you or any of your *supervised persons?*	☐	☐

For "yes" answers to the following questions, complete a Criminal Action DRP:

	Yes	No
A. In the past ten years, have you or any *advisory affiliate*:		
(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to any *felony*?	☐	☐
(2) been *charged* with any *felony*?	☐	☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.A.(2) to charges that are currently pending.

	Yes	No
B. In the past ten years, have you or any *advisory affiliate*:		
(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to a *misdemeanor* involving: investments or an *investment-related* business, or any fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?	☐	☐
(2) been *charged* with a *misdemeanor* listed in Item 11.B.(1)?	☐	☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.B.(2) to charges that are currently pending.

For "yes" answers to the following questions, complete a Regulatory Action DRP:

	Yes	No
C. Has the SEC or the Commodity Futures Trading Commission (CFTC) ever:		
(1) *found* you or any *advisory affiliate* to have made a false statement or omission?	☐	☐
(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of SEC or CFTC regulations or statutes?	☐	☐
(3) *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted?	☐	☐
(4) entered an *order* against you or any *advisory affiliate* in connection with *investment-related* activity?	☐	☐
(5) imposed a civil money penalty on you or any *advisory affiliate*, or *ordered* you or any *advisory affiliate* to cease and desist from any activity?	☐	☐
D. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:		
(1) ever *found* you or any *advisory affiliate* to have made a false statement or omission, or been dishonest, unfair, or unethical?	☐	☐
(2) ever *found* you or any *advisory affiliate* to have been *involved* in a violation of *investment-related* regulations or statutes?	☐	☐

	Yes	No
(3) ever *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted?	☐	☐
(4) in the past ten years, entered an *order* against you or any *advisory affiliate* in connection with an *investment-related* activity?	☐	☐
(5) ever denied, suspended, or revoked your or any *advisory affiliate's* registration or license, or otherwise prevented you or any *advisory affiliate*, by *order*, from associating with an *investment-related* business or restricted your or any *advisory affiliate's* activity?	☐	☐
E. Has any *self-regulatory organization* or commodities exchange ever:		
(1) *found* you or any *advisory affiliate* to have made a false statement or omission?	☐	☐
(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of its rules (other than a violation designated as a "*minor rule violation*" under a plan approved by the SEC)?	☐	☐
(3) *found* you or any *advisory affiliate* to have been the cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted?	☐	☐
(4) disciplined you or any *advisory affiliate* by expelling or suspending you or the *advisory affiliate* from membership, barring or suspending you or the *advisory affiliate* from association with other members, or otherwise restricting your or the *advisory affiliate's* activities?	☐	☐
F. Has an authorization to act as an attorney, accountant, or federal contractor granted to you or any *advisory affiliate* ever been revoked or suspended?	☐	☐
G. Are you or any *advisory affiliate* now the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 11.C., 11.D., or 11.E.?	☐	☐

For "yes" answers to the following questions, complete a Civil Judicial Action DRP:

	Yes	No
H. (1) Has any domestic or foreign court:		
(a) in the past ten years, *enjoined* you or any *advisory affiliate* in connection with any *investment-related* activity?	☐	☐
(b) ever *found* that you or any *advisory affiliate* were *involved* in a violation of *investment-related* statutes or regulations?	☐	☐
(c) ever dismissed, pursuant to a settlement agreement, an *investment-related* civil action brought against you or any *advisory affiliate* by a state or *foreign financial regulatory authority*?	☐	☐

(2) Are you or any *advisory affiliate* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 11.H(1)? ☐ ☐

Item 12 Small Businesses

The SEC is required by the Regulatory Flexibility Act to consider the effect of its regulations on small entities. In order to do this, we need to determine whether you meet the definition of "small business" or "small organization" under rule 0-7.

Answer this Item 12 only if you are registered or registering with the SEC and you indicated in response to Item 5.F.(2)(c) that you have regulatory assets under management of less than $25 million. You are not required to answer this Item 12 if you are filing for initial registration as a state adviser, amending a current state registration, or switching from SEC to state registration.

For purposes of this Item 12 only:

- Total Assets refers to the total assets of a firm, rather than the assets managed on behalf of *clients*. In determining your or another *person's* total assets, you may use the total assets shown on a current balance sheet (but use total assets reported on a consolidated balance sheet with subsidiaries included, if that amount is larger).

- *Control* means the power to direct or cause the direction of the management or policies of a *person*, whether through ownership of securities, by contract, or otherwise. Any *person* that directly or indirectly has the right to vote 25 percent or more of the voting securities, or is entitled to 25 percent or more of the profits, of another *person* is presumed to *control* the other *person*.

	Yes	No
A. Did you have total assets of $5 million or more on the last day of your most recent fiscal year?	☐	☐

If "yes," you do not need to answer Items 12.B. and 12.C.

B. Do you:

	Yes	No
(1) *control* another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) $25 million or more on the last day of its most recent fiscal year?	☐	☐
(2) *control* another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year?	☐	☐

C. Are you:

	Yes	No
(1) *controlled* by or under common *control* with another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) of $25 million or more on the last day of its most recent fiscal year?	☐	☐
(2) *controlled* by or under common *control* with another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year?	☐	☐

FORM ADV Schedule A	Your Name__________________ Date__________________	SEC File No.____________ *CRD* No.____________

Direct Owners and Executive Officers

1. Complete Schedule A only if you are submitting an initial application or report. Schedule A asks for information about your direct owners and executive officers. Use Schedule C to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer (Chief Compliance Officer is required if you are registered or applying for registration and cannot be more than one individual), director and any other individuals with similar status or functions;

   (b) if you are organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of your voting securities, unless you are a public reporting company (a company subject to Section 12 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of your voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if you are organized as a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of your capital;

   (d) in the case of a trust that directly owns 5% or more of a class of your voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of your capital, the trust and each trustee; and

   (e) if you are organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of your capital, and (ii) if managed by elected managers, all elected managers.

3. Do you have any indirect owners to be reported on Schedule B? ☐ Yes ☐ No

4. In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner or executive officer is an individual.

5. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are: NA - less than 5% | A - 5% but less than 10% | B - 10% but less than 25% | C - 25% but less than 50% | D - 50% but less than 75% | E - 75% or more

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Title or Status	Date Title or Status Acquired MM	YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

FORM ADV Schedule B	Your Name ____________ Date ____________	SEC File No. ____________ *CRD* No. ____________

Indirect Owners

1. Complete Schedule B only if you are submitting an initial application or report. Schedule B asks for information about your indirect owners; you must first complete Schedule A, which asks for information about your direct owners. Use Schedule C to amend this information.

2. Indirect Owners. With respect to each owner listed on Schedule A (except individual owners), list below:

   (a) in the case of an owner that is a corporation, each of its shareholders that beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 25% or more of a class of a voting security of that corporation;

   For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (b) in the case of an owner that is a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital;

   (c) in the case of an owner that is a trust, the trust and each trustee; and

   (d) in the case of an owner that is a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 25% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

3. Continue up the chain of ownership listing all 25% owners at each level. Once a public reporting company (a company subject to Sections 12 or 15(d) of the Exchange Act) is reached, no further ownership information need be given.

4. In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner is an individual.

5. Complete the Status column by entering the owner's status as partner, trustee, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are: C - 25% but less than 50% D - 50% but less than 75% E - 75% or more F - Other (general partner, trustee, or elected manager)

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired MM	YYYY	Ownership Code	Control Person	PR	CRD No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

FORM ADV Schedule C	Your Name________________ Date________________	SEC File No.________________ *CRD* No.________________

Amendments to Schedules A and B

1. Use Schedule C only to amend information requested on either Schedule A or Schedule B. Refer to Schedule A and Schedule B for specific instructions for completing this Schedule C. Complete each column.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are: NA - less than 5%; A - 5% but less than 10%; B - 10% but less than 25%; C - 25% but less than 50%; D - 50% but less than 75%; E - 75% or more; G - Other (general partner, trustee, or elected member)

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Title or Status	Date Title or Status Acquired MM/YYYY	Ownership Code	Control Person	PR	CRD No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

5. List below all changes to Schedule B (Indirect Owners):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Title or Status	Date Title or Status Acquired MM/YYYY	Ownership Code	Control Person	PR	CRD No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

Your Name________________ *CRD* Number________________
Date________________ SEC 801- or 802 Number________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 1.B. Other Business Names

List your other business names and the jurisdictions in which you use them. You must complete a separate Schedule D Section 1.B. for each business name.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name ________________ Jurisdictions ________________

SECTION 1.F. Other Offices

Complete the following information for each office, other than your *principal office and place of business*, at which you conduct investment advisory business. You must complete a separate Schedule D Section 1.F. for each location. If you are applying for SEC registration, if you are registered only with the SEC, or if you are an *exempt reporting adviser*, list only the largest five offices (in terms of numbers of *employees*).

Check only one box: ☐ Add ☐ Delete

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(area code) (telephone number) (area code) (facsimile number)

SECTION 1.I. Website Addresses

List your website addresses. You must complete a separate Schedule D Section 1.I. for each website address.

Check only one box: ☐ Add ☐ Delete

Website Address: ________________

SECTION 1.L. Location of Books and Records

Complete the following information for each location at which you keep your books and records, other than your *principal office and place of business*. You must complete a separate Schedule D Section 1.L. for each location.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of entity where books and records are kept: ________________

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(area code) (telephone number) (area code) (facsimile number)

This is (check one):
☐ one of your branch offices or affiliates.
☐ a third-party unaffiliated recordkeeper.
☐ other.

Briefly describe the books and records kept at this location. ________________

Your Name ____________________ Date ____________________

CRD Number ____________________
SEC 801- or 802 Number ____________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 1.M. Registration with *Foreign Financial Regulatory Authorities*

List the name and country, in English, of each *foreign financial regulatory authority* with which you are registered. You must complete a separate Schedule D Section 1.M. for each *foreign financial regulatory authority* with whom you are registered.

Check only one box: ☐ Add ☐ Delete

Name of *Foreign Financial Regulatory Authority* ____________________
Name of Country ____________________

SECTION 2.A.(8) Related Adviser

If you are relying on the exemption in rule 203A-2(b) from the prohibition on registration because you *control,* are *controlled* by, or are under common *control* with an investment adviser that is registered with the SEC and your *principal office and place of business* is the same as that of the registered adviser, provide the following information:

Name of Registered Investment Adviser ____________________
CRD Number of Registered Investment Adviser ____________________
SEC Number of Registered Investment Adviser 801-____________________

SECTION 2.A.(9) Newly Formed Adviser

If you are relying on rule 203A-2(c), the newly formed adviser exemption from the prohibition on registration, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations. You must make both of these representations:

☐ I am not registered or required to be registered with the SEC or a *state securities authority* and I have a reasonable expectation that I will be eligible to register with the SEC within 120 days after the date my registration with the SEC becomes effective.

☐ I undertake to withdraw from SEC registration if, on the 120th day after my registration with the SEC becomes effective, I would be prohibited by Section 203A(a) of the Advisers Act from registering with the SEC.

SECTION 2.A.(10) Multi-State Adviser

If you are relying on rule 203A-2(d), the multi-state adviser exemption from the prohibition on registration, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations.

If you are applying for registration as an investment adviser with the SEC, you must make both of these representations:

☐ I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of 15 or more states to register as an investment adviser with the *state securities authorities* in those states.

☐ I undertake to withdraw from SEC registration if I file an amendment to this registration indicating that I would be required by the laws of fewer than 15 states to register as an investment adviser with the *state securities authorities* of those states.

If you are submitting your *annual updating amendment*, you must make this representation:

☐ Within 90 days prior to the date of filing this amendment, I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of at least 15 states to register as an investment adviser with the *state securities authorities* in those states.

Your Name____________________ *CRD* Number____________________
Date____________________ SEC 801- or 802 Number____________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 2.A.(12) SEC Exemptive *Order*

If you are relying upon an SEC *order* exempting you from the prohibition on registration, provide the following information:

Application Number: 803-____________ Date of *order*: ____________ (mm/dd/yyyy)

SECTION 2.B. *Private Fund* Assets

If you check Item 2.B.(2) or (3), what is the amount of the *private fund* assets that you manage? __________.

NOTE: "*Private fund* assets" has the same meaning here as it has under rule 203(m)-1. If you are an investment adviser with its *principal office and place of business* outside of the United States only include *private fund* assets that you manage at a place of business in the United States.

SECTION 4 Successions

Complete the following information if you are succeeding to the business of a currently registered investment adviser. If you acquired more than one firm in the succession you are reporting on this Form ADV, you must complete a separate Schedule D Section 4 for each acquired firm. See Part 1A Instruction 4.

Name of Acquired Firm ______________________________

Acquired Firm's SEC File No. (if any) 801- ____________ Acquired Firm's *CRD* Number (if any) ____________

SECTION 5.G.(3) Advisers to Registered Investment Companies and Business Development Companies

If you check Item 5.G (3), what is the SEC file number (811 or 814 number) of each of the registered investment companies and business development companies to which you act as an adviser pursuant to an advisory contract? You must complete a separate Schedule D Section 5.G.(3) for each registered investment company and business development company to which you act as an adviser.

Check only one box: ☐ Add ☐ Delete

SEC File Number 811- or 814-____________

SECTION 5.I.(2) *Wrap Fee Programs*

If you are a portfolio manager for one or more *wrap fee programs,* list the name of each program and its *sponsor*. You must complete a separate Schedule D Section 5.I.(2) for each *wrap fee program* for which you are a portfolio manager.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of *Wrap Fee Program* ______________________________

Name of *Sponsor* ______________________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 6.A. Names of Your Other Businesses

If you are actively engaged in other business using a different name, provide that name and the other line(s) of business.

☐ Add ☐ Delete ☐ Amend

Other Business Name: ____________________

Other line(s) of business in which you engage using this name: (check all that apply)

- ☐ (1) broker-dealer (registered or unregistered)
- ☐ (2) registered representative of a broker-dealer
- ☐ (3) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (4) futures commission merchant
- ☐ (5) real estate broker, dealer, or agent
- ☐ (6) insurance broker or agent
- ☐ (7) bank (including a separately identifiable department or division of a bank)
- ☐ (8) trust company
- ☐ (9) registered municipal advisor
- ☐ (10) registered security-based swap dealer
- ☐ (11) major security-based swap participant
- ☐ (12) accountant or accounting firm
- ☐ (13) lawyer or law firm
- ☐ (14) other financial product salesperson (specify): ____________________

SECTION 6.B.(2) Description of Primary Business

Describe your primary business (not your investment advisory business):

If you engage in that business under a different name, provide that name:

SECTION 6.B.(3) Description of Other Products and Services

Describe other products or services you sell to your client. You may omit products and services that you listed in Section 6.B.2. above.

If you engage in that business under a different name, provide that name:

SECTION 7.A. Financial Industry Affiliations

Complete a separate Schedule D Section 7.A. for each *related person* listed in Item 7.A.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Your Name________________ CRD Number________________
Date________________ SEC 801- or 802 Number________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

1. Legal Name of *Related Person*: ________________
2. Primary Business Name of *Related Person*: ________________
3. *Related Person*'s SEC File Number (if any) (*e.g.*, 801-, 8-, 866-, 802-) ________
4. *Related Person's CRD* Number (if any): ________
5. *Related Person* is: (check all that apply)

☐ (a) broker-dealer, municipal securities dealer, or government securities broker or dealer
☐ (b) other investment adviser (including financial planners)
☐ (c) registered municipal advisor
☐ (d) registered security-based swap dealer
☐ (e) major security-based swap participant
☐ (f) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
☐ (g) futures commission merchant
☐ (h) banking or thrift institution
☐ (i) trust company
☐ (j) accountant or accounting firm
☐ (k) lawyer or law firm
☐ (l) insurance company or agency
☐ (m) pension consultant
☐ (n) real estate broker or dealer
☐ (o) sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles
☐ (p) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

6. Do you *control* or are you *controlled* by the *related person*? ☐ Yes ☐ No
7. Are you and the *related person* under common *control*? ☐ Yes ☐ No
8. (a) Does the *related person* act as a qualified custodian for your *clients* in connection with advisory services you provide to *clients*? ☐ Yes ☐ No

(b) If you are registering or registered with the SEC and you have answered "yes" to question 8.(a) above, have you overcome the presumption that you are not operationally independent (pursuant to rule 206(4)-(2)(d)(5)) from the *related person* and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*?

☐ Yes ☐ No

(c) If you have answered "yes" to question 8.(a) above, provide the location of the *related person*'s office responsible for *custody* of your *clients'* assets:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

9. (a) If the *related person* is an investment adviser, is it exempt from registration? ☐ Yes ☐ No

(b) If the answer is yes, under what exemption? ______

10. (a) Is the *related person* registered with a *foreign financial regulatory authority?* ☐ Yes ☐ No

(b) If the answer is yes, list the name and country, in English, of each *foreign financial regulatory authority* with which the *related person* is registered. ________________

11. Do you and the *related person* share any *supervised persons*? ☐ Yes ☐ No

Your Name____________________ *CRD* Number____________________
Date____________________ SEC 801- or 802 Number____________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

12. Do you and the *related person* share the same physical location? ☐ Yes ☐ No

---

SECTION 7.B.(1) *Private Fund* Reporting

Check only one box: ☐ Add ☐ Delete ☐ Amend

A. PRIVATE FUND

Information About the *Private Fund*

1. (a) Name of the *private fund*: __________________

   (b) *Private fund* identification number: __________________

2. Under the laws of what state or country is the *private fund* organized: ____________________

3. Name(s) of General Partner, Manager, Trustee, or Directors (or persons serving in a similar capacity):

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   ____

4. The *private fund* (check all that apply; you must check at least one):

   ☐ (1) qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940

   ☐ (2) qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

5. List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   English Name of *Foreign Financial Regulatory Authority* _______________ Name of Country _______________

6. (a) Is this a "master fund" in a master-feeder arrangement? ☐ Yes ☐ No

   (b) If yes, what is the name and *private fund* identification number (if any) of the feeder funds investing in this *private fund*?

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   ________ ________

   (c) Is this a "feeder fund" in a master-feeder arrangement? ☐ Yes ☐ No

   (d) If yes, what is the name and *private fund* identification number (if any) of the master fund in which this *private fund* invests?

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   ________ ________

   NOTE: You must complete question 6 for each master-feeder arrangement regardless of whether you are filing a single Schedule D, Section 7.B.(1) for the master-feeder arrangement or reporting on the funds separately.

FORM ADV Schedule D Page 7 of 13	Your Name__________________ Date__________________	*CRD* Number__________________ SEC 801- or 802 Number__________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

7. If you are filing a single Schedule D, Section 7.B.(1) for a master-feeder arrangement according to the instructions to this Section 7.B.(1), for each of the feeder funds answer the following questions:

Check only one box: ☐ Add ☐ Delete ☐ Amend

(a) Name of the *private fund*: __________

(b) *Private fund* identification number: ______________

(c) Under the laws of what state or country is the *private fund* organized: __________________

(d) Name(s) of General Partner, Manager, Trustee, or Directors (or persons serving in a similar capacity):

Check only one box: ☐ Add ☐ Delete ☐ Amend

____

(e) The *private fund* (check all that apply; you must check at least one):

☐ (1) qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940

☐ (2) qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

(f) List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

Check only one box: ☐ Add ☐ Delete ☐ Amend

English Name of *Foreign Financial Regulatory Authority* ______________ Name of Country ______________

NOTE: For purposes of questions 6 and 7, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets in a single master fund.

8. (a) Is this *private fund* a "fund of funds"? ☐ Yes ☐ No

(b) If yes, does the *private fund* invest in funds managed by you or by a *related person?* ☐ Yes ☐ No

NOTE: For purposes of this question only, answer "yes" if the fund invests 10 percent or more of its total assets in other pooled investment vehicles, whether or not they are also *private funds*, or registered investment companies.

9. During your last fiscal year, did the *private fund* invest in securities issued by investment companies registered under the Investment Company Act of 1940 (other than "money market funds," to the extent provided in Instruction 6.e.)? ☐ Yes ☐ No

10. What type of fund is the *private fund*?

☐ hedge fund ☐ liquidity fund ☐ private equity fund ☐ real estate fund ☐ securitized asset fund ☐ venture capital fund

☐Other *private fund*: ____________

NOTE: For funds of funds, refer to the funds in which the *private fund* invests. For definitions of these fund types, please see Instruction 6 of the Instructions to Part 1A.

11. Current gross asset value of the *private fund*:. $_____

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

Ownership

12. Minimum investment commitment required of an investor in the *private fund*: $______________

    NOTE: Report the amount routinely required of investors who are not your *related persons* (even if different from the amount set forth in the organizational documents of the fund).

13. Approximate number of the *private fund*'s beneficial owners: ____

14. What is the approximate percentage of the *private fund* beneficially owned by you and your *related persons*:

    _____%

15. What is the approximate percentage of the *private fund* beneficially owned (in the aggregate) by funds of funds:

    _____%

16. What is the approximate percentage of the *private fund* beneficially owned by *non-United States persons*:

    _____%

Your Advisory Services

17. (a) Are you a subadviser to this *private fund*? ☐ Yes ☐ No

    (b) If the answer to question 17(a) is "yes," provide the name and SEC file number, if any, of the adviser of the *private fund*. If the answer to question 17(a) is "no," leave this question blank. ______________

18. (a) Do any other investment advisers advise the *private fund*? ☐ Yes ☐ No

    (b) If the answer to question 18(a) is "yes," provide the name and SEC file number, if any, of the other advisers to the *private fund*. If the answer to question 18(a) is "no," leave this question blank.

    Check only one box: ☐ Add ☐ Delete ☐ Amend

    ______________ ______________

19. Are your *clients* solicited to invest in the *private fund*? ☐ Yes ☐ No

20. Approximately what percentage of your *clients* has invested in the *private fund*? ______%

Private Offering

21. Does the *private fund* rely on an exemption from registration of its securities under Regulation D of the Securities Act of 1933?
    ☐ Yes ☐ No

22. If yes, provide the *private fund*'s Form D file number (if any):

    Check only one box: ☐ Add ☐ Delete ☐ Amend

    021-______________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

B. SERVICE PROVIDERS

☐ Check this box if you are filing this Form ADV through the IARD system and want the IARD system to create a new Schedule D, Section 7.B.(1) with the same service provider information you have given here in Questions 23 - 28 for a new *private fund* for which you are required to complete Section 7.B.(1) If you check the box, the system will pre-fill those fields for you, but you will be able to manually edit the information after it is pre-filled and before you submit your filing.

Auditors

23. (a) (1) Are the *private fund*'s financial statements subject to an annual audit? ☐ Yes ☐ No

(2) Are the financial statements prepared in accordance with U.S. GAAP? ☐ Yes ☐ No

If the answer to 23(a)(1) is "yes," respond to questions (b) through (f) below. If the *private fund* uses more than one auditing firm, you must complete questions (b) through (f) separately for each auditing firm.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of the auditing firm: ____________

(c) The location of the auditing firm's office responsible for the *private fund's* audit (city, state and country): ____________

(d) Is the auditing firm an *independent public accountant*? ☐ Yes ☐ No

(e) Is the auditing firm registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

(f) If "yes" to (e) above, is the auditing firm subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(g) Are the *private fund*'s audited financial statements distributed to the *private fund*'s investors? ☐ Yes ☐ No

(h) Does the report prepared by the auditing firm contain an unqualified opinion? ☐ Yes ☐ No ☐ Report Not Yet Received

If you check "Report Not Yet Received," you must promptly file an amendment to your Form ADV to update your response when the report is available.

Prime Broker

24. (a) Does the *private fund* use one or more prime brokers? ☐ Yes ☐ No

If the answer to 24(a) is "yes," respond to questions (b) through (e) below for each prime broker the *private fund* uses. If the *private fund* uses more than one prime broker, you must complete questions (b) through (e) separately for each prime broker.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of the prime broker: ____________

(c) If the prime broker is registered with the SEC, its registration number: 8-____________

(d) Location of prime broker's office used principally by the *private fund* (city, state and country):

____

(e) Does this prime broker act as custodian for some or all of the *private fund*'s assets? ☐ Yes ☐ No

Custodian

25. (a) Does the *private fund* use any custodians (including the prime brokers listed above) to hold some or all of its assets? ☐ Yes ☐ No

If the answer to 25(a) is "yes," respond to questions (b) through (f) below for each custodian the *private fund* uses. If the *private fund* uses more than one custodian, you must complete questions (b) through (f) separately for each custodian.

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Legal name of custodian: ____________________

(c) Primary business name of custodian: ____________________

(d) The location of the custodian's office responsible for *custody* of the *private fund*'s assets (city, state and country): ____________

(e) Is the custodian a *related person* of your firm? ☐ Yes ☐ No

(f) If the custodian is a broker-dealer, provide its SEC registration number (if any) 8-____________

Administrator

26. (a) Does the *private fund* use an administrator other than your firm? ☐ Yes ☐ No

If the answer to 26(a) is "yes," respond to questions (b) through (f) below. If the *private fund* uses more than one administrator, you must complete questions (b) through (f) separately for each administrator.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of administrator: ____________________

(c) Location of administrator (city, state and country): ____________________

(d) Is the administrator a *related person* of your firm? ☐ Yes ☐ No

(e) Does the administrator prepare and send investor account statements to the *private fund*'s investors?

☐ Yes (provided to all investors) ☐ Some (provided to some but not all investors) ☐ No (provided to no investors)

(f) If the answer to 26(e) is "no" or "some," who sends the investor account statements to the (rest of the) *private fund*'s investors? If investor account statements are not sent to the (rest of the) private fund's investors, respond "not applicable."

____________________.

27. During your last fiscal year, what percentage of the *private fund*'s assets (by value) was valued by a *person,* such as an administrator, that is not your *related person*?

__________%

Include only those assets where (i) such person carried out the valuation procedure established for that asset, if any, including obtaining any relevant quotes, and (ii) the valuation used for purposes of investor subscriptions, redemptions or distributions, and fee calculations (including allocations) was the valuation determined by such person.

Marketers

28. (a) Does the *private fund* use the services of someone other than you or your *employees* for marketing purposes? ☐ Yes ☐ No

You must answer "yes" whether the person acts as a placement agent, consultant, finder, introducer, municipal advisor or other solicitor, or similar person. If the answer to 28(a) is "yes", respond to questions (b) through (g) below for each such marketer the *private fund* uses. If the *private fund* uses more than one marketer, you must complete questions (b) through (g) separately for each marketer.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Your Name____________________ *CRD* Number____________________
Date____________________ SEC 801- or 802 Number____________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

(b) Is the marketer a *related person* of your firm? ☐ Yes ☐ No

(c) Name of the marketer: ____________________

(d) If the marketer is registered with the SEC, its file number (*e.g.*, 801-, 8-, or 866-): __________ and *CRD* Number (if any) __________

(e) Location of the marketer's office used principally by the *private fund* (city, state and country):
____

(f) Does the marketer market the *private fund* through one or more websites? ☐ Yes ☐ No

(g) If the answer to 28(f) is "yes," list the website address(es): __________

SECTION 7.B.(2) *Private Fund* Reporting

(1) Name of the *private fund* ____________________

(2) *Private fund* identification number __________

(3) Name and SEC File number of adviser that provides information about this *private fund* in Section 7.B.(1) of Schedule D of its Form ADV filing ____________________, 801-__________ or 802-__________

(4) Are your *clients* solicited to invest in this *private fund*? ☐ Yes ☐ No

In answering this question, disregard feeder funds' investment in a master fund. For purposes of this question, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets in a single master fund.

SECTION 9.C. *Independent Public Accountant*

You must complete the following information for each *independent public accountant* engaged to perform a surprise examination, perform an audit of a pooled investment vehicle that you manage, or prepare an internal control report. You must complete a separate Schedule D Section 9.C. for each *independent public accountant*.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Name of the *independent public accountant*: ____________________

(2) The location of the *independent public accountant*'s office responsible for the services provided:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

(3) Is the *independent public accountant* registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

(4) If yes to (3) above, is the *independent public accountant* subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(5) The *independent public accountant* is engaged to:

Your Name________________ *CRD* Number________________
Date________________ SEC 801- or 802 Number________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

A. ☐ audit a pooled investment vehicle
B. ☐ perform a surprise examination of *clients'* assets
C. ☐ prepare an internal control report

(6) Does any report prepared by the *independent public accountant* that audited the pooled investment vehicle or that examined internal controls contain an unqualified opinion? ☐ Yes ☐ No ☐ Report Not Yet Received

If you check "Report Not Yet Received," you must promptly file an amendment to your Form ADV to update your response when the accountant's report is available.

SECTION 10.A. *Control Persons*

You must complete a separate Schedule D Section 10.A. for each *control person* not named in Item 1.A. or Schedules A, B, or C that directly or indirectly *controls* your management or policies.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Firm or Organization Name

____

(2) *CRD* Number (if any) ________________ Effective Date ________________ mm/dd/yyyy Termination Date ________________ mm/dd/yyyy

(3) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(4) Individual Name (if applicable) (Last, First, Middle)

____

(5) *CRD* Number (if any) ________________ Effective Date ________________ mm/dd/yyyy Termination Date ________________ mm/dd/yyyy

(6) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(7) Briefly describe the nature of the *control*:

____

____

____

SECTION 10.B. *Control Person* Public Reporting Companies

If any person named in Schedules A, B, or C, or in Section 10 A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934 , please provide the following information (you must complete a separate Schedule D Section 10.B. for each public reporting company):

FORM ADV Schedule D Page 13 of 13	Your Name__________________ Date__________________	*CRD* Number__________________ SEC 801- or 802 Number__________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

(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

You may use the space below to explain a response to an Item or to provide any other information.

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS
This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Items 11.A. or 11.B. of Form ADV.
Check item(s) being responded to: ☐ 11.A(1) ☐ 11.A(2) ☐ 11.B(1) ☐ 11.B(2)
Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.
Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the items listed above.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
- ☐ You (the advisory firm)
- ☐ You and one or more of your *advisory affiliates*
- ☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is	☐a firm ☐an individual
	Registered:	☐Yes ☐No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

____

____

____

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. If charge(s) were brought against an organization over which you or an *advisory affiliate* exercise(d) *control*: Enter organization name, whether or not the organization was an *investment-related* business and your or the *advisory affiliate's* position, title, or relationship.

2. Formal Charge(s) were brought in: (include name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, Docket/Case number).

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

   A. Date First *Charged* (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation:

   B. Event Disclosure Detail (include Charge(s)/Charge Description(s), and for each charge provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each charge, and (4) product type if charge is *investment-related*).

   C. Did any of the Charge(s) within the Event involve a *felony*? ☐ Yes ☐ No

   D. Current status of the Event? ☐ Pending ☐ On Appeal ☐ Final

   E. Event Status Date (complete unless status is Pending) (MM/DD/YYYY):

   ☐ Exact ☐ Explanation

If not exact, provide explanation:

4. Disposition Disclosure Detail: Include for each charge (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

5. Provide a brief summary of circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the charge(s) occurred. (Your response must fit within the space provided.)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Items 11.C., 11.D., 11.E., 11.F. or 11.G. of Form ADV.

Check item(s) being responded to:

☐ 11.C(1) ☐ 11.C(2) ☐ 11.C(3) ☐ 11.C(4) ☐ 11.C(5)
☐ 11.D(1) ☐ 11.D(2) ☐ 11.D(3) ☐ 11.D(4) ☐ 11.D(5)
☐ 11.E(1) ☐ 11.E(2) ☐ 11.E(3) ☐ 11.E(4)
☐ 11.F. ☐ 11.G.

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 11.C., 11.D., 11.E., 11.F. or 11.G. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
- ☐ You (the advisory firm)
- ☐ You and one or more of your *advisory affiliates*
- ☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is ☐ a firm ☐ an individual Registered: ☐ Yes ☐ No
Name (For individuals, Last, First, Middle)	

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.D(4), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

(continuation)

PART II

1. Regulatory Action initiated by:
   ☐ SEC ☐ Other Federal ☐ State ☐ *SRO* ☐ Foreign

(Full name of regulator, *foreign financial regulatory authority*, federal, state or *SRO*)

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s)
☐ Bar
☐ Cease and Desist
☐ Censure
☐ Denial
☐ Disgorgement
☐ Expulsion
☐ Injunction
☐ Prohibition
☐ Reprimand
☐ Restitution
☐ Revocation
☐ Suspension
☐ Undertaking
☐ Other ____________

Other Sanctions:

3. Date Initiated (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________

4. Docket/Case Number:

5. *Advisory Affiliate* Employing Firm when activity occurred which led to the regulatory action (if applicable):

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other ____________

Other Product Types:

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

7. Describe the allegations related to this regulatory action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, regulatory action appealed to (SEC, *SRO*, Federal or State Court) and Date Appeal Filed:

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐ Acceptance, Waiver & Consent (AWC)
☐ Consent
☐ Decision
☐ Decision & *Order* of Offer of Settlement
☐ Dismissed
☐ *Order*
☐ Settled
☐ Stipulation and Consent
☐ Vacated
☐ Withdrawn
☐ Other ____________

11. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________

12. Resolution Detail:

A. Were any of the following Sanctions *Ordered* (check all appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates (your response must fit within the space provided).

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 11.H. of Part 1A and Item 2.F. of Part 1B of Form ADV.

Check Part 1A item(s) being responded to: ☐ 11.H(1)(a) ☐ 11.H(1)(b) ☐ 11.H(1)(c) ☐ 11.H(2)
Check Part 1B item(s) being responded to: ☐ 2.F(1) ☐ 2.F(2) ☐ 2.F(3) ☐ 2.F(4) ☐ 2.F(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 11.H. of Part 1A or Item 2.F. of Part 1B. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
   ☐ You (the advisory firm)
   ☐ You and one or more of your *advisory affiliates*
   ☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number

This *advisory affiliate* is ☐ a firm ☐ an individual
Registered: ☐ Yes ☐ No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or advisory affiliate's favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.H.(1)(a), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
   ☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority, SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist
☐ Civil Penalty(ies)/Fine(s)
☐ Disgorgement
☐ Injunction
☐ Money Damages (Private/Civil Complaint)
☐ Restitution
☐ Restraining Order
☐ Other ________

Other Relief Sought:

3. Filing Date of Court Action (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ________

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other ________

Other Product Types:

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court - City or County and State or Country, Docket/Case Number):

6. *Advisory Affiliate* Employing Firm when activity occurred which led to the civil judicial action (if applicable):

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

7. Describe the allegations related to this civil action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, action appealed to (provide name of court) and Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled
☐ Dismissed ☐ Opinion ☐ Withdrawn ☐ Other ____________.

12. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________

13. Resolution Detail:

A. Were any of the following Sanctions Ordered or Relief Granted (check appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions:

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

C. Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above (your response must fit within the space provided).

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION**
  AND
- **REPORT BY EXEMPT REPORTING ADVISERS**

DOMESTIC INVESTMENT ADVISER EXECUTION PAGE

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial submission of Form ADV to the SEC and all amendments.

Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint the Secretary of State or other legally designated officer, of the state in which you maintain your *principal office and place of business* and any other state in which you are submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which you maintain your *principal office and place of business* or of any state in which you are submitting a *notice filing*.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having *custody* or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ______________________ Date: ______________________

Printed Name: ______________________ Title: ______________________

Adviser *CRD* Number: ______________________

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

STATE-REGISTERED INVESTMENT ADVISER EXECUTION PAGE

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial application for state registration and all amendments to registration.

1. Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint the legally designated officers and their successors, of the state in which you maintain your *principal office and place of business* and any other state in which you are applying for registration or amending your registration, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which you maintain your *principal office and place of business* or of any state in which you are applying for registration, or amending your registration.

2. State-Registered Investment Adviser Affidavit

If you are subject to state regulation, by signing this Form ADV, you represent that, you are in compliance with the registration requirements of the state in which you maintain your *principal place of business* and are in compliance with the bonding, capital, and recordkeeping requirements of that state.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having custody or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ______________________ Date: ____________________

Printed Name: ______________________ Title: ____________________

Adviser *CRD* Number: ______________

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION**
  AND
- **REPORT BY EXEMPT REPORTING ADVISERS**

NON-RESIDENT INVESTMENT ADVISER EXECUTION	PAGE 1

You must complete the following Execution Page to Form ADV. This execution page must be signed and attached to your initial submission of Form ADV to the SEC and all amendments.

1. Appointment of Agent for Service of Process

By signing this Form ADV Execution Page, you, the undersigned adviser, irrevocably appoint each of the Secretary of the SEC, and the Secretary of State or other legally designated officer, of any other state in which you are submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration (a) arises out of any activity in connection with your investment advisory business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of any state in which you are submitting a *notice filing*.

2. Appointment and Consent: Effect on Partnerships

If you are organized as a partnership, this irrevocable power of attorney and consent to service of process will continue in effect if any partner withdraws from or is admitted to the partnership, provided that the admission or withdrawal does not create a new partnership. If the partnership dissolves, this irrevocable power of attorney and consent shall be in effect for any action brought against you or any of your former partners.

3. *Non-Resident* Investment Adviser Undertaking Regarding Books and Records

By signing this Form ADV, you also agree to provide, at your own expense, to the U.S. Securities and Exchange Commission at its principal office in Washington D.C., at any Regional or District Office of the Commission, or at any one of its offices in the United States, as specified by the Commission, correct, current, and complete copies of any or all records that you are required to maintain under Rule 204-2 under the Investment Advisers Act of 1940. This undertaking shall be binding upon you, your heirs, successors and assigns, and any *person* subject to your written irrevocable consents or powers of attorney or any of your general partners and *managing agents*.

Signature

I, the undersigned, sign this Form ADV on behalf of, and with the authority of, the *non-resident* investment adviser. The investment adviser and I both certify, under penalty of perjury under the laws of the United States of America, that the information and statements made in this ADV, including exhibits and any other information submitted, are true and correct, and that I am signing this Form ADV Execution Page as a free and voluntary act.

I certify that the adviser's books and records will be preserved and available for inspection as required by law. Finally, I authorize any *person* having custody or possession of these books and records to make them available to federal and state regulatory representatives.

Signature: ______________________ Date: ____________________

Printed Name: ______________________ Title: ____________________

Adviser *CRD* Number: __________________

APPENDIX F

OMB APPROVAL
OMB Number: 3235-0538 Expires: November 30, 2013 Estimated average burden hours per response . . .1.00

Form ADV-H
APPLICATION FOR A TEMPORARY OR CONTINUING HARDSHIP EXEMPTION

Item 1 Type of Exemption

You are (check one):

- ☐ Requesting a Temporary Hardship Exemption; or
- ☐ Applying for a Continuing Hardship Exemption

A. If you are requesting a temporary hardship exemption, this Form ADV-H is for your (check one)
   - ☐ Initial SEC Application
   - ☐ *Annual updating amendment* to SEC Registration
   - ☐ Other-than-annual amendment to SEC Registration
   - ☐ Initial report to the SEC as an *exempt reporting adviser*
   - ☐ *Annual updating amendment* to your report as an *exempt reporting adviser*
   - ☐ Submit an other-than-annual amendment to your report as an *exempt reporting adviser*
   - ☐ Submit a final report an *exempt reporting adviser*

B. If you are applying for a continuing hardship exemption, this Form ADV-H is for all filings between the date you file this form and ______________________.
MM / DD / YYYY

Only an adviser that is a "small business" (as defined by SEC rule 0-7) is eligible for a continuing hardship exemption. To determine whether you are eligible for a continuing hardship exemption, review Item 12 of the Form ADV that you filed most recently with the SEC to answer the following questions:

Were you required to answer Item 12 of Part 1A of Form ADV? Yes ☐ No ☐

Did you check "yes" to any question on Item 12 of Part 1A of Form ADV? Yes ☐ No ☐

If you were not required to answer Item 12 or checked "yes" to any question on Item 12, you are not eligible for a continuing hardship exemption and must submit electronic filings to the IARD system.

Item 2 Identifying Information

SEC File number: 801 - __________ or 802 - __________

CRD Number (if you have one)__________

A. Your full legal name (if you are a sole proprietor, state your last, first, and middle names):

____

B. *Principal Office and Place of Business*
Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state) (country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

C. Name and telephone number of the individual filing this Form ADV-H:

____
(name) (title) (area code) (telephone number)

Item 3 Information Relating to the Hardship

A. If you are filing to request a temporary hardship exemption, attach a separate page that:

1. Describes the nature and extent of the temporary technical difficulties when you attempt to submit the filing in electronic format.

2. Describes the extent to which you previously have submitted documents in electronic format with the same hardware and software that you are unable to use to submit this filing.

3. Describes the burden and expense of employing alternative means (*e.g.* public library, service provider) to submit the filing in electronic format in a timely manner.

4. Provides any other reasons why a temporary hardship exemption is warranted.

B. If you are applying for a continuing hardship exemption, your application will be granted or denied based on the following items. You should attach a separate page to this Form ADV-H that:

1. Explains the reason(s) that the necessary hardware and software are not available without unreasonable burden and expense.

2. Describes the burden and expense of employing alternative means (*e.g.* public library, service provider) to submit your filings in electronic format in a timely manner.

3. Justifies the time period requested in Item 1 of this Form ADV-H.

4. Provides any other reasons why a continuing hardship exemption is warranted.

Item 4 How to Submit Your Form ADV-H

Sign this Form ADV-H. You must preserve in your records a copy of the Form ADV-H that you file. Mail one manually signed Form ADV-H and one copy to U.S. Securities and Exchange Commission, Branch of Regulations and Examinations, Mail Stop 0-25, 100 F Street, NE, Washington, DC 20549.

Item 5 Execution

I, the undersigned, have signed this Form ADV-H on behalf of, and with the authority of, the adviser requesting a temporary hardship exemption or applying for a continuing hardship exemption. The undersigned and the adviser represent that the information and statements made in this ADV-H, including any other information submitted, are true. The undersigned and the adviser further agree to waive any claim against the administrator of the IARD for errors made in good faith that may occur when converting to electronic format this Form ADV-H or any paper filing made in reliance of a continuing hardship exemption.

Signature: ______________________ Date: ______________________

Printed Name: ______________________ Title: ______________________

PRIVACY ACT STATEMENT. Section 203(c)(1) of the Advisers Act [15 U.S.C. § 80b-3(c)(1)] authorizes the Commission to collect the information required by Form ADV-H. The Commission collects this information for regulatory purposes, such as processing requests for temporary hardship exemptions and determining whether to grant a continuing hardship exemption. Filing Form ADV-H is mandatory for investment advisers requesting a temporary or continuing hardship exemption. The Commission maintains the information submitted on Form ADV-H and makes it publicly available. The Commission may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17. The information contained in Form ADV-H is part of a system of records subject to the Privacy Act of 1974, as amended. The Commission has published in the Federal Register the Privacy Act System of Records Notice for these records.

SEC'S COLLECTION OF INFORMATION. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Section 203(c)(1) of the Advisers Act authorizes the Commission to collect the information on this Form from applicants. *See* 15 U.S.C. § 80b-3(c)(1). Filing of this Form is mandatory for an investment adviser to request an exemption from the electronic filing requirements. The principal purpose of this collection of information is to enable the Commission to process requests for temporary hardship exemptions and to determine whether to grant a continuing hardship exemption. By accepting a form, however, the Commission does not make a finding that it has been completed or submitted correctly. The Commission will maintain files of the information on Form ADV-H and will make the information publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on page one of Form ADV-H, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507.

OMB APPROVAL
OMB Number: 3235-0240
Expires: October 31, 2013
Estimated average burden
hours per response.......... 1.00

Form ADV-NR

APPOINTMENT OF AGENT FOR SERVICE OF PROCESS BY NON-RESIDENT GENERAL PARTNER AND NON-RESIDENT MANAGING AGENT OF AN INVESTMENT ADVISER

You must submit this Form ADV-NR if you are a *non-resident* general partner or a *non-resident managing agent* of any investment adviser (domestic or *non-resident*). Form ADV-NR must be signed and submitted in connection with the adviser's initial Form ADV submission. If the mailing address you list below changes, you must file an amended Form ADV-NR to provide the current address. If you become a *non-resident* general partner or a *non-resident managing agent* after the date the adviser files its initial Form ADV, you must file Form ADV-NR with the Commission within 30 days of the date that you became a *non-resident* general partner or a *non-resident managing agent*. If you serve as a general partner or *managing agent* for multiple advisers, you must submit a separate Form ADV-NR for each adviser.

1. Appointment of Agent for Service of Process

By signing this Form ADV-NR, you, the undersigned *non-resident* general partner or *non-resident managing agent*, irrevocably appoint each of the Secretary of the SEC, and the Secretary of State, or equivalent officer, of the state in which the adviser referred to in this form maintains its *principal office and place of business*, if applicable, and any other state in which the adviser is applying for registration, amending its registration, or submitting a *notice filing*, as your agents to receive service, and agree that such *persons* may accept service on your behalf, of any notice, subpoena, summons, *order* instituting *proceedings*, demand for arbitration, or other process or papers, and you further agree that such service may be made by registered or certified mail, in any federal or state action, administrative *proceeding* or arbitration brought against you in any place subject to the jurisdiction of the United States, if the action, *proceeding* or arbitration: (a) arises out of any activity in connection with the investment adviser's business that is subject to the jurisdiction of the United States, and (b) is *founded*, directly or indirectly, upon the provisions of: (i) the Securities Act of 1933, the Securities Exchange Act of 1934, the Trust Indenture Act of 1939, the Investment Company Act of 1940, or the Investment Advisers Act of 1940, or any rule or regulation under any of these acts, or (ii) the laws of the state in which the adviser referred to in this Form maintains its *principal office and place of business*, if applicable, or of any state in which the adviser is applying for registration, amending its registration, or submitting a *notice filing*.

2. Appointment and Consent: Effect on Partnerships

If you are organized as a partnership, this irrevocable power of attorney and consent to service of process will continue in effect if any partner withdraws from or is admitted to the partnership, provided that the admission or withdrawal does not create a new partnership. If the partnership dissolves, this irrevocable power of attorney and consent shall be in effect for any action brought against you or any of your former partners.

Signature

I, the undersigned *non-resident* general partner or *non-resident managing agent*, certify, under penalty of perjury under the laws of the United States of America, that the information contained in this Form ADV-NR is true and correct and that I am signing this Form ADV-NR as a free and voluntary act.

Signature of Partner or Agent:

______________________ Date: ______________________

Printed Name: ______________________ Title: ______________________

Mailing Address of Partner or Agent (no P.O. Boxes):

____

____

____

____

____

Signature of Investment Adviser:

______________________ Date: ______________________

Printed Name: ______________________ Title: ______________________

Adviser SEC File Number: 801-__________ or 802-__________

Adviser *CRD* Number: ______________________

Adviser Name: ______________________

PRIVACY ACT STATEMENT. Section 211(a) of the Advisers Act [15 U.S.C. § 80b-11(a)] authorizes the Commission to collect the information required by Form ADV-NR. The Commission collects this information to ensure that a non-resident general partner or managing agent of an investment adviser appoints an agent for service of process in the United States. Filing Form ADV-NR is mandatory for non-resident general partners and non-resident managing agents of investment advisers. The Commission maintains the information submitted on Form ADV-NR and makes it publicly available. The Commission may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17. The information contained in Form ADV-NR is part of a system of records subject to the Privacy Act of 1974, as amended. The Commission has published in the Federal Register the Privacy Act System of Records Notice for these records.

SEC'S COLLECTION OF INFORMATION. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Section 211(a) of the Advisers Act authorizes the Commission to collect the information on this Form from applicants. *See* 15 U.S.C. § 80b-11(a). Filing of this Form is mandatory for non-resident general partners or managing agents of investment advisers. The principal purpose of this collection of information is to ensure that a non-resident general partner or managing agent of an investment adviser appoints an agent for service of process in the United States. The Commission will maintain files of the information on Form ADV-NR and will make the information publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on page one of Form ADV-NR, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. § 3507.

Appendix H

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

OMB APPROVAL	
OMB Number:	3235-0361
Expires:	March 31, 2013
Estimated average burden hours per response	0.05

FORM ADV-E

Certificate of Accounting of Client Securities and Funds in the Possession or Custody of an Investment Adviser
Pursuant to Rule 206(4)-2 [17 CFR 275.206(4)-2]

1. Investment Adviser Act SEC File Number: 801-	Date examination completed:

2. State Identification Number:

AL	AK	AZ	AR	CA
CO	CT	DE	DC	FL
GA	HI	ID	IL	IN
IA	KS	KY	LA	ME
MD	MA	MI	MN	MS
MO	MT	NE	NV	NH
NJ	NM	NY	NC	ND
OH	OK	OR	PA	RI
SC	SD	TN	TX	UT
VT	VI	VA	WA	WV
WI	WY	PUERTO RICO	Other (specify):	

3. Full name of investment adviser (if individual, state last, first, middle name):

4. Name under which business is conducted, if different from above:

5. Address of principal place of business (number, street, city, state, zip code):

INSTRUCTIONS

This Form must be completed by investment advisers that have custody of client funds or securities and that are subject to an annual surprise examination. This Form may *not* be used to amend any information included in an investment adviser's registration statement (e.g., business address).

Investment Adviser

1. All items must be completed by the investment adviser.
2. Give this Form to the independent public accountant that, in compliance with rule 206(4)-2 under the Investment Advisers Act of 1940 (the "Act") or applicable state law, examines client funds and securities in the custody of the investment adviser within 120 days of the time chosen by the accountant for the surprise examination and upon such accountant's resignation or dismissal from, or other termination of, the engagement, or if the accountant removes itself or is removed from consideration for being reappointed.

Accountant

3. The independent public accountant performing the surprise examination must submit electronically on the Investment Adviser Registration Depository:

   (i) this Form and a certificate of accounting (*i.e.*, accountant's report) required by rule 206(4)-2 under the Act or applicable state law within 120 days of the time chosen by the accountant for the surprise examination, and
   (ii) this Form and a statement, within four business days of its resignation or dismissal from, or other termination of, the engagement, or removing itself or being removed from consideration for being reappointed, that includes
      (A) the date of such resignation, dismissal, removal, or other termination, and the name, address, and contact information of the accountant, and
      (B) an explanation of any problems relating to examination scope or procedure that contributed to such resignation, dismissal, removal, or other termination:

THIS FORM MUST BE GIVEN TO YOUR INDEPENDENT PUBLIC ACCOUNTANT

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. Sections 203(c)(1) and 204 of the Advisers Act authorize the Commission to collect the information on this Form from applicants. *See* 15 U.S.C. §§ 80b-3(c)(1) and 80b-4. Filing of this Form is mandatory. The principal purpose of this collection of information is to make the examination certificates filed by an accountant pursuant to Rule 206(4)-2(a)(3)(ii)(B) under the Adviser Act (after that accountant has verified by actual examination the securities and funds of clients in the custody of an investment adviser) more accessible for inspection by the Commission staff and the public and will facilitate verification of compliance with examination requirements. *See* 17 CFR §275.206(4)-2(a)(3)(ii)(B). The Commission will maintain files of the information on Form ADV-E and will make the information publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on page one of Form ADV-E, and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507. The applicable Private Act system of records is SEC-2, and the routine uses of the records are set forth at 40 FR 39255 (Aug. 27, 1975) and 41 FR 5318 (Feb. 5, 1976).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA-3220; File No. S7-25-10]

RIN 3235-AK66

Family Offices

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the "Commission") is adopting a rule to define "family offices" that will be excluded from the definition of an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and thus will not be subject to regulation under the Advisers Act.

EFFECTIVE DATE: [insert date 60 days after publication in the Federal Register], 2011.

FOR FURTHER INFORMATION CONTACT: Sarah ten Siethoff, Senior Special Counsel, or Vivien Liu, Senior Counsel, at (202) 551-6787 or <IArules@sec.gov>, Office of Investment Adviser Regulation, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is adopting rule 202(a)(11)(G)-1 [17 CFR 275.202(a)(11)(G)-1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] (the "Advisers Act" or "Act").[1]

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1 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified.

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I. BACKGROUND

On October 12, 2010, the Commission issued a release proposing new rule 202(a)(11)(G)-1 that would exempt "family offices" from regulation under the Advisers Act.[2] We proposed this rule in anticipation of the Dodd-Frank Wall Street Reform and Consumer Protection Act's (the "Dodd-Frank Act")[3] repeal of the private adviser exemption from registration contained in section 203(b)(3) of the Advisers Act, effective July 21, 2011, upon which many family offices currently rely.[4]

The Dodd-Frank Act creates in its place a new exclusion from the Advisers Act in section 202(a)(11)(G) under which family offices, as defined by the Commission, are not investment advisers subject to the Advisers Act.[5] Historically, family offices that fell outside the private adviser exemption have sought and obtained from us orders under the Advisers Act declaring those offices not to be investment advisers within the intent of

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2 *See Family Offices*, Investment Advisers Act Release No. 3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] ("Proposing Release"). "Family offices" are entities established by wealthy families to manage their wealth and provide other services to family members. *See* section I of the Proposing Release for a discussion of family offices.

3 Pub. L. No. 111-203, 124 Stat. 1376 (2010), at section 403.

4 15 U.S.C. 80b-2(b)(3). This provision exempts from registration any adviser that during the course of the preceding 12 months had fewer than 15 clients and neither held itself out to the public as an investment adviser nor advised any registered investment company or business development company.

5 *See* section 409 of the Dodd-Frank Act.

section 202(a)(11) of the Advisers Act.[6] Recognizing this past practice, section 409 of the Dodd-Frank Act instructs that any family office definition the Commission adopts should be "consistent with the previous exemptive policy" of the Commission and recognize "the range of organizational, management, and employment structures and arrangements employed by family offices."[7]

We received approximately 90 comments on the proposed rule, most of which were submitted by law firms representing family offices.[8] Many urged that we adopt a broader exemption to accommodate typical family office structures that were not reflected in our previous exemptive orders.[9] Some urged us to include exceptions in various aspects of the rule to allow individuals or entities with no family relations to nevertheless receive investment advice from the family office without the protections of

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6 *See, e.g.*, *Bear Creek Inc.*, Investment Advisers Act Release Nos. 1931 (Mar. 9, 2001) (notice) [66 FR 15150 (Mar. 15, 2001)] and 1935 (Apr. 4, 2001) (order); *Riverton Management, Inc.*, Investment Advisers Act Release Nos. 2459 (Dec. 9, 2005) [70 FR 74381 (Dec. 15, 2005)] and 2471 (Jan. 6, 2006) (order). We are troubled by comment letters we receive by counsel to some family offices that appear to acknowledge that their clients were operating as unregistered investment advisers, although they were not eligible for the private adviser exemption and had not obtained an exemptive order from us. We note that an adviser may not "rely" on exemptive orders issued to other persons.

7 Section 409(b) of the Dodd-Frank Act. Section 409 also includes a "grandfathering clause" that precludes us from excluding certain family offices from the definition solely because they provide investment advice to certain clients and had provided investment advice to those clients before January 1, 2010. *See* section 409(b)(3) of the Dodd-Frank Act.

8 The public comments we received on the Proposing Release are available on our website at http://www.sec.gov/comments/s7-25-10/s72510.shtml.

9 *See, e.g.*, Comment Letter of the American Bar Association, Section of Business Law and Section of Real Property, Trust and Estate Law (Nov. 18, 2010) ("ABA Letter"); Comment Letter of Perkins Coie/Private Investor Coalition Inc. (Nov. 11, 2010) ("Coalition Letter"); Comment Letter of Tannenbaum, Helpern, Syracuse & Hirschtritt LLP (Nov. 18, 2010) ("Tannenbaum Letter").

the Advisers Act.[10] Some disputed our interpretation of the legislative direction we received to define the term "family office" consistent with our previous exemptive orders.[11] After careful consideration of these comment letters, we are adopting rule 202(a)(11)(G)-1, with certain modifications from our proposal as further described below.

II. DISCUSSION

We are adopting new rule 202(a)(11)(G)-1 under the Advisers Act to define the term "family office" for purposes of the Act. Family offices, as so defined, are excluded from the Act's definition of "investment adviser," and are thus not subject to any of the provisions of the Act. The scope of the rule is generally consistent with the conditions of exemptive orders that we have issued to family offices. As with the proposal, and as discussed in more detail below, our final rule in some cases has modified those conditions to turn the fact-specific exemptive orders into a rule of general applicability and to take into account the need for certain clarifications and further modifications identified by commenters.

As we discussed in the Proposing Release, our orders have provided an exclusion for family offices because we viewed them as not the sort of arrangement that the

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10 *See, e.g.*, Comment Letter of Miller & Martin PLLC (Nov. 18, 2010) ("Miller Letter") (recommending that non-family clients be permitted *de minimis* investments in family limited liability companies, partnerships, corporations and other entities and be permitted *de minimis* ownership stakes in the family office itself); Comment Letter of Porter Wright (Nov. 10, 2010) (supporting various forms of non-family client investment through the family office with five percent *de minimis* maximums for each type of exception).

11 *See, e.g.*, Coalition Letter.

Advisers Act was designed to regulate.[12] Disputes among family members concerning the operation of the family office could, as we noted in the Proposing Release, be resolved within the family unit or, if necessary, through state courts under laws designed to govern family disputes. In light of the purpose of the exclusion and the legislative instructions we received, we have not expanded the exclusion, as several commenters suggested, to permit family offices to provide advisory services to multiple families or to clients who are not family members, other than certain key employees.

The failure of a family office to be able to meet the conditions of the rule will not preclude the office from providing advisory services to family members either collectively or individually. Rather, the family office will need to register under the Advisers Act (unless another exemption is available) or seek an exemptive order from the Commission. A number of family offices currently are registered under the Advisers Act.

A. Family Office Structure and Scope of Activities

As proposed, rule 202(a)(11)(G)-1 contains three general conditions. First, the exclusion is limited to family offices that provide advice about securities only to certain "family clients." Second, it requires that family clients wholly own the family office and family members and/or family entities control the family office. Third, it precludes a family office from holding itself out to the public as an investment adviser. In addition to these conditions, we have incorporated into the rule the "grandfathering" provision required by section 409 of the Dodd-Frank Act.[13]

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12 *See* Proposing Release, *supra* note 2, at sections I and II for a discussion of the rationale for the family office exclusion.

13 *See supra* note 7 and section II.A.5 of this Release.

1. Family Clients

A family office excluded from the Act is limited to an office that advises only "family clients."[14] As discussed in more detail below, family clients include current and former family members, certain employees of the family office (and, under certain circumstances, former employees), charities funded exclusively by family clients, estates of current and former family members or key employees, trusts existing for the sole current benefit of family clients or, if both family clients and charitable and non-profit organizations are the sole current beneficiaries, trusts funded solely by family clients, revocable trusts funded solely by family clients, certain key employee trusts, and companies wholly owned exclusively by, and operated for the sole benefit of, family clients (with certain exceptions).[15]

a. *Family Member*

Under the rule, a "family member" includes all lineal descendants of a common ancestor (who may be living or deceased) as well as current and former spouses or spousal equivalents of those descendants, provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members.[16] All children by adoption and current and former stepchildren also are considered family members.

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14 Rule 202(a)(11)(G)-1(b)(1).

15 The term "company" used throughout this Release and rule 202(a)(11)(G)-1 has the same meaning as in section 202(a)(5) of the Advisers Act, which defines "company" as "a corporation, a partnership, an association, a joint-stock company, a trust, or any organized group of persons, whether incorporated or not; or any receiver, trustee in a case under title 11, or similar official, or any liquidating agent for any of the foregoing, in his capacity as such."

16 Rule 202(a)(11)(G)-1(d)(6).

We have expanded persons who may be considered family members in response to several comments we received. We had proposed to define the term "family member" by reference to the "founder" of the family office, and generally to include the founder's spouse (or spousal equivalent), their parents, their lineal descendants, and their siblings and their lineal descendants.[17] Commenters observed that the proposed rule implicitly assumed that the founder of the family office is the initial generator of the family's wealth and is an individual or couple.[18] They noted that in many cases, however, family offices are established by persons several generations remote from the initial wealth generator.[19] Some commenters also criticized our proposed approach because it would treat who could be a family member differently depending on when the family office was established.[20] For example, one commenter stated that our proposal would have allowed a family office that was formed a long time ago to provide services to persons that are currently third or fourth cousins to each other, but that a family office established today

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17 Proposed rule 202(a)(11)(G)-1(d)(5) (defining the founders as the "natural person and his or her spouse or spousal equivalent for whose benefit the family office was established and any subsequent spouse of such individuals." Proposed rule 202(a)(11)(G)-1(d)(3) (defining family members as "the founders, their lineal descendants (including by adoption and stepchildren), and such lineal descendants' spouses or spousal equivalents; the parents of the founders; and the siblings of the founders and such siblings' spouses or spousal equivalents and their lineal descendants (including by adoption and stepchildren) and such lineal descendants' spouses or spousal equivalents").

18 *See, e.g.*, Comment Letter of Dechert LLP (Nov. 29, 2010) ("Dechert Letter"); Comment Letter of Fried, Frank, Harris, Shriver & Jacobs LLP (Nov. 18, 2010) ("Fried Frank Letter").

19 *See, e.g.*, Coalition Letter; Comment Letter of the New York State Bar Association, Business Law Section, Securities Regulation Committee (Dec. 10, 2010) ("NY Bar Letter").

20 *See, e.g.*, NY Bar Letter; Comment Letter of Skadden, Arps, Slate, Meagher & Flom LLP (Nov. 17, 2010) ("Skadden Letter").

may need to wait at least 40 or 50 years before being able to provide services to equivalent types of family members.[21]

Some commenters recommended that the Commission address these concerns by leaving the term "family member" undefined,[22] while others recommended that the Commission retain the approach of the proposed rule, but expand the rule to treat as family members grandparents, great-grandparents, aunts, uncles, great aunts, and great uncles of the founders and their spouses and children.[23] Leaving the term family member undefined could allow typical commercial investment advisory businesses to rely on the exclusion (by, for example, designating an extremely remote family member as a common ancestor). On the other hand, attempting to expand the family member definition by ascending up the family tree from the founders would not address the difficulty in identifying the founders of the family office as identified by commenters and would not address the concern, depending on when the family office was founded, that the definition will not capture many family members of family offices established several generations after the initial family wealth was created.

We are adopting, instead, an approach suggested in several comment letters that permits a family to choose a common ancestor (who may be deceased) and define family

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21 Skadden Letter.

22 *See, e.g.*, Comment Letter of Foley & Lardner LLP (Nov. 18, 2010) ("Foley Letter"); Miller Letter; Comment Letter of Northern Trust (Nov. 18, 2010) ("Northern Trust Letter").

23 *See, e.g.*, Comment Letter of the American Institute of Certified Public Accountants (Nov. 16, 2010) ("AICPA Letter"); Comment Letter of The Blum Firm, P.C./Blum (Nov. 18, 2010) ("Blum Letter"); Comment Letter of Hogan Lovells US LLP (Nov. 18, 2010) ("Hogan Letter").

members by reference to the degree of lineal kinship to the designated relative.[24] This approach avoids any assumptions regarding the source of family wealth and the inconsistent treatment of extended family members compared to the approach we proposed.[25] In order to prevent families from choosing an extremely remote ancestor, which could allow commercial advisory businesses to rely on the rule, we are imposing a 10 generation limit between the oldest and youngest generation of family members. Such a limit, suggested by several commenters, would constrain the scope of persons considered family members while accommodating the typical number of generations served by most family offices.[26]

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24 *See, e.g.*, ABA Letter; Comment Letter of Duncan Associates (Nov. 18, 2010) ("Duncan Letter"); Comment Letter of Kozusko Harris Vetter Wareh LLP (Nov. 18, 2010) ("Kozusko Letter").

25 Moreover, the approach we are adopting has been used in other contexts to delimit members of a family for purposes of special regulatory treatment. *See, e.g.*, Section 1361(c)(1)(B) of the Internal Revenue Code of 1986, as amended (treating members of a family as a single shareholder of an S Corporation and defining family members as "a common ancestor, any lineal descendant of such common ancestor, and any spouse or former spouse of such common ancestor or any such lineal descendant" but providing that an "individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders"); Nevada Revised Statutes section 669.042 (defining a family trust company subject to special trust company regulation as having family members within 10 degrees of lineal kinship or 9 degrees of collateral kinship to the designated relative); New Hampshire Revised Statutes section 392-B:1 (defining a family trust company subject to special banking regulation as having family members within 5 degrees of lineal kinship or 9 degrees of collateral kinship to a designated relative).

26 *See, e.g.*, ABA Letter (suggesting a 9 generation limit); Duncan Letter (recommending that the Commission follow that used for Nevada family trust companies, which allows for 10 degrees of lineal kinship and 9 degrees of collateral kinship and stating that other states' family trust company laws with fewer degrees of kinship allowed had resulted in some family office clientele being outside the limitations); Kozusko Letter (recommending 10 generations (but not counting minors as a separate generation from their parents) as a size that, based on its experience and client base and on studies of family businesses, would comfortably accommodate most family offices but that would not open up the family office to abuse as a disguised commercial enterprise); Northern Trust Letter (stating that of the over 400 family offices they represent, some are now focused on their fifth through seventh generations). We have determined not to include a

Under this approach, the family office will be able to choose the common ancestor and may change that designation over time such that the family office clientele is able to shift over time along with the family members served by the family office. A family office exempt under the rule with a common ancestor several generations up from current family members will be able to serve a greater number of current collateral family members but fewer future lineal members.

For example, G1 (who is deceased) founded a business and placed his fortune into a trust for the benefit of his heirs. G4 founded a family office to manage that wealth for the ever growing number of family members descended from G1 and treated G1 as the common ancestor for purposes of which family members the family office could advise under the exclusion. At the time G4 created the family office, current clients extended as far as G4's great-grandchildren (or G7). Over time the family grows and additional generations are born. Eventually, to allow the family office to serve later generations that would otherwise extend beyond the 10 generation limit, the family office redesignates its common ancestor to an individual in G3.[27] The family office can do this under rule 202(a)(11)(G)-1 because the rule does not specify which individual the common ancestor is and it does not specify that it always has to be the same common ancestor. As a result of this redesignation, the family office is able to advise clients two generations younger,

separate limit on degrees of permissible collateral kinship because, given our relatively expansive 10 generation lineal limit, a reasonable collateral limit would not in practice expand the range of family members covered by the rule.

27 No formal documentation or procedure is required for designating or redesignating a common ancestor.

but would no longer be able to advise certain branches of G1's family tree without registering under the Advisers Act.[28]

The rule, as proposed, treats lineal descendants and their spouses, spousal equivalents, stepchildren, and adopted children as family members.[29] Most commenters generally supported our inclusion of spousal equivalents, stepchildren and children by adoption,[30] but two commenters[31] opposed the inclusion of spousal equivalents, invoking the Defense of Marriage Act ("DOMA").[32] Because the term "spouse" is not defined in the rule and a "spousal equivalent" is identified as a category of person, separate and distinct from a "spouse," that meets the definition of a "family member," we do not believe that the rule violates that Act.

In response to comments we have expanded the definition to include foster children and persons who were minors when another family member became their legal guardian.[33] We are persuaded by the commenters that argued that foster children and children in a guardianship relationship often have familial ties indistinguishable from that

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28 *See* Annex A for an illustration of the impact of redesignating the common ancestor.

29 Rule 202(a)(11)(G)-1(d)(6). As proposed, we are using the definition of spousal equivalent currently used under our auditor independence rules. *See* Proposing Release, *supra* note 2, at n.24.

30 *See, e.g.*, Coalition Letter; NY Bar Letter.

31 Comment Letter of Alliance Defense Fund (Nov. 18, 2010); Comment Letter of Thomas V. Cliff (Nov. 1, 2010).

32 1 U.S.C. 7. The Act provides that in "determining the meaning of any Act of Congress, or of any ruling, regulation, or interpretation of the various administrative bureaus and agencies of the United States…the word 'spouse' refers only to a person of the opposite sex who is a husband or wife."

33 *See, e.g.,* ABA Letter; Dechert Letter; Tannenbaum Letter.

of children and stepchildren, and that including such individuals would not cause the family office to resemble a typical commercial investment adviser.[34]

Finally, the rule treats former family members (*i.e.*, former spouses, spousal equivalents and stepchildren) as family members.[35] We had proposed permitting former family members to retain any investments held through the family office at the time they became a former family member, but to limit them from making any new investments through the family office.[36] Commenters pointed out that a former spouse's financial arrangements often remain intertwined with those of the family, particularly if they provide for children who remain family members.[37] Some argued that stepchildren of a divorced spouse may remain close to the family after the divorce.[38] We are persuaded by these arguments and have modified the definition of former family member to include stepchildren.[39]

b. *Involuntary Transfers*

As proposed, rule 202(a)(11)(G)-1 prevents an involuntary transfer of assets to a person who is not a family client (*e.g.*, a bequest to a friend of assets in a family office-

34 *See, e.g.*, Hogan Letter; Tannenbaum Letter. Guardianship arrangements for adults, however, can raise unique conflicts and issues as compared to guardianships for minors that we believe are more appropriately addressed through an exemptive order process where the Commission can consider the specific facts and circumstances, than through a rule of general applicability.

35 Rule 202(a)(11)(G)-1(d)(4)(ii).

36 Proposed rule 202(a)(11)(G)-1(d)(2)(vi), and (d)(4).

37 *See, e.g.*, Comment Letter of Perkins Coie/Lindquist (Nov. 18, 2010) ("Lindquist Letter"); Comment Letter of Proskauer Rose LLP (Nov. 16, 2010).

38 *See, e.g.*, Coalition Letter; Comment Letter of Kramer Levin Naftalis & Frankel LLP (Nov. 17, 2010) ("Kramer Levin Letter").

39 Rule 202(a)(11)(G)-1(d)(7).

advised private fund) from causing the family office to lose its exclusion. Under the rule, a family office may continue to provide advice with respect to such assets following an involuntary transfer for a transition period of up to one year.[40] The transition period permits the family office to orderly transition that client's assets to another investment adviser or otherwise restructure its activities to comply with the Advisers Act.

We proposed to allow the family office to continue to advise a non-family client for four months following the transfer of assets resulting from the involuntary event.[41] A number of commenters argued that four months is an inadequate period of time to transition investment advice arrangements as a result of an involuntary transfer,[42] particularly for illiquid assets such as investments in private funds.[43] Some suggested that the family office be required to transfer the assets as soon as legally and practically feasible.[44] Others suggested that we treat involuntary transfers in the same manner as we had proposed treating former family members—permitting their existing investments to

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40 Rule 202(a)(11)(G)-1(b)(1).

41 Proposed rule 202(a)(11)(G)-1(b)(1).

42 *See, e.g.*, Comment Letter of Davis Polk (Nov. 18, 2010) ("Davis Polk Letter"); Fried Frank Letter.

43 *See, e.g.*, ABA Letter; Comment Letter of Withers Bergman LLP (Nov. 17, 2010) ("Withers Bergman Letter").

44 *See, e.g.*, Comment Letter of Barnes & Thornburg LLP ("as soon as legally and reasonably practical, or in the alternative, within one year"); Coalition Letter ("as soon as it is both legally and practically feasible, and in any event would have a grace period of at least one year").

remain with the family office but prohibiting new investments.[45] Still others suggested that the transfer period be lengthened to anywhere from one year to three years.[46]

After an involuntary transfer, such as a bequest, the office would no longer be providing advice solely to members of a single family, and after several such bequests the office could cease to operate in any way as a family office. Thus, we believe that relief for involuntary transfers must be temporary. We are persuaded, however, that the four month transition period we proposed would be inadequate and have extended the period to one year.[47]

c. *Family Trusts and Estates*

Rule 202(a)(11)(G)-1 treats as a family client certain family trusts established for testamentary and charitable purposes. We have expanded the types of trusts that may be treated as a family client in response to several comments that our proposal failed to take into account certain aspects of trust and estate planning.[48] As discussed in more detail

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45 *See, e.g.*, Fried Frank Letter; Comment Letter of Sidley Austin LLP (Nov. 18, 2010).

46 *See, e.g.*, AICPA Letter (1 year); Comment Letter of Bessemer Securities Corporation (Nov. 17, 2010) ("Bessemer Letter") (1 year); Davis Polk Letter (3 years); Dechert Letter (2 years); Hogan Letter (2 years); Comment Letter of Kleinberg, Kaplan, Wolff & Cohen, P.C. (Nov. 17, 2010) ("Kleinberg Letter") (2 years); Kramer Levin Letter (1 year).

47 The one year period would not begin to run until completion of the transfer of legal title to the assets resulting from the involuntary event. We note also that if the involuntary transferee does not receive investment advice about securities for compensation from the family office, then the availability of rule 202(a)(11)(G)-1 would be unaffected. For a discussion of the Commission's and the staff's views on when investment advice about securities for compensation is provided under the Advisers Act, see *Applicability of the Investment Advisers Act to Financial Planners,* Pensions *Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)] ("Release 1092").

48 *See* rule 202(a)(11)(G)-1(d)(4). Several commenters questioned whether the identity of the trustee matters under the rule. *See, e.g.*, Comment Letter of SchiffHardin LLP/Debra L. Stetter (Nov. 18, 2010) ("Schiff/Stetter Letter"); Comment Letter of Vinson & Elkins

below, these expansions accommodate common estate planning and charitable giving plans and do not suggest that the family office is engaging in a commercial enterprise.

Irrevocable trusts. The rule treats as a family client any irrevocable trust in which one or more family clients are the only *current* beneficiaries.[49] We proposed including as a family client any trust or estate existing for the *sole* benefit of one or more family clients.[50]

As suggested by commenters, the final rule disregards contingent beneficiaries of trusts, which commenters explained are often named in the event that all family members are deceased to prevent the trust from distributing assets to distant relatives or escheating to the state.[51] If the contingent beneficiary later becomes an actual beneficiary and is not a permitted current beneficiary of a family trust under the exclusion (such as a family friend), the rule's provisions concerning involuntary transfers allow for an orderly transition of investment advice regarding those assets away from the family office.

Also in response to commenters, the rule permits the family office to advise irrevocable trusts funded exclusively by one or more other family clients in which the only current beneficiaries, in addition to other family clients, are non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations.[52] Several commenters noted that families often establish and fund trusts whose sole current

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LLP (Nov. 15, 2010). A trust that meets the conditions in the rule for qualifying as a family client is unaffected by whether the trust is managed by an independent trustee.

49 Rule 202(a)(11)(G)-1(d)(4)(vii).

50 Proposed rule 202(a)(11)(G)-1(d)(2)(iv).

51 *See, e.g.*, Comment Letter of Arnold & Porter LLP (Nov. 11, 2010); Bessemer Letter.

52 Rule 202(a)(11)(G)-1(d)(4)(viii).

beneficiaries are both family clients and public charities.[53] Such an entity may not be a "charitable trust" as a technical manner, but we see no reason for treating them differently under the rule from charitable trusts funded exclusively by family clients.

Other commenters argued that a trust should be permitted to have current beneficiaries that are not family clients and that the rule instead should merely require that the trust be for the primary benefit of one or more family clients.[54] These commenters argued that the family office's provision of investment advice to these kinds of trusts would not change the family office's character and that it is the trust that is the client of the family office, rather than the beneficiary. We disagree. Current beneficiaries of a trust are greatly affected by the nature and quality of investment advice provided to the trust and would be harmed if there were fraud committed by the family office in managing trust assets. Even if in small numbers, these individuals and entities stand to benefit substantially from the protections of the Advisers Act and do not necessarily have any family ties or investment sophistication to stand in the Act's stead.

Revocable Trusts. The rule also treats as a family client a revocable trust of which one or more family clients are the sole grantors.[55] Accordingly, a revocable trust may be advised by a family office relying on the rule regardless of whether the beneficiaries of the trust are family members. We received several comments that argued that revocable trusts should be treated differently than irrevocable trusts, since the grantor

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53 *See, e.g.*, Comment Letter of Jones Day (Nov. 11, 2010) ("Jones Day Letter"); Comment Letter of McDermott Will & Emery/Edwin C. Laurenson (Nov. 18, 2010) ("McDermott/Laurenson Letter").

54 *See, e.g.*, Comment Letter of Dorsey & Whitney LLP/Bruce A. MacKenzie (Nov. 17, 2010) ("Dorsey Letter"); McDermott/Laurenson Letter.

55 Rule 202(a)(11)(G)-1(d)(4)(ix).

of a revocable trust effectively controls the trust and the beneficiaries of the trust have no reasonable expectation of obtaining any benefit from the trust until the trust becomes irrevocable (generally upon the death of the grantor).[56] Therefore, the identity of the beneficiaries of the trust should not matter so long as one or more family clients are the sole grantors of the trust. We agree that in the case of a revocable trust, the contingent nature of any beneficiary's expectation that it will benefit from the trust's assets supports disregarding a revocable trust's beneficiaries under the exclusion, just as other contingent beneficiaries are disregarded.

Estates. The final rule treats as a family client an estate of a family member, former family member, key employee or former key employee.[57] As suggested by several commenters, this provision permits a family office to advise the executor of a family member's estate even if that estate will be distributed to (and thus be for the benefit of) non-family members.[58] The executor of an estate is acting in lieu of the deceased family client in managing and distributing the family client's assets. Therefore, advice to the executor is equivalent to providing advice to that family client.[59]

d. *Non-Profit and Charitable Organizations*

The rule treats as a family client any non-profit organization, charitable foundation, charitable trust (including charitable lead trusts and charitable remainder

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56 *See, e.g.*, Davis Polk Letter; Comment Letter of Lee & Stone (Nov. 17, 2010) ("Lee & Stone Letter").

57 Rule 202(a)(11)(G)-1(d)(4)(vi). For former key employees, the advice is subject to the condition contained in rule 202(a)(11)(G)-1(d)(4)(iv).

58 *See, e.g.*, ABA Letter; AICPA Letter.

59 *See, e.g.*, Comment Letter of K&L Gates/Paul T. Metzger (Nov. 17, 2010); Comment Letter of Levin Schreder & Carey Ltd (Nov. 18, 2010) ("Levin Schreder Letter").

trusts whose only current beneficiaries are other family clients and charitable or non-profit organizations), or other charitable organization, in each case funded exclusively by one or more other family clients.[60] We understand that some family offices currently advise charitable or non-profit organizations that have accepted funding from non-family clients.[61] So that these family offices have sufficient time to transition such advisory arrangements or restructure the charitable or non-profit organization, we are including a transition period of until December 31, 2013 before family offices have to comply with this aspect of the exclusion.[62]

We had proposed treating as a family client any charitable foundation, charitable organization, or charitable trust established and funded exclusively by one or more family members.[63] Some commenters recommended that the Commission change the requirement that charities be established and funded "by family members" to "by family clients" because they asserted that family charities are often established and funded by family trusts, corporations or estates, and not exclusively by family members.[64] We agree that making this change is consistent with our view of the scope of persons that should be permitted to be served by the family office. Several commenters also believed that we should not require that a charitable organization be established by family members or family clients in order to receive investment advice from the family office

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60 Rule 202(a)(11)(G)-1(d)(4)(v).

61 *See, e.g.*, Foley Letter; Comment Letter of Morgan, Lewis & Bockius LLP (Nov. 18, 2010) ("Morgan Lewis Letter").

62 Rule 202(a)(11)(G)-1(e)(1).

63 Proposed rule 202(a)(11)(G)-1(d)(2)(iii).

64 *See, e.g.*, Dorsey Letter; Levin Schreder Letter.

under the exclusion because in some cases such charitable organizations may have been originally established by distant relatives that do not currently qualify as "family members."[65] We agree that as long as all the funding currently held by the charitable organization came solely from family clients, the individuals or entities that originally established it are not of import for our policy rationale.[66] We have changed the rule accordingly.

A number of commenters stated that "charitable organization" can have varying meanings when considered under trust and estate law versus under tax law.[67] Some of these commenters suggested that we add the term "non-profit organization" to ensure that we capture what is generally considered a charitable organization under both trust and tax law and based on their view that, as long as the non-profit organization is solely funded by family clients, the family office providing it with investment advice under the exclusion should not be of concern as a policy matter.[68] We intended to broadly capture charitable and non-profit organizations as commonly understood under both trust law and tax law and have modified the rule as suggested. Other commenters asked that we clarify that charitable lead trusts and charitable remainder trusts are included as family clients

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65 *See, e.g.*, Comment Letter of Goodwin Procter LLP (Nov. 17, 2010) ("Goodwin Letter"); Comment Letter of Willkie Farr & Gallagher LLP (Nov. 17, 2010).

66 We note that only the actual contributions to the non-profit or charitable organization need be examined for this purpose, and not any income, gains or losses relating to those contributions. For purposes of determining whether funding provided by a non-family client to the non-profit or charitable organization is "currently held" by the organization, the non-profit or charitable organization may offset any spending by the organization occurring at any time in the year of that non-family client contribution or any subsequent year against the non-family client contribution (*i.e.*, the organization may treat the non-family client contributions as the first funding spent).

67 *See, e.g.*, Goodwin Letter; Kozusko Letter.

68 *See, e.g.*, Coalition Letter; Kozusko Letter.

under the exclusion.[69] The rule we are adopting today clarifies that such trusts are included if their sole current beneficiaries are other family clients and charitable or non-profit organizations and if they meet the terms of other charitable organizations that may be advised by the family office—namely that they are funded exclusively by other family clients.[70] We believe this treatment of charitable lead trusts and charitable remainder trusts ensures that they are treated consistently with other trusts and charitable or non-profit organizations under the exclusion.

Finally, several commenters stated that the Commission should permit the family office to provide investment advice under the exclusion to charitable organizations even if funded in part by non-family clients.[71] They argued that because the contributed assets will not be invested for the benefit of the donors, as long as the family controlled the charitable entity or was its substantial contributor, it served no public policy purpose to preclude third party contributions.[72] We are leaving this aspect of the proposal unchanged because a non-profit or charitable organization that currently holds non-family funding lacks the characteristics necessary to be viewed as a member of a family unit. Permitting such organizations to be advised by a family office would be inconsistent with

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69 *See, e.g.*, Dechert Letter; Fried Frank Letter. Charitable lead trusts are entities in which a charity receives payments from the trust for a specified period as a current beneficiary, but the remainder of the trust is distributed to specified beneficiaries. Charitable remainder trusts are entities in which specified individuals or entities receive payments from the trust for a specified period as a current beneficiary, but a charity receives the remainder of the trust.

70 *See* our discussion about family trusts in section II.A.1.c of this Release.

71 *See, e.g.*, Foley Letter; Kleinberg Letter.

72 *See, e.g.*, Ropes & Gray Letter; Skadden Letter.

the exclusion's underlying rationale that recognizes that the Advisers Act is not designed to regulate families managing their own wealth.

As noted above, however, we do recognize that some non-profit or charitable organizations advised by family offices have accepted non-family client funding. Such organizations may need time to spend the non-family funding so that none of it is "currently held" by the organization or to transition advisory arrangements. The rule provides until December 31, 2013 before this condition to the exclusion becomes applicable to family offices (*i.e.*, if the only reason the family office would not meet the exclusion is because it advises a non-profit or charitable organization that currently holds non-family client funding, the family office generally may nevertheless rely on the exclusion until December 31, 2013).[73] To rely on this transition period, a non-profit or charitable organization advised by the family office must not accept any additional funding from any non-family clients after August 31, 2011, except that during the transition period the non-profit or charitable organization may accept funding provided in fulfillment of any pledge made prior to August 31, 2011.

e. *Other Family Entities*

To allow the family office to structure its activities through typical investment structures, rule 202(a)(11)(G)-1 treats as a family client any company, including a pooled investment vehicle, that is wholly owned, directly or indirectly, by one or more family clients and operated for the sole benefit of family clients.[74] Some commenters objected

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73 Rule 202(a)(11)(G)-1(e)(1).

74 Rule 202(a)(11)(G)-1(d)(4)(xi). Under rule 202(a)(11)(G)-1(d)(2), control is defined as the power to exercise a controlling influence over the management or policies of an entity, unless such power is solely the result of being an officer of such entity. If any of these companies are pooled investment vehicles, they must be exempt from registration

to the requirement in our proposal that these entities be wholly owned and controlled by, and operated for the sole benefit of, family clients to qualify for the exclusion.[75] These commenters generally suggested modifying this aspect of the family client definition to require only that the entity be majority owned *or* controlled and operated for the *primary* benefit of family clients or similar variations.[76] One commenter suggested such an expansion to allow employees of the family that do not qualify as "key employees" to have a management role in the entity.[77] Others believed that non-family clients more broadly should be able to have a greater role in family office-advised entities.[78]

We believe that the elements of ownership and benefit are important to ensuring that the policy objectives underlying the family office exclusion are preserved. If non-family clients own a portion of such an entity, they have a vested interest in how the assets of that entity are managed—it is the source of their ownership stake's value. This is also true of a non-family client who is a beneficiary of that entity. As long as the entity is wholly owned by and for the sole benefit of family clients, however, we agree that, as with family trusts and family charitable organizations, the entity having non-family client

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as an investment company under the Investment Company Act of 1940 because the Advisers Act requires that an adviser to a registered investment company must register. *See* 15 U.S.C. 80b-3a(a)(1)(B).

75 *See, e.g.*, Blum Letter; Kramer Levin Letter (suggesting that the requirement be modified to require only that the entity be controlled and 80% owned by family clients to qualify as a family client).

76 *See, e.g.*, Coalition Letter; Kramer Levin Letter. *See also* Levin Schreder Letter (suggesting that the entity be controlled and substantially owned (80%) by family clients); Miller Letter (suggesting that the entity be wholly owned or controlled by and operated for the primary benefit of family clients).

77 Morgan Lewis Letter.

78 *See, e.g.*, Kramer Levin Letter; Miller Letter.

control does not change that family clients are the ultimate beneficiaries of the investment advice, and thus we have eliminated the requirement for control by family clients in the final rule.

f. *Key Employees*

The final rule treats certain key employees of the family office, their estates, and certain entities through which key employees may invest as family clients so that they may receive investment advice from, and participate in investment opportunities provided by, the family office. More specifically, the final rule permits the family office to provide investment advice to any natural person (including any key employee's spouse or spousal equivalent who holds a joint, community property or other similar shared ownership interest with that key employee) who is (i) an executive officer, director, trustee, general partner, or person serving in a similar capacity at the family office or its affiliated family office or (ii) any other employee of the family office or its affiliated family office (other than an employee performing solely clerical, secretarial, or administrative functions) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office, provided that such employee has been performing such functions or duties for or on behalf of the family office or affiliated family office, or substantially similar functions or duties for or on behalf of another company, for at least twelve months.[79] The final rule also permits the family office to advise certain trusts of key employees, as further described below. Finally, in addition to receiving direct advice from the family office, key employees (because they are "family clients") may indirectly receive investment

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[79] Rule 202(a)(11)(G)-1(d)(8).

advice through the family office by their investment in family office-advised private funds, charitable organizations, and other family entities, as described in previous sections of this Release.

Many commenters supported the inclusion of key employees as family clients.[80] They agreed that permitting investment participation by key employees of family offices would align their interests with those of family members and enable family offices to attract highly skilled investment professionals who may not otherwise be attracted to work at a family office.[81]

Some commenters, however, urged us to include key employees of family entities other than the family office as family clients.[82] Some reasoned that since the definition of key employee is based on the knowledgeable employee standard used in Investment Company Act rule 3c-5,[83] it should be expanded to cover key employees of any entity related to the family office because rule 3c-5 allows knowledgeable employees to be employees of certain affiliated entities.[84] Such an approach would extend Investment Company Act rule 3c-5 beyond its intended scope. That rule permits knowledgeable employees of affiliated entities to count as knowledgeable employees of the covered private fund *only* if the affiliated entity is participating in the investment activities of the

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80 *See, e.g.*, ABA Letter; Coalition Letter.

81 *Id.*

82 *See, e.g.*, Fried Frank Letter; NY Bar Letter; Skadden Letter.

83 *See* Proposing Release, *supra* note 2, at n.46 and accompanying text.

84 *See, e.g.*, NY Bar Letter; Skadden Letter.

covered private fund.[85] Because of this role, these individuals could be presumed to have sufficient financial sophistication, experience, and knowledge to evaluate investment risks and to take steps to protect themselves, even without the protection of the Investment Company Act.[86]

Many family entities advised by the family office, however, are not involved in providing investment advisory services to the family office or its clients and rather have principal business activities in a variety of industries unrelated to investment management. There is no reason to expect that their key employees have a level of knowledge and experience in financial matters sufficient to protect themselves without the protections afforded by the Advisers Act.[87] We agree, however, that if a person qualifies as a knowledgeable employee of an affiliated family office, that those employees should be in a position to protect themselves in receiving investment advice from a family office excluded from regulation under the Advisers Act.[88] We have modified the rule to include knowledgeable employees of an affiliated family office in the definition of key employee.[89]

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85 *See* Section III.B of *Privately Offered Investment Companies*, Investment Company Act Release 22597 (April 3, 1997) [62 FR 17512 (April 7, 1997)] ("3(c)(7) Release").

86 *See* 3(c)(7) Release, *supra* note 85, at Section III.A.2.B.

87 As we explained when we adopted rule 3c-5, employees who simply "obtain information" but do not "participate in" the investment activities of the fund are not included in the definition of knowledgeable employee because they may not have investment experience. *See* 3(c)(7) Release, *supra* note 85, at Section III.B.

88 Some commenters pointed out that a family may establish more than one family office for tax or other structuring reasons and recommended that the definition of key employee include employees of multiple family offices that serve the same family. *See, e.g.*, Davis Polk Letter; Fried Frank Letter.

89 Rule 202(a)(11)(G)-1(d)(8). "Affiliated family office" is defined as "a family office wholly owned by family clients of another family office and that is controlled (directly or

A few commenters suggested that we include as family clients long-term employees of the family, even if they do not meet the knowledgeable employee standard.[90] Expanding the family client definition in this way would exclude from the Advisers Act's protections individuals for whom we have no basis on which to conclude that they can protect themselves.[91] We therefore decline to make the change suggested by commenters.

We have made two other changes to definitions relating to key employees in response to recommendations from commenters. First, in response to commenters and to reduce uncertainty identified by commenters we have included a definition of "executive officer," which is virtually identical to the definition of the same term used in Advisers Act rule 205-3 and Investment Company Act rule 3c-5.[92] Similar to those rules, this

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indirectly) by one or more family members of such other family office and/or family entities affiliated with such other family office and has no clients other than family clients of such other family office." Rule 202(a)(11)(G)-1(d)(1).

90 *See, e.g.*, NY Bar Letter; Skadden Letter. Similarly, a few commenters suggested that we define key employees using the accredited investor standard from Regulation D under the Securities Act of 1933. *See, e.g.*, Comment Letter of Schulte Roth & Zabel LLP (Dec. 8, 2010); Lee & Stone Letter. We believe the knowledgeable employee standard more accurately encompasses employees that are likely to be financially sophisticated and to not need the protections of the Advisers Act.

91 Exemptive orders issued in the past 10 years generally did not permit family offices to provide investment advice to non-key employees. The two exemptive orders issued to family offices permitting such advice contained grandfathering provisions that restricted these employees' investments to the existing ones and prohibited the advisers from establishing new advisory relationships with a non-family member. *Adler Management, L.L.C.*, Investment Advisers Act Release Nos. 2500 (Mar. 21, 2006) [71 FR 15498 (Mar. 28, 2006)] (notice) and 2508 (Apr. 14, 2006) (order); *Longview Management Group LLC*, Investment Advisers Act Release Nos. 2008 (Jan. 3, 2002) [67 FR 1251 (Jan. 9, 2002)] (notice) and 2013 (Feb. 7, 2002) (order).

92 Commenters recommending this change include the Fried Frank Letter and the Skadden Letter. Paragraph (d)(3) of the rule, however, differs from rule 205-3 and section 3c-5 in that it does not include executives in charge of sales because such a function is not applicable to a family office.

definition delineates executive officers that should have enough financial experience and sophistication to invest without the protection of the Advisers Act. Second, the final rule clarifies that family clients include trusts of which the key employee generally is the sole contributor to the trust and the sole person authorized to make decisions with respect to the trust.[93]

Commenters recommended that we permit a trust established by a key employee with his or her lineal descendants or immediate family members as beneficiaries to be a family client, to allow typical estate planning by key employees.[94] We do not believe it is appropriate to broadly permit trusts for which the key employee is not the sole person authorized to make investment decisions to be a family client. Since a non-family client will be making investment decisions for this type of trust, and its beneficiaries are not family members or key employees, this type of trust stands to benefit from the protections of the Advisers Act. However, we are persuaded that it is appropriate to allow the family office to advise trusts for which the key employee is the sole person making investment decisions.[95] Permitting the family office to provide advice to this type of entity tracks a parallel concept included in the definition of "qualified purchaser" under the Investment Company Act[96] and thus creates consistency in entities considered not to need investor protection under our rules because investment decisions are made

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93 Rule 202(a)(11)(G)-1(d)(4)(x). The grantor of the trust could also be a current or former spouse or spousal equivalent of the key employee if, at the time of contribution, the spouse or spousal equivalent held a joint, community property, or other similar shared ownership interest in the trust with the key employee.

94 *See, e.g.*, Withers Bergman Letter (suggesting lineal descendants); Kleinberg Letter (suggesting immediate family members).

95 Rule 202(a)(11)(G)-1(d)(4)(x).

96 Section 2(a)(51)(A)(iii) of the Investment Company Act.

solely by individuals that we have already concluded should have sufficient financial experience and sophistication to act without the protection provided by our regulations.

Some commenters urged us to even further expand the definition of key employee to include their spouses and spousal equivalents (even if not with respect to joint property) or all of their immediate family members.[97] There is no reason to believe that the key employee's spouse or immediate family members independently have the financial sophistication and experience to protect themselves when receiving investment advice from the family office. Such individuals are not considered to be knowledgeable employees under Advisers Act rule 205-3 or Investment Company Act rule 3c-5. We see no basis for following a different approach in this context. The premise of the rule is to allow families to manage their own wealth. Key employee receipt of family office advice is permitted because their position and experience should enable them to protect themselves and to allow family offices to attract talented investment professionals as employees. This underlying rationale does not support as a general rule including key employees' family members unless there is a joint property interest involved.

Several commenters disagreed with the 12-month experience requirement for key employees who are not executive officers, directors, trustees, general partners, or persons serving in similar capacities of the family office, arguing that employees a family office would hire into these roles would presumably possess adequate knowledge and sophistication in financial matters regardless of whether he or she met the 12-month experience requirement.[98] We believe that the 12-month experience requirement is an

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97 *See, e.g.*, Kleinberg Letter; Kramer Levin Letter.

98 *See, e.g.*, ABA Letter; Comment Letter of Cadwalader, Wickersham & Taft LLP (Nov. 18, 2010) ("Cadwalader Letter").

important part of limiting employees who receive investment advice without the protections of the Advisers Act (or family membership) to those employees that are likely to be in a position or have a level of knowledge and experience in financial matters sufficient to be able to evaluate the risks and take steps to protect themselves. In addition, commenters' argument is equally applicable in a private fund or performance fee context, and we see no basis for distinguishing treatment of key employees of family offices from key employees of private funds or qualified client advisers under Investment Company Act rule 3c-5 and Advisers Act rule 205-3, respectively.[99] We therefore adopt this requirement as proposed.

Finally, as proposed, the final rule prohibits key employees (including their trusts and controlled entities) from making additional investments through the family office upon the end of the key employees' employment by the family office, but will not require former key employees to liquidate or transfer investments held through the family office to avoid imposing possible adverse tax or investment consequences that might otherwise result.[100] While some commenters supported this limitation,[101] one commenter expressed objections to it, asserting that former key employees of family offices often continue to have a close relationship with the family and it should be the family's decision whether to

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99 This analysis is consistent with our analysis in the 3(c)(7) Release where we stated that the 12-month experience requirement was designed to limit investments to employees that have the requisite experience to appreciate the risks of investing in the fund. 3(c)(7) Release, *supra* note 85, at Section III.B. As is the case under rule 3c-5, an employee need not work for a particular family office for the entire 12-month period. The time performing substantially similar functions or duties by that employee for or on behalf of another company may be counted toward the 12 month requirement. *See* 3(c)(7) Release, *supra* note 85.

100 Rule 202(a)(11)(G)-1(d)(4)(iv).

101 *See, e.g.*, ABA Letter; Coalition Letter.

terminate their family office's services to them.[102] We are including key employees as family clients because their particular role in the family office causes us to believe that the employee should be in a position to protect him or herself without the need for the protections of the Advisers Act. Once the employee is no longer in that role, this policy rationale no longer holds true to the same degree. Accordingly, we are adopting this aspect of the rule as proposed.[103]

2. Ownership and Control

The final rule requires that, to qualify for the exclusion from regulation under the Advisers Act, the family office must be wholly owned by family clients and exclusively controlled, directly or indirectly, by one or more family members or family entities.[104] Our final rule expands who may own the family office from "family members," as proposed, to "family clients." However, the rule continues to require that control of the

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102 Schiff/Stetter Letter.

103 A number of commenters requested that we clarify the extent to which a family office could provide investment advice to an employee benefit plan or pension plan sponsored by the family office without registering under the Act. *See, e.g.*, Comment Letter of the American Benefits Council/Committee on the Investment of Employee Benefit Assets (Nov. 18, 2010); Coalition Letter; Withers Bergman Letter. In our view, a family office or other employer that merely establishes an employee benefit plan or pension plan and selects one or more investment advisers for that plan would not be an investment adviser subject to the Advisers Act because it would not be an "investment adviser" within the meaning of section 202(a)(11). A family office (as defined in rule 202(a)(11)(G)-1) thus would not be required to register under the Act if, in addition to providing advice to family clients, its advisory activities are so limited. However, a family office providing additional advisory services to an employee benefit plan all of whose participants are not family clients may be required to register under the Act unless another exemption is available.

104 Rule 202(a)(11)(G)-1(b)(2). We have added the word "exclusively" to clarify that "control" cannot be shared with individuals or companies that are not family members or family entities. A family entity is defined as any of the trusts, companies or other entities set forth in paragraphs (v), (vi), (vii), (viii), (ix), or (xi) of subsection (d)(4) of rule 202(a)(11)(G)-1, but excluding key employees and their trusts from the definition of family client solely for purposes of this definition.

family office remain, directly or indirectly, with family members and their related entities.

Commenters urged us to expand both who could own the family office and who could control a family office under the rule.[105] Some stated that many family offices are owned by family trusts, and that allowing family members to indirectly own and control the family office did not provide sufficient clarity that such a trust could own and control the family office.[106] Commenters also pointed out that many family offices permit their employees to own equity interest in family offices as an incentive to attract and retain talented employees, and urged us not to prohibit such arrangements.[107] These commenters asked us to explicitly broaden the ownership requirement from "family members" to "family clients" to permit these types of arrangements. Other commenters argued more broadly that the "wholly owned and controlled" aspect of the proposed definition does not adequately reflect the variety of organizational arrangements already in place at family offices and that the Commission should focus as a policy matter solely on whether the family office is being operated for the benefit of members of a single family.[108]

Commenters persuaded us to expand who may own the family office from "family members" to "family clients." This change is consistent with the intent behind our proposed language (which contemplated that the family could own the family office

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105 *See, e.g.*, Coalition Letter; Comment Letter of McDermott Will & Emery/Richard L. Dees (Nov. 18, 2010) ("McDermott Dees Letter").

106 *See, e.g.*, Dorsey Letter; Comment Letter of McGuire Woods LLP (Nov. 18, 2010).

107 *See, e.g.*, AICPA Letter; Davis Polk Letter; Dechert Letter.

108 *See, e.g.*, Coalition Letter; Levin Schreder Letter; McDermott Dees Letter.

indirectly) and more clearly allows family members to structure their ownership of the family office for tax or other reasons. We also agree with suggestions that the rule permit key employees to own a non-controlling stake in the family office to serve as part of an incentive compensation package for key employees. We remain convinced, however, that for our core policy rationale to be fulfilled—that a family office is essentially a family managing its own wealth—the family, directly or indirectly, should control the family office. Accordingly, the final rule provides that while family clients may own the family office, family members and family entities (*i.e.*, their wholly owned companies or family trusts) must control the family office.[109]

3. Holding Out

As proposed, the final rule prohibits a family office relying on the rule from holding itself out to the public as an investment adviser.[110] Commenters supported this prohibition.[111] Holding itself out to the public as an investment adviser suggests that the family office is seeking to enter into typical advisory relationships with non-family

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109 We note that, as proposed, we are not limiting the exclusion to a family office that is not operated for the purpose of generating a profit. We also note that some family offices may be structured such that all or a portion of family client investment gains are distributed as dividends from the family office (when family clients own the family office) and that a not-for-profit requirement would preclude this family office structure. We were persuaded by several commenters who cautioned against limiting the exclusion for family offices to those that operate on a not-for-profit basis, arguing that it would be difficult to administer and is unnecessary given the limited clientele that a family office may advise and rely on the exclusion. *See, e.g.*, AICPA Letter; Davis Polk Letter; Kozusko Letter.

110 Rule 202(a)(11)(G)-1(b)(3). For purposes of this rule, despite language under rule 203(b)(3)-1(c) regarding holding out, a family office could not market non-public offerings to persons or entities that are not family clients since such activity would not be consistent with a family office that only provides investment advice to family clients and does not hold itself out to the public as an investment adviser.

111 *See, e.g.*, Coalition Letter; ABA letter.

clients, and thus is inconsistent with the basis on which we have provided exemptive orders and are adopting this rule.[112]

4. Multifamily Offices

The exclusion we are adopting today does not extend to family offices serving multiple families, as urged by several commenters.[113] Comments we received did not persuade us that the rule could be drafted to distinguish in any meaningful way between such offices and family-owned commercial advisory firms that offer their services to other families.[114] Moreover, they did not persuade us that the protections of the Advisers Act, including the application of the anti-fraud provisions of the Act, would not be relevant to a family obtaining services from an office established by another family with which it could have conflicts of interest. Families, of course, may have conflicts among members leading to disputes. But, as discussed in our Proposing Release, the premise of the exclusion is that such disputes could be worked out within the family unit or, if necessary, by state courts under laws that facilitate resolution of family disputes. In a multifamily office, these clients would be without the protections of the Advisers Act or

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112 *See* footnote 56 of the Proposing Release, *supra* note 2. In response to one commenter's request, we clarify that a family office that is currently registered as an investment adviser and expects to de-register in reliance on rule 202(a)(11)(G)-1, will not be prohibited from relying on the rule solely because it held itself out to the public as an investment adviser while it was registered under the Advisers Act. *See* Dechert Letter.

113 *See, e.g.*, Cadwalader Letter; Comment Letter of Lowenstein Sandler PC (Nov. 12, 2010); Comment Letter of Stradling Yocca Carlson & Rauth (Nov. 16, 2010).

114 We note that under section 208(d) of the Advisers Act, it is unlawful for any person indirectly to do anything that would be unlawful for such person to do directly under the Advisers Act or rules thereunder. Therefore, if several families that are unrelated through a common ancestor within 10 generations have established a separate family office for each of the families, but have staffed these family offices with the same or substantially the same employees such employees are managing a *de facto* multifamily office. As a result, these family offices may not claim the family office exclusion.

family relationships for preventing or handling any discriminatory or fraudulent treatment of different families.

B. Grandfathering Provisions, Transition Period and Effect of Rule on Previously Issued Exemptive Orders

The Dodd-Frank Act prohibits us from excluding from our definition of family office persons not registered or required to be registered on January 1, 2010 that would meet all of the required conditions under rule 202(a)(11)(G)-1 but for their provision of investment advice to certain clients specified in section 409(b)(3) of the Dodd-Frank Act.[115] We have incorporated this required grandfathering into paragraph (c) of our rule.[116] We received two comments on such incorporation. One commenter suggested that we incorporate the grandfathering provision only by reference to section 409(b)(3) of the Dodd-Frank Act.[117] We believe that incorporating the grandfathering provision of Dodd-Frank Act is a more user friendly approach for those attempting to comply with the Advisers Act compared to directing them to look up the grandfathering provision in a separate statute. Another commenter requested clarification of the Dodd-Frank grandfathering provision.[118] We believe clarification or interpretation of this provision would involve applying the provision to specific facts, and this release is not an

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115 *See* section 409(b)(3) and (c) of the Dodd-Frank Act.

116 We note that section 409(c) of the Dodd-Frank Act provides that "a family office that would not be a family office, but for section 409(b)(3) of the Dodd-Frank Act, shall be deemed to be an investment adviser for the purposes of paragraphs (1), (2) and (4) of section 206 of the Advisers Act." This provision is reflected in paragraph (3) of rule 202(a)(11)(G)-1(c).

117 Coalition Letter.

118 AICPA Letter.

appropriate means to provide such a clarification. Therefore, we are adopting paragraph (c) of the rule as proposed.

Several commenters suggested that we provide a transition period to allow family offices time to determine whether they meet the exclusion or to restructure or register under the Advisers Act if they do not.[119] We recognize that the time period between the adoption of this rule and the repeal of the private adviser exemption from registration contained in section 203(b)(3) of the Advisers Act, effective July 21, 2011, may not be sufficient for every family office to conduct such an evaluation, restructure or register. Accordingly, the rule provides that family offices currently exempt from registration under the Advisers Act in reliance on the private adviser exemption and that do not meet the new family office exclusion are not required to register with the Commission as investment advisers until March 30, 2012.[120] We believe that this aspect of the rule is necessary or appropriate in the public interest and is consistent with the protection of investors, and the purposes fairly intended by the policy and provisions of the Advisers Act.

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119 *See, e.g.*, Lee & Stone Letter (to provide time to restructure certain "club deals" in which clients of the family office may have engaged); Comment Letter of Paul, Hastings, Janofsky & Walker LLP (Nov. 17, 2010) (requesting an expanded grandfather provision to allow more time for an orderly restructuring); Ropes & Gray Letter.

120 Rule 202(a)(11)(G)-1(e)(2). *See also* Letter from Robert E. Plaze, Associate Director, Division of Investment Management, U.S. Securities and Exchange Commission, to David Massey, Deputy Securities Administrator, North Carolina Securities Division and President, NASAA (Apr. 8, 2011) *available at* http://www.sec.gov/rules/proposed/2010/ia-3110-letter-to-nasaa.pdf (stating that the Commission would potentially consider extending the date by which these advisers must register and come into compliance with the obligations of a registered adviser until the first quarter of 2012). Because initial applications for registration can take up to 45 days to be approved, family offices that determine they will need to register with the Commission should file a complete application, both Part 1 and a brochure(s) meeting the requirements of Part 2 of Form ADV, at least by February 14, 2012.

We have determined not to rescind exemptive orders previously issued to family offices under section 202(a)(11)(G) of the Advisers Act. As discussed above, the Commission has issued orders under section 202(a)(11)(G) of the Advisers Act to certain family offices declaring them and their employees acting within the scope of their employment to not be investment advisers within the intent of the Act. In some areas these exemptive orders may be slightly broader than the rule we are adopting today, and in other areas they may be narrower. We proposed not to rescind these exemptive orders and requested comment. All commenters addressing this subject supported our proposal. Thus, family offices currently operating under these orders may continue to rely on them.

III. PAPERWORK REDUCTION ACT

Rule 202(a)(11)(G)-1 does not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995.[121] Accordingly, the Paperwork Reduction Act is not applicable.

IV. ECONOMIC ANALYSIS

We are adopting rule 202(a)(11)(G)-1 in anticipation of the Dodd-Frank Act's repeal of section 203(b)(3) of the Advisers Act, which provides an exemption from registration for certain private fund advisers, and in light of the Dodd-Frank Act's directive that the Commission define family offices that will be excluded from regulation under the Advisers Act.[122] The rule we are adopting today defines a family office as a company that, with limited exceptions, has only family clients, is wholly owned by family clients and controlled by family members and/or family entities, and does not hold

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[121] 44 U.S.C. 3501 *et seq.*

[122] *See* section 409 of the Dodd-Frank Act.

itself out to the public as an investment adviser. The definition of family office provided in the rule is designed to limit the exclusion from Advisers Act regulation solely to those private advisory offices that we believe the Advisers Act was not designed to regulate and to prevent circumvention of the Adviser Act's protections by firms that are operating as commercial investment advisory firms.

As a preliminary matter, and as discussed earlier, as a result of the repeal of section 203(b)(3) of the Advisers Act a number of private advisory offices that may consider themselves to be family offices and that are not currently registered as investment advisers in reliance on that provision will be required to register under the Advisers Act after July 21, 2011 unless those advisers are eligible for a new exemption. The benefits and costs associated with the elimination of section 203(b)(3) are attributable to the Dodd-Frank Act. However, while Congress also adopted a family office exclusion, it directed the Commission to adopt rules defining the terms of that exclusion, subject to the terms of section 409 of the Dodd-Frank Act, and thus we discuss below the costs and benefits of our determination of which private advisory offices are deemed family offices and therefore excluded from regulation.

In proposing the rule, we requested comment on all aspects of our cost benefit analysis, including the accuracy of our estimates of costs and benefits, identification and assessment of any costs and benefits not discussed in our analysis, and data relevant to these costs and benefits.[123] While some commenters predicted that many private advisory offices would have to restructure or apply for an exemptive order and thus incur

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123 Section V of the Proposing Release.

substantial costs if the definition of family office were not expanded,[124] no estimates of such costs were provided. We discuss these comments more specifically below.

A. Benefits

As discussed in the Proposing Release, we expect that rule 202(a)(11)(G)-1 will result in several important benefits. First, family offices, as defined by this rule, will not be subject to the mandatory costs of registering with the Commission as an investment adviser and the associated compliance costs. Some investment advisers currently registered with us may qualify as family offices under the rule and have the choice to deregister. These reduced regulatory costs should result in direct cost savings to these family offices, and thus to their family clients.

Second, the rule will benefit family offices, as defined by the rule, and their clients by eliminating the costs of seeking (and considering) individual exemptive orders. Without rule 202(a)(11)(G)-1, the repeal of the exemption contained in section 203(b)(3) would result in a great number of family offices having to apply for exemptive relief and thus incurring significant costs for these family offices and their clients. We estimate that a typical family office will incur legal fees of $200,000 on average to engage in the exemptive order application process, including preparation and revision of an application and consultations with Commission staff.[125] The rule will benefit family offices and their family clients by eliminating the costs of applying to the Commission for an exemptive order that the Commission would grant and the associated uncertainty that they might not obtain such an order. Estimates of the number of family offices in the United States vary

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124 *See, e.g.*, Jones Day Letter; Withers Bergman Letter.

125 We included the same estimate in the Proposing Release. We received no comments on this estimate.

widely—ranging from less than 1,000 to 5,000.[126] If all of these family offices qualify for the new exclusion and otherwise would have applied for an exemptive order, the rule will provide a benefit ranging from $200 million to $1 billion by eliminating the costs of applying for those exemptive orders.[127]

Finally, the rule also will benefit the Commission by freeing staff resources from reviewing and processing large numbers of family office exemptive applications resulting from the repeal of section 203(b)(3) of the Advisers Act that the Commission would grant and allowing the staff to target its work more efficiently, and thus will indirectly benefit public investors.

B. Costs

We recognize that some private advisory offices that today consider themselves to be family offices likely will incur expenses to evaluate whether they meet the terms of the exclusion. One commenter estimated that such an office would incur expenses of $25,000 to $35,000 to hire a consulting firm or law firm to determine if it meets the exclusion provided by the rule.[128] If all family offices estimated to exist in the United States noted above[129] hire a consulting firm or law firm to determine if they meet the

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126 *See, e.g.*, Pamela J. Black, *The Rise of the Multi-Family Office*, FINANCIAL PLANNING (Apr. 27, 2010) (estimating 2,500 to 3,000 single family offices); Robert Frank, *Minding the Money—'Family Office' Chiefs Get Plied with Perks; Club Membership, Jets*, THE WALL STREET JOURNAL (Sept. 7, 2007), at W2 (estimating 3,000 to 5,000 family offices in the United States); Second Annual Single-Family Office Study, the Family Wealth Alliance (2010) (estimating 2,500 U.S.-based single family offices); *Creating a Single Family Office for Wealth Creation and Family Legacy Sustainability*, Family Office Association (2009) (estimating 1,000 single family offices worldwide).

127 $200,000 cost of applying for an exemptive order multiplied by a range of 1,000 family offices to 5,000 family offices.

128 Lindquist Letter.

129 *See supra* note 126 and accompanying text.

exclusion at such a cost, they would incur an aggregate cost ranging from $25 million to $175 million for this evaluation.[130]

Some of these private advisory offices may decide to restructure their businesses to meet the conditions imposed by rule 202(a)(11)(G)-1. Many commenters stated that the proposed definition of family office was too narrow, and that if it was adopted without changes, absent an exemptive order, many such advisory offices would be required to restructure themselves in order to qualify as family offices.[131] Restructuring or obtaining an exemptive order, some commenters asserted, would result in substantial costs to the advisory office and its clients.[132] We expect that each such office will weigh the costs of such restructuring under its particular circumstances against the costs and burdens of registration or seeking an exemptive order.

Our final rule broadens the definition of "family client" and "family office" from that proposed, particularly concerning permissible clients of the family office and ownership of the family office.[133] As a result, we expect that substantially fewer private advisory offices will need to confront these trade-offs than would have been the case under our proposal. Nevertheless, we recognize that some offices may decide to restructure their businesses in order to meet even the expanded family office definition under the final rule, rather than register or seek an exemptive order. The costs of any such restructuring will be highly dependent on the nature and extent of the restructuring,

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130 ($25,000 evaluation cost) x (1,000 family offices) = $25 million. ($35,000 evaluation cost) x (5,000 family offices) = $175 million.

131 *See, e.g.*, Lindquist Letter; Lee & Stone Letter; Withers Bergman Letter.

132 *See, e.g.*, Coalition Letter; Lee & Stone Letter.

133 *See* Section II of this Release for discussion of these expansions.

which we understand may vary significantly from office to office. No commenters provided an estimate of the costs to carry out any necessary restructuring.

We do not expect that the rule will impose any significant costs on family offices currently operating under a Commission exemptive order. We are permitting these family offices to continue to rely on their exemptive orders. They may choose, of course, to qualify for exclusion under the rule. We expect that most of these family offices will satisfy all the conditions of the rule without changing their structure or operations. However, these family offices may incur one-time "learning costs" in determining the differences between their orders and the rule. We estimate that such costs will be no more than $5,000 on average for a family office if it hires an external consulting firm or law firm to assist in determining the differences. Because the terms of these advisers' exemptive orders were similar to rule 202(a)(11)(G)-1, these family offices should incur significantly lower costs to evaluate the new rule than family offices that do not have an exemptive order. There are 13 family offices that have obtained exemptive orders. Accordingly, we estimate that these family offices collectively would incur outside consulting or legal expenses of $65,000 to discern the differences between their orders and the rule.

Finally, if there were any family offices that previously registered with the Commission, but now may de-register in reliance on the new family office exclusion in the Advisers Act, the rule may have competitive effects on investment advisers that may compete with the family office for the provision of investment management services to family clients since these third party investment advisers would bear the regulatory costs associated with compliance with the Advisers Act or state investment adviser regulatory requirements. We do not expect that the rule will impact capital formation.

V. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA") regarding rule 202(a)(11)(G)-1 in accordance with section 604 of the Regulatory Flexibility Act.[134] We prepared an Initial Regulatory Flexibility Analysis ("IRFA") in conjunction with the Proposing Release in October 2010.[135]

A. Need for the Rule

We are adopting rule 202(a)(11)(G)-1 defining family offices excluded from regulation under the Advisers Act because we are required to do so under section 409 of the Dodd-Frank Act.

B. Significant Issues Raised by Public Comment

In the Proposing Release, we requested comment on the IRFA. None of the comment letters we received specifically addressed the IRFA. None of the comment letters made specific comments about the proposed rule's impact on smaller family offices.

C. Small Entities Subject to the Rule

Under Commission rules, for purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a

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134 5 U.S.C. 604(a).

135 *See* Proposing Release, *supra* note 2, at Section VI.

natural person) that had $5 million or more on the last day of its most recent fiscal year.[136]

We do not have data and are not aware of any databases that compile information regarding how many family offices will be a small entity under this definition, but since family offices only are established for the very wealthy and given the statistics included in the Proposing Release showing that they generally serve families with at least $100 million or more of investable assets and have an average net worth of $517 million, we believe it is unlikely that any family offices would be small entities.[137]

D. Projected Reporting, Recordkeeping, and other Compliance Requirements

Rule 202(a)(11)(G)-1 imposes no reporting, recordkeeping or other compliance requirements.

E. Agency Action to Minimize Effect on Smaller Entities

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant impact on small entities. In connection with the rule, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (iii) the use of performance rather than

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136 17 CFR 275.0-7(a).

137 *See* Proposing Release, *supra* note 2, at n.2 and accompanying text. One commenter (Comment Letter of Robert Stenson (Oct. 18, 2010)) cited a 1999 survey which estimated that 32% of family offices had investment assets of less than $100 million. However, this commenter did not indicate how many family offices had assets under management of less than $25 million and thus qualified as "small entities" as defined in Advisers Act rule 0-7, *supra* note 136 and accompanying text.

design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for small entities.

Rule 202(a)(11)(G)-1 is exemptive and compliance with the rule is voluntary. We therefore do not believe that different or simplified compliance, timetable, or reporting requirements, or an exemption from coverage of the rule for small entities, is appropriate. The conditions in the rule are designed to ensure that family offices operating under the rule provide advice only to the family itself and not the general public and, accordingly, the protections of the Advisers Act are not warranted. Reducing these conditions for smaller family offices would be inconsistent with the policy underlying the exclusion and would harm investor protection.

Our prior exemptive orders have not made any differentiation based on the size of the family office. In addition, as discussed above, we expect that very few, if any, family offices are small entities. The Commission also believes that rule 202(a)(11)(G)-1 will decrease burdens on small entities by making it unnecessary for most of them to seek an exemptive order from the Commission to operate without registration under the Advisers Act. As a result, we do not anticipate that the potential impact of the rule on small entities will be significant.

The rule specifies broad conditions with which a family office must comply to rely on the exclusion; the rule leaves to each family office how to structure its specific operations to meet these conditions. The rule thus already incorporates performance rather than design standards. For these reasons, alternatives to the rule appear unnecessary and in any event are unlikely to minimize any impact that the rule might have on small entities.

VI. STATUTORY AUTHORITY

We are adopting rule 202(a)(11)(G)-1 [17 CFR 275.202(a)(11)(G)-1] pursuant to our authority set forth in sections 202(a)(11)(G) and 206A of the Advisers Act [15 U.S.C. 80b-2(a)(11)(G) and 80b-6A].

LIST OF SUBJECTS IN 17 CFR PART 275

Reporting and recordkeeping requirements, Securities.

TEXT OF RULE

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.

* * * * *

2. Section 275.202(a)(11)(G)-1 is added to read as follows:

§ 275.202(a)(11)(G)-1 Family offices.

(a) *Exclusion.* A family office, as defined in this section, shall not be considered to be an investment adviser for purpose of the Act.

(b) *Family office.* A family office is a company (including its directors, partners, members, managers, trustees, and employees acting within the scope of their position or employment) that:

(1) Has no clients other than family clients; provided that if a person that is not a family client becomes a client of the family office as a result of the death of a

family member or key employee or other involuntary transfer from a family member or key employee, that person shall be deemed to be a family client for purposes of this section 275.202(a)(11)(G)-1 for one year following the completion of the transfer of legal title to the assets resulting from the involuntary event;

(2) Is wholly owned by family clients and is exclusively controlled (directly or indirectly) by one or more family members and/or family entities; and

(3) Does not hold itself out to the public as an investment adviser.

(c) *Grandfathering*. A family office as defined in paragraph (a) above shall not exclude any person, who was not registered or required to be registered under the Act on January 1, 2010, solely because such person provides investment advice to, and was engaged before January 1, 2010 in providing investment advice to:

(1) Natural persons who, at the time of their applicable investment, are officers, directors, or employees of the family office who have invested with the family office before January 1, 2010 and are accredited investors, as defined in Regulation D under the Securities Act of 1933;

(2) Any company owned exclusively and controlled by one or more family members; or

(3) Any investment adviser registered under the Act that provides investment advice to the family office and who identifies investment opportunities to the family office, and invests in such transactions on substantially the same terms as the family office invests, but does not invest in other funds advised by the family office, and whose assets as to which the family office directly or indirectly provides investment advice represents, in the aggregate, not more than 5 percent of the value of the total assets as to

which the family office provides investment advice; provided that a family office that would not be a family office but for this subsection (c) shall be deemed to be an investment adviser for purposes of paragraphs (1), (2) and (4) of section 206 of the Act.

(d) *Definitions*. For purposes of this section:

(1) *Affiliated Family Office* means a family office wholly owned by family clients of another family office and that is controlled (directly or indirectly) by one or more family members of such other family office and/or family entities affiliated with such other family office and has no clients other than family clients of such other family office.

(2) *Control* means the power to exercise a controlling influence over the management or policies of a company, unless such power is solely the result of being an officer of such company.

(3) *Executive officer* means the president, any vice president in charge of a principal business unit, division or function (such as administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions, for the family office.

(4) *Family client* means:

(i) Any family member;

(ii) Any former family member;

(iii) Any key employee;

(iv) Any former key employee, provided that upon the end of such individual's employment by the family office, the former key employee shall not receive investment advice from the family office (or invest additional assets with a family office-advised trust, foundation or entity) other than with respect to assets advised (directly or indirectly) by the family office immediately prior to the end of such individual's employment, except that a former key employee shall be permitted to receive investment advice from the family office with respect to additional investments that the former key employee was contractually obligated to make, and that relate to a family-office advised investment existing, in each case prior to the time the person became a former key employee.

(v) Any non-profit organization, charitable foundation, charitable trust (including charitable lead trusts and charitable remainder trusts whose only current beneficiaries are other family clients and charitable or non-profit organizations), or other charitable organization, in each case for which all the funding such foundation, trust or organization holds came exclusively from one or more other family clients;

(vi) Any estate of a family member, former family member, key employee, or, subject to the condition contained in paragraph (d)(4)(iv) of this section, former key employee;

(vii) Any irrevocable trust in which one or more other family clients are the only current beneficiaries;

(viii) Any irrevocable trust funded exclusively by one or more other family clients in which other family clients and non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations are the only current beneficiaries;

(ix) Any revocable trust of which one or more other family clients are the sole grantor;

(x) Any trust of which: (A) each trustee or other person authorized to make decisions with respect to the trust is a key employee; and (B) each settlor or other person who has contributed assets to the trust is a key employee or the key employee's current and/or former spouse or spousal equivalent who, at the time of contribution, holds a joint, community property, or other similar shared ownership interest with the key employee; or

(xi) Any company wholly owned (directly or indirectly) exclusively by, and operated for the sole benefit of, one or more other family clients; provided that if any such entity is a pooled investment vehicle, it is excepted from the definition of "investment company" under the Investment Company Act of 1940.

(5) *Family entity* means any of the trusts, estates, companies or other entities set forth in paragraphs (v), (vi), (vii), (viii), (ix), or (xi) of subsection (d)(4) of this section, but excluding key employees and their trusts from the definition of family client solely for purposes of this definition.

(6) *Family member* means all lineal descendants (including by adoption, stepchildren, foster children, and individuals that were a minor when another family member became a legal guardian of that individual) of a common ancestor (who may be living or deceased), and such lineal descendants' spouses or spousal equivalents; provided that the common ancestor is no more than 10 generations removed from the youngest generation of family members.

(7) *Former family member* means a spouse, spousal equivalent, or stepchild that was a family member but is no longer a family member due to a divorce or other similar event.

(8) *Key employee* means any natural person (including any key employee's spouse or spouse equivalent who holds a joint, community property, or other similar

shared ownership interest with that key employee) who is an executive officer, director, trustee, general partner, or person serving in a similar capacity of the family office or its affiliated family office or any employee of the family office or its affiliated family office (other than an employee performing solely clerical, secretarial, or administrative functions with regard to the family office) who, in connection with his or her regular functions or duties, participates in the investment activities of the family office or affiliated family office, provided that such employee has been performing such functions and duties for or on behalf of the family office or affiliated family office, or substantially similar functions or duties for or on behalf of another company, for at least 12 months.

(9) *Spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

(e) *Transition.*

(1) Any company existing on July 21, 2011 that would qualify as a family office under this section but for it having as a client one or more non-profit organizations, charitable foundations, charitable trusts, or other charitable organizations that have received funding from one or more individuals or companies that are not family clients shall be deemed to be a family office under this section until December 31, 2013, provided that such non-profit or charitable organization(s) do not accept any additional funding from any non-family client after August 31, 2011 (other than funding received prior to December 31, 2013 and provided in fulfillment of any pledge made prior to August 31, 2011).

(2) Any company engaged in the business of providing investment advice, directly or indirectly, primarily to members of a single family on July 21, 2011, and that

is not registered under the Act in reliance on section 203(b)(3) of this title on July 20, 2011, is exempt from registration as an investment adviser under this title until March 30, 2012, provided that the company:

(i) During the course of the preceding twelve months, has had fewer than fifteen clients; and

(ii) Neither holds itself out generally to the public as an investment adviser nor acts as an investment adviser to any investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a), or a company which has elected to be a business development company pursuant to section 54 of that Act (15 U.S.C. 80a-54) and has not withdrawn its election.

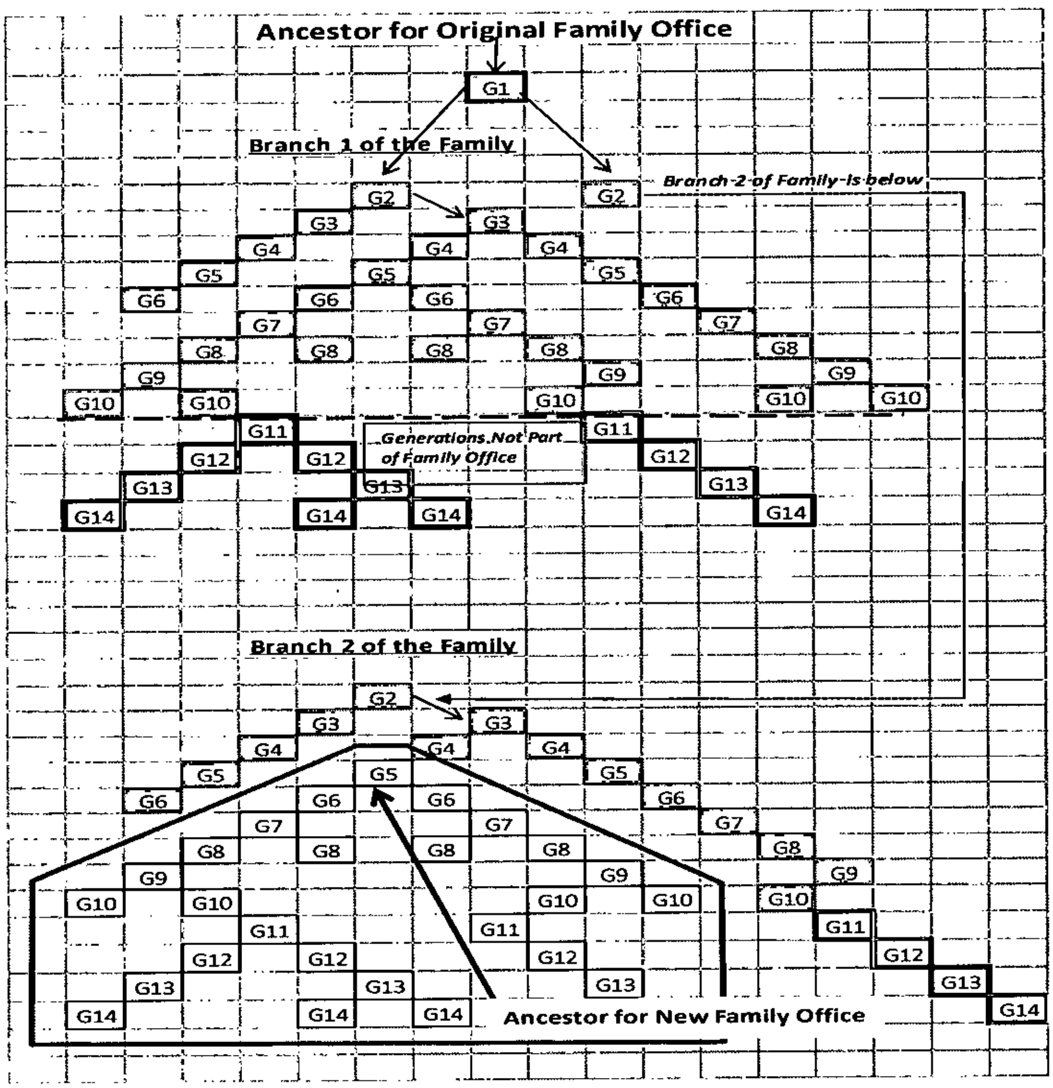
By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

June 22, 2011

The following diagram illustrates the effect of a family office redesignating its common ancestor. In the first chart, the green/shaded boxes indicate persons in various generations that are "family members" of the family office. The double-outlinedboxes indicate persons in various generations that are outside the 10-generation limit and thus may not be advised by the family office under the exclusion. The lower diagram shows the impact of redesignating the common ancestor from an individual in generation 1 to an individual in generation 5. The single-outlined boxes indicate the new group of family clients that the family office may advise and maintain its exclusion. The green/shaded boxes indicate individuals that previously the family office could advise, but that are no longer "family members" due to the redesignation. The double-outlined boxes indicate individuals that were too remote from the common ancestor in both cases to be considered "family members."



UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64747 / June 24, 2011

Admin. Proc. File No. 3-13055

In the Matter of the Application of

AMERICAN FUNDS DISTRIBUTORS, INC.
c/o Seth M. Schwartz, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
Four Times Square
New York, NY 60443

For Review of Disciplinary Action Taken by

NASD

ORDER SETTING ASIDE DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

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

ORDERED that the findings of violations and the sanctions imposed by NASD in this action against American Funds Distributors, Inc., be, and they hereby are, set aside.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Chairman Schapiro
Commissioner Walter
not participating
Commissioner Aguilar
Disapproved

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
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New York, NY 60443

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Violation of Conduct Rules

Alleged Violation of Rule Related to "Directed Brokerage" Practices

NASD member firm appeals from findings that it violated rule prohibiting mutual fund underwriters from requesting or arranging for the direction of a specific amount or percentage of brokerage commissions to member broker-dealers conditioned upon their sales of mutual fund shares. *Held*, association's findings of violations and sanctions it imposed are *set aside*.

APPEARANCES:

Seth M. Schwartz, *Raoul D. Kennedy*, *Jeffrey W. McKenna*, and *William J. O'Brien* of Skadden, Arps, Slate, Meagher & Flom LLP, for American Funds Distributors, Inc.

Marc Menchel, *Alan Lawhead*, and *Jante Santos*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: May 29, 2008
Last brief received: September 12, 2008

I.

American Funds Distributors, Inc. ("AFD"), an NASD member firm and principal underwriter and distributor for the American Funds, a family of twenty-nine mutual funds, appeals from NASD disciplinary action.[1] NASD found that AFD, from 2001 to 2003 (the "Relevant Period"), requested or arranged for the direction of specific amounts or percentages of brokerage commissions to broker-dealers that sold American Funds shares, in violation of former NASD Conduct Rule 2830(k) and Conduct Rule 2110.[2] NASD censured AFD and imposed a $5 million fine. We base our findings on an independent review of the record.

II.

A. Regulatory Background

NASD Rule 2830(k), commonly known as the "Anti-Reciprocal Rule" (the "Rule"),[3] governs the conduct of NASD members in connection with mutual fund directed brokerage – the practice whereby an open-end investment company, or "mutual fund," generally acting through its adviser, directs execution of the mutual fund's portfolio securities transactions to retail broker-dealers as a form of compensation for selling the fund's shares.[4]

The version of the Rule in effect during the Relevant Period was adopted as part of NASD's 1981 amendments to the Rule (the "1981 Amendments"), which relaxed previous prohibitions against directing brokerage commissions to broker-dealers in connection with their

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1 On July 26, 2007, NASD's Certificate of Incorporation was amended to reflect its name change to Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 72 Fed. Reg. 42,190 (Aug. 1, 2007) (SR-NASD-2007-053). Because the disciplinary action here was initiated before that date, we continue to use the designation NASD.

2 FINRA has since revised and renumbered its rules. *See* Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008). NASD Rule 2110 was recodified as new FINRA Rule 2010, without substantive change. NASD Rule 2830(k) remained unchanged.

3 NASD has referred to the Rule as the "Anti-Reciprocal Rule" since its enactment. *E.g.*, NASD Notice to Members 73-42 (May 1973); NASD Notice to Members 84-40 (July 1984).

4 The Rule does not apply to investment companies or investment advisers because such entities do not register with NASD and are not subject to NASD jurisdiction.

sale of fund shares.[5] As amended, Rule 2830(k)(3) prohibited a member underwriter from "request[ing] or arrang[ing] for the direction to any member of a specific amount or percentage of brokerage commissions *conditioned upon* that member's sales or promise of sales of shares of an investment company."[6] Rule 2830(k)(7)(B) provided an exception to the general prohibitions under the Rule, permitting a member to "act[] as underwriter for an investment company which follows a policy, disclosed in its prospectus, of considering sales of shares of the investment company as a factor in selection of broker-dealers to execute portfolio transactions, subject to the requirements of best execution."[7]

In 1984, NASD amended subparagraph (k)(7)(B)'s exception to clarify that it applied only if "the member d[id] not violate any of the specific provisions of . . . paragraph (k)."[8] The same year, NASD also issued a Notice to Members that set forth several examples of conduct that the NASD noted violated the Rule, including, as relevant here, "an offer or agreement by a principal underwriter, for a specified percentage of portfolio brokerage commissions relative to the dealer's sale of fund shares" and "an offer or agreement by a principal underwriter that portfolio orders be placed in recognition of the representative's prior or future sales of fund shares."[9]

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5 *See Order Approving Proposed Rule Change and Related Interpretation Under Section 36 of the Investment Company Act*, Exchange Act Rel. No. 17599 (Mar. 4, 1981), 22 SEC Docket 329, 329-31 (stating that NASD would no "longer prohibit, subject to certain restrictions, members from seeking or granting brokerage commissions in connection with the sale of fund shares," and noting that "it [wa]s not inappropriate for investment companies to seek to promote the sale of their shares through the placement of brokerage *without* the incurring of any additional expense" (emphasis in original)).

6 NASD Manual at 2105-4 (1981 ed.) (emphasis supplied). Previously, this subparagraph prohibited members from "request[ing] or arrang[ing] for the direction to any member of an amount or percentage of brokerage commission . . . *as an inducement or reward* for the sale of shares of an investment company." Art. III, § 26(k)(3) of NASD Rules of Fair Practice, NASD Manual at 2106 (1973 ed.) (emphasis supplied).

7 NASD Manual at 2105-5 (1981 ed.); *see also Clarke T. Blizzard*, 58 S.E.C. 723, 726 (2005) (defining "best execution" as an investment adviser's duty to "seek the most favorable terms for a customer transaction reasonably available under the circumstances, which might include directing trades to brokers who also provide research or other services to the adviser").

8 *National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change*, Exchange Act Rel. No. 21128 (July 10, 1984), 30 SEC Docket 1360, 1360 (stating "NASD is amending subsection (k)(7) . . . to clarify that a member must comply with the other provisions of subsection (k) notwithstanding subsection (k)(7)").

9 NASD Notice to Members 84-40.

In 2004, NASD again amended the Rule (the "2004 Amendments") in response to changes to Rule 12b-1 of the Investment Company Act of 1940[10] that prohibited investment companies from paying for fund distribution with directed brokerage commissions.[11] The 2004 Amendments substantially revised the Rule, eliminating the exception contained in Rule 2830(k)(7)(B) and adding a new subparagraph (k)(2)[12] to "clarify that no member may . . . act as an underwriter for an investment company if the member knows . . . that such investment company, or an investment adviser or principal underwriter of the company, has a written or oral agreement or understanding" to direct brokerage transactions to broker-dealers "in consideration" for promoting or selling shares of the investment company.[13] AFD concedes that, as a result of the 2004 Amendments, the directed brokerage practices at issue in this case would violate the version of the Rule currently in effect, but contends that those practices did not violate the version of the Rule in effect during the Relevant Period, 2001 to 2003.[14]

B. American Funds' Directed Brokerage Practices

Capital Research and Management Company ("CRMC") is the investment adviser to each of the American Funds. During the Relevant Period, CRMC, on behalf of the American Funds, compensated the top forty-six selling retail brokerage firms of American Funds shares (the "Retail Firms") by directing portfolio trading in the American Funds to, or for the benefit of, the Retail Firms, which generated commission revenue for these firms. For Retail Firms that lacked the capacity to execute portfolio trades, CRMC directed trading to a clearing firm that would execute the portfolio trades and then allocate, or "step out," all or part of the generated brokerage commissions to the non-executing Retail Firms (the "Step-Out Firms").

AFD, a wholly owned subsidiary of CRMC, calculated the target brokerage commissions for CRMC to generate under its directed trading program. Each year, AFD furnished CRMC a target commission list to distribute to its traders who, in part, used the target commission amounts to determine where to place portfolio trades for American Funds over the course of the

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10 17 C.F.R. § 270.12b-1.

11 *See Prohibition on the Use of Brokerage Commissions to Finance Distribution*, Investment Company Act Rel. No. 26591 (Sept. 2, 2004), 83 SEC Docket 2490.

12 NASD Manual at 4306 (2006 ed.).

13 *Self-Regulatory Organizations; Order Approving Proposed Rule Change by NASD, Inc., Relating to Investment Company Portfolio Transactions*, 69 Fed. Reg. 77,287 (Dec. 27, 2004) ("*2004 Amendments*") (stating that the new Rule "will now explicitly state that members are not permitted to sell the shares of investment companies that the member knows or has reason to know engages in such practices").

14 NASD Rule 2830(k), NASD Manual at 4291-92 (2003 ed.).

year. In 2001 and 2002, AFD based its target commission calculations primarily on the Retail Firms' previous year's sales: For the top-ten selling Retail Firms, AFD calculated target commissions equal to fifteen basis points (or 0.15%) of that firm's previous year's sales. For the next thirty-six top-selling Retail Firms, AFD calculated target commissions equal to ten basis points (or 0.10%) of the firm's prior year sales.

AFD personnel often informed the Retail Firms of the commission amount it had calculated for the firm for a given year. AFD personnel told the firms that the commissions were a reward for the firm's past year's sales, but that the amounts were non-negotiable and that it could not guarantee that CRMC, in placing portfolio trades with the firm over the year, would necessarily meet the target commissions it had calculated. While witnesses from AFD and the Retail Firms testified that they expected CRMC to meet the targeted amounts, the Retail Firms understood that the target commissions were not binding on AFD. CRMC traders generally placed enough trades with Retail Firms by year end to meet AFD's target commissions; however, the record reflects divergence between the targeted amounts and the commissions actually generated by CRMC traders. Often, CRMC paid commissions far exceeding AFD's targets (*e.g.*, by as much as 239 basis points); in other instances, CRMC failed to meet the target levels.

Unlike other firms, AFD did not enter into written contracts to provide specific amounts of brokerage commissions to retail firms in exchange for their mutual fund selling efforts; CRMC also directed brokerage commissions based "on prior year sales" rather than current year sales; and CRMC declined to make up shortfalls in the actual amount of brokerage commissions paid by year end. Record evidence also shows that, compared with the ten to fifteen basis points calculated by AFD, some of American Funds' competitors agreed to pay up to forty basis points in directed brokerage commissions.

In early 2002, Commission staff expressed concern informally to CRMC regarding its practice of directing brokerage with respect to Step-Out Firms and indicated that the Commission was considering revising Investment Company Act Rule 12b-1 to limit or prohibit the practice. As a result, CRMC and AFD began to reevaluate their directed brokerage practices. In July 2002, CRMC ceased directing brokerage commissions for the benefit of all Step-Out Firms, which were surprised by the decision because many other firms continued the practice.[15] Later that year, AFD determined to change the basis upon which it calculated target commissions for CRMC in 2003. Rather than basing its targets almost solely on sales, AFD relied on a combination of factors for 2003 that included past sales, previous commissions paid to the Retail Firm, assets under management, rates of redemption, and the "quality" of the relationship AFD had with the Retail Firm. In 2003, AFD also stopped its practice of informing Retail Firms of the target commission levels.

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15 Contemporaneous record evidence shows that the Step-Out Firms were "outraged," "shocked," and "dismayed" by CRMC's decision.

In a letter to the Commission dated December 16, 2003, the Investment Company Institute ("ICI") recommended that "the Commission and/or NASD adopt new rules that would prohibit funds from taking into account sales of fund shares in allocating fund brokerage."[16] Following the ICI's recommendation, on January 1, 2004, CRMC and AFD terminated their directed brokerage program with respect to all Retail Firms more than a year before NASD's 2004 Amendments took effect.

C. NASD Proceeding

NASD's complaint alleged that AFD violated the Rule by arranging for CRMC to direct to Retail Firms a percentage of brokerage commissions conditioned upon the firms' sales of shares of American Funds during the Relevant Period.[17] AFD disputed NASD's charges, claiming that its directed brokerage practices were fully disclosed, did not compromise the best execution of the funds' portfolio trades, and were not based on binding agreements between AFD and the Retail Firms and, therefore, did not conflict with the Rule's prohibitions because they were not "conditioned upon" the Retail Firms' sales. NASD's Hearing Panel, after conducting a six-day hearing, disagreed, finding that AFD's "targets tied to sales of the Funds" triggered the Rule's prohibitions.

The Panel, in considering a sanction (and rejecting NASD Enforcement's request for a $98 million fine), however, identified several factors that, in its view, mitigated AFD's violations. In particular, the Panel found that AFD's directed brokerage practices were "consistent with practices that had arisen in the mutual fund industry over a number of years." It also determined that AFD's conduct was "negligent, not intentional or reckless" and that its violations "were not serious," based on its finding that AFD "acted voluntarily to change [its] practices – even though its competitors did not – when regulators began expressing concerns about the mutual fund industry's use of directed brokerage." In addition, the Panel found no evidence that AFD was unjustly enriched as a result of its directed brokerage practices. The Panel stated, among other things, that it had not found evidence that "CRMC placed unwarranted trades or paid excessive commissions to generate directed brokerage," and therefore that AFD's practices did not harm American Funds investors. Based on these circumstances, the Panel censured AFD and fined it $5 million.

NASD's National Adjudicatory Counsel ("NAC") affirmed the Hearing Panel's decision and sanctions it imposed. As the NAC acknowledged, the case presented a question of "the correct interpretation of Rule 2830(k)(3) . . . [,] a matter of first impression, not decided in a previous [NASD] disciplinary case." The NAC found that AFD violated the Rule because its

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16 Letter from Matthew P. Fink to then Commission Chairman William H. Donaldson, SEC Chairman, ICI Statements & Publications (Dec. 16, 2003), *available at* http://www.ici.org/policy/comments/03_sec_soft_com.

17 NASD brought its action two days after the 2004 Amendments became effective.

target commissions, while considered non-binding arrangements with the Retail Firms, "constituted a specific amount or percentage of brokerage for the sale of mutual fund shares, in violation of Rule 2830(k)(3)."[18]

In upholding the Panel's sanction determination, the NAC, like the Panel, indicated that the evidence did not show that AFD's practices had harmed American Funds' investors, stating that "[t]he portfolio trades that CRMC placed required the mutual funds to pay brokerage commissions . . . regardless of whether AFD violated [NASD] rules." In this connection, the NAC noted that NASD Enforcement had stipulated that CRMC did not violate its duty, as investment adviser to the funds, of best execution in placing portfolio trades on behalf of the American Funds. The NAC also found no evidence "that retail firms would have ceased or diminished their sales of American Funds if AFD did not violate Rule 2830(k)."

III.

A. The parties largely agree as to the relevant facts of the case, *i.e.*, AFD's directed brokerage practices between 2001 and 2003. They disagree as to the meaning of the language used in the former Rule and whether that language was adequate to give AFD "fair notice" that its practices were prohibited.

NASD contends that the phrase "conditioned upon," as used in former Rule 2830(k)(3), should be construed broadly to prohibit using mutual fund sales as a "prerequisite" to directing brokerage commissions to broker-dealers selling fund shares.[19] NASD further contends that the Rule's exception contained in Rule 2830(k)(7)(B) only applied, by its very terms, if "the member does not violate any of the other specific provisions of Rule 2830(k)." Because AFD violated subparagraph (k)(3), according to NASD, the exception did not apply. In addition, NASD states that it provided clear guidance of the Rule's prohibitions, most notably through written guidance it issued in a 1984 Notice to Members, which identified examples of certain practices covered by the Rule.[20]

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18 The NAC also found that AFD violated NASD Rule 2110 based on its violation of Rule 2830(k)(3), noting that "a violation of another FINRA rule . . . is a violation of Rule 2110."

19 Citing *The American Heritage College Dictionary* 290 (3d ed. 1997) ("condition" means "[something] indispensable to the appearance or occurrence of another; prerequisite").

20 NASD Notice to Members 84-40; *see supra* text accompanying note 9.

AFD counters that the term "conditioned upon"[21] should be interpreted as prohibiting arrangements by which a fund committed or otherwise became obligated to direct brokerage commissions to firms that sold fund shares. AFD asserts that it is undisputed that the target commissions it communicated to Retail Firms were non-binding. AFD also claims that its interpretation is bolstered by the relationship between the prohibition contained in former Rule 2830(k)(3) and the exception to the Rule's coverage provided by former Rule 2830(k)(7)(B), which, according to AFD, permitted directed brokerage practices that: (1) did not compromise best execution and (2) were properly disclosed – both requirements AFD claims were met. AFD contends that, if a fund became bound by a contractual agreement or commitment to direct brokerage, best execution would necessarily be jeopardized; conversely, where a fund underwriter reserved the right, but avoided any obligation, to consider fund sales, it did not have to direct brokerage to a firm that failed to provide best execution. AFD argues that, in the event its practices ran afoul of the Rule, it was a consequence of ambiguity in the Rule's language and inadequate guidance from NASD as to the Rule's meaning.

B. Regulatory authorities have a fundamental obligation to "give fair warning of prohibited conduct before a person may be disciplined for that conduct."[22] We believe that AFD has raised valid questions about the clarity of the Rule's language and find that the Rule in place during the period at issue was ambiguous.[23] Indeed, evidence of potentially competing interpretations of the Rule's parameters was provided by NASD itself when, for example, the Hearing Panel chairperson observed at the pre-hearing conference:

> I try to figure out what the rule means and not what [the parties] . . . want to have it mean . . . what it actually meant, actually required and prohibited . . . . [which] is not that easy . . . just reading the rule and parts of the rule history that have been

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21 Citing *Black's Law Dictionary*, 312 (8th ed. 2004) ("condition" means "[a] future and uncertain event on which the existence or extent of an obligation or liability depends; an uncertain act or event that triggers or negates a duty to render a promised performance").

22 *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006).

23 Although we find NASD's former Rule here ambiguous, we do not intend to suggest that regulatory requirements are enforceable only to the extent the language used precisely delineates each course of conduct that is covered. *See Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982) (stating that "economic regulation is subject to a less strict vagueness test . . . because," among other reasons, "businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action. Indeed, the regulated enterprise may have the ability to clarify the meaning of the regulation by its own inquiry, or by resort to an administrative process" (citing *United States v. Nat'l Dairy Prods. Corp.*, 372 U.S. 29 (1963))); *see also Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) (stating that, because drafters of regulations are "[c]ondemned to the use of words, we can never expect mathematical certainty from our language").

> provided. I read it one day I think well, it probably means this and then I read it again and I go well maybe it meant that.

In addition, although the Hearing Panel ultimately found that AFD's practices conflicted with the Rule, the Panel's expressed view of what practices were permitted by the Rule diverged, to some degree, from interpretations offered by NASD Enforcement and the NAC. NASD Enforcement argued before the Hearing Panel that "AFD could have simply provided [CRMC] traders with a list of dealers that sold fund shares, and even indicated which ones should get the highest priority," but the Panel held that the Rule "may have allowed underwriters . . . to recommend to funds and investment advisers that, as a general matter, they consider sales in placing trades." The NAC, in contrast, determined that the Rule prohibited any directed brokerage arrangement whereby the sale of mutual fund shares was a "'prerequisite' to the receipt of [directed brokerage] commissions."

Moreover, NASD's interpretation of the Rule could not have been ascertained from any enforcement action. For the twenty-year period following adoption of the 1981 Amendments, NASD brought no enforcement proceeding under the Rule that could have helped elucidate its meaning. Significantly, the 2004 Amendments addressed the uncertainty in the Rule identified by AFD and, as a result of these changes, the directed brokerage practices at issue are now clearly prohibited, as AFD concedes.[24]

In addition to our concerns about ambiguity in the Rule before the 2004 Amendments, we have considered other factors in assessing the merits of AFD's appeal – including evidence that AFD, sought proactively to ensure that its directed brokerage practices conformed to regulatory requirements. For example, as noted above, AFD and CRMC terminated their directed trading program with Step-Out Firms in mid-2002 ahead of the industry and to the consternation of the Retail Brokers, modified their target calculations for CRMC in 2003 to include consideration of factors other than just sales, and canceled their directed brokerage program altogether in 2004 – more than a year before the new Rule took effect.

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[24] *2004 Amendments*, 69 Fed. Reg. at 77,287 (clarifying that the Rule's prohibition applied to "written or oral agreement[s] or understanding[s]" to direct brokerage in consideration for fund sales); *see supra* note 13 and accompanying text. As noted, NASD brought its action against AFD two days after the 2004 Amendments became effective. *See supra* note 17.

While NASD's subsequent clarification here is one factor, among several, that we have considered, we are mindful that amendments to a rule often seek to clarify its meaning. Such a clarification, however, should not necessarily be construed to mean that conduct more specifically addressed thereby was outside the reach of the prior version of the rule. *See, e.g., Rentz v. Co.*, 43 S.E.C. 436, 439-40 (1967) (stating "the fact that a subsequent amendment of the NASD interpretation [against free riding that] specifically added senior officers of insurance companies . . . does not mean that such officers were not covered by the prior interpretation").

Under all of the circumstances, including our concern about uncertainty resulting from the language of the Rule in effect during the period at issue, the fact that the 2004 Amendments clarified the extent of the Rule's prohibition, and the evidence of AFD's compliance efforts with respect to directed brokerage practices, we have determined to set aside the NASD's action.

An appropriate order will issue.[25]

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

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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25 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

Commissioner AGUILAR, dissenting:

Since 1973, the NASD[1] has maintained some form of the "Anti-Reciprocal Rule." As characterized by the NASD, "[t]he rule's goal is to curb conflicts of interest that might cause retail firms to recommend investment company shares based upon the receipt of commissions from that investment company."[2] After amending the rule in 1981, the NASD reiterated that the rule continues to prohibit directing brokerage commissions conditioned upon sales of fund shares and gave examples of conduct that would be inconsistent with the rule. As further described below, I believe the text, history and guidance of the rule were sufficiently clear to put AFD on notice that its directed brokerage arrangements violated the rule. Therefore, I dissent from the majority opinion setting aside the findings of violations and sanctions imposed.

AFD, as principal underwriter and distributor of American Funds, had numerous non-binding arrangements to direct brokerage commissions to broker-dealers as partial compensation for their sale of American Fund shares. For those firms that lacked the capacity to execute the portfolio trades, Capital Research and Management Company ("CRMC"), the investment adviser to the American Funds, directed trading to the clearing firm that executed the portfolio trades and would then allocate, or "step-out," all or part of the brokerage commissions to the brokerage firms. Pursuant to these arrangements, the American Funds paid $98 million in brokerage commissions to top-selling retail brokerage firms during the relevant time period.

Based on this conduct, the NASD found that AFD requested or arranged for the direction of specific amounts or percentages of brokerage commissions to broker-dealers that sold shares in the American Funds, in violation of former NASD Rule 2830(k). Rule 2830(k) is the NASD's "Anti-Reciprocal Rule."

> The rule in effect during the relevant period, as amended in 1981, provided that: No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.[3]

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1 The "NASD" designation is used throughout this opinion because the disciplinary action was initiated by the NASD prior to its name change to Financial Industry Regulatory Authority, Inc. ("FINRA").

2 NASD Notice to Members 73-42.

3 NASD Manual at 2105-4 (1981 ed.). The 1981 Amendments also added NASD Rule 2830(k)(7)(B), which read in relevant part: "(7) Provided that the member does not violate any of the specific provisions of this paragraph (k), nothing herein shall be deemed to prohibit any of the specific provisions of this paragraph (k), nothing herein shall be deemed to prohibit

(continued...)

The parties disagree whether AFD's brokerage practices were "conditioned upon" the retail firms' sales or promises of sales of shares in the American Funds, and furthermore, whether AFD had fair notice that its brokerage practices were prohibited by the rule. Based on my review of the facts of this case, I believe that Rule 2830(k) was sufficiently clear in proscribing AFD's directed brokerage practices. I am compelled to this conclusion not only because the NASD's interpretation of its rule is reasonable, but also because of the obvious arbitrage opportunities that AFD's interpretation would have created under the former rule.

In essence, AFD advocates an interpretation of the phrase "conditioned upon" that would limit the rule's application to only binding arrangements that obligated a fund to direct brokerage to particular firms. I cannot accept AFD's invitation to interpret the rule so narrowly. To do so would be to adopt an interpretation that eviscerates the rule's effectiveness. AFD's interpretation of the rule would have permitted members to circumvent the rule by simply maintaining non-binding agreements that nevertheless perpetuate the same conflicts of interest the rule was designed to alleviate. To this end, I agree with the NASD's observation that allowing "AFD to circumvent Rule 2830(k) with a quid pro quo arrangement calling for reciprocal brokerage practices would have the same corrupting influence as an agreement memorialized in writing and enforceable under contract law."

While the version of the rule in effect during the relevant period may not have been a model of clarity,[4] I find more reasonable the NASD's interpretation of the "conditioned upon" phrase as prohibiting fund sales as a "prerequisite" to directing brokerage commissions to broker-dealers selling fund shares. It is true that the rule provided an exception to member firms that did not otherwise violate paragraph (k), if the directed brokerage policy was properly disclosed and where consideration of mutual fund sales was a "factor" in the selection of executing broker-dealers, "subject to the requirements of best execution."[5] Disclosure and best execution only become relevant, however, if the member firm does not violate the rule's general prohibition against reciprocal arrangements. Because AFD's arrangements constituted a quid pro quo of directing brokerage in exchange for sales, it did not comply with the rule's general prohibitions and thereby violated 2830(k). Thus, I believe that the NASD's interpretation of the anti-reciprocal rule is the more reasonable one.

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3 (...continued)
. . . (B) a member from selling shares of, or acting as underwriter for, an investment company which follows a policy, disclosed in its prospectus, of considering sales of shares of the investment company as a factor in the selection of broker/dealers to execute portfolio transactions, subject to the requirements of best execution."

4 As noted in the majority opinion, for example, there were indications in the record of competing interpretations of the rule's parameters within the NASD.

5 *See supra* note 3.

In addition, I note that it is well established that self-regulatory organizations are accorded "some level of deference"[6] in interpreting and applying their rules. I believe this should apply here as well.

Additionally, while the text of the rule may have been open to a certain amount of varying interpretation, the NASD's subsequent guidance undermines AFD's claims that it lacked fair notice. In 1984, the NASD issued a Notice to Members concerning compensation arrangements with respect to the sale of mutual fund shares.[7] In this guidance, the NASD noted that some members may have incorrectly viewed the amendments "as having altered the specific standards of the rule more extensively than was actually the case." The NASD went on to provide examples of specific situations that would be inconsistent with the rule. Among these examples were practices that resembled AFD's brokerage practices, including, an offer or agreement by a principal underwriter:

- "for a specified percentage of portfolio brokerage commissions relative to the dealer's sales of fund shares";
- "that portfolio orders be placed in recognition of the representative's prior or future sales of fund shares"; or
- "that portfolio brokerage commissions be placed on the understanding that this would result in placement of the funds on the dealer's preferred list."

In this matter, the NASD found that AFD calculated and recommended target brokerage commissions; identified top-selling retail firms of American Funds; provided CRMC with the amount of commissions to be sent to the firms; monitored CRMC's trading with, and the stepping out of commissions to, the brokerage firms; and tracked the trading activity to ensure proper crediting of the commissions. In light of these findings, AFD's arrangements constituted a clear quid pro quo of directing brokerage commissions in exchange for sales of American Fund shares. And while there may have been some ambiguity at the margins, AFD's arrangements were in the zone of conduct readily identifiable as violating the rule, particularly in light of the 1984 Notice to Members. Thus, given the 1984 Notice to Members and these facts, I find that AFD had "fair notice" that its directed brokerage practices in place during the relevant period were prohibited by Rule 2830(k).

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6 *Heath v. SEC,* 586 F.3d 122, 139 (2d Cir. 2009) (citing *Shultz v. SEC*, 614 F.2d 561, 571 (7th Cir. 1980) ("[B]ecause these are rules of the Exchange, the Exchange should be allowed discretion in determining their meaning.")).

7 NASD Notice to Members 84-40.

Finally, I note the majority's contention that the "NASD's interpretation of the Rule could not have been ascertained from any enforcement action." While there may have been some ambiguity as to the precise contours of the rule's prohibitions during the relevant period, AFD's arrangements did not fall within any perceptible grey area at the margin. To the contrary, AFD's arrangements – particularly with respect to the "step-out" firms – amounted to a clear quid pro quo of directing commissions in exchange for mutual fund sales. As described above, the text, history and guidance of the anti-reciprocal rule was sufficiently clear to have put AFD on notice that its directed brokerage practices violated the rule.

For all of the reasons I have stated, I respectfully dissent.

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64739 / June 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14436

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

I.

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

II.

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

III.

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

1. Wright, age 48, is a resident of Draper, Utah. Wright formed and controlled Waterford Funding, LLC, Waterford Loan Fund, LLC, Waterford Services, LLC and Waterford 1031 Exchange Services, LLC, all Utah limited liability companies. Wright was not registered with the Commission in accordance with Section 15(b) nor was he associated with a broker or dealer. From at least the autumn of 2001 through the spring of 2009, Wright was acting as an unregistered broker.

2. On May 3, 2011, a final judgment was entered by consent against Wright, permanently enjoining him from future violations of Sections 17(a), 5(a) and (c) of the Securities Act of 1933 and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Travis L. Wright, Civil Action Number 2:10-cv-602-CW-PMW, in the United States District Court for the District of Utah.

3. The Commission's Complaint alleged that from the fall of 2001 through the spring of 2009, Wright raised at least $145 million through the sale of secured promissory notes from approximately 175 investors. The Complaint further alleged that Wright made misrepresentations to investors, including that investors' funds would be used solely to make loans secured by first liens on commercial real estate. The Complaint also alleged that Wright failed to place all of the assets of his entity, Waterford Loan Fund, LLC, into a trust held for the collective benefit of the investors. The Complaint further alleged that many of the loans and/or investments Wright made were not consistent with his representations to investors. Instead, the Complaint alleged Wright used investors' funds to finance various ventures and to make unsecured loans to individuals.

IV.

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

Accordingly, it is hereby ORDERED:

Respondent Wright be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer or transfer agent, 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, and 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.

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 240

[Release No. 34-64748; File No. S7-03-10]

RIN 3235-AK53

Risk Management Controls for Brokers or Dealers with Market Access

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; limited extension of compliance date for certain requirements.

SUMMARY: The Commission is extending the compliance date for certain recently adopted requirements of Rule 15c3-5 under the Securities Exchange Act of 1934 ("Exchange Act"). Specifically, the Commission is extending the compliance date, until November 30, 2011, for all of the requirements of Rule 15c3-5 for fixed income securities, and the requirements of Rule 15c3-5(c)(1)(i) for all securities. The compliance date remains July 14, 2011 for all provisions of Rule 15c3-5 not subject to this limited extension. Among other things, Rule 15c3-5 requires broker-dealers with access to trading securities directly on an exchange or alternative trading system ("ATS"), including those providing sponsored or direct market access to customers or other persons, and broker-dealer operators of an ATS that provide access to trading securities directly on their ATS to a person other than a broker-dealer, to establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, is reasonably designed to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access, and ensure compliance with all regulatory requirements that are applicable in connection with market access.

The Commission is extending the compliance date for all of the requirements of Rule 15c3-5 for fixed income securities, and the requirements of Rule 15c3-5(c)(1)(i) for all securities

to give broker-dealers with market access additional time to develop, test, and implement the relevant risk management controls and supervisory procedures required under the Rule.

DATES: The effective date for this release is [insert date of publication in Federal Register]. The effective date for Rule 15c3-5 remains January 14, 2011. The compliance date is extended to November 30, 2011, for all of the requirements of Rule 15c3-5 for fixed income securities, and the requirements of Rule 15c3-5(c)(1)(i) for all securities. The compliance date remains July 14, 2011, for all provisions of Rule 15c3-5 not subject to the limited extension.

FOR FURTHER INFORMATION

CONTACT: Theodore S. Venuti, Senior Special Counsel, at (202) 551-5658; Marc F. McKayle, Special Counsel, at (202) 551-5633; and Daniel Gien, Special Counsel, at (202) 551-5747, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

I. Introduction

On November 3, 2010, the Commission adopted Rule 15c3-5 under the Exchange Act.[1] Among other things, Rule 15c3-5 requires each broker-dealer with access to trading securities[2] directly on an exchange or ATS, including a broker-dealer providing sponsored or direct market access to customers or other persons, and each broker-dealer operator of an ATS that provides access to trading securities directly on their ATS to a person other than a broker-dealer, to establish, document, and maintain a system of risk management controls and supervisory procedures that, among other things, is reasonably designed to (1) systematically limit the

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1 See Exchange Act Release No. 63241 (Nov. 3, 2010), 75 FR 69792 (Nov. 15, 2010) ("Rule 15c3-5 Adopting Release").

2 Rule 15c3-5 applies to trading in all securities on an exchange or ATS. Id. at 69765.

financial exposure of the broker-dealer that could arise as a result of market access,[3] and (2) ensure compliance with all regulatory requirements that are applicable in connection with market access.[4] The required financial risk management controls and supervisory procedures must be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds,[5] or that appear to be erroneous.[6] The regulatory risk management controls and supervisory procedures must also be reasonably designed to prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied on a pre-order entry basis,[7] prevent the entry of orders that the broker-dealers or customer is restricted from trading,[8] restrict market access technology and systems to authorized persons,[9] and assure appropriate surveillance personnel receive immediate post-trade execution reports.[10]

The Commission understands that, as broker-dealers with market access have worked to meet the July 14, 2011 compliance date, some have determined that additional time is needed to implement effective policies and procedures and complete the systems changes necessary to comply with certain requirements of Rule 15c3-5. The Financial Information Forum ("FIF"), the Securities Industry and Financial Markets Association ("SIFMA"), and the Wholesale

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3 See 17 CFR 240.15c3–5(c)(1).

4 See 17 CFR 240.15c3–5(c)(2).

5 See 17 CFR 240.15c3–5(c)(1)(i).

6 See 17 CFR 240.15c3–5(c)(1)(ii).

7 See 17 CFR 240.15c3–5(c)(2)(i).

8 See 17 CFR 240.15c3–5(c)(2)(ii).

9 See 17 CFR 240.15c3–5(c)(2)(iii).

10 See 17 CFR 240.15c3–5(c)(2)(iv).

Market Brokers' Association ("WMBA") have submitted letters requesting that the Commission extend the compliance date for those requirements.[11] Specifically, FIF, SIFMA, and WMBA have indicated that more time is needed to comply with Rule 15c3-5(c)(1)(i), which requires the implementation of risk management controls and supervisory procedures that are reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds, because the type of controls required by the Rule are not currently in place at many broker-dealers, and developing and implementing appropriate controls in this area can be a complex exercise.[12] In addition, they have indicated that more time is needed generally to comply with the requirements under Rule 15c3-5 with respect to fixed income securities, because the type of pre-trade controls required by the Rule have generally not been used in the fixed income market, and developing and implementing controls that appropriately account for the differences in fixed income trading will require substantial effort.[13] SIFMA and WMBA requested that the compliance date for these provisions be extended until November 30, 2011, and FIF requested an extension until January 2012.

The Commission believes that providing a limited extension of the compliance date to November 30, 2011, for (1) all of the requirements of Rule 15c3-5 for fixed income securities, and (2) the requirements of Rule 15c3-5(c)(1)(i) for all securities, is reasonable to assure market

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11 See letter from Manisha Kimmel, Executive Director, Financial Information Forum, to David Shillman, Associate Director, Division of Trading and Markets ("Division"), Commission, dated April 15, 2011; see also letters from Sean Davy, Managing Director, et al., Securities Industry and Financial Markets Association, to Robert Cook, Director, Division, Commission, dated April 21, 2011; and Stephen Merkel, Chairman, Wholesale Markets Brokers' Association, Americas, to Robert Cook, Director, Division, Commission, dated May 31, 2011.

12 Id.

13 Id.

participants have sufficient time to develop and implement the required risk management controls for activities where the application of these types of controls may not be widespread. Accordingly, the Commission is extending the compliance date to November 30, 2011, for (1) all of the requirements of Rule 15c3-5 for fixed income securities, and (2) the requirements of Rule 15c3-5(c)(1)(i) for all securities.

II. Conclusion

For the reasons cited above, the Commission, for good cause, finds that notice and solicitation of comment regarding the extension of the compliance date set forth herein are impractical, unnecessary, or contrary to the public interest.[14] The Commission notes that the compliance date is quickly approaching, and that a limited extension of the compliance date for the reasons cited above will facilitate the orderly implementation of Rule 15c3-5. In light of time constraints, full notice and comment could not be completed prior to the July 14, 2011 compliance date. Broker-dealers with market access will have additional time to comply with the provisions of Rule 15c3-5 discussed above beyond the compliance date originally set forth in the Rule 15c3-5 Adopting Release. Further, the Commission recognizes that it is imperative for broker-dealers with market access to receive notice of the extended compliance date, and

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

providing immediate effectiveness upon publication of this release will allow them to adjust their implementation plans accordingly.[15]

The Commission identified certain costs and benefits associated with the Rule in the Rule 15c3-5 Adopting Release. The extension of the compliance date for Rule 15c3-5 will delay benefits of the Rule, but the Commission believes that the limited extension is necessary and appropriate because it will provide broker-dealers with market access additional time to develop, test, and implement certain of the required risk management controls and supervisory procedures under the Rule. The extension also will delay the costs of complying with the Rule.[16] The Commission believes that the extension does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, because the extension will give broker-dealers with market access additional time to develop, test, and implement certain of the risk management controls and supervisory procedures that are required under the Rule.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: June 27, 2011

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

16 The Commission identified in the Rule 15c3-5 Adopting Release certain ongoing costs associated with Rule 15c3-5. Because of the extension of the compliance date, certain costs may be avoided from July 14, 2011 to November 30, 2011.

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3223 / June 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14314

In the Matter of **PRINTZ CAPITAL MANAGEMENT, LLC,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), against Printz Capital Management, LLC ("Respondent" or "Printz Capital").

II.

Following the institution of these proceedings on March 31, 2011, 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, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

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

1. Printz Capital, located in Philadelphia, Pennsylvania, is a Delaware limited liability company formed in May 2006 and has been registered with the Commission as an investment adviser since September 19, 2006. Printz Capital is wholly controlled by Alfred Clay Ludlum III ("Ludlum"), who also controls a number of other business entities, including Printz Financial Group, Inc. and PCM Global Holdings LLC (together with Printz Capital, the "Printz

Entities"). On March 30, 2009, Printz Capital filed an annual update to its Form ADV stating that it was no longer eligible to register with the Commission because it had 58 non-discretionary clients and $4 million in assets under management, rather than 100 clients and $30 million in assets under management as it had reported in its February 27, 2008 annual Form ADV. On March 4, 2010, Printz Capital filed an annual update to its Form ADV which again stated that it was no longer eligible to remain registered with the Commission, and stated that the firm had twenty non-discretionary accounts with $5 million in assets under management. However, Printz Capital has never filed the required Form ADV-W as required by Rule 203A-2(d)(3) [17 C.F.R. § 279.2] under the Advisers Act.

2. On March 15, 2011, a final judgment was entered by default against Printz Capital, permanently enjoining it from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), 203A, 204, and 207 of the Advisers Act, in the civil action entitled Securities and Exchange Commission v. Alfred Clay Ludlum, III, et al., Civil Action No. 10-CV-7379, in the United States District Court for the Eastern District of Pennsylvania. The final judgment ordered Printz Capital, jointly and severally with the other Printz Entities, to pay $735,617 in disgorgement, $49,817 in prejudgment interest, and a civil penalty of $735,617.

3. The Commission's complaint, filed on December 20, 2010, alleged that Printz Capital, acting through Ludlum, made fraudulent misrepresentations and material omissions to investors concerning unregistered offerings of equity and debt securities in the Printz Entities. Some of these investors were Printz Capital advisory clients. These investors were told that their funds would be used for working capital and to grow and operate the businesses of the Printz Entities. In fact, however, Ludlum used most of these funds to support his lifestyle, pay his personal expenses, and repay other investors. In addition, the Commission alleged that Printz Capital fraudulently obtained loans from one advisory client and transferred funds from three advisory client accounts to accounts controlled by Ludlum without those clients' consents.

4. The Commission's complaint further alleged that the Printz Entities, including Printz Capital, failed to register their securities offerings with the Commission, even though no exemption from registration applied. The complaint also alleged that Printz Capital remained registered with the Commission as an investment adviser when it was not eligible to be registered by falsely claiming that it had assets under management of $25 million or more, when, in fact, Printz Capital never had more than $10 million under management. In addition, Printz Capital willfully made untrue statements of material fact in its Forms ADV by falsely representing that it did not recommend securities to advisory clients in which it had an ownership interest when, in fact, Ludlum was recommending that his clients purchase securities offered by the Printz Entities. The complaint also alleged that Printz Capital failed to make available to the Commission complete and accurate records concerning its business in response to subpoenas and requests issued by the Commission staff.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(e) of the Advisers Act that the registration of Respondent Printz Capital as an investment adviser be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64750 / June 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-13487

In the Matter of NEW YORK LIFE INVESTMENT MANAGEMENT LLC Respondent.	ORDER TERMINATING THE FAIR FUND

On May 27, 2009, the Commission instituted settled administrative proceedings against New York Life Investment Management LLC (NYLIM) for violating Section 206(2) of the Investment Advisers Act of 1940 (Advisers Act) and Sections 15(c) and 34(b) of the Investment Company Act of 1940 (Company Act) in connection with a mutual fund NYLIM advised. Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Rel. Nos. IA-2883; IC-28747; Admin. Proc. File No. 3-13487 (Order). The Commission ordered NYLIM, among other things, to pay a total of $6,100,784 in disgorgement, prejudgment interest and penalties and to self-administer these funds' distribution and to bear all costs associated with the distribution. The Commission authorized the creation of a Fair Fund to make distribution to all affected shareholders of the mutual fund that were due $20.00 or more pursuant to the methods outlined in the Order. Any excess amount that NYLIM was unable to pay to affected shareholders due to factors beyond its control or to affected shareholders' being due less than $20.00 were to be transferred to the Commission for its ultimate transfer to the United States Treasury. The Order also required that NYLIM submit a Final Accounting to the Commission.

NYLIM determined that approximately $4.66 million of the $6.1 million ordered was eligible for distribution under the Order. On October 16, 2009, NYLIM began distribution of that amount. All distributions have been made. A total of $3,521,727.16 was distributed to investors. NYLIM terminated its distribution program on December 22, 2010, and returned the remaining $2,579,779.46 to the Commission for transfer to the U.S. Treasury.

A Final Accounting of the Fair Fund was submitted to the Commission. The Commission approved the Final Accounting. Pursuant to the Final Accounting, $2,579,779.46 in residual funds is to be transmitted to the U.S. Treasury.

Accordingly, IT IS ORDERDED that the Fair Fund is terminated and all residual funds shall be transferred to the U.S. Treasury.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64751 / June 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14437

In the Matter of JASON MUTASCIO, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

1. In 2009 Respondent was a registered representative, residing in Aventura, Florida, associated with Brewer Financial Services, LLC, a registered broker-dealer.

2. On March 4, 2010, Respondent pled guilty to one count of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Southern District of Florida in *U.S. v. Mutascio*, Case No. 10-60025-CR-COHN. On May 13, 2010, a Judgment in the criminal case was entered against Respondent. He was sentenced to a prison term of 15 months followed by three years of supervised release and ordered to make restitution in the amount of $52,500.

3. In his guilty plea, Respondent admitted that in March 2009, he devised a scheme to defraud one of his clients and to obtain money and property by means of false and fraudulent pretenses, representations, and promises. He also admitted that, as the stock broker for his client, Respondent had access and control over the client's brokerage account at Brewer Financial Services and, without the permission of his client, he caused the wire transfer of funds in the amount of $44,000 from his client's brokerage account at Brewer Financial Services to a bank

account owned and controlled by one of his family members and then to a bank account under his control.

III.

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

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

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

IV.

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

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

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

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

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64752 / June 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14438

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

I.

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

II.

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

III.

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

1. In 2009, Maher was a salesperson who sold the securities of Express International, LLC. Maher participated in the unregistered offer and sale of Express International securities. Maher was not registered with the Commission in any capacity at the time of these sales. From 1994 through 2000, Maher had been a registered representative associated with broker-dealers registered with the Commission. Maher, 43 years old, is a resident of Tiburon, California.

2. On June 1, 2011, a final judgment was entered by consent against Maher, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Curtis Peterson, et al., Civil Action Number CV 11-01143 ODW (JEMx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, in connection with the offer and sale of securities in the form of investment contracts, Maher made false statements to investors, orally and in writing, concerning the nature of the Express International investment program, the safety of investor principal, and the profits to be realized from participation in the investment program. The complaint also alleged that Respondent sold unregistered securities, and acted as an unregistered broker-dealer.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Maher be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and 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 of or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock; with the right to apply for reentry after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64757 / June 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14439

In the Matter of **International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.), International Thoroughbred Breeders, Inc., Ionic Fuel Technology, Inc., and Ipex, Inc. (n/k/a Salus Labs International, Inc.),** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.), International Thoroughbred Breeders, Inc., Ionic Fuel Technology, Inc., and Ipex, Inc. (n/k/a Salus Labs International, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.) (CIK No. 808371) is a void Delaware corporation located in Delray Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Poultry 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 4, 1994, which reported a net loss of over $536,000 for the prior eight months. As of June 23, 2011, the company's stock (symbol "CRLY") was quoted on OTC Link (previously,

"Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. International Thoroughbred Breeders, Inc. (CIK No. 320573) is a Delaware corporation located in Riviera Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Thoroughbred Breeders 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, 2007, which reported a net loss of over $3 million for the prior three months. On December 7, 2006, International Thoroughbred Breeders filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Florida, which was converted to Chapter 7, and the case was terminated on April 20, 2011. As of June 23, 2011, the company's common stock (symbol "ITGB") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3), and the company's preferred shares (symbol "ITGBP") were traded on the over-the-counter markets.

3. Ionic Fuel Technology, Inc. (CIK No. 925006) is a void Delaware corporation located in Wilmington, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ionic is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2002, which reported a net loss of over $333,000 for the prior nine months. As of June 23, 2011, the company's stock (symbol "IFTI") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Ipex, Inc. (n/k/a Salus Labs International, Inc.) (CIK No. 1258383) is a Nevada corporation located in Flint, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ipex 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, 2006, which reported a net loss of over $337,000 for the prior three months. As of June 23, 2011, the company's stock (symbol "IPEX") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64758 / June 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14440

In the Matter of **Internet Marketing, Inc.,** **Intrepid Technology & Resources, Inc.,** **Ion Technology, Inc.,** **Itemus, Inc., and** **ITIS Holdings, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Internet Marketing, Inc., Intrepid Technology & Resources, Inc., Ion Technology, Inc., Itemus, Inc., and ITIS Holdings, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Internet Marketing, Inc. (CIK No. 1081851) is a Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Internet Marketing is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2006, which reported a net loss of $731 for the prior twelve months. As of June 23, 2011, the company's stock (symbol "IMIZ") was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Intrepid Technology & Resources, Inc. (CIK No. 1083742) is an Idaho corporation located in Idaho Falls, Idaho with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Intrepid Technology & Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2008, which reported a net loss of over $4.5 million for the prior twelve months. As of June 23, 2011, the company's stock (symbol "ITRP") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Ion Technology, Inc. (CIK No. 1181920) is a revoked Nevada corporation located in Campbell, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ion is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on September 10, 2002. On May 29, 2003, Ion filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on November 18, 2003. As of June 23, 2011, the company's stock (symbol "IOTG") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Itemus, Inc. (CIK No. 907358) 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). Itemus is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 40-F for the period ended December 31, 1999, which reported a net loss of over $107 million for the prior twelve months. On November 15, 2001, the Ontario Securities Commission closed trading in the company's stock because of delinquent filings. As of June 23, 2011, the company's stock (symbol "ITMUQ") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. ITIS Holdings, Inc. (CIK No. 3959) is a defaulted Nevada corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ITIS Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2006, which reported a net loss of over $277,000 for the prior three months. As of June 23, 2011, the company's stock (symbol "ITHH") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

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 file 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 Casey.
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64759 / June 28, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3224 / June 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14441

In the Matter of

EDDIE W. SAWYERS,

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 Eddie W. Sawyers ("Sawyers" or "Respondent").

II.

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

III.

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

1. Sawyers was associated with Wachovia Securities, Inc., a registered broker-dealer, as a registered representative from January 2004 to October 14, 2008. While at Wachovia, Sawyers held Series 7, 63, and 66 licenses. During the relevant time period, Sawyers acted as an investment adviser to several of his Wachovia customers.

2. On April 15, 2011, a judgment was entered by consent against Sawyers, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. § 77 q(a)], Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], and Sections 206(1), 206(2), and 206(4) of the Advisers Act [15 U.S.C. §§ 80b-6(1), (2), & (4)] and Rule 206(4)-8, thereunder [17 C.F.R. § 275.206(4)-8], in the civil action entitled Securities and Exchange Commission v. William K. Harrison, et al., Civil Action Number 3:10-cv-00634, in the United States District Court for the Western District of North Carolina.

3. The Commission's complaint alleged the following facts: Between approximately December 2007 and October 2008, Sawyers and his co-defendant William K. Harrison used misrepresentations and omissions of material fact to defraud at least forty-two Wachovia brokerage customers of at least $8 million in customer funds. On or around December 2007, Harrison and Sawyers, acting under the d/b/a "Harrison/Sawyers Financial Services," began offering their Wachovia customers an investment opportunity outside of Wachovia through an advisory firm they owned. They misrepresented that the investment opportunity was guaranteed to make a 35% return, with no risk of loss of principal. In those instances when customers were informed that their monies would be used for trading options, Harrison and Sawyers misrepresented the riskiness of their trading strategy by telling customers that they had a foolproof approach to trading options and that their principal investment was secure and would make handsome returns regardless of market volatility. Harrison and Sawyers either opened accounts with optionsXpress in the client's name or commingled the client's funds in accounts opened in Harrison's wife's name or a joint account in the name of Harrison and his wife. So as to not draw attention to their conduct, Harrison and Sawyers placed "limited trading authorizations" and other related documentation associated with their scheme in the name of Harrison's wife. Although the trading strategy that Harrison and Sawyers employed was initially successful, it soon resulted in substantial investor losses. By October 2008, they had depleted the vast majority of the money they had raised from investors. On October 13, 2008, Harrison submitted to Wachovia a resignation letter in which he confessed to "misdirecting" $6.6 million from seventeen of his Wachovia customers in order to trade online. He also admitted that he had conducted this online trading without first securing the authorization of these 17 individuals.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, Sawyers shall be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Sawyers shall 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

Elizabeth M. Murphy
Secretary

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64763 / June 28, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3225 / June 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14443

In the Matter of Level Global Investors, L.P., 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 A CEASE-AND-DESIST ORDER AND REMEDIAL SANCTIONS**

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 Level Global Investors, L.P. ("Level Global" 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 a Cease-and-Desist Order and Remedial Sanctions ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of two violations of Rule 105 of Regulation M of the Exchange Act by Level Global, a non-registered investment adviser based in New York, NY. Rule 105 prohibits short selling of equity securities during a restricted period prior to a public offering and then purchasing the subject securities in the offering. Level Global violated Rule 105 in April 2009 in connection with certain short sales it effected within the Rule 105 restricted period preceding its participation in a public offering by Goldman Sachs Group, Inc. ("GS"), resulting in profits of $298,415. Next, Level Global violated Rule 105 again 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 Regions Financial Corporation ("RF"), resulting in profits of $2,381,100. Altogether, Level Global made a profit of $2,679,515.

Respondent

2. Level Global Investors, L.P. is a limited partnership organized under Delaware law and headquartered in New York, NY, with an additional office in Greenwich, Connecticut. Level Global is the investment adviser to two hedge funds: 1) Level Global Overseas Master Fund, Ltd. and 2) Level Radar Master Fund, Ltd., with an aggregate value of approximately $3.7 billion of assets under management as of December 31, 2010. On or about February 11, 2011, Level Global announced that it planned to wind down its operations, fully liquidate its funds' portfolios, and to distribute redemption proceeds to investors.

Background

3. Rule 105 of Regulation M of the Exchange Act makes it unlawful for a person to purchase securities in a public offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule. Rule 105 defines the restricted period as the period: (1) beginning five business days prior to the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of such registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. Ch. II §242.105. Pursuant to amendments that became effective in October 2007, it is not required that the shares purchased in the offering be used to "cover" the restricted period short sales. Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 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

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

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.

Level Global's Violation in Connection with the Goldman Sachs Trades

5. On Monday, April 13, 2009, Level Global sold short 50,000 shares of GS at $128.7081 per share.

6. That same day, Monday, April 13, 2009, following the close of the market, GS announced a public secondary offering of common stock (the "GS Offering"). The GS Offering was priced that evening at $123 per share.

7. On Tuesday, April 14, 2009, Level Global purchased 400,000 shares of GS common stock in the GS Offering at $123.00 per share. Level Global made a profit of $285,405 on its 50,000 share short position in GS stock. Level Global did not cover its restricted period short sales of GS stock with shares bought in the public offering.

8. On Tuesday, April 14, 2009 Level Global sold 100,000 of the GS Offering shares at $123.1301 per share. Level Global made an additional profit of $13,010 on this sale of 100,000 of the GS Offering shares.

9. Because Level Global sold short shares of GS during the restricted period and then purchased shares in the GS Offering, Level Global violated Rule 105. As a result of its violation of Rule 105, Level Global received a total profit of $298,415 on the GS Offering shares.

Level Global's Violation in Connection with the Regions Financial Trades

10. Between Thursday, May 14, 2009 and Tuesday, May 19, 2009, Level Global sold short 1.5 million shares of RF at prices ranging between $5.0506 and $5.4878 per share.

11. On Wednesday morning, May 20, 2009, RF announced a public secondary offering of common stock (the "RF Offering"). The RF Offering was priced after the close of the market on May 20, 2009 at $4 per share. Accordingly, the five-day restricted period began on Thursday, May 14, 2009.

12. On May 20, 2009, Level Global purchased a total of two million shares of RF common stock in the RF Offering at $4.00 per share. Level Global made a profit of $1,936,100 on its $1.5 million share short position in RF stock. Level Global did not cover its restricted period short sales of RF stock with shares bought in the public offering.

13. In addition, Level Global obtained a benefit of $445,000 on the remaining 500,000 RF Offering shares that it received at a discount from RF's market price. Accordingly, Level Global's total profit from its participation in the RF Offering was $2,381,100.

14. At the time of both of the violations, Level Global had no written policies, procedures or controls in place designed to detect or prevent Rule 105 violations.

15. As a result of both of its violations of Rule 105, Level Global received a total profit of $2,679,515 on the GS Offering shares and RF Offering shares.

16. As a result of the conduct described above, Level Global twice willfully[1] violated Rule 105 of Regulation M of the Exchange Act.

Level Global's Remedial Efforts

17. After Level Global learned of its Rule 105 violation in the RF Offering, and prior to the investigation by the staff of the Commission, Level Global made efforts to develop and formalize policies and procedures relating to Rule 105. These efforts included the prompt distribution of an educational memorandum to trading and investment staff. Level Global also instituted a policy whereby participation in any secondary offering required prior written approval from the compliance department. Further, Level Global updated and reissued its compliance manual and conducted mandatory formal training sessions, and the compliance department adopted the practice of distributing periodic e-mail reminders about Rule 105 to relevant employees.

18. In deciding to accept the Offer, the Commission considered the remedial acts promptly undertaken by Respondent Level Global and cooperation afforded the Commission staff.

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Level Global cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Level Global is censured;

C. Level Global shall within 14 days of the entry of this Order pay disgorgement in the amount of $2,679,515, prejudgment interest in the amount of $189,656, and a civil monetary penalty in the amount of $375,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. Payment shall be: (A) made by wire

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[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)).

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 sent via overnight mail to the Office of Financial Management, U.S. Securities and Exchange Commission, 100 F Street, NE, Mail Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Level Global Investors, L.P. as a Respondent in these proceedings and includes the file number of these proceedings; a copy of that cover letter and money order, check, or wire transfer shall be simultaneously mailed to Linda Berrafati Moran, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010A.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64764 / June 28, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3226 / June 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14444

In the Matter of Brookside Capital, LLC, Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND REMEDIAL SANCTIONS**

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 Brookside Capital, LLC ("Brookside" 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 a Cease-and-Desist Order and Remedial Sanctions ("Order"), as set forth below.

III.

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

Summary

1. These proceedings arise out of a violation of Rule 105 of Regulation M of the Exchange Act by Brookside, a registered investment adviser based in Boston, Massachusetts. Rule 105 prohibits short selling of equity securities during a restricted period prior to a public offering and then purchasing the subject securities in the offering. Brookside violated Rule 105 in June 2009 in connection with certain short sales it effected within the Rule 105 restricted period preceding its participation in a public offering by Lincoln National Corporation Co. ("LNC"), resulting in profits of $1,658,660.

Respondent

2. Brookside Capital, LLC, is a limited liability company organized under Delaware law and headquartered in Boston, Massachusetts. During the relevant time period, Brookside was the investment adviser to Brookside Capital Trading Fund, L.P. ("Brookside Fund"), and the trading described in this Order was conducted by Brookside on behalf of this fund. Brookside Fund is a hedge fund that primarily invests in the securities of public companies. At the end of 2009, Brookside had approximately $11.2 billion in assets under management. Brookside is an investment adviser registered with the Commission, and has been since 2008.

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 "to foster secondary and follow-on offering prices that are determined by independent market dynamics." Id. At 45,094. Rule 105 prohibits

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

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. On Friday, June 12, 2009, Brookside sold short 600,000 shares of LNC at prices ranging between $17.70 and $17.75 per share.

6. On Monday, June 15, 2009, following the close of the market, LNC announced a public secondary offering of common stock (the "Offering"), which was priced after the close of the market on June 16, 2009 at $15 per share.

7. As a result of LNC's offering announcement, Brookside's investment plan concerning LNC changed, and Brookside decided to pursue a long strategy regarding LNC stock.

8. On June 16, 2009, Brookside purchased a total of one million shares of LNC common stock in the Offering at $15.00 per share.

9. Because Brookside sold short shares of LNC for the Brookside Fund during the restricted period and then purchased shares in the Offering, Brookside violated Rule 105. As a result of its violation of Rule 105, Brookside made a profit for the Brookside Fund of $1,633,740 on the shares sold short. In addition, Brookside improperly obtained a benefit for the Brookside Fund of $24,920 from the remaining 400,000 offering shares it received at a discount from LNC's market price. Accordingly, the total profit from participating in the Offering was $1,658,660.

10. At the time of the violation, Brookside had no policies, procedures or controls in place designed to detect or prevent Rule 105 violations.

11. As a result of the conduct described above, Brookside willfully[1] violated Rule 105 of Regulation M of the Exchange Act.

Brookside's Remedial Efforts

12. After Brookside learned of its Rule 105 violation, it developed and implemented policies, procedures and training programs relating to its Rule 105 compliance.

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

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[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)).

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Brookside cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Brookside is censured;

C. Brookside shall within 14 days of the entry of this Order pay disgorgement in the amount of $1,658,660, prejudgment interest in the amount of $90,419, and a civil monetary penalty in the amount of $375,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. 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 sent via overnight mail to the Office of Financial Management, U.S. Securities and Exchange Commission, 100 F St., NE, Mail Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Brookside Capital, LLC as a Respondent in these proceedings and includes the file number of these proceedings; a copy of that cover letter and money order, check, or wire transfer shall be simultaneously mailed to Linda Berrafati Moran, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, D.C. 20549-5010A.

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

June 28, 2011

In the Matter of **International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.),** **International Thoroughbred Breeders, Inc.,** **Internet Marketing, Inc.,** **Intrepid Technology & Resources, Inc.,** **Ion Technology, Inc.,** **Ionic Fuel Technology, Inc.,** **Ipex, Inc. (n/k/a Salus Labs International, Inc.),** **Itemus, Inc., and** **ITIS Holdings, Inc.** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.) because it has not filed any periodic reports since the period ended December 4, 1994.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of International Thoroughbred Breeders, Inc. because it has not filed any periodic reports since the period ended March 31, 2007.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 28, 2011

In the Matter of

International Poultry Co., Inc. (n/k/a Carley Enterprises, Inc.),
International Thoroughbred Breeders, Inc.,
Internet Marketing, Inc.,
Intrepid Technology & Resources, Inc.,
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Ionic Fuel Technology, Inc.,
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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Internet Marketing, Inc. because it has not filed any periodic reports since the period ended December 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities Intrepid Technology & Resources, Inc. because it has not filed any periodic reports since the period ended June 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ion Technology, Inc. because it has not filed any periodic reports since it filed a registration statement on September 10, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ionic Fuel Technology, Inc. because it has not filed any periodic reports since the period ended March 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ipex, Inc. (n/k/a Salus Labs International, Inc.) because it has not filed any periodic reports since the period ended March 31, 2006.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Itemus, Inc. because it has not filed any periodic reports since the period ended December 31, 1999.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ITIS Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2006.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on June 28, 2011, through 11:59 p.m. EDT on July 12, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-64766; File No. S7-25-11]

RIN 3235-AL10

Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing for comment new rules under the Securities Exchange Act of 1934 ("Exchange Act") that are intended to implement provisions of Title VII ("Title VII") of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act") relating to external business conduct standards for security-based swap dealers ("SBS Dealers") and major security-based swap participants ("Major SBS Participants").

DATES: Comments should be received on or before August 29, 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); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-25-11 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-25-11. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Lourdes Gonzalez, Acting Co-Chief Counsel, Joanne Rutkowski, Branch Chief, Cindy Oh, Special Counsel, Office of Chief Counsel, Division of Trading and Markets, at (202) 551-5550, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is proposing Rules 15Fh-1 to 15Fh-6 and 15Fk-1 under the Exchange Act governing certain business conduct requirements for SBS Dealers and Major SBS Participants. The Commission is soliciting comments on all aspects of the proposed rules and will carefully consider any comments received.

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I. Introduction

A. Statutory Framework

On July 21, 2010, the President signed the Dodd-Frank Act into law.[1] Title VII of the Dodd-Frank Act generally provides the Commission with authority to regulate "security-based swaps," the Commodity Futures Trading Commission ("CFTC") with authority to regulate "swaps," and both the CFTC and the Commission with authority to regulate "mixed swaps."[2]

Section 764 of the Dodd-Frank Act amends the Exchange Act by adding new Section 15F.[3] Paragraph (h) of the new section authorizes and requires the Commission

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L.111-203, 124 Stat. 1376 (2010).

2 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." Pub. L. 111-203, 124 Stat. 1376, 1644-1646 (2010). 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. Section 721(c) of the Dodd-Frank Act also 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. Pub. L. 111-203, 124 Stat. 1376, 1658-1672, 1754, 1759 (2010). Finally, Section 712(a) of the Dodd-Frank Act provides that the Commission and CFTC, after consultation with the Federal Reserve, shall jointly prescribe regulations regarding "mixed swaps," as may be necessary to carry out the purposes of Title VII. Pub. L. 111-203, 124 Stat. 1376, 1642 (2010).

3 See Pub. L. 111-203, 124 Stat. 1376, 1789-1792, §764(a) (adding Exchange Act Section 15F). All references to the Exchange Act are to the Exchange Act, as amended by the Dodd-Frank Act.

to adopt rules specifying business conduct standards for SBS Dealers[4] and Major SBS Participants[5] in their dealings with counterparties, including counterparties that are "special entities." "Special entities" are generally defined to include federal agencies, states and their political subdivisions, employee benefit plans as defined under the Employee Retirement Income Security Act of 1974 ("ERISA"), governmental plans as defined under ERISA, and endowments.[6] Congress granted the Commission broad authority to promulgate business conduct requirements, as appropriate in the public

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4 Section 761 of the Dodd-Frank Act amends Section 3(a) of the Exchange Act to add new Exchange Act Section 3(a)(71)(A), which generally defines "security-based swap dealer" as "any person who: (i) holds themself [sic] 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." Pub. L. 111-203, 124 Stat. 1376, 1758, §761.

The Commission and the CFTC are jointly proposing rules and interpretive guidance under the Exchange Act and the Commodity Exchange Act to further define the terms "swap dealer," "security-based swap dealer," "major swap participant," "major security-based swap participant," and "eligible contract participant." See Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant," Exchange Act Release No. 63452 (Dec. 7, 2010), 75 FR 80174 (Dec. 21, 2010) ("Definitions Release").

5 Section 761 of the Dodd-Frank Act amends Section 3(a) of the Exchange Act to add new Exchange Act Section 3(a)(67)(A), which defines "major security-based swap participant" as "any person: (i) who is not a security-based swap dealer; and (ii)(I) who maintains a substantial position in security-based swaps for any of the major security-based swap categories, as such categories are determined by the Commission, excluding both positions held for hedging or mitigating commercial risk and positions maintained by any employee benefit plan (or any contract held by such a plan) as defined in paragraphs (3) and (32) of Section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002) for the primary purpose of hedging or mitigating any risk directly associated with the operation of the plan; (II) whose outstanding security-based swaps create substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets; or (III) that is a financial entity that (aa) is highly leveraged relative to the amount of capital such entity holds and that is not subject to capital requirements established by an appropriate Federal banking regulator; and (bb) maintains a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission." Pub. L. 111-203, 124 Stat. 1376, 1755-1756, §761(a) (to be codified at 15 U.S.C. 78c(a)(67)(A)).

See also Definitions Release, supra note 4.

6 Pub. L. 111-203, 124 Stat. 1376, 1789-1790, §764(a) (to be codified at 15 U.S.C. 78o-10(h)(2)(C)).

interest, for the protection of investors or otherwise in furtherance of the purposes of the Exchange Act.[7]

Section 15F(h)(6) of the Exchange Act directs the Commission to prescribe rules governing business conduct standards for SBS Dealers and Major SBS Participants (collectively, "SBS Entities"). These standards, as described in Exchange Act Section 15F(h)(3), must require an SBS Entity to: verify that a counterparty meets the eligibility standards for an "eligible contract participant" ("ECP"); disclose to the counterparty material information about the security-based swap, including material risks and characteristics of the security-based swap, and material incentives and conflicts of interest of the SBS Entity in connection with the security-based swap; and provide the counterparty with information concerning the daily mark for the security-based swap. Section 15F(h)(3) also directs the Commission to establish a duty for SBS Entities to communicate in a fair and balanced manner based on principles of fair dealing and good faith. Section 15F(h)(1) of the Exchange Act grants the Commission authority to promulgate rules applicable to SBS Entities that relate to, among other things, fraud, manipulation and abusive practices involving security-based swaps (including security-based swaps that are offered but not entered into), diligent supervision of SBS Entities and adherence to all applicable position limits.[8]

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7 See Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(D)) ("[b]usiness conduct requirements adopted by the Commission shall establish such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act"). See also Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(D)) (requiring that SBS Entities comply as well with "such business conduct standards . . . as may be prescribed by the Commission by rule or regulation that relate to such other matters as the Commission determines to be appropriate").

8 The Commission has proposed for comment a new Rule 9j-1 under the Exchange Act, which is intended to prevent fraud, manipulation, and deception in connection with the offer, purchase or sale of any security-based swap, the exercise of any right or performance of any obligation under a security-

Section 15F(h)(4) of the Exchange Act requires that an SBS Dealer that "acts as an advisor to a special entity" must act in the "best interests" of the special entity and undertake "reasonable efforts to obtain such information as is necessary to make a reasonable determination" that a recommended security-based swap is in the best interests of the special entity. Section 15F(h)(5) requires that SBS Entities that offer to or enter into a security-based swap with a special entity comply with any duty established by the Commission that requires an SBS Entity to have a "reasonable basis" for believing that the special entity has an "independent representative" that meets certain criteria and undertakes a duty to act in the "best interests" of the special entity.[9] This provision also requires that an SBS Entity disclose in writing the capacity in which it is acting (e.g., as principal) before initiating a transaction with a special entity.[10]

Section 15F(k) of the Exchange Act requires each SBS Entity to designate a chief compliance officer and imposes certain duties on that person.

B. Consultations

In developing the rules proposed herein, the Commission staff has, in compliance with Sections 712(a)(2)[11] and 752(a)[12] of the Dodd-Frank Act, consulted and coordinated

based swap, or the avoidance of such exercise or performance. Prohibition against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, Exchange Act Release No. 63236 (Nov. 3, 2010), 75 FR 68560 (Nov. 8, 2010). The Commission is separately considering the matter of position limits, and would propose any position limits in a separate rulemaking, as necessary.

9. Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)).

10 Id.

11 Section 712(a)(2) of the Dodd-Frank Act states in part, "the Securities and Exchange Commission shall consult and coordinate to the extent possible with the Commodity Futures Trading Commission and the prudential regulators for the purposes of assuring regulatory consistency and comparability, to the extent possible." Pub. L. 111-203, 124 Stat. 1376, 1641-1642 (to be codified at 15 U.S.C. 8302(a)(2)).

with the CFTC and the prudential regulators.[13] Commission staff also met with persons representing a broad spectrum of views on the proposed rules.[14] These meetings were conducted jointly with CFTC staff. Among the persons who participated in the meetings were other regulators, broker-dealers, consumer and investor advocates, endowments, end-users, financial institutions, futures commission merchants, industry trade groups, investment fund managers, labor unions, pension fund managers, self-regulatory organizations ("SROs"), state and local governments, and swap dealers. We have considered standards or guidance issued by prudential regulators and international organizations, requirements applicable under foreign regulatory regimes, and recommendations for industry "best practices."[15] We have also taken into account the

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12 Section 752(a) of the Dodd-Frank Act states in part that, "[i]n order to promote effective and consistent global regulation of swaps and security-based swaps, the Commodity Futures Trading Commission, the Securities and Exchange Commission, and the prudential regulators (as that term is defined in Section 1a(39) of the Commodity Exchange Act), as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps." Pub. L. 111-203, 124 Stat. 1376, 1749-1750 (to be codified at 15 U.S.C. 8325(a)).

13 "Prudential regulator," as explained in Section 711 of the Dodd-Frank Act, has the meaning given to it in section 1a of the Commodity Exchange Act (7 U.S.C. 1a), including any modification thereof under section 721(b) of the Dodd-Frank Act. Pub. L. 111-203, 124 Stat. 1376, 1641 (to be codified at 15 U.S.C. 8301).

14 A list of Commission staff meetings in connection with this rulemaking is available on the Commission's website under "Meetings with SEC Officials" at http://www.sec.gov/comments/df-title-vii/swap/swap.shtml. In addition, the Commission received several letters from the public, available at http://www.sec.gov/comments/df-title-vii/swap/swap.shtml.

15 See, e.g., Int'l Org. of Securities Commissions, Operational and Financial Risk Management Control Mechanisms for Over-the-Counter Derivatives Activities of Regulated Securities Firms, (July 1994) ("IOSCO Report"); Bank for Int'l Settlements, Basel Committee on Banking Supervision, Risk Management Guidelines for Derivatives (July 1994) ("BIS Report"); Derivatives Policy Group, Framework for Voluntary Oversight (Mar. 1995), http://www.riskinstitute.ch/137790.htm; The Counterparty Risk Management Group, Improving Counterparty Risk Management Practices (June 1999) ("CRMPG I Report"); The Counterparty Risk Management Group, Toward Greater Financial Stability: A Private Sector Perspective. The Report of the Counterparty Risk Management Policy Group II (July 27, 2005) ("CRMPG II Report"); The Counterparty Risk Management Group, Containing Systemic Risk: The Road to Reform, The Report of the CRMPG III (Aug. 6, 2008) ("CRMPG III Report"). In considering industry voluntary best practices, the Commission acknowledges that such best practices were not necessarily intended to establish or guide regulatory standards for which market participants would have legal liability if violated.

more than 70 comments received by the CFTC on its proposed business conduct rules for swap dealers and major swap entities.[16]

The staffs of the Commission and the CFTC have been consulting with the staff of the Department of Labor, and will continue to do so, concerning the potential interface between ERISA and the business conduct requirements of the Dodd-Frank Act. We recognize the importance of the ability of SBS Dealers to offer security-based swaps to special entities that are subject to ERISA, both for dealers and for the pension plans that may rely on security-based swaps to manage risk and reduce volatility.

C. Approach to Drafting the Proposed Rules

1. General Objectives

Section 15F(h) of the Exchange Act provides the Commission with both mandatory and discretionary rulemaking authority. Our intent, in exercising this authority, is to establish a regulatory framework that both protects investors and promotes efficiency, competition, and capital formation.[17] The Commission staff has worked closely with CFTC staff in consulting with the public and in developing the proposed rules, with a view to establishing consistent and comparable requirements for our respective registrants, to the extent possible.[18]

The Commission understands that the proposed rules discussed herein, as well as other proposals that the Commission is considering to implement the Dodd-Frank Act, if

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16 See Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 75 FR 80638 (Dec. 22, 2010) ("CFTC External Business Conduct Release"). Comments received by the CFTC are available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=935.

17 See Section 3(f) of the Exchange Act, 15 U.S.C. 78c(f).

18 See Section I.B, supra.

adopted, could significantly affect — and be significantly affected by — the development of the security-based swaps market in a number of ways. If the Commission adopts rules that are too permissive, for example, they may not adequately protect investor interests or promote the purposes of the Dodd-Frank Act. If, however, the Commission adopts measures that are too onerous, they could unduly limit hedging and other legitimate activities by discouraging participation in security-based swap markets. We are aware that the further development of the security-based swaps market, including in response to rules adopted by the Commission under the Dodd-Frank Act, may alter the calculus for regulation of business conduct of SBS Entities. We urge commenters, as they review the proposed rules, to consider generally the role that regulation may play in the development of the market for security-based swaps, as well as the role that market developments may play in changing the nature and implications of regulation, and to focus in particular on this issue with respect to the proposed business conduct standards for SBS Entities.

2. SRO Rules as a Potential Point of Reference

Under the framework established in the Dodd-Frank Act, SBS Entities are not required to be members of SROs, and no SRO has authority to regulate the activities of an SBS Entity, unless the SBS Entity is otherwise a member of that SRO. Nevertheless, we preliminarily believe that SRO business conduct rules provide a potential point of reference to inform our development of business conduct rules for SBS Entities, for several reasons.[19]

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[19] We have looked, in particular, to the requirements imposed by the Financial Industry Regulatory Authority, Inc., the Municipal Securities Rulemaking Board, and the National Futures Association.

First, a number of the business conduct standards in Section 15F(h) of the Exchange Act, including those regarding fair and balanced communications,[20] supervision,[21] and designation of a chief compliance officer,[22] appear to be patterned on and are consistent with standards that have been established by SROs for their members, with Commission approval.[23]

Second, business conduct standards under SRO rules have been developed over the course of many decades with input from market participants. Many market participants are familiar with these standards and are experienced with implementing them through existing compliance and supervisory controls and procedures. Indeed, if the Commission were to promulgate completely new business conduct standards that deviate in approach from established SRO rules in the same areas, our actions could increase uncertainty and impose burdens on the many market participants already familiar with SRO business conduct standards by requiring them to adapt to and implement a new and different business conduct regime for security based swap transactions.

Third, to the extent that certain SBS Entities may also be registered as broker-dealers, they would be subject to the full panoply of SRO rules, including SRO business

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20 Section 15F(h)(3)C) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(C)). Cf. NASD Rule 2210(d)(1)(A).

21 Section 15F(h)(1)(B) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(B)). Cf. NASD Rules 3010 and 3012.

22 Section 15F(k) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376. 1793 – 1794 (to be codified at 15 U.S.C. 78o-10(k)). Cf. FINRA Rule 3130.

23 The Commission exercises oversight over SROs with respect to their interpretive, rulemaking and enforcement activities. See Section 19 of the Exchange Act, 15 U.S.C. 78s.

conduct rules, with respect to their activities related to security-based swaps.[24] If the Commission were to adopt business conduct standards that differ materially from those imposed by SRO rules, these firms could be required to comply with two different, and potentially inconsistent, business conduct regimes – the Commission's and the SRO's – for the same transaction. Conversely, consistency between the business conduct requirements could reduce potential competitive disparities between SBS Entities that are SRO members and those that are not. Consistent regulatory requirements could also potentially benefit counterparties to SBS Entities, by providing a more uniform level of protection and limiting the confusion or uncertainty that might otherwise arise if substantially different rules were to apply to the same type of transaction based solely on whether the SBS Entity is an SRO member.

At the same time, in considering the business conduct standards that have been developed by SROs, we are mindful that the security-based swap market historically has been primarily an institutional market in which transactions are typically negotiated on a principal-to-principal basis. While there is a wide range of counterparty sophistication within this market, the greater participation of institutional investors in the security-based swap market suggests a potentially different dynamic in the nature of the interactions between SBS Entities and their counterparties. Accordingly, it may be appropriate, for example, for the business conduct requirements applicable to SBS Entities to diverge to some extent from the requirements generally applicable to broker-dealers, whose

24 Because security-based swap transactions are "securities" within the meaning of Section 3(a)(10) of the Exchange Act, broker-dealers would be subject to SRO business conduct and other rules applicable to such transactions. Pub. L. 111-203, 124 Stat. 1376, 1755, §761(a)(2) (to be codified at 15 U.S.C. 78c(a)(10)).

activities may range from principal trading with institutional counterparties to retail brokerage on behalf of individual investors.

In light of these considerations, the Commission is seeking to strike a balance in its use of SRO business conduct standards as a point of reference for the proposed rules. As noted above, one potential benefit of this approach would be to provide greater legal certainty and promote consistent requirements across different types of SBS Entities. That potential benefit would not be achieved if the Commission were to implement, interpret and enforce its business conduct standards in a manner that differs substantially from that of the SROs without grounding such actions in functional differences between the security-based swap market and other securities markets. Thus, absent such functional differences, when a business conduct standard in these proposed rules is based on a similar SRO standard, we would expect – at least as an initial matter – to take into account the SRO's interpretation and enforcement of its standard when we interpret and enforce our rule. At the same time, as noted above, we are not bound by an SRO's interpretation and enforcement of an SRO rule, and our policy objectives and judgments may diverge from those of a particular SRO. Accordingly, we would also expect to take into account such differences in interpreting and enforcing our rules.

We request comment on all aspects of our approach to using business conduct requirements applicable to market professionals (such as broker-dealers and futures commission merchants) under existing SRO rules as a point of reference in developing the business conduct requirements applicable to SBS Entities.

3. Business Conduct Rules Not Expressly Addressed by the Dodd-Frank Act

In addition to business conduct requirements expressly addressed by Title VII of the Dodd-Frank Act, we are proposing for comment certain other business conduct requirements for SBS Dealers that we preliminarily believe would further the principles that underlie the Dodd-Frank Act. These rules would, among other things, impose certain "know your counterparty" and suitability obligations on SBS Dealers, and restrict SBS Dealers from engaging in certain "pay to play" activities.[25]

Know Your Counterparty – Broker-dealers are subject to "know your customer" standards that help to ensure investor protection and fair dealing in securities transactions, both for retail and institutional investors.[26] We preliminarily believe that a "know your counterparty" standard would be consistent with the principles underlying the Dodd-Frank Act. Accordingly, we are proposing, in addition to the rules expressly addressed by Section 15F(h) of the Exchange Act, certain "know your counterparty" requirements for SBS Dealers.[27]

Suitability – Broker-dealers are subject to suitability standards that help to ensure investor protection and fair dealing in securities transactions, both for retail and

[25] The CFTC has recently proposed rules that would impose similar requirements for swap dealers and major swap participants. See CFTC External Business Conduct Release, supra, note 16.

[26] See Notice of Filing of Amendment No. 1 to a Proposed Rule Change and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook, Exchange Act Release No. 63325 (Nov. 17, 2010), 75 FR 71479 (Nov 23, 2010) (effective July 9, 2012) ("Suitability Order").

[27] Proposed Rule 15Fh-3(e), discussed in Section II.C.3, infra.

institutional investors.[28] In addition, the Dodd-Frank Act effectively imposes a suitability requirement on SBS Dealers that, when acting as advisors, make recommendations to special entities.[29] We preliminarily believe that it would be appropriate to extend these protections to certain situations in which an SBS Dealer is entering into a security-based swap with a counterparty that is not a special entity. Accordingly, we are proposing certain suitability requirements for SBS Dealers when making recommendations to counterparties.[30]

Pay to Play – We are also proposing pay to play restrictions for SBS Dealers that are intended to complement the restrictions applicable to other market intermediaries seeking to engage in securities transactions with municipal entities. As explained more fully in Section II.D.5, pay to play practices, in which elected officials may allow political contributions to play a role in the selection of financial services providers, distort the process by which public contracts are awarded. Concerns about pay to play practices in the municipal securities and investment adviser contexts have prompted the promulgation of pay to play restrictions for those market professionals.[31] We are concerned that similar

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28 See Suitability Order, supra.

29 Section 15F(h)(4)(C) of the Exchange Act ("Any security-based swap dealer that acts as an advisor to a special entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any security-based swap recommended by the security-based swap dealer is in the best interests of the special entity"). Pub. L. 111-203, 124 Stat. 1376, 1790 – 1791 (to be codified at 15 U.S.C. 78o-10(h)(4)(C)).

30 Proposed Rule 15Fh-3(f), discussed in Section II.C.4, infra. The suitability obligation would not apply if the counterparty is an SBS Entity or a swap dealer or major swap participant. In addition, the proposed rule would include an alternative similar to the FINRA "institutional suitability" exemption, as described more fully below.

31 See Rule 205(4)-5 under the Investment Advisers Act of 1940 (applying pay to play restrictions to investment advisers), and MSRB Rule G-37 (which seeks to eliminate pay to play practices in the municipal securities market through restrictions on political contributions and prohibitions on municipal securities business).

pay to play practices could distort the market for securities-based swap transactions.[32] These abuses encourage corrupt market practices, and can harm municipal entities that subsequently enter into inappropriate security-based swaps.[33] Because certain SBS Dealers may not be covered by other pay to play rules already in effect, we are proposing for comment here pay to play rules intended to create a comparable regulatory framework with respect to those SBS Dealers. Given the similarity of pay to play practices across various contexts, and to facilitate compliance, we are proposing pay to play rules that are intended to be consistent with existing pay to play rules, to the extent practicable.

We request comment on all aspects of our proposal to impose certain limited business conduct requirements not expressly addressed by the Dodd-Frank Act.

4. Differences Between SBS Dealers and Major SBS Participants

We have also considered how the differences between the definitions of SBS Dealer and Major SBS Participant may be relevant in formulating the business conduct

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[32] For example, the Commission has brought a number of actions in connection with payments by J.P. Morgan Securities Inc. to local firms whose principals or employees were friends of Jefferson County, Alabama public officials in connection with $5 billion in County bond underwriting and interest rate swap agreement business awarded to the broker-dealer. The Commission has alleged that J.P. Morgan Securities engaged in pay to play practices in connection with obtaining municipal security underwriting and interest swap agreement business from municipalities. The Commission has alleged that J.P. Morgan Securities incorporated certain of the costs of these payments into higher swap interest rates it charged the County, directly increasing the swap transaction costs to the County and its taxpayers. See SEC v. Larry P. Langford, Litigation Release No. 20545 (Apr. 30, 2008) and SEC v. Charles E. LeCroy, Litigation Release No. 21280 (Nov. 4, 2009) (charging Alabama local government officials and J.P. Morgan employees with undisclosed payments made to obtain municipal bond offering and swap agreement business from Jefferson County, Alabama). See also J.P. Morgan Securities Inc., File No. 3-13673 (Nov. 4, 2009) (instituting administrative and cease-and-desist proceedings against a broker-dealer that allegedly was awarded bond underwriting and interest rate swap agreement business by Jefferson County in connection with undisclosed payments by employees of the firm).

[33] See also Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 3043 (July 1, 2010), 75 FR 41018 (July 14, 2010) (describing concerns that led to adoption of Advisers Act Rule 206(4)-5); Alexander W. Butler, Larry Fauver, and Sandra Mortal, Corruption, Political Connections, and Municipal Finance, 22 The Review of Financial Studies 2873 (2009) (describing effect of pay to play practices on greater credit risk, higher bond yields and underwriting premium fees in municipal bond sales and underwriting).

standards applicable to these entities. The Dodd-Frank Act defines "security-based swap dealer" in a functional manner, by reference to the way a person holds itself out in the market and the nature of the conduct engaged in by that person, and how the market perceives the person's activities.[34] As described in our joint proposal with the CFTC regarding this definition:

> [S]wap 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. 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.[35]

The definition of "major security-based swap participant," in contrast, focuses on the market impacts and risks associated with an entity's security-based swap positions.[36]

Despite the differences in focus, the Dodd-Frank Act applies substantially the same statutory standards to SBS Dealers and Major SBS Participants.[37] We have

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34 See note 4, supra (definition of "security-based swap dealer").

35 Definitions Release (using "swap dealer" to refer both to security-based swap dealer and to swap dealer).

36 As explained in the Definitions Release, the "major security-based swap participant" definition uses terms – particularly "systemically important," "significantly impact the financial system," and "create substantial counterparty exposure" – that denote a focus on entities that pose a high degree of risk through their 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").

37 In particular, under Section 15F of the Exchange Act, SBS Dealers and Major SBS Participants generally are subject to the same types of margin, capital, business conduct and certain other

attempted to take into account these differing definitions and regulatory concerns in considering whether the business conduct requirements that we are proposing for SBS Dealers that are not expressly addressed by the statute should or should not apply to Major SBS Participants as well.[38] In general, where the Dodd-Frank Act imposes a business conduct requirement on both SBS Dealers and Major SBS Participants, we have proposed rules that would apply equally to SBS Dealers and Major SBS Participants. Where, however, a business conduct requirement is not expressly addressed by the Dodd-Frank Act, the proposed rules generally would not apply to Major SBS Participants.[39]

We request comment on whether this approach is appropriate. Where the Dodd-Frank Act requires that a business conduct rule apply to all SBS Entities, should the rule impose the same requirements on Major SBS Participants as on SBS Dealers? Where we are proposing rules for SBS Dealers that are not expressly addressed by the Dodd-Frank Act, should any of these rules apply as well to Major SBS Participants? If so, which rules and why?

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requirements, unless an exclusion applies. In this way, the statute applies comprehensive regulation to entities (i.e., Major SBS Participants) whose 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. See Pub. L. 111-203, 124 Stat. 1376, 1785-1796 (to be codified at 15 U.S.C. 78o-10).

[38] See Section I.C.4, infra.

[39] There are exceptions to this principle. We are proposing that all SBS Entities be required to determine if a counterparty is a special entity. In addition, Section 3C(g)(5) of the Exchange Act creates certain rights with respect to clearing for counterparties entering into security-based swaps with SBS Entities but does not require disclosure. We are proposing a rule that would require an SBS Entity to disclose to a counterparty certain information relating to these rights. See Pub. L. 111-203, 124 Stat. 1376, 1766 - 1767 (to be codified at 15 U.S.C. 78c-3(g)(5)). The proposed rule is intended to further the purposes of the Dodd-Frank Act to ensure that, wherever possible and appropriate, derivatives contracts formerly traded exclusively in the OTC market are cleared through a regulated clearing agency.

5. Treatment of Special Entities

Congress has provided certain additional protections in the Dodd-Frank Act for "special entities" – including certain municipalities, pension plans, and endowments – in connection with security-based swaps. In particular, as described in Section II.D below, Sections 15F(h)(4) and (5) of the Exchange Act, as amended by the Dodd Frank Act, establish a set of additional provisions addressed solely to the interactions between SBS Entities and special entities in connection with security-based swaps.

Some commenters have noted that special entities, like other market participants, may use swaps and security-based swaps for a variety of beneficial purposes, including risk management and portfolio adjustment.[40] For example, we understand that pension plans can be authorized to use such instruments in order to meet the investment objectives of their members.[41] At the same time, some commenters have also noted that

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[40] As explained by one commenter:

> "Swaps permit [pension] plans to hedge against market fluctuations, interest rate changes, and other factors that create volatility and uncertainty with respect to plan funding. Swaps also help plans rebalance their investment portfolios, diversify their investments, and gain exposure to particular asset classes without direct investments. By helping to protect plan assets as part of a prudent long-term investment strategy, swaps benefit the millions of participants who rely on these plans for retirement income, health care, and other important benefits."

Letter from Mark J. Ugoretz, President and CEO, The ERISA Industry Committee to David A. Stawick, Secretary, CFTC (Feb. 22, 2011).

[41] See, e.g., Letter from Joseph A. Dear, Chief Investment Officer, California Public Employees' Retirement System et al. to David A. Stawick, Secretary, CFTC (Feb. 18, 2011) (the "Public Pension Funds Letter"):

> To fulfill obligations to our members, we invest in a wide variety of assets classes, including alternative investment management, global equity, global fixed income, inflation-linked assets, and real estate. As part of our investment and risk management policies, we have authorized the use of certain derivates. The authorized derivatives include futures, forward, swaps, structured notes and options.

the financial sophistication of these entities can vary greatly.[42] Such variation in sophistication, among other factors, has raised concerns about potential abuses in connection with security-based swap transactions with special entities.[43]

In implementing the special entity provisions of the Dodd-Frank Act, we have sought to give full effect to the additional protections for these entities contemplated by the statute, while not imposing restrictions on SBS Entities that would unduly limit their willingness or ability to provide special entities with the access to security-based swaps that special entities may need for risk management and other beneficial purposes. We request comment on all aspects of the approach to special entities described in this release.

II. Discussion of Proposed Rules Governing Business Conduct

The proposed rules would implement the requirements of the Dodd-Frank Act relating to business conduct standards for SBS Entities.

A. Scope: Proposed Rule 15Fh-1

Proposed Rule 15Fh-1 provides that proposed Rules 15Fh-1 through 15Fh-6 and Rule 15Fk-1 are not intended to limit, or restrict, the applicability of other provisions of the federal securities laws, including but not limited to Section 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 9 and 10(b) of the Exchange Act, and the rules and

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42 See, e.g., Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, Lisa Donner, Executive Director, Americans for Financial Reform, Michael Greenberger, J.D., Founder and Director of University of Maryland Center for Health and Homeland Security, and Damon Silvers, Director of Policy and Special Counsel, AFL-CIO to David A. Stawick, Secretary, CFTC (Feb. 22, 2011).

43 See, e.g., 156 Cong. Rec. S5903 (daily ed. Jul. 15, 2010) (statement of Sen. Lincoln) (discussing how "pension plans, governmental investors, and charitable endowments were falling victim to swap dealers marketing swaps and security-based swaps that they knew or should have known to be inappropriate or unsuitable for their clients. Jefferson County, AL, is probably the most infamous example, but there are many others in Pennsylvania and across the country.").

regulations thereunder.[44] It also provides that proposed Rules 15Fh-1 through 15Fh-6 and Rule 15Fk-1 would not only apply in connection with entering into security-based swaps but also would continue to apply, as relevant, over the term of executed security-based swaps. Specifically, as discussed more fully herein, an SBS Entity's obligations under proposed Rules 15Fh-3(c) (daily mark) and 15Fh-3(g) (fair and balanced communications) would continue to apply over the life of a security-based swap. In addition, SBS Entities would be subject to ongoing obligations under proposed Rules 15Fh-3(h) (supervision) and 15Fk-1 (chief compliance officer). The proposed rules would not, however, apply to security-based swaps executed prior to the compliance date of these rules.

<u>Request for Comments</u>

The Commission requests comments generally on all aspects of proposed Rule 15Fh-1 and the scope of the proposed business conduct rules. In addition, we request comment on the following specific issues:

- Should any rule proposed by this release specify in greater detail the manner in which its disclosure or other requirements apply to associated persons?[45] If so, for which rules would such clarification be helpful? How should the Commission apply the requirements of such rules to the associated person?
- Should the proposed rules apply to transactions between an SBS Entity and its affiliates? If so, which rules? Why or why not?

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44 Section 15F(h) of the Exchange Act does not, by its terms, create a new private right of action or right of rescission, nor do we anticipate that the proposed rules would create any new private right of action or right of rescission.

45 As described below, proposed Rule 15Fh-2(d) would provide that the term "security-based swap dealer or major security-based swap participant" would include, "where relevant," an associated person of the SBS Entity in question.

- Should any rules proposed by this release, such as those relating to the daily mark or fair and balanced communications, apply to security-based swaps that were entered into prior to the effective date of these rules? If so, which rules and why?
- Should any of the proposed rules apply to amendments, made after the effective date of these rules, to security-based swaps that were entered into prior to the effective date of the rules? If so, which rules and why?
- Are there any specific interactions or relationships between the proposed rules and existing federal securities laws that should be addressed? Are there any specific interactions or relationships between the proposed rules and other regulatory requirements, such as SRO rules, that should be addressed? Are there any specific interactions or relationships between the proposed rules and other existing non-securities statutes and regulations (e.g., ERISA) that should be addressed? If so, how should those interactions or relationships be clarified?
- To the extent any of the rules proposed herein are intended to provide additional protections for a particular counterparty, should the counterparty be able to opt out of those protections? Should the ability to opt out be limited to certain types of counterparties? Why or why not? What criteria should determine or inform the decision to permit a counterparty to opt out? For example, should opt out be permitted when a counterparty is a regulated entity such as a registered broker-dealer? A registered futures commission merchant? A bank? Should opt out be permitted when a counterparty meets certain objective standards, such as being a "qualified institutional buyer" within the meaning of Rule 144A under the

Securities Act?[46] Why or why not? What other standards, if any, should the Commission consider? What would be the advantages and disadvantages of permitting a counterparty to opt out? What are the reasons that a counterparty might want to opt out of protections provided by the proposed business conduct standards? For example, would permitting counterparties to opt out lower costs? Would these reasons vary among different types of counterparties? Would counterparties have a meaningful opportunity to elect whether or not to opt out of these protections, or would they face commercial or other pressure from SBS Entities that could curtail their choice? How would permitting counterparties to opt out affect the protections otherwise afforded by the proposed rules to the counterparties of SBS Entities? How would the overall effectiveness of a proposed rule be affected if a substantial population of counterparties opts out of that rule?

- As discussed below in Section II.E, proposed Rule 15Fk-1 would require an SBS Entity to have policies and procedures reasonably designed to achieve compliance with Section 15F and the rules and regulations thereunder. Should an SBS Entity be deemed to have complied with a requirement under the proposed rules if: (i) the SBS Entity has established and maintained written policies and procedures, and a documented system for applying those policies and procedures, that are reasonably designed to achieve compliance with the requirement; and (ii) the SBS

[46] See Rule 144A(a), 17 CFR 230.144A(a) (defining "qualified institutional buyer"). See Letter from Kenneth E. Bensten, Jr., Executive Vice President, Public Policy and Advocacy, SIFMA, and Robert C. Pickel, Executive Vice Chairman, ISDA to David A. Stawick, Secretary, CFTC (Feb. 17, 2011) (on file with Commission) ("SIFMA/ISDA 2011 Letter") (recommending that Commission permit opt out by "sophisticated counterparties," including "'qualified institutional buyers' as defined in Rule 144A . . . and corporations having total assets of $100 million or more").

Entity has reasonably discharged the duties and obligations required by the written policies and procedures and documented system and did not have a reasonable basis to believe that the written policies and procedures and documented system were not being followed? Why or why not? Please explain the advantages or disadvantages of this approach to the extent it results in rules that effectively require SBS Entities to maintain and enforce specified policies and procedures regarding certain conduct, rather than rules that directly require, or prohibit, that conduct. Would this approach be appropriate for certain specific requirements of the rules but not for others? Why or why not? Would such an approach encourage or discourage compliance with the requirements under the proposed rules? Would the behavior of SBS Entities or the way in which they design their compliance programs be different under this approach than it would be under the rules as proposed? How would the effectiveness of such an approach compare to the effectiveness of the rules as proposed in implementing the requirements of the Dodd-Frank Act regarding the business conduct of SBS Entities, especially with respect to special entities? Would such an approach affect the ability of the Commission to inspect for compliance with the rules or to bring enforcement actions regarding violations? If so, how?

- As discussed herein, we preliminarily believe that, absent special circumstances, it would be appropriate for SBS Entities to rely on counterparty representations in connection with certain specific requirements under the proposed rules. To solicit input on when it would no longer be appropriate for an SBS Entity to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Entity to rely on a representation from a counterparty unless it knows that the representation is not accurate. The second would permit an SBS Entity to rely on a representation unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation. Should the rules that the Commission ultimately adopts include a standard addressing the circumstances in which an SBS Entity may rely on representations to establish compliance with the proposed rules? Why or why not?

B. Definitions: Proposed Rule 15Fh-2

Proposed Rule 15Fh-2(a), as discussed in Section II.D.3 below, would define "act as an advisor" for purposes of Section 15F(h)(4) of the Exchange Act and proposed Rule 15Fh-4(b).

Proposed Rule 15Fh-2(b) would define "eligible contract participant" to mean any person defined in Section 3(a)(66) of the Exchange Act.

Proposed Rule 15Fh-2(c), as discussed in Section II.D.4.b. below, would define "independent representative of a special entity" for purposes of Section 15F(h)(5) of the Exchange Act and proposed Rule 15Fh-5.

Proposed Rule 15Fh-2(d) would provide that "security-based swap dealer or major security-based swap participant" would include, where relevant, an associated person of the SBS Dealer or Major SBS Participant.[47] To the extent that an SBS Entity

[47] See Section 3(a)(70) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1757-1758 (to be codified at 15 U.S.C. 78c(a)(70)) (defining "Person Associated with a Security-Based Swap Dealer or Major Security-Based Swap Participant").

acts through, or by means of, an associated person of that SBS Entity, the associated person must comply as well with the applicable business conduct standards.[48]

Proposed Rule 15Fh-2(e), as discussed in Section II.D.1 below, would define "special entity."

Proposed Rule 15Fh-2(f), as discussed in Section II.D.4.e below, would define a person that is "subject to a statutory disqualification" to mean a person that would be subject to a statutory disqualification under the provisions of Section 3(a)(39) of the Exchange Act.

Request for Comments

The Commission requests comments generally on all aspects of proposed Rule 15Fh-2. In addition, we request comments on the following specific issues:

- Are there additional terms that should be defined by the Commission; if so, how should such terms be defined and why?[49]
- Should the proposed rules expressly identify the requirements that apply to associated persons of an SBS Entity? If so, which rules and why?
- Is it possible that an associated person that is an entity (i.e., not a natural person) that effects or is involved in effecting security-based swaps on behalf of an SBS Entity would be subject to a statutory disqualification? If so, should the Commission consider excepting any such persons from the prohibition in Section 15F(b)(6)? Under what circumstances and why? Should the Commission except

48 See Section 20(b) of the Exchange Act, 15 U.S.C. 78t(b) ("It shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.").

49 The Commission is proposing to define certain additional terms solely for purposes of proposed Rules 15Fh-6 and 15Fk-1. See proposed Rules 15Fh-6(a) and 15Fk-1(c).

such persons globally or on an individual basis?

- Are there certain statutorily disqualified persons who should not be permitted to remain associated with an SBS Entity based upon the nature of the disqualification?
- Should there be any differentiation in relief based upon the nature of the person, e.g., a natural person or an entity? If so, when and why?

C. Business Conduct Requirements: Proposed Rule 15Fh-3

1. Counterparty Status

Proposed Rule 15Fh-3(a)(1) would require an SBS Entity, as provided by Section 15F(h)(3)(A) of the Exchange Act, to verify that a counterparty whose identity is known to an SBS Entity prior to the execution of the transaction meets the eligibility standards for an ECP before entering into a security-based swap with that counterparty other than on a registered national securities exchange.[50] Although the statute is silent concerning the timing of the verification, we believe it is important for an SBS Entity to verify ECP status before entering into a security-based swap because, among other things, Section 6(l) of the Exchange Act makes it unlawful to effect a transaction in a security-based swap with or for a person that is not an ECP, unless the transaction is effected on a registered national securities exchange.[51] In addition, proposed Rule 15Fh-3(a)(1)

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50 See Section 15F(h)(3)(A) of the Exchange Act (requiring the Commission to establish a duty for an SBS Entity to verify that its counterparty meets the eligibility requirements of an ECP). Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(A). Under Exchange Act Section 3(a)(65), the term "eligible contract participant" has the same meaning as in Section 1a of the Commodity Exchange Act (7 U.S.C. 1a). Pub. L. 111-203, 124 Stat. 1376, 1755 (to be codified at 15 U.S.C. 78c(a)(65)). See also Definitions Release (proposing to further define "eligible contract participant" to include, among others, swap dealers, major swap participants, security-based swap dealers and major security-based swap participants).

51 Pub. L. 111-203, 124 Stat. 1376, 1777, § 764(e) (to be codified at 15 U.S.C. 78f(l)) ("[i]t shall be unlawful for any person to effect a transaction in a security-based swap with or for a person that is not

would not require an SBS Entity to verify the ECP status of a counterparty in a transaction executed on a registered national securities exchange or a registered security-based swap execution facility ("SEF"). Such verification would not be necessary because, under proposed Rule 809, SEFs may not provide access to entities that are not ECPs, and thus an SBS Entity could effectively rely on the verification of ECP status by a SEF or any broker or SBS Dealer indirectly providing access.[52]

Proposed Rule 15Fh-3(a)(2) would require an SBS Entity to verify whether a counterparty whose identity is known to an SBS Entity prior to the execution of the transaction is a special entity before entering into a security-based swap with that counterparty.[53] Although the Dodd-Frank Act does not specifically require an SBS Entity to verify whether a counterparty is a special entity, we preliminarily believe that such verification would facilitate the implementation of the special business conduct rules under the Dodd-Frank Act that apply to SBS Entities dealing with special entities.[54]

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an eligible contract participant, unless such transaction is effected on a [registered] national securities exchange"). See also Pub. L. 111-203, 124 Stat. 1376, 1801, § 768(b) (to be codified at 15 U.S.C. 77e(d)) ("unless a registration statement meeting the requirements of section 10(a) [of the Securities Act] is in effect as to a security-based swap, it shall be unlawful for any person . . . to offer to sell, offer to buy or purchase or sell a security-based swap to any person who is not an eligible contract participant").

52 Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposed Rule 809 would permit, but not require SEF participation "only if such person is registered with the Commission as a security-based swap dealer, major security-based swap participant, or broker (as defined in section 3(a)(4) of the Act, 15 U.S.C. 78c(a)(4)), or if such person is an eligible contract participant (as defined in section 3(a)(65) of the Act, 15 U.S.C. 78c(a)(65)).").

53 See generally Section 15F(h)(1)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(D)) (authorizing the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate").

54 See Section II.D, infra. Because proposed Rule 15Fh-3(a)(2) would only apply when an SBS Entity knows the identity of its counterparty prior to the execution of a transaction, it is consistent with Section 15F(h)(7) of the Exchange Act, which contemplates an exception to all of the various business conduct requirements of Section 15F(h) for any transaction that is initiated by a special entity on an

We believe that SBS Entities may satisfy these proposed verification requirements through any reasonable means.[55] For example, an SBS Entity could verify that a counterparty is an ECP by obtaining a written representation from the counterparty. We preliminarily believe that it would not be reasonable for an SBS Entity to rely on a representation that merely states that the counterparty is an ECP because the counterparty may not be familiar with the definitions of the term under the federal securities laws. However, it would be reasonable for an SBS Entity to rely on a written representation as to specific facts about the counterparty (e.g., that it has $10 million in assets) in order to conclude that the counterparty is an ECP.

Similarly, we preliminarily believe that it would not be reasonable for an SBS Entity to rely on a representation that merely states that the counterparty is not a "special entity" because the counterparty may not be familiar with the definition of the term under the federal securities laws. However, an SBS Entity could verify that a counterparty is not a special entity by obtaining a written representation from the counterparty that it does not fall within any of the enumerated categories of persons that are "special entities" for purposes of Section 15F of the Exchange Act (e.g., that the counterparty is not a municipality, pension plan, etc.). In the context of either the ECP or the special entity verification , an SBS Entity would be entitled to rely on a counterparty's written

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exchange or SEF, where the SBS Entity does not know the identity of the counterparty to the transaction.

[55] The SBS Entity must keep records of its verification. See proposed Rule 15Fk-1, discussed infra at Section II.E, which would require an SBS Entity to have written policies and procedures and maintain records sufficient to enable its chief compliance office to verify compliance with the requirements of the proposed rules. In addition, the Commission is required to propose a rule regarding reporting and recordkeeping requirements for SBS Entities. See Section 15F(f)(2) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1788 (to be codified at 15 U.S.C. 78o-10(f)(2)) ("The Commission shall adopt rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants").

representation for purposes of compliance with Rule 15Fh-3(a) without further inquiry, absent special circumstances described below.[56]

To solicit input on when it would no longer be appropriate for an SBS Entity to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Entity to rely on a representation from a special entity for purposes of Rule 15Fh-3(a) unless it knows that the representation is not accurate. The second would permit an SBS Entity to rely on a representation unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation.

Under either approach, an SBS Entity could not ignore information in its possession as a result of which the SBS Entity would know that a representation is inaccurate.[57] In addition, under the second approach, an SBS Entity also could not ignore information that would cause a reasonable person to question the accuracy of a representation and, if the SBS Entity had such information, it would need to make further reasonable inquiry to verify the accuracy of the representation.[58]

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56 An SBS Entity would not be required to obtain a representation from the counterparty and so could elect to verify the counterparty's status through any other reasonable means.

57 As described infra, proposed Rule 15Fh-3(e) would require an SBS Dealer to have policies and procedures reasonably designed to obtain and retain certain essential facts regarding a counterparty. As a result, information in the SBS Entity's possession would include information gathered by an SBS Dealer through compliance with the "know your counterparty" provisions of proposed Rule 15Fh-3(e), as well as any other information the SBS Entity has acquired through its interactions with the counterparty including other representations obtained from the counterparty by the SBS Entity.

58 Cf. Rule 144A(d)(1)(iv) under the Securities Act, 17 CFR 230.144A(d)(1)(iv) (providing that in determining whether a prospective purchaser is a qualified institutional buyer, a seller of securities is entitled to rely on a certification by an executive officer of the purchaser with respect to the amount of securities owned and invested on a discretionary basis). The Commission, in its release adopting Rule 144A, explained that "[u]nless circumstances exist giving a seller reason to question the veracity of the certification, the seller would not have a duty of inquiry to verify the certification." Private Resales of Securities to Institutions, Securities Act Release No. 6862 (April 27, 1990), 55 FR 17933 (Apr. 30, 1990). Cf. also Short Sales, Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (Aug. 6, 2004) at n. 58 (explaining that a broker-dealer can rely on a customer's assurance to establish the

An SBS Entity that has complied with the requirements of proposed Rule 15Fh-3(a)(1) concerning a counterparty's eligibility for a particular security-based swap would fulfill its obligations under the proposed rule for that security-based swap, even if the counterparty subsequently ceases to meet the eligibility standards for an ECP during the term of that security-based swap. However, verification of a counterparty's status as an ECP (and, as applicable, as a special entity) for one security-based swap would not necessarily satisfy the SBS Entity's obligation with respect to other security-based swaps executed with that counterparty in the future. An SBS Entity would need to verify the counterparty's status for each subsequent security-based swap (which it could do by relying on written representations from the counterparty, as described above). An SBS Entity could satisfy this obligation by relying on a representation in a master or other

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"reasonable grounds" required by Rule 203(b)(1)(ii) unless the broker-dealer "knows or has reason to know" that a customer's prior assurances resulted in failures to deliver).

Under Regulation R, a bank or a broker-dealer satisfies its customer eligibility requirements if the bank or broker-dealer ''has a reasonable basis to believe that the customer'' is an institutional customer or high net worth customer before the time specified in the rule. When adopting Regulation R, the Commission stated that a bank or broker-dealer would have a ''reasonable basis to believe'' if it obtains a signed acknowledgment that the customer met the applicable standards, unless it had information that would cause it to believe that the information provided by the customer was or was likely to be false. Definitions of Terms and Exemptions Relating to the ''Broker'' Exceptions for Banks, Exchange Act Release No. 56501 (Sep. 28, 2007), 72 FR 56514 (Oct. 3, 2007).

Commenters have suggested a similar approach. See SIFMA/ISDA 2011 Letter (suggesting that an SBS Entity should be able to rely on written representations by the counterparty "absent actual notice of countervailing facts (or facts that reasonably should have put the [SBS Entity] on notice)").

We note that Congress used similar language in the statutory provisions governing registration of SBS Entities. See Section 15F(b)(6) of the Exchange Act. Pub. L. 111-203, 124 Stat. 1376, 1785 (to be codified at 15 U.S.C. 78o-10(b)(6)) (generally making it unlawful for an SBS Entity to permit an associated person that is subject to a statutory disqualification to effect or participate in effecting security-based swaps on behalf of the SBS Entity if the SBS Entity "knew, or in the exercise of reasonable care should have known," of the statutory disqualification).

agreement that is deemed to be repeated and incorporated into each security-based swap under that agreement as of the date on which each security-based swap is executed.[59]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Although we are proposing to require that an SBS Entity verify that a counterparty is an ECP, we are not proposing at this time to require that the SBS Entity otherwise determine that a potential counterparty is "qualified" to engage in security-based swaps before entering into a security-based swap with that person.[60] Given that the Dodd-Frank Act permits any ECP to engage in security-based swaps, would it be appropriate for the Commission to limit which ECPs may engage in security-based swaps? Should the Commission impose an additional requirement that an SBS Entity determine that an ECP is otherwise "qualified" before the SBS Entity can enter into security-based swaps with such ECP? If so, what qualifications should be applied, and to which types of ECPs? For example, the definition of ECP includes persons with $5 million or more invested on a discretionary basis that enter into the security-based swap "to

[59] See, e.g., SIFMA/ISDA 2011 Letter (suggesting that an SBS Entity should be able to rely on a master agreement that contains (1) a counterparty eligibility representation that is deemed to be made at the inception of each transaction and (2) a covenant that the counterparty will notify the SBS Entity if it ceases to be an ECP).

[60] Cf. FINRA Rule 2360(16)(A) (providing that no member or person associated with a member shall accept an order from a customer to purchase or write an option contract unless, among other things, the customer's account has been approved for options trading).

manage risks."[61] In contrast, under FINRA rules, "retail customers" would include persons (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of up to $50 million.[62] To what extent do natural persons and institutions with assets of less than $50 million engage in security-based swap transactions? Would the "know your counterparty" and suitability obligations of an SBS Dealer under proposed Rule15Fh-3(e) and (f), as described more fully below, help to mitigate concerns regarding these persons?

- Are there alternative approaches that would be feasible in terms of market practice for determining ECP and special entity status? If so, what would be the advantages and disadvantages of these approaches for SBS Entities and counterparties? Should the Commission, for example, establish specific documentation requirements or procedures that could be used to verify ECP or special entity status? Should specific types of documentation be required? If so, what types of documentation (e.g., bank or brokerage statements, legal entity filings)?
- Should the Commission otherwise specify the means by which SBS Entities should verify the status of a counterparty? If so, what means should it require?
- What are the advantages and disadvantages of the two alternative proposed approaches for determining when an SBS Entity may no longer rely on counterparty representations? Which alternative would strike the better balance

[61] A natural person with $5 million or more invested on a discretionary basis would qualify as an ECP if he or she entered into a security-based swap "to manage risks." See Section 1a(18)(A)(xi) of the Commodity Exchange Act.

[62] Under FINRA rules, unless a person had total assets of at least $50 million, a broker-dealer engaging in transactions with that person would be subject to retail suitability obligations. See FINRA Rule 2111(b) (referring to NASD Rule 3110(c)(4)).

among the regulatory interest in the verification of ECP and special entity status, the sound functioning of the security-based swap market, and the potential compliance costs for market participants? What, if any, other alternatives should the Commission consider (e.g., a recklessness standard) and why?

- In light of the additional protections that are afforded special entities under the Dodd-Frank Act described in Section I.C.5 above, should an SBS Entity be required to undertake diligence or further inquiry in ascertaining the special entity status of a potential counterparty before it can rely on any representation as to such status from the counterparty? Why or why not? If such diligence or inquiry is not required, should an SBS Entity be permitted to rely on representations as to special entity status from a counterparty only where the SBS Entity does not have information that would cause a reasonable person to question the accuracy of the representation? Why or why not? Would requiring such diligence or further inquiry – or allowing reliance on representations only in such a manner – unduly limit the willingness or ability of SBS Entities to provide special entities with the access to security-based swaps for the purposes described in Section I.C.5 above? Why or why not? What, if any, other measures should be required in connection with an SBS Entity's verification of a counterparty's special entity status?
- Are there particular classes of ECPs or special entities for which an SBS Entity should be required to undertake further review or inquiry, rather than rely on written representations to verify status? Should further review or inquiry be required when, for example, a potential counterparty is a natural person or a

special entity? If so, what review or inquiry should be required and, in what circumstances?

- Are there other potentially reasonable means or procedures that an SBS Entity might use to verify ECP or special entity status, other than through written representations, as to which the Commission should consider providing guidance? If so, what means or procedures should such guidance address, and how?

2. Disclosure

Section 15F(h)(3)(B) of the Exchange Act broadly requires the Commission to adopt rules requiring disclosures by SBS Entities to counterparties of information related to "material risks and characteristics" of the security-based swap, "material incentives or conflicts of interest" that an SBS Entity may have in connection with the security-based swap, and the "daily mark" of a security-based swap.

a. Disclosure not Required When the Counterparty is an SBS Entity or a Swap Dealer or a Major Swap Participant

Section 15F(h)(3)(B) further provides that disclosures under that section are not required when the counterparty is "a security-based swap dealer, major security-based swap participant, security-based swap dealer, or major security-based swap participant."[63] We believe that the repetition of the terms "security-based swap dealer and major security-based swap participant" in this Exchange Act provision is a drafting error, and that Congress instead intended an exclusion identical to that found in the Commodity Exchange Act, which provides that these general disclosures are not required when the counterparty is "a swap dealer, major swap participant, security-based swap dealer, or

[63] Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(B)).

major security-based swap participant."[64] Accordingly, we are proposing that the disclosure requirements under Rule 15Fh-3(b) (information about material risks and characteristics, and material incentives or conflicts of interests), Rule 15Fh-3(c) (the daily mark), and Rule 15Fh-3(d) (clearing rights) not apply whenever the counterparty is an SBS Dealer, a Major SBS Participant, a swap dealer or a major swap participant.[65]

Request for Comments

The Commission requests comments generally on all aspects of this exception. In addition, we request comments on the following specific issues:

- Should some or all of the disclosure requirements under proposed Rule 15Fh-3(b) (information about material risks and characteristics, material incentives or conflicts of interests), Rule 15Fh-3(c) (the daily mark), and Rule 15Fh-3(d) (clearing rights) apply when the counterparty is an SBS Entity, swap dealer or major swap participant? Why or why not? For example, we are not proposing to require that an SBS Entity provide a daily mark to a counterparty that is an SBS Entity, swap dealer or major swap participant, because we preliminarily believe that a counterparty that falls into one of these categories would be able to perform the function on its own. Nevertheless, would there be some advantage in requiring such counterparties to exchange their respective marks, on a daily basis, so that any discrepancies are more transparent and can be identified and addressed promptly? Why or why not? Would there be disadvantages to this approach? Why or why not? Similarly, would there be any advantage in requiring any of the

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64 Pub. L. 111-203, 124 Stat. 1376, 1708 (to be codified at 7 U.S.C. 6s(h)(3)(B)).

65 But see proposed Rule 15Fh-1 (the proposed rules "are not intended to limit, or restrict, the applicability of other provisions of the federal securities laws, including but not limited to, Section 17(a) of the Securities Act of 1933 and Sections 9 and 10(b) of the Securities Exchange Act of 1934.").

other disclosures to be made to a counterparty that is an SBS Entity, swap dealer or major swap participant? Why or why not? Would there be disadvantages? Why or why not?

- Should the Commission instead require that disclosures be made upon request by a counterparty that is an SBS Entity, swap dealer or major swap participant? Why or why not?
- Should the Commission require a different type or amount of disclosure for categories of counterparties that are market professionals such as broker-dealers, futures commission merchants and banks? What criteria should determine or inform the type or amount of disclosure? For example, should an SBS Entity be permitted to provide different or less detailed disclosure to a counterparty that is a registered broker-dealer? A registered futures commission merchant? A bank?

b. Timing and Manner of Certain Disclosures

Proposed Rule 15Fh-3(b) would require that disclosures regarding material risks and characteristics and material incentives or conflicts of interest be made to potential counterparties before entering into a security-based swap, but would not mandate the manner in which those disclosures are made.[66] Proposed Rule 15Fh-3(d) similarly would require that disclosures regarding certain clearing rights be made before entering into a security-based swap, but also would not mandate the manner of disclosure. To the extent such disclosures were not otherwise provided to the counterparty in writing prior to entering into a security-based swap, proposed Rules 15Fh-3(b)(3) and 15Fh-3(d)(3) would require an SBS Entity to make a contemporaneous record of the non-written

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[66] Section 15F(h)(3)(B) of the Exchange Act is silent regarding both form and timing of disclosure. See Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(B)).

disclosures made pursuant to proposed Rules15Fh-3(b) and 15Fh-3(d), respectively, and provide a written version of these disclosures to the counterparty in a timely manner, but in any case no later than the delivery of the trade acknowledgement[67] of the particular transaction.[68]

Because disclosures of material risks and characteristics, material incentives or conflicts of interests, and clearing rights include information that the counterparty should consider in deciding whether to enter into the security-based swap, we are proposing to require that these disclosures be provided before entry into a security-based swap.

Concerning the manner of disclosure, however, we preliminarily believe that parties should have flexibility to make disclosures by various means, provided that the SBS Entity (1) makes an appropriate record of such disclosures and (2) supplies its counterparty with a written version of any disclosure required under these rules that was not made in writing prior to the transaction. Means of disclosure may include master

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67 See Trade Acknowledgement and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859 (Jan. 21, 2011) (proposing Rule 15Fi-1(c)(1), which would require a trade acknowledgement to be provided within 15 minutes of execution for a transaction that has been executed and processed electronically; within 30 minutes of execution for a transaction that is not electronically executed, but that will be processed electronically; and within 24 hours of execution for a transaction that the SBS Entity cannot process electronically).

68 See also Section 15F(g) of the Exchange Act (requiring the Commission to adopt rules governing daily trading records, including recordings of telephone calls):

> (g) DAILY TRADING RECORDS.--
> (1) IN GENERAL. – Each registered security-based swap dealer and major security-based swap participant shall maintain daily trading records of the security-based swaps of the registered security-based swap dealer and major security-based swap participant and all related records (including related cash or forward transactions) and recorded communications, including electronic mail, instant messages, and recordings of telephone calls, for such period as may be required by the Commission by rule or regulation.
> (2) INFORMATION REQUIREMENTS. – The daily trading records shall include such information as the Commission shall require by rule or regulation.
> (3) COUNTERPARTY RECORDS. – Each registered security-based swap dealer and major security-based swap participant shall maintain daily trading records for each counterparty in a manner and form that is identifiable with each security-based swap transaction.

Pub. L. 111-203, 124 Stat. 1376, 1788-1789 (to be codified at 15 U.S.C. 78o-10(g)).

agreements and related documentation, telephone calls, emails, instant messages, and electronic platforms.[69] Proposed Rule 15Fh-3(b) would require that the required disclosures regarding material risks and characteristics and material incentives or conflicts of interest be made "in a manner reasonably designed to allow the counterparty to assess" the information being provided. This provision is intended to require that disclosures be reasonably clear and informative as to the relevant material risks or conflicts that are the subject of the disclosure. This provision is not intended to impose a requirement that disclosures be tailored to a particular counterparty or to the financial, commercial or other status of that counterparty.[70]

We understand that security-based swaps generally are executed under master agreements, with much of the transaction-specific disclosure provided over the telephone, in instant messages or in confirmations. We anticipate that SBS Entities may elect to make certain required disclosures of material information to their counterparties in a master agreement or other written document accompanying such agreement.[71]

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69 For SBS Entities to rely on electronic media, however, their counterparties must have the capability to effectively access all of the information required by Rule 15Fh-3(b)(3) in a format that is understandable but not unduly burdensome for the counterparty. See Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers for Delivery of Electronic Information, Securities Act Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996). See also Use of Electronic Media, Exchange Act Release No. 42728 (Apr. 28, 2000), 65 F.R. 25843 (May 4, 2000).

70 SBS Entities would, of course, have an on-going obligation to communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith. See proposed Rule 15Fh-3(g) (discussed infra at Section II.C.5).

71 While certain forms of disclosure may be highly standardized, the Commission anticipates that even such forms of disclosures will require certain provisions to be tailored to the particular transaction, most notably pricing and other transaction-specific commercial terms. We believe the proposed approach is generally consistent with the use of standardized disclosures suggested by industry groups and commenters. See CRMPG III Report (suggesting that standardized risk disclosures should be viewed as a supplement to, rather than a substitute for, more detailed disclosures); and Letter from Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, SIFMA and Robert G. Pickel, Executive Vice Chairman, ISDA to Elizabeth M. Murphy, Secretary, Commission and David A. Stawick, Secretary, Commodity Futures Trading Commission (Oct. 22, 2010) (on file with Commission) ("SIFMA/ISDA 2010 Letter") (recommending the use of standard disclosure templates

Commenters have asked that we clarify the applicability of these disclosure requirements to SEF- and exchange-traded security-based swaps in which the SBS Entity may not know the identity of the counterparty until immediately prior to (or after) execution of a transaction. The Dodd-Frank Act only addresses this issue in the context of special entities. Specifically, Section 15F(h)(7) provides an exception to the requirements of Section 15F(h) for a transaction that is "initiated" by a special entity on a SEF or an exchange and for which the SBS Entity does not know the identity of the counterparty to the transaction.[72]

We are seeking comment, therefore, on whether and how the proposed disclosure requirements should be satisfied for security-based swap transactions that are executed on a SEF or exchange and for which the SBS Entity does not know the identity of the counterparty until immediately prior to (or after) the execution of the transaction. In particular, we seek comment on how the disclosure obligations discussed below under proposed Rule 15Fh-3(b) (concerning material risks and characteristics, and material incentives or conflicts of interest) and proposed Rule 15Fh-3(d) (regarding clearing rights) could be met.

The statute requires rules adopted by the Commission to require the SBS Entity to make these disclosures. We believe that SBS Entities generally should be able to rely on means reasonably designed to achieve timely delivery of the required disclosures. In particular, an SBS Entity could cause the required disclosures to be delivered through a

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that could be adopted on an industry-wide basis, and noting that "the process of developing standardized disclosure materials would . . . provide a means for identifying circumstances in which more tailored disclosure might be appropriate").

72 Pub. L. 111-203, 124 Stat. 1376, 1792 (to be codified at 15 U.S.C. 78o-10(h)(7). See Section II.D, infra.

third party or other indirect means (such as by contracting with a SEF to deliver the disclosure electronically) in circumstances in which it may not be practicable for an SBS Entity to directly provide the disclosures in a timely manner.

Commenters have suggested that SBS Entities should be able to rely on trade acknowledgements to satisfy certain disclosure requirements.[73] Because proposed Rule 15Fh-3(b) would require that disclosures be made before "entering into" a security-based swap, SBS Entities generally would not be able to rely on trade acknowledgements and other documents that are provided after the transaction is executed to satisfy the rule's disclosure obligations. SBS Entities could, however, rely on trade acknowledgements to memorialize disclosures they made, whether orally or by other means, prior to entering into the proposed transaction.[74]

Finally, although we are proposing to permit disclosure by a range of means, both oral and written, we may revisit whether Congress's objectives under Section 15F(h) and the focus here on supervision and compliance require some further specific obligations concerning the manner in which disclosures are made.

Request for Comments

The Commission requests comments generally on all aspects of this approach to the timing and manner of disclosure. In addition, we request comments on the following specific issues:

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[73] See SIFMA/ISDA 2010 Letter ("We recommend that the Commissions clarify that, to the extent that a counterparty is in possession of the master documentation and confirmation specifying the economic and other material terms of a specific transaction, registrant counterparties will have satisfied this requirement.").

[74] Proposed Rule 15Fk-1, discussed infra at Section II. E, would require an SBS Entity to have reasonable written policies and procedures concerning the timing and form of disclosure, and maintain records sufficient to enable its chief compliance officer to verify compliance with the disclosure requirements under the proposed rules.

- Should the Commission impose more specific requirements concerning the timing and manner of disclosures? If so, what additional requirements should the Commission impose, and why?
- Commenters have urged the Commission to encourage the use of standardized disclosure templates.[75] Who would develop those templates? What would the content be? What disclosures do or do not lend themselves to a standardized template? How would the templates be updated or supplemented to respond to market developments or account for the characteristics of a specific transaction?
- Should the Commission require that all material disclosures be provided in writing prior to the execution of the transaction? If not, does the option to memorialize the disclosure and provide a written version of the disclosure to the counterparty provide adequate safeguards to ensure that parties are complying with the disclosure, supervision and compliance requirements discussed more fully below, as well as the provisions intended to increase the protection of special entities? Are there any other safeguards the Commission should consider? How do such safeguards provide the same or better protection or information for counterparties than written disclosures in advance of a transaction?
- Should the Commission require disclosures to be made a certain period of time before execution of a transaction? If so, what would be the advantages and disadvantages of various periods?
- Should the Commission impose specific requirements concerning the timing and manner in which disclosures are made to certain counterparties, such as special

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75 See, e.g., SIFMA/ISDA 2010 Letter at 3.

entities or categories of special entities? If so, which counterparties, and why? What requirements would be appropriate for which counterparties?

- Should the Commission require that disclosures be made in writing prior to the execution of the transaction when the counterparty is a special entity? Why or why not? If so, should this requirement apply with respect to all special entities? If not, how should the Commission distinguish among special entities?
- Should the Commission permit SBS Entities to rely on information in trade acknowledgements to satisfy certain disclosure requirements? Why or why not? Are there other approaches that would be more effective or efficient than the Commission's proposed approach to disclosure?
- In which situations (or under what circumstances) would the SBS Entity not know the identity of the counterparty prior to execution of the transaction on a SEF or exchange? If the SBS Entity subsequently learns the identity of the counterparty, when would such identity typically be ascertained (e.g., before, at the time of, or after the execution of the transaction)? In such situations, how should material information be disclosed?
- The Dodd-Frank Act and the Commission's proposal with respect to SEFs contemplate that SEFs and exchanges will promulgate detailed standards for the listing and trading of security-based swaps that may be transacted on their markets. Should SEFs and exchanges also be required to provide a means to deliver the disclosures to counterparties required under proposed Rules 15Fh-3(b) and (d)? Would SEF and exchange listing and trading rules provide an adequate alternative means for providing the required disclosures? Why or why not? How

would differences in rules across markets for similar products be addressed? What other issues may arise in connection with this approach and how could they be addressed?

- Should disclosures by means of a SEF or exchange require a standardized format? Are there specific transactions, classes of transactions, or types of counterparties for which this approach would or would not be appropriate? Are there other means by which SBS entities could satisfy their disclosure obligations in this context?
- Should an SBS Entity be permitted to reference publicly available information to comply with its disclosure requirements to its counterparty without having the information deemed to be adopted or affirmed by the SBS Entity? For example, should an SBS Entity be permitted to direct its counterparty to reports filed under the Exchange Act and publicly available on EDGAR without being considered to affirm or adopt the disclosure? Should an SBS Entity be permitted to satisfy the disclosure requirements by directing its counterparty to the website of a company underlying a credit default swap regarding disclosures of material risks without being considered to affirm or adopt the disclosure?

c. Material Risks and Characteristics of the Security-Based Swap

Section 15F(h)(3)(B) of the Exchange Act provides that business conduct requirements adopted by the Commission shall require disclosure by the SBS Entity of information about the material risks and characteristics of the security-based swap.[76] A fact is material if there is a substantial likelihood that a reasonable investor would

[76] We read this provision to require disclosure about the material risks and characteristics of the security-based swap itself and not of the underlying reference security or index.

consider the information to be important in making an investment decision.[77] Disclosures should include a clear explanation of the material economic characteristics of the security-based swap, including a discussion of the key assumptions that give rise to the expected pay-offs.[78] The SBS Entity should consider, among other things, the complexity of each of the characteristics of the security-based swap in determining the materiality of the characteristic, as well as the related material risks to be disclosed.[79]

We understand that there are certain general types of risks, including credit risk,[80] settlement risk,[81] market risk,[82] liquidity risk,[83] operational risk,[84] and legal risk[85] that are commonly associated with securities-based swaps.[86] Proposed Rule 15Fh-3(b)(1) would require an SBS Entity to disclose the material factors that influence the day-to-day

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77 Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988).

78 See CRMPG III Report at 61. See also SIFMA/ISDA 2010 Letter (stating that "[t]here is no better description of the characteristics of a transaction than the contract provisions expressly defining its economic terms.").

79 The adequacy of such disclosures will be determined by reference to the "reasonable investor" standard above.

80 By "credit risk," we mean the risk that a party to a security-based swap will fail to perform on an obligation under the security-based swap. IOSCO Report at 3; BIS Report at 11.

81 By "settlement risk," we mean the risk that a party will not receive funds or instruments from its counterparty at the expected time, either as a result of a failure of the counterparty to perform or a failure of the clearing agency to perform. See IOSCO Report at 3.

82 By "market risk," we mean the risk to the value of a security-based swap resulting from adverse movements in the level or volatility of market prices. See BIS Report at 12.

83 By "liquidity risk," we mean the risk that a counterparty may not be able to, or cannot easily, unwind or offset a particular position at or near the previous market price because of inadequate market depth or because of disruptions in the marketplace. See BIS Report at 13.

84 By "operational risk," we mean the risk that deficiencies in information systems or internal controls, including human error, will result in unexpected loss. See IOSCO Report at p. 3; BIS Report at 14.

85 By "legal risk," we mean the risk that agreements are unenforceable or incorrectly or inadequately documented. See IOSCO Report at p. 4; BIS Report at 16.

86 See generally IOSCO Report; BIS Report.

changes in valuation, the factors or events that might lead to significant losses, the sensitivities of the security-based swap to those factors and conditions, and the approximate magnitude of the gains or losses the security-based swap would experience under specified circumstances.[87] SBS Entities should also consider the unique risks and characteristics associated with a particular security-based swap, class of security-based swap or trading venue, and tailor their disclosures accordingly.[88]

An SBS Entity also should consider risks that may be associated specifically with uncleared security-based swaps. Among other things, the absence of a credit support agreement in an uncleared security-based swap could create risks associated with the absence of a bilateral obligation to post initial and variation margin.[89] An SBS Entity should consider whether the absence of provisions that would typically be associated with a cleared security-based swap, for example, could create a material risk that would need

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87 See CRMPG III Report at 60. These disclosures are intended to be disclosures concerning the material risks and characteristics of the security-based swap itself, not the material risks and characteristics of the security-based swap with respect to a particular counterparty. In other words, the proposed rule would not require an SBS Entity to disclose different material risks and characteristics to different counterparties solely because of the identity or nature of the counterparty.

As noted previously, proposed Rule 15Fh-3(b) would require disclosures to be made in a manner reasonably designed to allow the counterparty to assess the material risks and characteristics. In addition, SBS Entities would have an on-going obligation to communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith. See proposed Rule 15Fh-3(g) (discussed infra at Section II.C.5).

88 We anticipate that SBS Entities may provide these disclosures through various means, including scenario analysis. See, e.g., CRMPG III Report at 60 (recommending that disclosure include "rigorous scenario analyses and stress tests that prominently illustrate how the instrument will perform in extreme scenarios, in addition to more probable scenarios").

89 We note that currently market participants often choose to use a credit support agreement or annex specifying the applicable valuation methodologies for the calculation of margin or collateral and the mechanics for the exchange of margin or collateral in connection with a security-based swap.

to be disclosed in connection with a transaction involving a security-based swap that is not submitted for clearing.[90]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- The documentation governing a security-based swap transaction should include all of the terms agreed by the parties that could affect the economic and other risks of the transaction. Should the requirements for disclosure of material characteristics of a security-based swap be deemed satisfied if the SBS Entity has entered into a master agreement with and provided a trade acknowledgement (or draft trade acknowledgement) or other documentation governing the particular security-based swap to the counterparty? Why or why not? How would such an approach provide meaningful disclosure to counterparties regarding the risks of the transactions they are entering into? What types of risks might not be readily apparent to a counterparty from a review of the governing documentation for a transaction? Would the timeliness of such disclosure be a problem if information on a trade acknowledgement, for example, is not provided to a counterparty until after the parties have entered into a security-based swap?

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[90] With respect to uncleared security-based swaps, the Commission expects to propose rules regarding a counterparty's right to have any of its property received by an SBS Entity to margin, guarantee, or secure the obligations of the counterparty in an uncleared security-based swap segregated from the funds of the SBS Entity. See Section 3E(f)(1)(A) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1775-1776 (to be codified at 15 U.S.C. 78c-5(f)(1)(A)) (requiring an SBS Entity to notify a counterparty at the beginning of a security-based transaction that the counterparty has the right to require segregation of the funds or other property supplied to margin, guarantee, or secure the obligations of the counterparty).

- Are there particular material risks or characteristics that the Commission should specifically require an SBS Entity to disclose to a counterparty? If so, which ones and why?
- Are there specific material risks or characteristics that should be disclosed with respect to swaps that are not cleared, or are not SEF- or exchange-traded? If so, which ones and why?
- Are there particular material risks or characteristics that the Commission should specifically require an SBS Entity to disclose when the counterparty is a special entity or a particular category of special entity? If so, which ones and why? Should any such special disclosure requirements apply to any categories of counterparties other than special entities?
- Should the Commission require an SBS Entity to disclose its anticipated profit for the security-based swap? If so, how should an SBS Entity be required to compute profitability for purposes of the rule?[91] If the Commission were to adopt such a requirement, should it be limited to transactions in which the counterparty is a special entity, a particular category of special entity, or another type of counterparty?
- Should the SBS Entity disclose or identify for the counterparty information regarding the issuer of the underlying security that is publicly available, such as whether the issuer of an underlying security is subject to the periodic reporting requirements of the Exchange Act?

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91 See Swap Financial Group, Dodd-Frank Title VII: Business Conduct and Special Entities Briefing for SEC/CFTC Joint Working Group (Aug. 9, 2010) (on file with the Commission) ("Swap Financial Group Presentation") at 55 (describing profit as the "[m]ark-up or 'spread' between price charged to the client and cost of dealer's hedge").

- Is there a basis for distinguishing between the types of disclosures that should be required to be provided by an SBS Dealer and those that should be required to be provided by a Major SBS Participant? If so, how should the types of disclosures required to be provided by a Major SBS Participant differ from those that have been proposed?
- Should the Commission specifically require scenario analysis disclosure? Why or why not? If such analysis should be required, should the Commission require the disclosure for uncleared security-based swaps? Should the Commission limit the scenario analysis disclosure requirement to "high-risk complex security-based swaps," as described in the CRMPG III Report? If so, how should the definitional hurdles outlined in the CRMPG III Report be addressed?[92] If not, why? Is there another standard the Commission should consider for requiring scenario analysis?
- Should an SBS Entity be required to provide a scenario analysis for any security-based swap, upon reasonable request by any counterparty? What are the advantages and disadvantages to SBS Entities and counterparties associated with such an analysis? If the cost varies by type of security-based swap, please provide an average cost by category of security-based swap.
- Should a scenario analysis provided by an SBS Entity to a counterparty be required to be consistent with similar analyses prepared by the SBS Entity for its

[92] See CRMPG III Report at 54-56 ("The definition of a high-risk complex financial instrument is itself a complex subject. . . . [T]he definitional challenge is better framed by identifying the key characteristics of classes of high-risk complex financial instruments that warrant special treatment in terms of sales and marketing practices, disclosure practices, diligence standards, and, more broadly, the level of sophistication required for all market participants . . . . While issues surrounding leverage, market liquidity, and price transparency are the key characteristics in identifying high-risk complex financial instruments, other factors have contributed to the problems witnessed during the credit market crisis.").

own internal purposes (e.g., risk management)? If not, how would they differ and why?

- We do not intend that the proposed rule require an SBS Entity to disclose any information considered proprietary in nature. Would disclosure of proprietary information be a concern under the current formulation of the rule? If so, what types of proprietary information might be subject to disclosure under the proposed rule? Is there other information that could adequately substitute for purposes of meaningful disclosure? What methods, if any, could be applied to transform specific types of proprietary information into comparable information suitable for a counterparty (e.g., aggregation, averaging)? What other mechanisms, if any, could be used to protect proprietary information while providing adequate disclosure to counterparties?

- As noted above, we understand that security-based swaps are often entered into under a master agreement that governs the relationship between the SBS Entity and its counterparty.[93] In particular, master agreements generally contain terms that govern all succeeding security-based swaps and other derivatives between the counterparties, and include provisions such as events of default, cross-default provisions, additional termination events, payment netting and close-out netting,

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93 See, e.g., Thrifty Oil Co. v. Bank of America Nat'l Trust and Sav. Ass'n, 322 F.3d 139, 143 (9th Cir. 2003) (describing use of master agreements). We note that market participants may already look to certain master agreements that are generally considered covered by the swap safe harbors in the U.S. Bankruptcy Code ("Bankruptcy Code"). Sections 362(b)(17) and 560 of the Bankruptcy Code provide an exception to the automatic stay and ipso facto prohibitions in the Bankruptcy Code to allow for the exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements, including netting and set-off rights. See 11 U.S.C. 362(b)(27) and 560. The definition of "swap agreement" under Section 101(53B)(v) of the Bankruptcy Code specifically contemplates master agreements. See 11 U.S.C. 101(53B)(v).

and information regarding rights and obligations as a result of particular events.[94] Should the Commission require the use of a master agreement for security-based swaps? If a master agreement is required when parties enter into a security-based swap, what particular issues should be addressed in the master agreement? For example, should the master agreement be required to address whether payment netting or close-out netting rights exist? If the Commission does not require the use of a master agreement, should it require that all security-based swaps include certain provisions typically included in master agreements? If so, which provisions?

- Should an SBS Entity be required to disclose the absence of certain material provisions typically contained in master agreements for security-based swap transactions?[95] Similarly, should an SBS Entity be required to disclose if the documentation includes material provisions that are unusual in light of typical master agreements? In either case, how should the "normal" or "typical" master agreement be defined? By reference to particular types of standardized master agreements? If so, which ones? To what extent would a requirement to provide a disclosure separate from a master agreement regarding the material terms of the master agreement have the effect of incentivizing counterparties to review their agreements less carefully (and instead rely on the disclosure)? To what extent

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94 Parties may also choose to use a credit support agreement or annex specifying the applicable valuation methodologies for the calculation of margin or collateral and the mechanics for the exchange of margin or collateral in connection with a security-based swap.

95 For example, absent provisions for payment netting or close-out netting, questions may arise as to whether all of the counterparty's trades with the particular SBS Entity would be taken into account in calculating (1) net periodic payments, (2) one net close-out amount in respect of a default by either party, and (3) net margin obligations.

might disclosures regarding the documentation between the parties potentially affect any interpretation of the terms agreed by the parties in the event of a subsequent dispute over such terms? How might that in turn affect the nature or usefulness of the disclosures that SBS Entities might provide regarding their documentation?

- Should the Commission establish certain minimum standards for the agreements governing security-based swaps? If so, what standards and why?

d. Material Incentives or Conflicts of Interest

Proposed Rule 15Fh-3(b)(2) would require that an SBS Entity disclose all material incentives or conflicts it may have in connection with a security-based swap.[96] We preliminarily believe that the term "incentives" – which is used in Section 15F(h)(3)(b)(ii) of the Dodd-Frank Act – refers not to any profit or return that the SBS Entity would expect to earn from the security-based swap itself, or from any related hedging or trading activities of the SBS Entity, but rather to any other financial arrangements pursuant to which an SBS Entity may have an incentive to encourage the counterparty to enter into the transaction. This disclosure would include, among other things, information concerning any compensation (e.g., under revenue-sharing arrangements) or other incentives the SBS Entity receives from any source other than the counterparty in connection with the security-based swap to be entered into with the counterparty, but would not include, for example, expected cash flows received from a

[96] See Section 15F(h)(3)(B)(ii) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(B)(ii)) (providing that business conduct requirements adopted by the Commission shall require disclosure by an SBS Entity of "any material incentives or conflicts of interest" that the SBS Entity may have in connection with the security-based swap).

transaction to hedge the security-based swap or that the security-based swap is intended to hedge.[97]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Are there specific material incentives or conflicts that the Commission should require an SBS Entity to disclose to a counterparty? Are there specific material incentives or conflicts that should be disclosed with respect to security-based swaps that are not cleared, or are not SEF- or exchange-traded?
- Should we require an SBS Entity to disclose affiliations or material business relationships with a SEF or exchange? Why or why not?
- Should we require an SBS Entity to disclose affiliations or material business relationships with a clearing agency? Why or why not?
- Should the Commission impose other more specific requirements concerning the content of the required disclosures when the counterparty is a special entity? If so, which ones and why? Should such specific requirements apply only to certain categories of special entities?
- Should the Commission impose other more specific requirements concerning the content of the required disclosures when an SBS Dealer is acting as an advisor to

97 If an SBS Entity is also registered as a broker-dealer, it would be subject to similar disclosure requirements under FINRA rules in certain circumstances. See, e.g., FINRA Rule 2269, Disclosure of Participation or Interest in Primary or Secondary Distribution ("A member who is acting as a broker for a customer or for both such customer and some other person, or a member who is acting as a dealer and who receives or has promise of receiving a fee from a customer for advising such customer with respect to securities, shall, at or before the completion of any transaction for or with such customer in any security in the primary or secondary distribution of which such member is participating or is otherwise financially interested, give such customer written notification of the existence of such participation or interest.").

a special entity? If so, which ones and why? Should such specific requirements apply only to certain categories of special entities?

- Is there a basis for distinguishing between the types of conflicts disclosures required to be provided by an SBS Dealer and those required to be provided by a Major SBS Participant? If so, how should the types of conflicts disclosures required to be provided by a Major SBS Participant differ from those that have been proposed?
- We do not intend to require the disclosure of information considered proprietary in nature in order for an SBS Entity to discharge its obligation under the proposed rule. Is such disclosure a concern under the current formulation of the rule? If so, what types of proprietary information might be subject to disclosure under the proposed rule? Is there other information that could adequately substitute for purposes of meaningful disclosure? What other mechanisms, if any, could be used to protect proprietary information while providing adequate disclosure to counterparties?

e. Daily Mark

Exchange Act Section 15F(h)(3)(B)(iii) directs the Commission to adopt rules that require an SBS Entity to disclose: (i) for cleared security-based swaps, upon request of the counterparty, the daily mark from the appropriate derivatives clearing organization;[98]

[98] Although Section 15F(h)(3)(B)(iii) of the Exchange Act refers to a "derivatives clearing organization," the Commission believes that this was a drafting error and that Congress intended to refer to a "clearing agency" because the Dodd-Frank Act elsewhere requires security-based swaps to be cleared at registered clearing agencies, not derivatives clearing organizations. See Section 17A(g) of the Exchange Act. Pub. L. 111-203, 124 Stat. 1376, 1768 (to be codified at 15 U.S.C. 78q-1(g)).

and (ii) for uncleared security-based swaps, the daily mark of the transaction.[99] We preliminarily believe that the daily mark, as proposed for the purposes of this rule, would provide helpful transparency to counterparties during the lifecycle of a security-based swap. As explained below, the daily mark under the proposed rule is intended to provide a counterparty with a useful and meaningful reference point against which to assess, among other things, the calculation of variation margin for a security-based swap or portfolio of security-based swaps, and otherwise inform the counterparty's understanding of its financial relationship with the SBS Entity.[100]

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99 We note that various market participants have expressed concerns that the statutory requirement to provide a daily mark to a pension plan would necessarily include an SBS Entity within the definition of "fiduciary" for ERISA purposes under a current Department of Labor proposal, which may then cause the security-based swap to be a prohibited transaction under ERISA, unless it qualifies for a Prohibited Transaction Exemption. See Definition of the Term "Fiduciary," 75 FR 65263 (Oct. 22, 2010); SIFMA/ISDA Letter; Joint Letter from American Bankers Association, American Benefits Council, Committee on Investment of Employee Benefit Assets, The ERISA Industry Committee, Financial Executives International's Committee on Corporate Treasury, Financial Services Roundtable, Insured Retirement Institute, National Association of Insurance and Financial Advisors, National Association of Manufacturers, Securities Industry and Financial Markets Association to David A. Stawick, Secretary, CFTC (Feb. 22, 2011); Letter from Sandra Haas, Managing Director, Head of Pensions, Endowment and Foundation Coverage, Morgan Stanley & Co., Incorporated, and Jim McCarthy, Managing Director, Head of Retirement Services and Client Advisory, Morgan Stanley Smith Barney LLC to Office of Regulations and Interpretations, Employee Benefits Security Admin., Dep't of Labor (Feb. 2, 2011); Letter from Don Thompson, Managing Director and Assistant General Counsel, JPMorgan Chase & Co. to Office of Regulations and Interpretations, Employee Benefits Security Admin., Dep't of Labor (Feb. 3, 2011). As noted in Section I.B., the staffs of the Commission, DoL and CFTC have been consulting and will continue to do so in order to address these concerns. See Letter from Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, Department of Labor, to Gary Gensler, Chairman, CFTC (April 28, 2011) ("In DOL's view, a swap dealer or major swap participant that is acting as a plan's counterparty in an arm's length bilateral transaction with a plan represented by a knowledgeable independent fiduciary would not fail to meet the terms of the counterparty exception [to the proposed revised definition of ERISA fiduciary] solely because it complied with the business conduct standards set forth in the CFTC's proposed regulation."). The Commission also solicits comments with respect to alternatives for addressing this issue.

In addition, as discussed infra in Section II.C.4, we do not believe that disclosure of the daily mark would in and of itself constitute a recommendation under proposed Rule 15Fh-3(f).

100 As explained below, the daily mark under the proposed rule would not necessarily represent the last price at which a security-based swap traded, or a price that is executable.

The term "daily mark" is not defined in the statute and, as explained below, we are proposing that the term have analogous meanings for cleared and uncleared security-based swaps. For cleared security-based swaps, proposed Rule 15Fh-3(c)(1) would require an SBS Entity, upon the request of the counterparty, to disclose to the counterparty in writing the daily end-of-day settlement price received by the SBS Entity from the appropriate clearing agency. "End-of-day settlement price" in this context refers to the value for any given security-based swap used by the clearing agency that forms the basis of subsequent margin calculations for clearing participants.[101]

We are not proposing to require that clearing agencies use a particular calculation methodology for purposes of the proposed rule.[102] We understand that, for a given security-based swap, a clearing agency uses the same end-of-day settlement price for the daily valuation of positions held by all clearing members regardless of position direction or size, and independent of any member-specific attribute, such as credit quality, other portfolio holdings, or concentration of positions. Accordingly, the prices do not

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101 For example, ICE Trust, a clearing agency for credit default swaps, indicates that it "establishes a daily settlement price for all cleared CDS instruments, using a pricing process developed specifically for the CDS market by ICE Trust. ICE Trust clearing participants are required to submit prices on a daily basis. ICE Trust conducts an auction process daily which results in periodic trade executions between its clearing participants. This process determines the daily settlement prices, which are validated by the ICE Trust Chief Risk Officer and used for the daily mark-to-market valuations." ICE Trust, https://www.theice.com/ice_trust.jhtml (March 14, 2011).

102 The Commission understands that the particular methodologies used by clearing agencies to produce the end of day settlement price may vary. We understand that there are various means by which security-based swap clearing agencies calculate end-of-day settlement prices for each product in which they hold a cleared interest each business day. In the credit default swap context, for example, end-of-day settlement prices may be determined each business day for each eligible product based upon pricing data from one or more of various sources, including prices of over-the-counter transactions submitted for clearing; indicative settlement prices contributed by clearing members; and pricing information licensed from other third-party sources. See, e.g., Letter from Ann K. Shuman, Managing Director and Deputy General Counsel, Chicago Mercantile Exchange Inc., to Elizabeth Murphy, Secretary, Commission, (Dec. 14, 2009) (File No. S7-06-09); Letter from Kevin McClear, General Counsel, ICE Trust, to Elizabeth Murphy, Secretary, Commission (Dec. 4, 2009) (File No. S7-05-09).

necessarily represent the last price at which the security-based swap traded, or a price that is executable.

Because the term "daily mark" is used both in the context of cleared and uncleared security-based swaps, the Commission preliminarily believes that the meaning of "daily mark" for uncleared swaps should be analogous to that for cleared swaps, and that the attributes of daily marks produced by clearing agencies for cleared security-based swaps under proposed Rule 15Fh-3(c)(1) should be equally applicable to, and provide guidance for the computation of, the daily mark required to be provided with respect to uncleared security-based swaps. To ensure a degree of uniformity in market practices among SBS Entities, proposed Rule 15Fh-3(c)(2) would require an SBS Entity to disclose the midpoint between the bid and offer prices for a particular uncleared security-based swap, or the calculated equivalent thereof, as of the close of business unless the parties agree in writing otherwise.[103] We preliminarily believe that the proposed rule would result in a daily mark that reflects daily changes in valuation that is: (a) the same for all counterparties of the SBS Entity that have a position in the uncleared security-based swap, (b) not adjusted to account for holding-specific attributes such as position direction, size, or liquidity, and (c) not adjusted to account for counterparty-specific attributes such as credit quality, other counterparty portfolio holdings, or concentration of positions.[104]

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[103] Parties could agree that the daily mark would be computed as of a time other than the close of business but could not agree to waive the requirement that the daily mark be provided on a daily basis, as required by the statute.

[104] SIFMA and ISDA have suggested that "[b]y market convention and often by contract, parties generally agree to utilize a mid-market level for margin purposes. Counterparties understand that this level does not represent a valuation at which a transaction may be entered into or terminated and accordingly may differ from actual market prices. We recommend that the Commissions endorse this use of mid-market levels for margin purposes as a uniform market practice." SIFMA/ISDA 2010 Letter at 17. For a

For actively traded security-based swaps that have sufficient liquidity, computing a daily mark as the midpoint between the bid and offer prices for a particular security-based swap, known as a "midmarket value," would be consistent with the proposed Rule 15Fh-3(c)(2). For security-based swaps that are not actively traded, or do not have up-to-date bid and offer quotes, the SBS Entity may calculate an equivalent to a midmarket value using mathematical models, quotes and prices of other comparable securities, security-based swaps, or derivatives, or any combination thereof, provided that these calculations produce a daily mark that is consistent with the attributes described above.[105] Again, the daily mark is not intended to represent the value that either an SBS Entity or its counterparty would use for its own, internal valuation, or fair value for financial reporting purposes for the particular security-based swap. Nor would the daily mark necessarily represent a price at which the SBS Entity would be willing to execute a trade.[106]

Furthermore, though the daily mark may be used as an input to compute the variation margin between an SBS Entity and its counterparty, it is not necessarily the sole determinant of how such margin is computed. Differences between the daily mark and computations for variation margin result from adjustments for position size, position direction, credit reserve, hedging, funding, liquidity, counterparty credit quality, portfolio

discussion of midmarket value and adjustments, see ISDA Research Notes, The Value of a New Swap, Issue 3, 2010, available at http://www.isda.org/researchnotes/pdf/NewSwapRN.pdf ("ISDA Note") (describing midmarket value as "the net present value of the transaction assuming it is priced at mid-market").

105 See ISDA Note.

106 As discussed in Section II.C.4, infra, we do not believe that compliance with the requirements of proposed Rule 15Fh-3(c), in and of itself, should cause an SBS Dealer to be deemed to have made a recommendation under proposed Rule 15Fh-3(f).

concentration, bid-ask spreads, or other costs, that may be included as part of the margin computations. Nonetheless, the Commission believes the daily mark, as proposed for the purposes of this rule, would provide a useful and meaningful reference point, similar to that for cleared security-based swaps, for counterparties holding positions in uncleared security-based swaps.[107]

Proposed Rule 15Fh-3(c)(2) would also require that, at or before delivery of the first disclosure of the daily mark, an SBS Entity disclose to the counterparty its data sources and a description of the methodology and assumptions to be used to prepare the daily mark for an uncleared security-based swap.[108] We preliminarily believe that such disclosure would provide the counterparty a useful context with which it can assess the

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[107] See ISDA Note ("even though market participants do not actually transact at the midmarket rate, it is nonetheless useful because it is an objective, transparent rate that might be used as a basis for actual pricing").

[108] Cf. Trading & Capital-Markets Manual § 2150 (Bd. of Gov. Fed. Reserve Sys. Jan. 2009), available at http://www.federalreserve.gov/boarddocs/supmanual/trading/200901/0901trading.pdf:

> When observable market prices are available for a transaction, two pricing methodologies are primarily used—bid/offer or midmarket. Bid/offer pricing involves assigning the lower of bid or offer prices to a long position and the higher of bid or offer prices to short positions. Midmarket pricing involves assigning the price that is midway between bid and offer prices. Most institutions use midmarket pricing schemes, although some firms may still use bid/offer pricing for some products or types of trading. Midmarket pricing is the method recommended by the accounting and reporting subcommittee of the Group of Thirty's Global Derivatives Study Group, and it is the method market practitioners currently consider the most sound. . . .
>
> For many illiquid or customized transactions, such as highly structured or leveraged instruments and more complex, nonstandard notes or securities, reliable independent market quotes are usually not available, even infrequently. In such instances, other valuation techniques must be used to determine a theoretical, end-of-day market value. These techniques may involve assuming a constant spread over a reference rate or comparing the transaction in question with similar transactions that have readily available prices (for example, comparable or similar transactions with different counterparties). More likely, though, pricing models will be used to price these types of customized transactions.

quality of the mark received.[109] In addition, proposed Rule 15Fh-3(c) would also require that an SBS Entity promptly disclose any material changes to the data sources, methodology, or assumptions over the term of the security-based swap. An SBS Entity would not be required to disclose the data sources or a description of the methodology and assumptions more than once unless it materially changes the data sources, methodology or assumptions used to calculate the daily mark. For the purposes of this rule, a material change would include any change that has a material impact on the daily mark provided. We understand that the daily mark for illiquid security-based swaps may be generated using models that may or may not be proprietary. The required disclosure of the data sources or description of the methodology and assumptions used to prepare the daily mark is not intended to require so much detail as to result in disclosure of an SBS Entity's proprietary information.

We preliminarily believe that, for the disclosure to the counterparty to be meaningful, the daily mark for both cleared and uncleared security-based swaps should be provided without charge and with no restrictions on internal use by the recipient, although restrictions on dissemination to third parties are permissible. The rule would not, however, mandate the means by which an SBS Entity makes the required disclosures. Commenters have asked if SBS Entities may satisfy their obligations in this

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109 The Commission recognizes that different SBS Entities may produce somewhat different marks for similar security-based swaps, depending on the respective data sources, methodologies and assumptions used to calculate the marks. Thus, the data sources, methodologies and assumptions would provide a context in which the quality of the mark could be evaluated. See Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments, Securities Act Release No. 7386 (Jan. 31, 1997), 62 FR 6044 (Feb. 10, 1997). We understand that currently, industry practice is often to include similar disclosures for margin calls in swap documentation, such as a credit support annex.

regard by making the relevant information available to counterparties through password-protected access to a website containing the relevant information.[110] The Commission preliminarily believes that such a method would be an appropriate way for SBS Entities to discharge their obligations with respect to daily marks, subject to compliance with the Commission's guidance on the use of electronic media.[111] In particular, the use of electronic media should not be so burdensome that intended recipients cannot effectively access the information provided. Further, persons to whom information is sent or provided electronically must have the opportunity to download directly the information, or otherwise have an opportunity to retain and analyze the information through the selected medium or have ongoing access equivalent to personal retention.[112] Information of this kind is directly relevant to a counterparty's understanding of its financial relationship under a security-based swap and so, we preliminarily believe that access to the information as described above is necessary to ensure a counterparty's ability to monitor that relationship over the life of the transaction.[113]

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110 SIFMA/ISDA 2010 Letter at p. 17.

111 See Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers for Delivery of Electronic Information, Securities Act Release No. 7288 (May 9, 1996), 61 FR 24644 (May 15, 1996) ("Electronic Media Release"). See also Use of Electronic Media, Exchange Act Release No. 42728 (Apr. 28, 2000), 65 F.R. 25843 (May 4, 2000).

112 See Electronic Media Release.

113 A counterparty may also require continuing access to satisfy recordkeeping requirements to which it may be subject.

The Commission has proposed to require clearing agencies to make available to the public, on terms that are fair and reasonable and not unreasonably discriminatory, all end-of-day settlement prices and any other prices with respect to security-based swaps that the clearing agency may establish to calculate mark-to-market margin requirements for its participants and any other pricing or valuation information with respect to security-based swaps as is published or distributed by the clearing agency to is participants. See Clearing Agency Standards for Operation and Governance, Exchange Act Release No. 64017 (March 2, 2011), 76 FR 14472 (March 16, 2011) (proposed Rule17Aj-1). As we explained in proposing Rule 17Aj-1, we preliminarily believe that public availability of this information would help to improve fairness, efficiency, and market competition by making available to

SBS Entities also should consider the need to provide appropriate clarifying statements or disclosures relating to the daily mark. Such statements or disclosures may include, as appropriate, that the daily mark may not be a price at which the SBS Entity would agree to replace or terminate the security-based swap, nor the value at which the security-based swap is recorded in the books of the SBS Entity.[114]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Is the end-of-day settlement price an appropriate "daily mark" for cleared security-based swaps for purposes of this rule? If not, how should the Commission define "daily mark" in this context?
- Should the Commission prescribe a method for determining the end-of-day settlement price for cleared security-based swaps for purposes of this rule? If so, what method and why?
- Is the midpoint between the bid and offer prices for a particular uncleared security-based swap, or the calculated equivalent thereof, as of the close of business unless the parties agree in writing otherwise, an appropriate "daily mark" for uncleared security-based swaps? If not, how should the Commission define "daily mark" in this context, and why?
- Should the Commission prescribe a different method for calculating the daily mark for uncleared security-based swaps for purposes of this rule? If so, what

all market participants data that may otherwise be available only to a limited subset of market participants. See id.

[114] Cf. CFTC External Business Conduct Release (proposed Rule 17 CFR 23.431(c)).

method and why? Should valuations of equivalent positions used by the SBS Entity for other purposes, such as collateral valuation or the preparation of financial statements, be taken into consideration? Why or why not, and how?

- Are there requirements under proposed Rule 15Fh-3(c) that would cause an SBS Entity to be a fiduciary for ERISA purposes? If so, which requirements, and is there an alternate method for calculating the daily mark that would not cause an SBS Entity to be a fiduciary for ERISA purposes?
- In calculating the midmarket value, should the Commission require an SBS Entity to use third-party market quotations (i.e., should the Commission allow an SBS Entity to use its own market quotations)? Why or why not? Should there be constraints or conditions on such use? Why or why not?
- Should the Commission require an SBS Entity to provide an executable quote or the price at which the SBS Entity would terminate the security-based swap, in addition to the daily mark, for purposes of comparison or other reasons? If so, should this additional information always be required or is there a stronger rationale for the additional information to be required for certain identifiable types of security-based swap positions, such as security-based swaps that are highly customized to a counterparty's requirements, or otherwise illiquid, and for which the daily mark may be significantly different from an executable quote?
- Should the Commission require an SBS Entity to provide a value that would be used for purposes of variation margin, in addition to the daily mark, for purposes of comparison or other reasons? If so, should this additional information always be required or is there a stronger rationale for the additional information to be

required for certain identifiable types of security-based swap positions, such as security-based swaps that are highly customized to a counterparty's requirements, or otherwise illiquid, and for which the daily mark may be significantly different from a value used for variation margin?

- If the SBS Entity and a particular counterparty are parties to more than one security-based swap transaction with one another, should the SBS Entity be permitted to provide a single aggregate daily mark for all of the security-based swaps, allowing for netting between the parties? Why or why not?
- Should the Commission require an SBS Entity to provide additional disclosures including, as appropriate: (1) that the daily mark may not necessarily be a price at which either the counterparty or the SBS Entity would agree to replace or terminate the security-based swap; (2) that, depending upon the agreement of the parties, calls for margin may be based on considerations other than the daily mark provided to the counterparty; and (3) that the daily mark may not necessarily be the value of the security-based swap that is recorded in the books of the SBS Entity?[115] In addition to disclosing any material changes to data sources, methodology or assumptions used, should an SBS Entity be required to disclose the impacts of these material changes? Are there any other disclosures that the Commission should require the SBS Entity to provide in connection with the daily mark?
- We do not intend the proposed disclosures regarding the data sources and description of the methodologies and assumptions used to prepare the daily marks

115 Cf. CFTC External Business Conduct Release (proposed §23.431(c)).

to require the disclosure of information considered proprietary in nature in order for an SBS Entity to discharge its obligations. Is such disclosure a concern under the current formulation of the rule? If so, what types of proprietary information might be subject to disclosure under the proposed rule? Is there other information that could adequately substitute for purposes of meaningful disclosure? What mechanisms, if any, could be used to protect proprietary information implicated by the daily mark requirement while providing adequate disclosure to counterparties?

- Should access to a website or electronic platform be considered sufficient for disclosure of the daily mark? Why or why not? Should other forms of Internet-based or electronic disclosure be addressed, and if so, how?
- Should we require that the daily mark for both cleared and uncleared security-based swaps should be provided without charge and with no restrictions on internal use by the recipient, although restrictions on dissemination to third parties are permissible? Why or why not?

f. Clearing Rights

Proposed Rule 15Fh-3(d) would require an SBS Entity, before entering into a security-based swap with a counterparty, to disclose to the counterparty its rights under Section 3C(g) of the Exchange Act concerning submission of a security-based swap to a clearing agency for clearing.[116] Although they are not required by the Dodd-Frank Act,

[116] See Section 15F(h)(1)(D) of the Exchange Act (authorizing the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate"); see also Dodd-Lincoln Letter (describing anticipated benefits of clearing as a means of "bringing transactions and counterparties into a sound, conservative and transparent risk management framework"). Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(D)).

we preliminarily believe that such disclosures would promote the objectives of Section 3C(g).

The counterparty's rights, and thus the proposed disclosure obligations, would differ depending on whether the clearing requirement of Section 3C(a) applies to the relevant transaction.[117] When the clearing requirements of Section 3C(a)(1) apply to a security-based swap, proposed Rule 15Fh-3(d)(1)(i) would require the SBS Entity to disclose to the counterparty the clearing agencies that accept the security-based swap for clearing and through which of those clearing agencies the SBS Entity is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap. The SBS Entity would also be required to notify the counterparty of the counterparty's sole right to select which clearing agency is to be used to clear the security-based swap, provided it is a clearing agency at which the SBS Entity is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap.[118] We note that, while proposed Rule 15Fh-3(d) would not require an SBS Entity to become a member or participant of a specific clearing agency, an SBS

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117 Section 3C(a)(1) of the Exchange Act provides that: "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 this Act if the security-based swap is required to be cleared." Pub. L. 111-203, 124 Stat. 1376, 1762 (to be codified at 15 U.S.C. 78c-3(a)(1)).

118 Proposed Rule 15Fh-3(d)(1)(ii). See Exchange Act 3C(g)(5)(A), Pub. L. 111-203, 124 Stat. 1376, 1766 – 1777 (to be codified at 15 U.S.C. 78c-3(g)(5)(A)):

> With respect to any security-based swap that is subject to the mandatory clearing requirement under subsection (a) and entered into by a security-based swap dealer or a major security-based swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty shall have the sole right to select the clearing agency at which the security-based swap will be cleared.

Entity could not enter into security-based swaps that are subject to a mandatory clearing requirement without having some arrangement in place to clear the transaction.[119]

For security-based swaps that are not subject to the clearing requirement under Exchange Act Section 3C(a)(1), proposed Rule 15Fh-3(d)(2) would require the SBS Entity to determine whether the security-based swap is accepted for clearing by one or more clearing agencies and, if so, to disclose to the counterparty the counterparty's right to elect clearing of the security-based swap.[120] Proposed Rule 15Fh-3(d)(2)(ii) would require the SBS Entity to disclose to the counterparty the clearing agencies that accept the type, category, or class of security-based swap transacted and whether the SBS Entity is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap through such clearing agencies. Proposed Rule 15Fh-3(d)(2)(iii) would require the SBS Entity to notify the counterparty of the counterparty's sole right to select the clearing agency at which the security-based swap would be cleared, provided it is a clearing agency at which the SBS Entity is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap. Once again, the proposed rule would not require an SBS Entity to become a member or participant of a

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119 See Exchange Act Section 3C(a), Pub. L. 111-203, 124 Stat. 1376, 1762, §763(a) (to be codified at 15 U.S.C. 78c-3(a)).

120 See Exchange Act Section 3C(g)(5)(B), Pub. L. 111-203, 124 Stat. 1376, 1767, (to be codified at 15 U.S.C. 78c-3(g)(5)(B)):

> With respect to any security-based swap that is not subject to the mandatory clearing requirement under subsection (a) and entered into by a security-based swap dealer or a major security-based swap participant with a counterparty that is not a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant, the counterparty -- (i) may elect to require clearing of the security-based swap; and (ii) shall have the sole right to select the clearing agency at which the security-based swap will be cleared.

particular clearing agency, notwithstanding the election of the counterparty to clear the transaction.

The proposed rule would require that disclosure be made before a transaction occurs. The Commission believes that it would be appropriate for a counterparty to exercise its statutory right to select the clearing agency at which its security-based swaps would be cleared (as provided above) on a transaction-by-transaction basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions the counterparty may execute with the SBS Entity.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission require SBS Entities to disclose a counterparty's rights to select a clearing agency, as provided above? What benefits would this requirement provide? Would the proposed disclosure requirement impose an undue burden on SBS Entities? If so, what would the burden be, and are there other ways to ensure that a counterparty is aware of its rights with respect to clearing?
- Would the SBS Entity be in a position to know, in all cases, the information the that would be required to be disclosed under proposed Rule 15Fh-3(d)? If not, why? Would the time needed to gather the required information affect the transaction process for security-based swaps to any material extent? If so, how?
- Should the Commission require SBS Entities to disclose any other information to counterparties regarding their rights or obligations in connection with the clearing

of security-based swap transactions? For example, under Section 3C(g) of the Exchange Act, certain "end users" have the option not to have their security-based swaps cleared, even if those security-based swaps have been made subject to a mandatory clearing requirement.[121] Should an SBS Entity be required to disclose to such end users that they may elect not to have their security-based swaps cleared under these circumstances? Why or why not?

- Should an SBS Entity be permitted to allow its counterparties to elect the clearing agency at which its security-based swaps would be cleared on a transaction-by-transaction basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions? If not, what restrictions should apply to the SBS Entity in this context?

3. Know Your Counterparty

Proposed Rule 15Fh-3(e) would establish a "know your counterparty" requirement for SBS Dealers.[122] The proposed rule would require an SBS Dealer to have policies and procedures reasonably designed to obtain and retain a record of the essential facts that are necessary for conducting business with each counterparty that is known to the SBS Dealer.[123] For purposes of the proposed rule, "essential facts" would be: (i) facts

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[121] Exchange Act Section 3C(g), Pub. L. 111-203, 124 Stat. 1376, 1767, §763(a) (to be codified at 15 U.S.C. 78c-3(g)). See End-User Exception to Mandatory Clearing of Security-Based Swaps, Exchange Act Release No. 63556 (Dec. 15, 2010), 75 FR 79992 (Dec. 21, 2010) (proposing new Rule 3Cg-1 under the Exchange Act governing the exception to mandatory clearing of security-based swaps available for counterparties meeting certain conditions).

[122] See Section 15F(h)(1)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789, (to be codified at 15 U.S.C. 78o-10(h)(1)(D)) (authorizing, but not explicitly mandating, the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate").

[123] The proposed rule would not apply to security-based swaps for which the SBS Dealer does not know the identity of the counterparty, as is the case, for example, for many security-based swaps traded on a SEF or an exchange.

necessary to comply with applicable laws, regulations and rules, (ii) facts necessary to effectuate the SBS Dealer's credit and operational risk management policies in connection with transactions entered into with such counterparty, (iii) information regarding the authority of any person acting for such counterparty, and (iv) if the counterparty is a special entity, such background information regarding the independent representative as the SBS Dealer reasonably deems appropriate.[124]

The "know your counterparty" obligations under the proposed rule are a modified version of the "know your customer" obligations imposed on other market professionals, such as broker-dealers, when dealing with customers.[125] Although the statute does not require the Commission to adopt a "know your counterparty" standard, we preliminarily believe that such a standard would be consistent with basic principles of legal and regulatory compliance, operational and credit risk management, and authority. Further, we preliminarily believe that entities that currently operate as SBS Dealers typically would already have in place, as a matter of their normal business practices, "know your counterparty" policies and procedures that could potentially satisfy the requirements of the proposed rule. We are proposing to apply the requirement in proposed Rule 15Fh-

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[124] The Commission is considering the minimum requirements for an SBS Dealer's operational and credit risk management practices and expects to address any such matters in a separate rulemaking.

[125] Cf. FINRA Rule 2090 ("Every member shall use reasonable diligence, in regard to the opening and maintenance of every account, to know (and retain) the essential facts concerning every customer and concerning the authority of each person acting on behalf of such customer"). Supplementary Material .01 to FINRA Rule 2090 defines the "essential facts" for purposes of the FINRA rule to include certain information not required by our proposed rule. For purposes of FINRA Rule 2090, facts "essential" to "knowing the customer" are those required to (a) effectively service the customer's account, (b) act in accordance with any special handling instructions for the account, (c) understand the authority of each person acting on behalf of the customer, and (d) comply with applicable laws, regulations, and rules. See also 14 CFR 13.5 (requiring a bank that is a government securities broker or dealer to make reasonable efforts to obtain information concerning the customer's financial status, tax status and investment objectives, and such other information used or considered to be reasonable by the bank in making recommendations to the customer).

3(e) to SBS Dealers but not to Major SBS Participants because we do not anticipate that Major SBS Participants would serve a dealer-type role in the market.

Request for Comments

The Commission requests comments generally on all aspects of proposed 15Fh-3(e). In addition, we request comments on the following specific issues:

- Should the Commission impose a "know your counterparty" requirement? If not, why not? Does the Commission need to clarify any of the proposed requirements? If so, how? Are there any specific categories of information that an SBS Dealer should be required to obtain from a counterparty? Should the Commission specify how any such information should be obtained from the counterparty?
- Should the "know your counterparty" obligations apply to Major SBS Participants, as well as to SBS Dealers? If so, why?
- To what extent would the current business practices of SBS Dealers, including their compliance procedures and their credit and operational risk management procedures, comply with the proposed "know your counterparty" requirements? To what extent would the proposed rule require SBS Dealers to change their current business practices? Would the proposed requirements impose any particular burdens on market participants?
- Should SBS Dealers be required to obtain any particular or additional information regarding their counterparty beyond what would be required under the proposed rule? If so, what specific information should SBS Dealers be required to obtain?
- Should the proposed requirement track more closely the "know your customer"

requirement imposed under SRO rules? In particular, should the proposed rule require an SBS Dealer to obtain information necessary to effectively "service the counterparty," to implement a counterparty's "special instructions," or to evaluate the counterparty's security-based swaps experience, financial wherewithal and trading objectives?[126] If so, how should such terms be interpreted in the context of SBS Dealers and the security-based swap market?

- Are there any circumstances in which it would not be appropriate to apply a "know your counterparty" obligation? What circumstances and why?
- Should "know your counterparty" requirements apply differently with respect to cleared and uncleared swaps? If so, how and why?

4. Recommendations by SBS Dealers

Proposed Rule 15Fh-3(f) would generally require an SBS Dealer that makes a "recommendation" to a counterparty to have a reasonable basis for believing that the recommended security-based swap or trading strategy involving security-based swaps is suitable for the counterparty.

In determining whether to propose Rule 15Fh-3(f), a business conduct requirement not expressly addressed by the statute, the Commission considered the suitability obligations imposed when other market professionals recommend a security or trading strategy to customers, including institutional customers.[127] The obligation to

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[126] Cf. Supplementary Material .01 to FINRA Rule 2090 ("For purposes of this Rule, facts 'essential' to 'knowing the customer' are those required to (a) effectively service the customer's account, (b) act in accordance with any special handling instructions for the account, (c) understand the authority of each person acting on behalf of the customer, and (d) comply with applicable laws, regulations, and rules.").

[127] See Section 15F(h)(1)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(D)) (authorizing, but not explicitly requiring, the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate"), and Section 15F(h)(3)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1790

make only suitable recommendations is a core business conduct requirement for broker-dealers.[128] Municipal securities dealers also have a suitability obligation when recommending municipal securities transactions to a customer.[129] Federally regulated banks have a suitability obligation as well when acting as a broker or dealer in connection with the purchase or sale of government securities.[130] Depending on the scope of its activities, an SBS Dealer may be subject to one of these other suitability obligations, in addition to those under our proposed rule. In particular, if an SBS Dealer is also a registered broker-dealer and a FINRA member, it would be subject as well to FINRA suitability requirements in connection with the recommendation of a security-based swap or trading strategy involving a security-based swap, as well as the anti-fraud provisions of the Exchange Act.[131] Proposed Rule 15Fh-3(f) is intended to ensure that all SBS Dealers

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(to be codified at 15U.S.C. 78o-10(h)(3)(D)) (authorizing the Commission to establish "such other standards and requirements as the Commission may determine are appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act").

128 See, e.g., FINRA Rules 2090 and 2111 (effective July 9, 2012). See also Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943) (enforcing suitability obligations under the antifraud provisions of the Exchange Act).

129 MSRB Rule G-19(c) provides that:

> In recommending to a customer any municipal security transaction, a broker, dealer, or municipal securities dealer shall have reasonable grounds: (i) based upon information available from the issuer of the security or otherwise, and (ii) based upon the facts disclosed by such customer or otherwise known about such customer, for believing that the recommendation is suitable.

130 See Trading & Capital-Markets Manual § 2150 (imposing a suitability obligation on federally regulated banks acting as a government securities broker or government securities dealer); Government Securities Sales Practices, 62 FR 13276 (Mar. 19, 1997) (codified at 12 CFR pts. 13, 208, 211, and 368).

131 See Section II.A, supra. See also FINRA Rule 2111 (effective July 9, 2012). Under FINRA rules, unless a counterparty had total assets of at least $50 million, he or she would be entitled to the protections provided by retail suitability obligations in the broker-dealer context. See FINRA Rule 2111(b) (referring to NASD Rule 3110(c)(4)).

that make recommendations are subject to this obligation, tailored as appropriate in light of the nature of the security-based swap markets.[132]

Proposed Rule 15Fh-3(f) would only apply when an SBS Dealer makes a "recommendation" to a counterparty. The Commission preliminarily believes that the determination of whether an SBS Dealer has made a recommendation that triggers a suitability obligation should turn on the facts and circumstances of the particular situation and, therefore, whether a recommendation has taken place is not susceptible to a bright line definition. This is consistent with the FINRA approach to what constitutes a recommendation. In the context of the FINRA suitability standard, factors considered in determining whether a recommendation has taken place include whether the communication "reasonably could be viewed as a 'call to action' " and "reasonably would influence an investor to trade a particular security or group of securities."[133] The more individually tailored the communication to a specific customer or a targeted group of customers about a security or group of securities, the greater the likelihood that the communication may be viewed as a "recommendation." The Commission preliminarily believes that this approach should apply in the context of proposed Rule 15Fh-3(e) as well.

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132 Some dealers have indicated that they already apply "institutional suitability" principles to their swap business. See, e.g., Letter from Richard Ostrander, Managing Director and Counsel, Morgan Stanley, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, and David A. Stawick, Secretary, Commodity Futures Trading Commission (Dec. 3, 2010) at 5; Report of the Business Standards Committee, Goldman Sachs (Jan. 2011), http://www2.goldmansachs.com/our-firm/business-standards-committee/report.pdf.

133 See FINRA Notice to Members 01-23 (Mar. 19, 2001), and Notice of Filing of Proposed Rule Change to Adopt FINRA Rules 2090 (Know Your Customer) and 2111 (Suitability) in the Consolidated FINRA Rulebook, Exchange Act Release No. 62718 (Aug. 13, 2010), 75 FR 51310 (Aug. 19, 2010), as amended, Exchange Act Release No. 62718A (Aug. 20, 2010), 75 FR 52562 (Aug. 26, 2010) (discussing what it means to make a "recommendation").

An SBS Dealer typically would not be deemed to be making a recommendation solely by reason of providing general financial or market information, or transaction terms in response to a request for competitive bids.[134] Furthermore, compliance with the requirements of the proposed rules, in particular, Rule 15Fh-3(a) (verification of counterparty status), 15Fh-3(b) (disclosures of material risks and characteristics, and material incentives or conflicts of interest), 15Fh-3(c) (disclosures of daily mark), and 15Fh-3(d) (disclosures regarding clearing rights) would not, in and of itself, result in an SBS Dealer being deemed to be making a "recommendation."

When the suitability obligation of proposed Rule 15Fh-3(f) applies, the SBS Dealer must, as a threshold matter, understand the security-based swap or trading strategy that it is recommending. Proposed Rule 15Fh-3(f)(1)(i) would require an SBS Dealer to have a reasonable basis to believe, based on reasonable diligence, that the recommendation is suitable for at least some counterparties. In general, what constitutes reasonable diligence will vary depending on, among other things, the complexity of and risks associated with the security-based swap or trading strategy and the SBS Dealer's familiarity with the security-based swap or trading strategy. An SBS Dealer's reasonable diligence must provide it with an understanding of the potential risks and rewards associated with the recommended security-based swap or trading strategy. An SBS Dealer that lacks this understanding would not be able to meet its obligations under the proposed rule.[135] In addition, under proposed Rule 15Fh-3(f)(1), in order to establish a

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[134] Cf. Supplementary Material .03 to FINRA Rule 2090.

[135] See, e.g., Michael F. Siegel, 2007 NASD Discip. LEXIS 20 (2007), aff'd, Exchange Act Release No. 58737 (Oct. 6, 2008), vacated in part and remanded on other grounds, 592 F.3d 147 (10th Cir. 2010) (finding that registered representative lacked any reasonable basis for recommending securities because he did not have sufficient understanding of what he was recommending). See also Distribution by Broker-Dealers of Unregistered Securities, Exchange Act Release No. 6721 (Feb. 2,

reasonable basis for a recommendation to a particular counterparty, the SBS Dealer would need to have or obtain relevant information regarding the counterparty, including the counterparty's investment profile (including trading objectives) and its ability to absorb potential losses associated with the recommended security-based swap or trading strategy.[136]

Proposed Rule 15Fh-3(f)(2) would provide an alternative to the general suitability requirement, under which an SBS Dealer could fulfill its obligations with respect to a particular counterparty if: (1) the SBS Dealer reasonably determines that the counterparty (or its agent) is capable of independently evaluating investment risks with regard to the relevant security-based swap or trading strategy involving a security-based swap; (2) the counterparty (or its agent) affirmatively represents in writing that it is exercising independent judgment in evaluating the recommendations by the SBS Dealer; and (3) the SBS Dealer discloses that it is acting in the capacity of a counterparty, and is not undertaking to assess the suitability of the security-based swap or trading strategy.[137] We

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1962) ("the making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation"). Cf. Supplementary Material .03 to FINRA Rule 2090.

[136] Under FINRA Rule 2111(a) (effective July 9, 2012), a customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation. See also FINRA Rule 2360(b)(19)(B) ("No member or person associated with a member shall recommend to a customer an opening transaction in any option contract unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer . . . is financially able to bear the risks of the recommended position in the option contract.").

[137] As discussed in Section II.D.3, the standards for determining that an SBS Dealer is not acting as an advisor under proposed Rule 15Fh-2(a) would be substantially the same as the standards that an SBS Dealer must satisfy to qualify for the alternative to the general suitability standard under proposed Rule 15Fh-3(f). Accordingly, as described more fully below, we are also proposing that the general suitability requirement be deemed satisfied if an SBS Dealer is deemed not to be acting as an advisor to a special entity in accordance with proposed Rule 15Fh-2(a).

preliminarily believe that parties should be able to make these disclosures on a transaction-by-transaction basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions between the parties.[138]

If an SBS Dealer cannot rely on the alternative provided by proposed Rule 15Fh-3(f)(2), it would need to make an independent determination that the recommended security-based swap or trading strategy involving security-based swaps is suitable for the counterparty.[139]

We preliminarily believe that an SBS Dealer, for purposes of Rule 15Fh-3(f)(2), reasonably could determine that the counterparty (or its agent) is capable of independently evaluating investment risks with regard to the relevant security-based swap (or trading strategy involving a security-based swap) through a variety of means, including the use of written representations from its counterparty. For example, absent special circumstances described below, we preliminarily believe it would be reasonable for an SBS Dealer to rely on written representations by its counterparty that the counterparty (or its agent) is capable of independently evaluating investment risks with regard to any security-based swap (or trading strategy involving a security-based swap). Upon receiving such a representation (or the representation required by Rule 15Fh-3(f)(2)(ii) with respect to the counterparty's exercise of independent judgment), the SBS

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138 This approach is consistent with FINRA's approach to institutional suitability. See Supplementary Material .07 to FINRA Rule 2111 (effective July 9, 2012) ("With respect to having to indicate affirmatively that it is exercising independent judgment in evaluating the member's or associated person's recommendations, an institutional customer may indicate that it is exercising independent judgment on a trade-by-trade basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions for its account.").

139 This also is consistent with FINRA's approach to institutional suitability. See id.

Dealer would be entitled to rely on the representation without further inquiry, absent special circumstances described below.

To solicit input on when it would no longer be appropriate for an SBS Dealer to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Dealer to rely on a representation from a counterparty for purposes of Rule 15Fh-3(f)(2)(i) or (ii) unless it knows that the representation is not accurate. The second would permit an SBS Dealer to rely on a representation unless the SBS Dealer has information that would cause a reasonable person to question the accuracy of the representation.

Under either approach, an SBS Dealer could not ignore information in its possession as a result of which the SBS Dealer would know that a representation is inaccurate. In addition, under the second approach, an SBS Dealer also could not ignore information that would cause a reasonable person to question the accuracy of a representation and, if the SBS Dealer had such information, it would need to make further reasonable inquiry to verify the accuracy of the representation.

We are proposing to apply the requirement in proposed Rule 15Fh-3(f) to SBS Dealers but not to Major SBS Participants because we do not anticipate that Major SBS Participants will serve a dealer-type role in the market.[140] Further, under the proposed rule, the obligation would not apply to an SBS Dealer in dealings with an SBS Entity, swap dealer, or major swap participant.[141] We preliminarily believe that these types of

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[140] See discussion in Section I.C.4, supra. If a Major SBS Participant is, in fact, recommending security-based swaps to counterparties, we believe it is likely that person is engaged in other activities that would cause it to come within the definition of an SBS Dealer (and therefore no longer able to qualify as a Major SBS Participant) or other regulated entity that historically has been subject to a suitability obligation.

[141] See proposed Rule 15Fh-3(f).

counterparties, which are professional intermediaries or major participants in the swaps or security-based swap markets, would not need the protections that would be afforded by this rule.

In addition, when an SBS Dealer is acting as an advisor to a special entity, we are proposing that the suitability requirement will be deemed satisfied by compliance with the requirements of Rule 15Fh-4(b). Under Section 15F(h)(4), an SBS Dealer that acts as an advisor to a special entity is required to make a reasonable determination that its recommendations are in the best interests of the counterparty.[142] The statute and proposed Rule 15Fh-4(b)(2) set forth specific information that an SBS Dealer must make reasonable efforts to obtain as necessary when making that determination. As explained more fully in Section II.D.3, infra, the proposed rule would further require that the SBS Dealer act in the "best interests" of the special entity, which goes beyond and encompasses the general suitability requirements of proposed Rule 15Fh-3(f). Accordingly, we preliminarily believe that the general suitability requirement of proposed Rule 15Fh-3(f) should be deemed satisfied by compliance with the requirements of proposed Rule 15Fh-4(b).

Request for Comments

The Commission requests comments generally on all aspects of proposed Rule 15Fh-3(f). In addition, we request comments on the following specific issues:

- As noted above, the term "recommendation" has been interpreted in the context of

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[142] Section 15F(h)(4)(C) ("Any security-based swap dealer that acts as an advisor to a special entity shall make reasonable efforts to obtain such information as is necessary to make a reasonable determination that any security-based swap recommended by the security-based swap dealer is in the best interests of the special entity"). Pub. L. 111-203, 124 Stat. 1376, 1790- 1791 (to be codified at 15 U.S.C. 78o-10(h)(4)(C)).

the FINRA suitability requirement. Should the Commission define or describe more fully what is a "recommendation" in this context, and if so, what should the definition or description be and why? In what specific circumstances, if any, would additional guidance as to the meaning of a "recommendation" be useful? Does the existing FINRA guidance provide sufficient clarity in this regard? Why or why not? Would a different approach be appropriate given the differences in the market for security-based swaps? Why or why not? Should the Commission expressly address the application of any part of the FINRA guidance in this context? If so, how?

- Should the Commission permit an SBS Dealer to rely on the institutional suitability alternative that would be available under proposed Rule 15Fh-3(f)(2)? Why or why not? Should additional or different requirements be placed upon an SBS Dealer's use of this alternative? If so, what requirements should be added or changed and why?
- Is FINRA's guidance regarding the customer information a broker-dealer should have available in order to make a suitability determination an appropriate model for security-based swap markets? How, if at all, should that guidance be modified? Should the SBS Dealer be required to obtain different or additional information regarding the counterparty?
- Should the suitability obligations apply to Major SBS Participants, as well as to SBS Dealers? Why or why not?
- Should the suitability obligations apply to recommendations made to SBS Entities, swap dealers and major swap participants? Why or why not?

- Should the suitability obligations apply when recommendations are made to a counterparty that is a broker-dealer?[143] Another type of market intermediary? Why or why not? Are there any other circumstances in which the proposed suitability requirement should not apply, or should apply in a different way?
- Are there any particular types of security-based swap transactions for which heightened or otherwise modified suitability requirements should apply? If so, what types of transactions? What requirements should apply to these transactions?
- Should different categories of ECPs be treated differently under the proposed rules for purposes of suitability determinations? If so, how? For example, under our proposed rules an SBS Entity would be subject to the suitability requirement of proposed Rule 15F-3(f)(2) when entering into security-based swaps with any person that qualified as an ECP, a category that includes persons with $5 million or more invested on a discretionary basis that enter into the security-based swap "to manage risks."[144] In contrast, under FINRA rules, in order to apply an analogous suitability standard, a broker-dealer must be dealing with an entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least $50 million.[145] Should the Commission apply a different standard of suitability depending on whether the counterparty would be protected as a retail investor under FINRA rules when the SBS Dealer is also a registered

[143] FINRA "know your customer" obligations do not apply to a broker-dealer's dealings with another broker or dealer. See NASD Rule 0120(g) ("[t]he term 'customer' shall not include a broker or dealer").

[144] See Section 1a(18)(A)(xi) of the Commodity Exchange Act, as amended by the Dodd-Frank Act.

[145] See FINRA Rule 2111(b) (referring to NASD Rule 3110(c)(4)).

broker-dealer?[146] If so, what should the standard be and to whom should it apply? In what ways should the similarities and differences between security-based swaps and the types of securities transactions otherwise subject to FINRA rules inform the standard applied by the Commission in this context?

- Is it appropriate for the Commission to exclude from the scope of the proposed rule situations in which an SBS Dealer is making recommendations to a special entity, since recommendations to those entities are subject to separate and heightened suitability requirements? Why or why not?
- Should the proposed alternative available under proposed Rule 15Fh-3(f)(2) be limited to counterparties that would not be protected as retail investors under FINRA rules or another category of counterparties?[147] If not, should we require that the proposed alternative be addressed on a transaction-by-transaction basis (i.e., not generally on a relationship basis or asset-class-by-asset-class) for counterparties that would otherwise be protected as retail investors under FINRA rules or another category of counterparties? Why or why not?
- Should the suitability obligation be limited to recommendations to counterparties that would be protected as retail investors under FINRA rules or another subset of counterparties? If so, should these counterparties be covered by a suitability rule

146 Under FINRA rules, a retail customer would generally be an entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of less than $50 million). See NASD Rule 3110(c)(4). An SBS Dealer that is also a broker-dealer would need to have a reasonable basis to believe that any recommendation of security-based swap or trading strategy to such a person is suitable for that person, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the counterparty's investment profile. This general suitability obligation under current FINRA rules would apply regardless of whether the SBS Dealer could otherwise rely on the alternative under proposed Rule 15Fh-3(f)(2).

147 See id.

similar to FINRA Rule 2360 regarding options suitability? Should this requirement be limited to another category of counterparties?[148] Why or why not?

- Should the Commission provide guidance on other methods by which an SBS Dealer can assess a counterparty's capability to independently evaluate investment risks and exercise independent judgment? If so, what alternative approaches, and what would be the advantages and disadvantages for SBS Dealers and counterparties?
- Should the Commission impose specific requirements with respect to the level of detail that should be required for representations? If so, what requirements and why?
- Should the Commission permit SBS Dealers to rely on disclosures made by counterparties for purposes of proposed Rule 15Fh-3(f)(2) on a transaction-by-transaction basis, on an asset-class-by-asset-class basis, or in terms of all potential transactions between the parties? Why or why not? What are the potential advantages and disadvantages of such an approach?

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[148] FINRA Rule 2360(b)(19) (Suitability) provides that:

> (A) No member or person associated with a member shall recommend to any customer any transaction for the purchase or sale of an option contract unless such member or person associated therewith has reasonable grounds to believe upon the basis of information furnished by such customer after reasonable inquiry by the member or person associated therewith concerning the customer's investment objectives, financial situation and needs, and any other information known by such member or associated person, that the recommended transaction is not unsuitable for such customer.
>
> (B) No member or person associated with a member shall recommend to a customer an opening transaction in any option contract unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that he may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the option contract.

- What are the advantages and disadvantages of the two alternative proposed approaches to guidance on when an SBS Dealer may not rely on a representation? Which alternative would strike the best balance among the potential disadvantages to market participants, the regulatory interest (including protecting counterparties in security-based swap transactions) and promoting the sound functioning of the security-based swap market? What, if any, other alternatives should the Commission consider (e.g., a recklessness standard) and why?
- Are there particular categories of counterparties for which an SBS Dealer should be required to undertake further review or inquiry to establish a counterparty's capability? Should additional information be required when, for example, a potential counterparty is a natural person? If so, what review or inquiry should be required in what circumstances?
- Are there other potential reasonable methods of establishing a counterparty's capability to independently evaluate investment risks and exercise independent judgment besides written representations? Should the Commission consider providing guidance regarding these other methods? If so, what methods should such guidance address and how?

5. Fair and Balanced Communications

Proposed Rule 15Fh-3(g) would implement the statutory requirement that SBS Entities communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith.[149] This obligation would apply in connection with entering into security-based swaps, and would continue to apply over the term of a

[149] See Exchange Act Section 15F(h)(3)(C), Pub. L. 111-203, 124 Stat. 1376, 1790 (to be codified at 15 U.S.C. 78o-10(h)(3)(C)).

security-based swap.[150] The standard is consistent with the similarly worded requirement in the FINRA customer communications rule, which is designed to ensure that any customer communications reflect a balanced treatment of potential benefits and risks.[151] As we explained in Section I.C.2, supra, when a business conduct standard is based on a similar SRO standard, we generally expect to interpret our standard consistently with SRO interpretations of their rules, recognizing that we may need to account for functional differences between the security-based swap market and other securities markets. Accordingly, we are proposing three additional standards, drawn from FINRA regulation, to clarify the statutory requirement.[152] These standards do not represent an exclusive list of considerations that an SBS Entity must make in determining whether a communication with a counterparty is fair and balanced.

We propose to require that communications must provide a sound basis for evaluating the facts with respect to any security-based swap or trading strategy involving a security-based swap that the communication is designed to cover.[153] In addition, we propose to prohibit communications that imply that past performance would recur, or that

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150 See proposed Rule 15Fh-1.

151 NASD Rule 2210(d). See IM-2210-1(1), Guidelines to Ensure That Communications with the Public Are Not Misleading ("Members must ensure that statements are not misleading within the context in which they are made. A statement made in one context may be misleading even though such a statement could be appropriate in another context. An essential test in this regard is the balanced treatment of risks and potential benefits.").

152 Cf. SIFMA/ISDA 2010 Letter at 4 (requesting the Commission clarify the standards for fair and balanced communication by reference to the existing FINRA standards for customer communication, subject to appropriate modifications to reflect the heightened standards for participation in the swap markets).

153 Proposed Rule 15Fh-3(g)(1). Cf. NASD Rule 2210(d)(1)(A) ("All member communications with the public shall be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service.").

make any exaggerated or unwarranted claim, opinion, or forecast.[154] Finally, we propose to require that any statement referring to the potential opportunities or advantages presented by a security-based swap or trading strategy involving a security-based swap be balanced by a statement of the corresponding risks having the same degree of specificity as the statement of opportunities.[155] SBS Entities should also avoid broad generalities in their communications, to the extent appropriate and practicable under the circumstances.

We note that, regardless of the scope of the rules proposed herein, all communications by SBS Entities will be subject to the specific anti-fraud provisions added to the Exchange Act under Title VII of the Dodd-Frank Act,[156] as well as general anti-fraud provisions under the federal securities laws.[157]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission further clarify any proposed requirements to engage in fair and balanced communications? If so, how? Are there specific circumstances

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[154] Proposed Rule 15Fh-3(g)(2). Cf. NASD Rule 2201(d)(1)(D) ("Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy."). Proposed Rule 15Fh-3(e)(4) does not constitute a blanket prohibition of communications such as scenario or profitability analyses that are required or advisable under other provisions of these rules.

[155] Proposed Rule 15Fh-3(g)(3). Cf. NASD IM-2210-1(1) ("An essential test in this regard is the balanced treatment of risks and potential benefits.").

[156] See Sections 9(j) and 15F(h)(4)(A) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1777- 1778 and 1790 (to be codified at 15 U.S.C. 78i(j) and 15 U.S.C. 78o-10(h)(4)(A)). See also Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps, Exchange Act Release No. 63236 (Nov. 3, 2010), 75 FR 68560 (Nov. 8, 2010) (proposing Rule 9j-1 to implement the anti-fraud prohibitions of Section 9(j) of the Exchange Act).

[157] See, e.g., 15 U.S.C. 77q and 78i, and, if the SBS Entity is registered as a broker-dealer, 15 U.S.C. 78o.

regarding the application of the proposed requirements that the Commission should address? If so, which circumstances, and what guidance is required?

- Should the Commission specify any additional requirements for the duty to engage in fair and balanced communications? If so, what requirements and why?
- Should an SBS Entity be able to rely on SRO guidance with respect to communications for purposes of compliance with the proposed rule? If so, how would such reliance function as both the security-based swap market and the broader securities markets continue to evolve?
- Should the Commission provide additional guidance with respect to the nature of fair and balanced communications for purposes of furthering compliance with the proposed rule and providing greater legal certainty to market participants? If so, what guidance and why?
- What are the specific practical effects, advantages and disadvantages that market participants identify in considering how to comply with the proposed rules? Are there modifications or clarifications to the proposed rules that would better balance the advantages and disadvantages of the statutory requirement while furthering the Commission's regulatory objectives?
- Are there any particular differences between the traditional securities markets and the markets for security-based swaps that need to be taken into account in clarifying the statutory requirement to communicate in a fair and balanced manner based on principles of fair dealing and good faith? If so, what are these differences, and how should the Commission's proposal be modified to take them into account?

- Should we distinguish between the fair and balanced communication requirements applicable to an SBS Dealer and those applicable to a Major SBS Participant? If so, how should the requirements applicable to a Major SBS Participant differ from those that are being proposed?
- Are there any circumstances in which the fair and balanced communications requirements should not apply? Which circumstances, and why?
- We preliminarily believe that proposed Rule 15F-3(g) would provide additional investor protection beyond what would otherwise arise by virtue of applicable anti-fraud rules. Will the proposed communications requirements have the effect of reducing communications between SBS Entities and their counterparties? In what respects, and why? What alternative approaches might the Commission consider to effectively implement the statutory requirement without unduly discouraging effective communication between market participants?

6. Obligation Regarding Diligent Supervision

Exchange Act Section 15F(h)(1)(B) authorizes the Commission to adopt rules for the diligent supervision of the business of SBS Entities. Proposed Rule 15Fh-3(h) would establish supervisory obligations that incorporate principles from both Exchange Act Section 15(b) and existing SRO rules.[158] As we discussed earlier, the concept of diligent

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[158] The Commission's policy regarding failure to supervise is well established. 15 U.S.C. 78o(b)(4)(E) and 15 U.S.C. 78o(b)(6)(A). As we have explained in other contexts:

> The Commission has long emphasized that the responsibility of broker-dealers to supervise their employees is a critical component of the federal regulatory scheme. . . . In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention. The supervisory obligations imposed by the federal securities laws require a vigorous response even to indications of wrongdoing. Many of the Commission's cases involving a failure to supervise arise from situations where supervisors were aware

supervision is consistent with business conduct standards for broker-dealers that have historically been established by SROs for their members, subject to Commission approval. We anticipate that certain SBS Entities may also be registered broker-dealers and thus subject to substantially similar requirements under SRO rules.[159] More generally, we believe that the SRO requirements provide a useful point of reference that has been implemented by a wide range of firms in the U.S. financial services industry.

Under proposed Rule 15Fh-3(h)(1), each SBS Entity would be required to establish, maintain and enforce a system to supervise, and would be required to supervise diligently, the business of the SBS Entity involving security-based swaps.[160] This system would be required to be reasonably designed to achieve compliance with applicable federal securities laws and the rules and regulations thereunder.[161] Proposed Rule 15Fh-

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> only of "red flags" or "suggestions" of irregularity, rather than situations where, as here, supervisors were explicitly informed of an illegal act.
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> Even where the knowledge of supervisors is limited to "red flags" or "suggestions" of irregularity, they cannot discharge their supervisory obligations simply by relying on the unverified representations of employees. Instead, as the Commission has repeatedly emphasized, "[t]here must be adequate follow-up and review when a firm's own procedures detect irregularities or unusual trading activity...." Moreover, if more than one supervisor is involved in considering the actions to be taken in response to possible misconduct, there must be a clear definition of the efforts to be taken and a clear assignment of those responsibilities to specific individuals within the firm.

John H. Gutfreund, Exchange Act Release No. 31554 (Dec. 3, 1992) (report pursuant to Section 21(a) of the Exchange Act) (footnotes omitted).

159 See, e.g., NASD Rules 3010 and 3012.

160 We will consider consolidating any recordkeeping obligations proposed as part of this rule into a separate recordkeeping rule that we are required to adopt under the Dodd-Frank Act. See Section 15F(f)(2) of the Exchange Act, 15 U.S.C. 78o-10(f)(2) ("The Commission shall adopt rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants.").

161 Proposed Rule 15Fh-3(h)(2). See NASD Rule 3010(a) ("Each member shall establish and maintain a system to supervise the activities of each registered representative, registered principal, and other associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules.").

3(h) would provide a baseline requirement for an effective supervisory system, although a particular system may need additional elements in order to be effective. For that reason, proposed Rule 15Fh-3(h)(2) would state that it establishes only minimum requirements; by implication, the list would not be exhaustive. These obligations are based on SRO standards and we generally expect to interpret these obligations taking into account SRO interpretations of their rules, recognizing that we are not bound by SRO interpretations and may need to account for functional differences between the security-based swap market and other securities markets.

Proposed Rule 15Fh-3(h)(2)(i) would require an SBS Entity to designate at least one qualified person with supervisory responsibility for security-based swap transactions.[162] Proposed Rule 15Fh-3(h)(2)(ii) would require an SBS Entity to use reasonable efforts to determine that all supervisors are qualified and have sufficient training, experience, and competence to adequately discharge their responsibilities.[163] Proposed Rule 15Fh-3(h)(2)(iii) would require an SBS Entity to adopt written policies and procedures addressing the types of security-based swap business in which the SBS Entity is engaged. The policies and procedures would need to be reasonably designed to achieve compliance with applicable securities laws and the rules and regulations thereunder,[164] and include, at a minimum: (1) procedures for the review by a supervisor

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[162] Cf. NASD Rule 3010(a)(2) (requiring "[t]he designation, where applicable, of an appropriately registered principal(s) with authority to carry out the supervisory responsibilities of the member for each type of business in which it engages for which registration as a broker/dealer is required").

[163] Cf. NASD Rule 3010(a)(6) (requiring members to use "[r]easonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities").

[164] Cf. NASD Rule 3010(b)(1) ("Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered

of all transactions for which registration as an SBS Entity is required;[165] (2) procedures for the review by a supervisor of written correspondence with counterparties and potential counterparties and internal written (including electronic) communications relating to the securities-based swap business;[166] (3) procedures for a periodic review of the security-based swap business in which it engages;[167] (4) procedures to conduct reasonable investigation into the background of associated persons;[168] (5) procedures to monitor employee personal accounts held at another SBS Dealer, broker, dealer, investment adviser, or other financial institution;[169] (6) a description of the supervisory

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representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD.").

165 Proposed Rule 15Fh-3(h)(2)(iii)(A). Cf. NASD Rule 3010 (d)(1) ("Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member. Such procedures should be in writing and be designed to reasonably supervise each registered representative.").

166 Proposed Rule 15Fh-3(h)(2)(iii)(B). Cf. NASD Rule 3010(d)(2) (which provides in part that "[e]ach member shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business, including procedures to review incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures").

167 Proposed Rule 15Fh-3(h)(2)(iii)(C). Cf. NASD Rule 3010(c)(1) ("Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable NASD rules.").

168 Proposed Rule 15Fh-3(h)(2)(iii)(D). Cf. NASD Rule 3010(e) ("Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association.").

169 Proposed Rule 15Fh-3(h)(2)(iii)(E).

system, including identification of the supervisory personnel;[170] (7) procedures prohibiting supervisors from supervising their own activities or reporting to, or having their compensation or continued employment determined by, a person or persons they are supervising;[171] and (8) procedures preventing the standards of supervision from being reduced due to any conflicts of interest that may be present with respect to the associated person being supervised.[172] Proposed Rule 15Fh-3(h)(4) would require SBS Entities to promptly update their supervisory procedures as legal or regulatory changes warrant. Proposed Rule 15Fh-3(h)(2)(iii)(F) would require SBS Entities to maintain records identifying supervisory personnel.

As part of the required system reasonably designed to achieve compliance with applicable federal securities laws and regulations, proposed Rule 15Fh-3(h)(2)(iv) would require an SBS Entity to adopt written policies and procedures reasonably designed, taking into consideration the nature of such SBS Entity's business, to comply with the

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170 Proposed Rule 15Fh-3(h)(2)(iii)(F). Cf. NASD Rule 3010(b)(3) ("The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the Rules of this Association.").

171 Proposed Rule 15Fh-3(h)(2)(iii)(G). Cf. NASD Rule 3012(a)(2)(A)(i) ("General Supervisory Requirement. A person who is either senior to, or otherwise independent of, the producing manager must perform such supervisory reviews.").

172 Proposed Rule 15Fh-3(h)(2)(iii)(H). These conflicts could arise from the position of the associated person being supervised, the revenue that person generates for the SBS Entity, or any compensation that the person conducting the supervision may derive from the associated person being supervised. Cf. NASD Rule 3012(a)(2)(C) (requiring "procedures that are reasonably designed to provide heightened supervision over the activities of each producing manager who is responsible for generating 20% or more of the revenue of the business units supervised by the producing manager's supervisor. For the purposes of this subsection only, the term 'heightened supervision' shall mean those supervisory procedures that evidence supervisory activities that are designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial, or financial interests that the supervisor holds in the associated persons and businesses being supervised.").

duties set forth in Section 15F(j) of the Exchange Act.[173] Section 15F(j) of the Exchange Act requires an SBS Entity to comply with obligations concerning: (1) monitoring of trading to prevent violations of applicable position limits; (2) establishing sound and professional risk management systems; (3) disclosing to regulators information concerning its trading in security-based swaps; (4) establishing and enforcing internal systems and procedures to obtain any necessary information to perform any of the functions described in Section 15F of the Exchange Act, and providing the information to regulators, on request; (5) implementing conflict-of-interest systems and procedures that establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap, or acting in the role of providing clearing activities, or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards addressed in Title VII of the Dodd-Frank Act; and (6) addressing antitrust considerations such that the SBS Entity does not adopt any process or take any action that results in any unreasonable restraint of trade or impose any material anticompetitive burden on trading or clearing.

Under proposed Rule 15Fh-3(h)(3), an SBS Entity or associated person would not have failed diligently to supervise a person that is subject to the supervision of that SBS Entity or associated person, if two conditions are met. First, the SBS Entity must have

[173] Pub. L. 111-203, 124 Stat. 1376, 1792-- 1793 (to be codified at 15U.S.C. 78o-10(j)).

established policies and procedures, and a system for applying those policies and procedures, which would reasonably be expected to prevent and detect, to the extent practicable, any violation of the federal securities laws and the rules thereunder related to security-based swaps. Second, such person must have reasonably discharged the duties and obligations incumbent on it by reason of such procedures and system without a reasonable basis to believe that such procedures were not being followed. However, the absence of either or both of these conditions would not necessarily mean that an SBS Entity or associated person failed to diligently supervise any other person.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should supervisory requirements be imposed on Major SBS Participants? Why or why not?
- Should different supervisory requirements apply to SBS Dealers and Major SBS Participants? If so, how should the requirements differ, and why?
- Should we require a specific means by which an SBS Entity must determine whether a supervisor is qualified and has sufficient training, experience, and competence to adequately discharge his or her responsibilities? If so, what means? For example, should we require that supervisors pass exams comparable to FINRA Series 24? Should any such requirement apply to supervisors at Major SBS Participants as well, or only to supervisors at SBS Dealers?
- Should the Commission consider imposing a testing requirement comparable to FINRA Series 7 for all associated persons of an SBS Dealer or Major SBS

Participant? Why or why not? Are there other models the Commission should consider? Which models, and why?

- Would any of these proposed supervisory requirements be more appropriately assigned to the chief compliance officer, and if so, which ones and why?
- Should certain obligations not be imposed on a supervisor of an SBS Entity? If so, which ones and why?
- Should an SBS Entity be able to rely on SRO guidance with respect to supervision for purposes of compliance with the proposed rule? Is that guidance sufficiently clear under the circumstances? Should that guidance be adopted or modified for purposes of its application to SBS Entities in the context of the security-based swap markets? If so, how and why?
- Do any of these proposed supervisory obligations conflict with current supervisory obligations, and if so, which ones and how?
- Should the Commission impose explicit supervision obligations with respect to the requirements of Section 15F(j), and if so, which ones and why? In particular, should the Commission impose explicit obligations with respect to the monitoring of trading to prevent violations of applicable position limits? Should the Commission impose explicit obligations with respect to establishing sound and professional risk management systems? Should the Commission impose explicit obligations to disclose to regulators information concerning trading in security-based swaps? Should the Commission impose explicit obligations with respect to establishing and enforcing internal systems and procedures to obtain any necessary information to perform any of the functions described in Section 15F of

the Act? Should the Commission impose explicit obligations with respect to providing the information to regulators, on request? Should the Commission impose explicit obligations with respect to implementing conflict-of-interest systems and procedures to ensure that activities relating to research or analysis of the price or market for any security-based swap, clearing activities, and determinations as to accepting clearing customers are separated from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards addressed in the Act? Should the Commission impose explicit obligations with respect to addressing antitrust considerations such that the SBS Entity does not adopt any process or take any action that results in any unreasonable restraint of trade; or impose any material anticompetitive burden on trading or clearing?

- Should an SBS Entity be required to have policies and procedures reasonably designed to prevent the improper use or disclosure of counterparty information?[174]

[174] As noted above, proposed Rule 15Fh-3(h)(2)(iv) would require SBS Entities to adopt written policies and procedures reasonably designed, taking into consideration the nature of such SBS Entity's business, to comply with the duties set forth in Section 15F(j) of the Exchange Act, including implementing conflict-of-interest systems and procedures that establish structural and institutional safeguards to ensure that the activities of any person within the firm relating to research or analysis of the price or market for any security-based swap, or acting in the role of providing clearing activities. and or making determinations as to accepting clearing customers are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of persons whose involvement in pricing, trading, or clearing activities might potentially bias their judgment or supervision and contravene the core principles of open access and the business conduct standards described in Title VII of the Dodd-Frank Act.

D. Proposed Rules Applicable to Dealings with Special Entities

Congress has provided certain additional protections under Sections 15F(h)(4) and (5) of the Exchange Act for "special entities" in connection with security-based swaps.[175] Under the terms of Section 15F(h)(7) of the Exchange Act, Section 15F(h) would not apply to a transaction that is initiated by a special entity on an exchange or SEF and the SBS Entity does not know the identity of the counterparty to the transaction. The statute does not define the term "initiated". We preliminarily believe that there may be circumstances in which it may be unclear which party, in fact, "initiated" the communications that resulted in the parties entering into a security-based swap transaction. Accordingly, we are proposing to read Section 15F(h)(7) to apply to any transaction with a special entity on a SEF or an exchange where the SBS Entity does not know the identity of its counterparty. We recognize that, under this reading, the exemption under Section 15F(h)(7) would be available regardless of which side "initiates" a transaction, so long as the other conditions are met. We are seeking comment on whether this reading is appropriate or whether another possible reading of this provision should be made.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission adopt a different interpretation of Section 15F(h)(7)? If so, what interpretation and why?

[175] See discussion in Section I.C.5, supra.

- Should the exemption be limited to situations in which the special entity takes specific steps, such as submitting a request for quote or some other communication regarding a potential transaction on an exchange or SEF? Are there other communications or circumstances of entry into a security-based swap that should be regarded as the "initiation" of a transaction by a special entity? If so, which ones?

- Should the exemption continue to apply if the SBS Entity learns the identity of the special entity? If so, under what conditions and why?

1. Scope of the Definition of "Special Entity"

Exchange Act Section 15F(h)(2)(C) defines a "special entity" as: (i) a Federal agency;[176] (ii) a State, State agency, city, county, municipality, or other political subdivision of a State;[177] (iii) any employee benefit plan, as defined in section 3 of ERISA;[178] (iv) any governmental plan, as defined in section 3 of ERISA;[179] or (v) any

[176] The definition of "security-based swap" excludes an "agreement, contract or transaction a counterparty of which is a Federal Reserve bank, the Federal Government, or a Federal agency that is expressly backed by the full faith and credit of the United States." Section 3(a)(68) of the Exchange Act, by reference to Section 1a of the Commodity Exchange Act. Accordingly, the Commission expects that special entities that are Federal agencies will be a narrow category for purposes of these rules.

[177] Cf. Exchange Act Section 15B(e)(8), Pub. L. 111-203, 124 Stat. 1376, 1790 – 1791 (to be codified at 15 U.S.C. 78o-4(e)(8)) (defining "municipal entity" to include "any agency, authority, or instrumentality of the States, political subdivision, or municipal corporate entity"); 17 CFR 275.206(4)-5 (defining "governmental entity" to include "any agency, authority, or instrumentality of the state or political subdivision").

[178] 29 U.S.C. 1002. The term "special entity" includes employee benefit plans defined in section 3 of ERISA. This class of employee benefit plans is broader than the category of plans that are "subject to" ERISA for purposes of Section 15F(h)(5)(A)(i)(VII) of the Exchange Act. Employee benefit plans not "subject to" regulation under ERISA include: (1) governmental plans; (2) church plans; (3) plans maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws; (4) plans maintained outside the U.S. primarily for the benefit for persons substantially all of whom are nonresident aliens; or (5) unfunded excess benefit plans. See 29 U.S.C. 1003(b).

endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.[180] Commenters have raised a number of questions about the scope of the definition, as to which we are soliciting further comment below.[181]

Request for Comments

The Commission requests comment on all aspects of the definition of "special entity." In particular, we are seeking comment as to what clarifications to the definition may be required and why. Commenters should also explain why any suggested clarification is consistent with both the express statutory language and the policies underlying Section 764 of the Dodd-Frank Act. In addition, the Commission requests comments on the following specific issues.

- Should the Commission interpret "employee benefit plan, as defined in section 3" of ERISA to mean a plan that is subject to regulation under ERISA?[182] Why or why not?

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179 Section 3(32) of ERISA defines "governmental plan" as a "plan established or maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing." 29 U.S.C. 1002(32).

180 The term "endowment" is not defined in the Dodd-Frank Act, or in the securities laws generally.

181 See, e.g., SIFMA/ISDA 2010 Letter at 2 (requesting confirmation that "collective investment vehicles do not become 'Special Entities' merely as a result of the investment by Special Entities in such vehicles," and asserting that "master trusts holding the assets of one or more funded plans of a single employer should be considered 'Special Entities'").

182 See, e.g., id. (requesting confirmation that "plans not subject to the Employee Retirement Income Security Act of 1974 ('ERISA') (unless they are covered by another applicable prong of the "Special Entity" definition (e.g., governmental plans)) are not 'Special Entities'"). Section 4 of ERISA provides that the provisions of ERISA shall not apply to an employee benefit plan that is a governmental plan (as defined in section 1002(32) of ERISA); a church plan (as defined in section 1002(33) of ERISA) with respect to which no election has been made under 26 U.S.C. section 410(d); a plan that is maintained solely for the purpose of complying with applicable workmen's compensation laws or unemployment compensation or disability insurance laws; a plan that is maintained outside of the United States primarily for the benefit of persons substantially all of whom are nonresident aliens; or a plan that is an excess benefit plan (as defined in section 1002(36) of ERISA) and is unfunded.

- Should the Commission interpret "government plan" to include government investment pools or other plans, programs or pools of assets? Why or why not?
- Should the Commission define "endowment"? If so, how? What organizations should be included in or excluded from the definition, and why?[183] Should the Commission interpret "endowment" to include funds that are not separate legal entities? Why or why not? Should the term "endowment" include legal entities or funds that are not organized or located in the United States? Should the term "endowment" be limited to those organizations described in Section 501(c)(3) of the Internal Revenue Code?
- Should the Commission interpret "endowment" to include an organization that uses the assets of its endowment to pledge or maintain collateral obligations, or otherwise enhance or support the organization's obligations under a security-based swap?[184] Why or why not?
- Should the Commission interpret "special entity" to exclude a collective investment vehicle in which one or more special entities have invested?[185] Should

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See Letter from Daniel Crowley, Partner, K&L Gates on behalf of the Church Alliance, to David A. Stawick, Secretary, CFTC (Feb. 22, 2011) (on file with the CFTC), http://comments.cftc.gov/PublicComments/CommentList.aspx?id=935 (requesting clarification that church plans be included in the definition of special entity).

183 For accounting purposes, the term "endowment" is defined to mean "[a]n established fund of cash, securities, or other assets to provide income for the maintenance of a not-for-profit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Endowment funds generally are established by donor-restricted gifts and bequests to provide a permanent endowment, which is to provide a permanent source of income, or a term endowment, which is to provide income for a specified period." Financial Accounting Standards Board ASC Section 958-205-20, Glossary, Non-for-Profit Entities.

184 See Swap Financial Group Presentation at 8 (concerning the scope of this prong of the definition of "special entity").

185 See note 181, supra.

a collective investment vehicle be considered a special entity if the fund manager, for example, becomes subject to fiduciary duties under ERISA with respect to plan assets in the fund? Why or why not?

- Should the Commission exclude from the definition of "special entity" any foreign entity?
- Should the Commission interpret "special entity" to include a master trust holding the assets of one or more funded plans of a single employer and its affiliates?[186] Why or why not?

2. Best Interests

Section 15F(h) of the Exchange Act uses the term "best interests" in several instances with respect to special entities. Section 15F(h)(4)(B) imposes on an SBS Dealer that "acts as an advisor" to a special entity a duty to act in the "best interests" of the special entity. In addition, Section 15F(h)(4)(C) requires the SBS Dealer that "acts as an advisor" to a special entity to make "reasonable efforts to obtain such information as is necessary to make a reasonable determination" that any swap recommended by the SBS Dealer is in the "best interests" of the special entity. Finally, Section 15F(h)(5) of the Exchange Act requires an SBS Entity that is a counterparty to a special entity to have a "reasonable basis" to believe that the special entity has an independent representative that undertakes to act in the best interests of the special entity.[187]

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186 See id.

187 Section 15F(h)(5)(A)(i)(IV) of the Exchange Act, Pub. L. No. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(i)(IV)).

The term "best interests" is not defined in the Dodd-Frank Act. The Commission is not proposing to define "best interests" in this rulemaking. Instead we are seeking comment on whether we should define that term, and if so, whether such definition should use formulations based on the standards applied to investment advisers,[188] municipal advisors,[189] or ERISA fiduciaries,[190] or some other formulation.[191]

Request for Comments

The Commission is seeking comment generally on whether and how it should clarify the meaning of the term "best interests" under Section 15F(h). In addition, we request comments on the following specific issues:

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188 We recently stated that, under the Advisers Act, an adviser is a fiduciary whose duty is to serve the best interests of its clients, which includes an obligation not to subordinate clients' interests to its own. An adviser must deal fairly with clients and prospective clients, seek to avoid conflicts with its clients and, at a minimum, make full disclosure of any material conflict or potential conflict. See Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010), 75 FR 49234 (Aug. 12, 2010), citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-194 (1963) (holding that investment advisers have a fiduciary duty enforceable under Section 206 of the Advisers Act, that imposes upon investment advisers the "affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation to 'employ reasonable care to avoid misleading'" their clients and prospective clients).

189 See, e.g., Exchange Act Section 15B(b)(2)(L), Pub. L. No. 111-203, 124 Stat. 1376, 1919 (to be codified at 15 U.S.C. 78o-4(b)(2)(L)) (requiring the MSRB to prescribe means reasonably designed to prevent acts, practices, and courses of conduct that are not consistent with a municipal advisor's fiduciary duty to its municipal entity clients). The MSRB requested comment on draft Rule G-36 concerning the fiduciary duty of municipal advisors, and a draft interpretive notice under Rule G-36. See MSRB Notice 2011-14 (Feb. 14, 2011).

190 See, e.g., 29 U.S.C. 1104(a)(1)(A) ("a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan") and 29 U.S.C. 1104(a)(1)(B) (a fiduciary must act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims").

191 We note that Section 913 of the Dodd-Frank Act authorizes the Commission to promulgate rules to provide that the standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide) shall be to act in the best interest of the customer without regard to the financial or other interest of the intermediary providing the advice. Pub. L. No. 111-203, 124 Stat. 1376, 1827-1829.

- Should the Commission define the term "best interests" in this context? If so, what definitions should the Commission consider and why? What are the advantages and drawbacks of particular definitions in this context? What factors should be included in the determination of a special entity's "best interests"?
- Should the Commission adopt a definition of "best interests" that is based on the fiduciary duty applicable to investment advisers under the Investment Advisers Act of 1940 ("Advisers Act")?[192] Why or why not?
- Should the Commission adopt a definition of "best interests" that is based on the fiduciary duty applicable to municipal advisors under the Exchange Act?[193] Why or why not?
- Should the Commission adopt a definition of "best interests" that is based on the fiduciary duty applicable to fiduciaries under ERISA?[194] Why or why not?
- Should the Commission define "best interests" in a manner consistent with how it may define "best interests" in any rulemaking it may choose to propose under Section 913 of the Dodd-Frank Act, if any? Why or why not?

3. Anti-fraud Provisions: Proposed Rule 15Fh-4(a)

Section 15F(h)(4)(A) of the Exchange Act provides that it shall be unlawful for an SBS Entity to: (i) employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity; (ii) engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective

192 See supra note 188.

193 See supra note 189.

194 See supra note 190.

customer who is a special entity; or (iii) to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative. Consistent with the guidance in our previous order regarding the effective date of this provision, we are proposing a rule to render the statutory standard effective.[195]

4. Advisor to Special Entities: Proposed Rules 15Fh-2(a) and 15Fh-4(b)

Exchange Act Section 15F(h)(4) imposes a duty on an SBS Dealer that acts as an advisor to a special entity to act in the best interests of the special entity.[196] The Dodd-Frank Act does not define "advisor." Commenters have urged us to establish a clear standard for determining when an SBS Dealer is acting as an advisor within the meaning of Section 15F(h)(4).[197] These commenters have expressed concern that compliance with the "best interests" standard applicable to advisors would create significant burdens and potential legal liability for SBS Dealers, and therefore SBS Dealers need certainty as to when they would or would not be acting as an advisor. For example, commenters have

195 See Order Pursuant to Sections 15F(b)(6) and 36 of the Securities Exchange Act of 1934 Granting Temporary Exemptions and Other Temporary Relief, Together with Information on Compliance Dates for New Provisions of the Securities Exchange Act of 1934 Applicable to Security-Based Swaps, and Request for Comment, Securities Act Release No. 64678 (June 15, 2011), 76 FR 36287 (June 22, 2011) at note 192:

> Section 15F(h)(6) of the Exchange Act, 15 U.S.C. 78o-10(h)(6), directs the Commission to "prescribe rules under this subsection [(h) of the Exchange Act, 15 U.S.C. 78o-10(h),] governing business conduct standards." Accordingly, business conduct standards pursuant to section 15F(h) of the Exchange Act, 15 U.S.C. 78o-10(h), will be established by rule and compliance will be required on the compliance date of the Commission rule establishing these business conduct standards.

196 Section 15F(h)(2)(A) of the Exchange Act requires all SBS Entities to comply with the requirements of Section 15F(h)(4). Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(2)(A)). The anti-fraud prohibitions of Section 15F(h)(4)(A) apply by their terms to all SBS Entities. Sections 15F(h)(4)(B) and (C) impose certain "best interests" obligations on an SBS Dealer that acts as an advisor to a special entity. See also Section II.D.2, infra.

197 See, e.g., SIFMA/ISDA 2010 Letter at 2 ("It is essential that the Commissions articulate a clear standard for the circumstances that give rise to 'advisor' status and the corresponding imposition of the statutory 'fiduciary-like' duty to act in the best interests of a Special Entity.")

expressed concern that the business conduct obligations imposed by the Dodd-Frank Act might cause an SBS Dealer to be a "fiduciary" under ERISA, and therefore effectively prohibit SBS Dealers from entering into security-based swaps with pension plans that are subject to ERISA.[198] We recognize the importance of this issue, both for dealers and for the pension plans that may rely on security-based swaps to manage risk and reduce volatility. The determination whether an SBS Dealer is acting as an advisor for purposes of Section 15F(h)(4) and proposed Rule 15Fh-4(b) is not intended to prejudice the determination whether the SBS Entity is otherwise subject to regulation as an ERISA fiduciary.[199] Although each regulatory regime applies independently, we anticipate that Commission staff will continue to consult with representatives of the Department of Labor to facilitate a full understanding of how the regulatory regimes interact with one another, and to determine whether any modifications to our proposed rules may be necessary or appropriate in light of these interactions.

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198 As discussed in note 99, supra, the Department of Labor is proposing amendments to the definition of a fiduciary under ERISA that would provide a limited exception for a person that renders "investment advice" for compensation if that person "can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice." The Department of Labor in its proposing release explained that it had determined that "such communications ordinarily should not result in fiduciary status . . . if the purchaser knows of the person's status as a seller whose interests are adverse to those of the purchaser, and that the person is not undertaking to provide impartial investment advice." Definition of the Term "Fiduciary," 75 FR 65263, 65267 (Oct. 22, 2010).

199 See Letter from Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, Department of Labor, to Gary Gensler, Chairman, CFTC (Apr. 28, 2011) ("In [the Department of Labor's] view, a swap dealer or major swap participant that is acting as a plan's counterparty in an arm's length bilateral transaction with a plan represented by a knowledgeable independent fiduciary would not fail to meet the terms of the counterparty exception solely because it complied with the business conduct standards set forth in the CFTC's proposed regulation."), http://comments.cftc.gov/PublicComments/CommentList.aspx?id=935.

An SBS Dealer that is acting as an advisor must in any case comply with the requirements of the Dodd-Frank Act. If an SBS Dealer is acting as an advisor, then under Section 15F(h)(4) and proposed Rule 15Fh-4(b), it must act in the best interests of the special entity. As part of its duty to act in the best interests of the special entity, the SBS Dealer would be required to provide suitable advice.[200] Consistent with Section 15F(h)(4)(C), proposed Rule 15Fh-4(b)(2) would require an SBS Dealer in these circumstances to make reasonable efforts to obtain the information it considers necessary to make a reasonable determination that any recommended security-based swap or trading strategy involving a security-based swap is in the best interests of the special entity. The proposed rule would identify specific types of information that the SBS Dealer should take into account in making this determination. This information would include, but not be limited to, the authority of the special entity to enter into a security-based swap; the financial status of the special entity, as well as future funding needs; the tax status of the special entity; the investment or financing objectives of the special entity; the experience of the special entity with respect to entering into security-based swaps, generally, and security-based swaps of the type and complexity being recommended; whether the special entity has the financial capability to withstand changes in market conditions during the term of the security-based swap; and such other information as is relevant to the particular facts and circumstances of the special entity, market conditions and the type of security-based swap or trading strategy involving a security-based swap being recommended.

200 See Section II.C.4. infra (discussing the interaction of the "best interests" and "suitability" standards).

Proposed Rule 15Fh-2(a) would generally define "act as an advisor" in the context of an SBS Dealer to mean recommending a security-based swap or a trading strategy involving a security-based swap to a special entity.[201] For these purposes, "recommending" would have the same meaning as that discussed above in connection with proposed Rule 15Fh-3(f). An SBS Dealer would not be deemed an "advisor" to a special entity with a duty under Section 15F(h)(4) and proposed Rule 15Fh-4(b) to act in the "best interests" of the special entity if it did not make a "recommendation" to a special entity. Commenters have advised us that, in order to avoid making a "recommendation" and unintentionally becoming an "advisor" to a special entity SBS Dealers may simply refrain from interacting with special entities – particularly to the extent that they perceive any uncertainty in the determination of whether a particular communication would constitute a "recommendation."[202]

It is important to note that the duties imposed on an SBS Dealer that is "acting as an advisor" – as well as the definition of that phrase in proposed Rule 15Fh-2(a) – are specific to this advisory context, and are in addition to any duties that may be imposed under other applicable law. Among other things, an SBS Dealer that acts as an advisor to a special entity may fall within the definition of "investment adviser" under Section 202(a)(11) of the Advisers Act unless it can rely on the exclusion provided by Section 202(a)(11)(C) for a broker-dealer whose advice is "solely incidental" to the conduct of its business as a broker dealer and who receives no special compensation therefor, or other

201 See Section II.C.4 regarding what would or would not generally be considered a recommendation.

202 See, e.g., SIFMA 2011 Letter.

applicable exclusion.[203] An SBS Dealer that acts as an advisor to a municipal entity may also be a "municipal advisor" under Section 15B(e) of the Exchange Act.[204]

Commenters have suggested that the standard established by Section 15F(h)(4) for an SBS Dealer acting as an advisor to a special entity could "have the effect of chilling a critical element of the customary commercial interactions" with special entities, absent some greater legal certainty about when an SBS Dealer would, in fact, be deemed to be "acting as advisor" to a special entity.[205] Accordingly, proposed Rule 15Fh-2(a) would provide this legal certainty by permitting an SBS Dealer to establish that it is not acting as an advisor where certain conditions are met. Under the proposed rule, the special entity must represent, in writing, that it will not rely on recommendations provided by the SBS Dealer and that it instead will rely on advice from a "qualified independent representative," as defined in proposed Rule 15Fh-5(a) and discussed more fully below in Section II.D.4.c. In addition, the SBS Dealer must disclose to the special entity that by obtaining the special entity's written representation as described above, the SBS Dealer is not undertaking to act in the best interests of the special entity, as would otherwise be required under Section 15F(h)(4).[206] Finally, the SBS Dealer must have a reasonable basis to conclude that the special entity has a qualified independent representative.[207]

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203 See 15 U.S.C. 80b-2(a)(11).

204 See Pub. L. 111-203, 124 Stat. 1376, 1921 – 1922 (to be codified at 15 U.S.C. 78o-4).

205 SIFMA/ISDA 2011 Letter at 33.

206 Proposed Rule 15Fh-2(a).

207 As noted above, an SBS Dealer in these circumstances must separately determine whether it is subject to regulation as an investment adviser, a municipal advisor or other regulated entity.

The Commission believes that the SBS Dealer could form this reasonable basis through a variety of means, including relying on written representations from the special entity to the same extent as discussed below in connection with an SBS Dealer acting as a counterparty to a special entity.[208] Upon receiving such representations, the SBS Dealer would be entitled to rely on these representations without further inquiry, absent special circumstances described below.

To solicit input on when it would no longer be appropriate for an SBS Dealer to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Dealer to rely on a representation from a special entity for purposes of Rule 15Fh-2(a) unless it knows that the representation is not accurate. The second would permit an SBS Dealer to rely on a representation unless the SBS Dealer has information that would cause a reasonable person to question the accuracy of the representation.

Under either approach, an SBS Dealer could not ignore information in its possession as a result of which the SBS Dealer would know that a representation is inaccurate. In addition, under the second approach, an SBS Dealer also could not ignore information that would cause a reasonable person to question the accuracy of a representation and, if the SBS Dealer had such information, it would need to make further reasonable inquiry to verify the accuracy of the representation.

While the Dodd-Frank Act does not preclude an SBS Dealer from acting as both advisor and counterparty, commenters have argued that it could be impracticable for an SBS Dealer that is acting as a counterparty to a special entity to meet the "best interests"

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208 See Section II.D.4.c, infra.

standards that would be imposed by Section 15F(h)(4) if it were also acting as an advisor to the special entity.[209] We recognize the potential tension in the statute itself between the role of a party acting as a principal in a security-based swap transaction, and the obligation imposed by Section 15F(h)(4) for an advisor to determine that a transaction is in the "best interests" of the special entity. We are seeking comment on whether we should further clarify the obligations of an SBS Dealer that is seeking to act both as an advisor and a counterparty to a special entity. We also are seeking comment on the need to define "best interests" in this context. Finally, as noted above, we understand that there are concerns arising from the potential interaction between the requirements of the Dodd-Frank Act (and our rules thereunder) and the requirements of other applicable law, including ERISA.

Request for Comments

The Commission requests comments generally on all aspects of proposed Rules 15Fh-2(a) and 15Fh-4(b). In addition, we request comments on the following specific issues:

- Is the proposed definition of the term "acts as an advisor" appropriate? Why or why not? What, if any, material inconsistencies would the proposed definition create with respect to any other applicable laws? What specific practical effects,

[209] See SIFMA/ISDA 2010 Letter at 8:

> Dealers will almost certainly refuse to engage in any swap activity in which they could potentially be deemed an "advisor." The actions that a Dealer acting as an "advisor" would be required to take pursuant to Dodd-Frank are the very actions that could lead the Dealer to be deemed a fiduciary under ERISA. The penalties that would result were the Dealer deemed a fiduciary under ERISA are draconian, including that a swap between the Dealer and the plan would be deemed a prohibited transaction in violation of ERISA and would be subject to rescission and an excise tax equal to 15% of the amount involved in the transaction for each year or part of a year that the transaction remains uncorrected (which, if not corrected upon notice, could escalate up to a 100% excise tax).

advantages or disadvantages may arise in connection with the proposed definition? How, if at all, should any definition or interpretation of "recommendation" in this context diverge from the meaning of the term for purposes of the suitability obligation under Proposed Rule 15Fh-3(f)?

- Should the Commission instead define "advisor" to mean "any person who, for compensation, engages in the business of advising special entities, as to the value of security-based swaps or as to the advisability of security-based swaps or trading strategies involving security-based swaps," consistent with the definition of an investment adviser?[210] Why or why not?
- Should the Commission instead define "act as an advisor" as "providing advice to or on behalf of a special entity with respect to a security-based swap or trading strategy involving a security-based swap," consistent with the definition of a municipal advisor?[211] Why or why not? What other definitions should be considered by the Commission and why?
- When, if at all, could an SBS Dealer, in fact, act as both an advisor and counterparty to a special entity in a securities-based swap transaction, consistent with the "best interests" requirements of Section 15F(h)(4) and proposed Rule 15Fh-4(b)? [212] In what way could disclosure help to address concerns about the

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210 See Advisers Act Section 202(a)(11) (definition of "investment adviser").

211 See Exchange Act Section 15B(e)(4), Pub. L. 111-203, 124 Stat. 1376, 1921-1922 (to be codified at 15 U.S.C. 78o-4(e)(4)); see generally Registration of Municipal Advisors, Exchange Act Release No. 63579 (Dec. 20, 2011), 76 FR 824 (Jan. 6, 2011).

212 Commenting on a parallel provision in the Commodity Exchange Act, Senator Lincoln stated that:

> [N]othing in [Commodity Exchange Act Section 4s(h)] prohibits a swap dealer from entering into transactions with Special Entities. Indeed, we believe it will be quite common that swap dealers will both provide advice and offer to enter into or enter

potentially conflicting roles of an SBS Dealer in these circumstances? Should the Commission, for example, clarify that it would not be inconsistent with an SBS Dealer's duty to act in the best interests of the special entity if the SBS Dealer, as principal, were to earn a reasonable profit or fee from the transaction it enters into with the special entity?

- Should the Commission instead prohibit an SBS Dealer from acting as both an advisor and counterparty to a special entity?[213] Why or why not?
- Should the Commission define "acts as an advisor" to require an understanding among the parties that the SBS Dealer is undertaking to act as an advisor to the special entity? Why or why not? If such a definition should be contemplated, in what circumstances, if any, should such an understanding not be permitted? Should a written agreement be required to establish that the SBS Dealer is undertaking to "act as an advisor"?
- How would the proposed rules with respect to acting as an advisor change current practice regarding recommending and entering into security-based swaps with special entities?
- Should the Commission impose specific requirements with respect to the level of detail that should be required for written representations? If so, what requirements and why?

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into a swap with a special entity. However, unlike the status quo, in this case, the swap dealer would be subject to both the acting as advisor and business conduct requirements under subsections (h)(4) and (h)(5).

156 Cong. Rec. S5923 (daily ed. Jul. 15, 2010) (statement of Sen. Lincoln).

213 Recently approved amendments to MSRB Rule G-23 would prohibit dealer-financial advisers from switching roles and becoming underwriters in the same municipal securities transactions. See also MSRB Notice 2011-29 (May 31, 2011) (discussing rule amendment and interpretive notice).

- What are the advantages and disadvantages of the two alternative proposed approaches regarding when it would no longer be appropriate to rely on written representations? Which alternative would strike the best balance among the potential disadvantages to market participants, the regulatory interest in appropriate rules for advisory relationships, and the sound functioning of the security-based swap market? What, if any, other alternatives should the Commission consider (e.g., a recklessness standard) and why?
- In light of the additional protections that are afforded special entities under the Dodd-Frank Act, as described in Section I.C.5 above, should an SBS Dealer be required to undertake diligence or further inquiry before it can rely on any representation from a special entity for purposes of Rules 15Fh-2(a) and 15Fh-4(b)? Why or why not? If such diligence or inquiry is not required, should an SBS Dealer be permitted to rely on representations from the special entity only where the SBS Dealer does not have information that would cause a reasonable person to question the accuracy of the representation? Why or why not? Would requiring such diligence or further inquiry – or allowing reliance on representations only in such a manner – unnecessarily limit the willingness or ability of SBS Dealers to provide special entities with the access to security-based swaps for the purposes described in Section I.C.5 above? Why or why not? What, if any, other measures should be required in connection with an SBS Dealer's satisfaction of the requirements of these rules?
- Are there particular circumstances under which an SBS Dealer should be required to obtain information or undertake further review or inquiry about a special

entity's independent representative or other facts in addition to obtaining written representations from the special entity as described above? Are there particular categories of special entities for which an SBS Dealer should be required to undertake further review or inquiry? Which categories, and why? What review or inquiry should be required, and in what circumstances?

- Are there other potential reasonable methods of establishing the relationship between a special entity and an SBS Dealer, and if so, what guidance should the Commission consider providing with respect to such methods?

5. Counterparty to Special Entities: Proposed Rule 15Fh-5

Under Exchange Act Section 15F(h)(5)(A), any SBS Entity that offers to enter into or enters into a security-based swap with a special entity must comply with any duty established by the Commission requiring that SBS Entity to have a "reasonable basis" for believing that the special entity has an "independent representative" that meets certain requirements, including that it undertakes a duty to act in the best interests of the counterparty it represents. Proposed Rules 15Fh-2(c) and 15Fh-5(a) would implement this provision. In particular, proposed Rule 15Fh-2(c) would define an "independent representative," and proposed Rule 15Fh-5(a) would require an SBS Entity to have a reasonable basis to believe that this independent representative is qualified to represent the special entity by virtue of satisfying certain specified requirements.

Request for Comments

The Commission requests comments generally on all aspects of proposed Rule 15Fh-5. In addition, we request comments on the following specific issues:

- Is it sufficiently clear what is meant by "offers to enter into" a security-based swap? If not, how should the Commission clarify the requirement?

- Should the proposed rule apply to all transactions with all special entities? Why or why not? Which, if any, transactions or special entities should be excluded from the scope of the proposed rule, and why?

a. Scope of Qualified Independent Representative Requirement

We are proposing to apply the qualified independent representative requirements to Major SBS Participants as well as to SBS Dealers because, although Section 15F(h)(2)(B) addresses only the requirement for SBS Dealers to comply with the requirements of Section 15F(h)(5), the specific requirements under Section 15F(h)(5)(A) apply by their terms to both SBS Dealers and Major SBS Participants that offer to or enter into a security-based swap with a special entity.

We are further proposing to apply the qualified independent representative requirement under Section 15F(h)(5) to security-based swap transactions with all special entities. There is a statutory ambiguity concerning the scope of this requirement. Section 15F(h)(5)(A) provides broadly that "[a]ny security-based swap dealer or major security-based swap participant that offers to [enter into] or enters into a security-based swap with a special entity shall" comply with certain requirements. These requirements are defined in Section 15F(h)(5)(A)(i) to include "any duty established by the Commission . . . with respect to a counterparty that is an eligible contract participant within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of the Commodity Exchange Act [i.e., governmental or multinational or supranational entities]." We are proposing standards that would apply whenever an SBS Entity is acting as counterparty to any special entity as defined in Section 15F(h)(1)(C), including a special entity that is an ECP within the meaning of subclause (I) or (II) of clause (vii) of Commodity Exchange Act Section 1a(18). The proposed rule would be consistent with categories of special entities mentioned in the legislative history.[214] It also would give meaning to the requirement of Section 15F(h)(5)(A)(i)(VII) concerning "employee benefit plans subject to ERISA," that are not ECPs within the meaning of subclause (I) or (II) of clause (vii) of section 1a(18) of the Commodity Exchange Act but are included in the category of retirement plans identified in the definition of special entity.[215]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should proposed Rule 15Fh-5 apply to both SBS Dealers and Major SBS Participants? Why or why not?

b. Independent Representative – Proposed Rule 15Fh-2(c)

Proposed Rule 15Fh-5(a) would require that the SBS Entity have a reasonable basis to believe that a special entity has as qualified "independent representative." Under proposed Rule 15Fh-2(c)(1), a representative of a special entity must be independent of the SBS Entity that is the counterparty to a proposed security-based swap. Proposed Rule 15Fh-2(c)(2) would provide that a representative of a special entity is "independent" of an SBS Entity if the representative does not have a relationship with the SBS Entity, whether compensatory or otherwise, that reasonably could affect the independent

214 See H.R. Conf. Rep. 111-517 (June 29, 2010) ("When acting as counterparties to a pension fund, endowment fund, or state or local government, dealers are to have a reasonable basis to believe that the fund or governmental entity has an independent representative advising them.") (emphasis added).

215 See Section 15F(h)(1)(C)(iii) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(C)(iii)).

judgment or decision-making of the representative. This standard is similar to the "no material relationship" standard that is used or proposed in other contexts.[216] We preliminarily believe it would be an appropriate standard here because the SBS Entity would possess the necessary facts to determine if, in fact, there exists a relationship with the independent representative that would be likely to impair the independence of the independent representative in making decisions that may affect the SBS Entity.

Proposed Rule 15Fh-2(c)(3) would provide that a representative of a special entity will be deemed to be independent of an SBS Entity if two conditions are satisfied. First, the representative is not and, within one year, was not an associated person of the SBS Entity and second, the representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly, from the SBS Entity. This latter restriction would apply, for example, with respect to revenues received as a result of referrals by the SBS Entity, and so is intended to address the situation in which a representative is hired by the special entity as a result of a recommendation by the SBS Entity. This restriction would apply as well to revenues received, directly or indirectly, from associated persons of the SBS Entity.

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216 Proposed Rules 15Fh-2(c)(1) and (2). This proposed alternative standard of independence would be consistent with the standard for existing and currently proposed director independence in other contexts. See Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges with Respect to Security-Based Swaps under Regulation MC, Exchange Act Release No. 63107, (Oct. 14, 2010), 75 FR 65882, 65897 (Oct. 26, 2010) (proposed Rule 700(l)); Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306, 77322 (Dec. 10, 2010); MSRB, Notice of Filing of Amendment No. 1 to and Order Granting Accelerated Approval of a Proposed Rule Change, as Modified by Amendment No. 1, to Amend Rule A-3, on Membership on the Board, to Comply with the Dodd-Frank Wall Street Reform and Consumer Protection Act, Exchange Act Release No. 63025 (Sep. 30, 2010), 75 FR 61806, 61808 (Oct. 6, 2010). It also would be consistent with the NYSE standard for director independence and how public companies have addressed this standard in their policies to determine director independence. See NYSE Rule 303A.02(A) ("No director qualifies as 'independent' unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company).

For the SBS Entity to form a reasonable basis to believe the percentage of the independent representative's gross revenues that is received directly or indirectly from the SBS Entity, the SBS Entity would likely need to obtain information regarding the independent representative's gross revenues from either the special entity or the independent representative. The Commission believes that an SBS Entity could use a variety of methods to gather this information. The SBS Entity may request the financial statements of the independent representative for the relevant periods. Another way to obtain this information would be to obtain written representations from the special entity or independent representative regarding the revenues received, directly or indirectly from the SBS Entity and that such revenues were less than ten percent of the independent representative's gross revenues. Upon receiving such representations, the SBS Entity would be entitled to rely on them without further inquiry, absent special circumstances described below.

To solicit input on when it would no longer be appropriate for an SBS Entity to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Entity to rely on a representation from a special entity for purposes of Rule 15Fh-2(c) unless it knows that the representation is not accurate. The second would permit an SBS Entity to rely on a representation unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation.

Under either approach, an SBS Entity could not ignore information in its possession as a result of which the SBS Entity would know that a representation is inaccurate. In addition, under the second approach, an SBS Entity also could not ignore information that would cause a reasonable person to question the accuracy of a representation and, if the SBS Entity had such information, it would need to make further reasonable inquiry to verify the accuracy of the representation.

An SBS Entity may obtain information from the independent representative as part of its efforts to form a reasonable basis for its determination that it is independent of the independent representative. In order for the basis for its determination to be reasonable, however, the SBS Entity could not ignore information it possesses concerning whether the independent representative is or has been, an associated person of the SBS Entity, for example, if it were seeking to rely on the objective standard of proposed Rule 15Fh-2(c)(1), or whether there exists any other relationship with the SBS Entity that reasonably could affect the independent judgment or decision-making of the independent representative for purposes of proposed Rule 15Fh-2(c)(2).

A number of special entities have requested that the Commission confirm that the representative is only required to be independent of the SBS Entity and not independent of the special entity itself.[217] We preliminarily believe that Section 15F(h)(5)(A)(i)(III) requires only that the independent representative be independent of the SBS Entity. The Dodd-Frank Act is silent concerning the question of independence from the special entity, and nothing in the legislative history suggests that the Commission should preclude the use of a qualified independent representative that is affiliated with the special entity.[218]

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217 Letter from Lynn D. Dudley, Senior Vice President, Policy, American Benefits Council, to Elizabeth M. Murphy, Secretary, Commission and David A. Stawick, Secretary, CFTC (Sept. 8, 2010) ("American Benefits Council Letter") at 6.

218 See also 156 Cong. Rec. S5903 (daily ed. Jul. 15, 2010) (statements of Sens. Lincoln and Harkin):

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission adopt a different definition of "independent representative of a special entity" in proposed Rule 15Fh-2(c), and if so, why? Are there other standards of independence that we should consider, such as standards that would be relevant to determining the independence of a fiduciary for ERISA purposes? Which standards and why? How should such standards be modified to address the particular concerns of Section 15F(h)(5)? Should the Commission require consideration of other or additional factors in determining the independence of the independent representative of a special entity? Which factors and why? Should such factors include consideration of relationships the independent representative may have with an SBS Entity on behalf of multiple special entities? Should the Commission also consider relationships the independent representative has entered into with an SBS Entity on behalf of a special entity outside of the security-based swap transaction context?

Mrs. LINCOLN. Our intention in imposing the independent representative requirement was to ensure that there was always someone independent of the swap dealer or the security-based swap dealer reviewing and approving swap or security-based swap transactions. However, we did not intend to require that the special entity hire an investment manager independent of the special entity. Is that your understanding, Senator Harkin?

Mr. HARKIN. Yes, that is correct. We certainly understand that many special entities have internal managers that may meet the independent representative requirement. For example, many public electric and gas systems have employees whose job is to handle the day-to-day hedging operations of the system, and we intended to allow them to continue to rely on those in-house managers to evaluate and approve swap and security-based swap transactions, provided that the manager remained independent of the swap dealer or the security-based swap dealer and meet the other conditions of the provision. Similarly, the named fiduciary or in-house asset manager ("INHAM") for a pension plan may continue to approve swap and security-based swap transactions.

- Should the definition of "independent representative of a special entity" exclude certain categories of associated persons of the SBS Entity? Of the independent representative? Which ones and why?
- Should the gross revenues in the definition exclude the revenues of affiliates of the independent representative?
- Is ten percent of gross revenues an appropriate measure of independence? Should the percentage be increased or decreased, and why? Should the Commission adopt a standard that is consistent with that used by the Department of Labor, for example, under which the general standard of independence for fiduciaries in connection with prohibited transaction exemptions under ERISA is that no more than 1% of an independent fiduciary's annual income is derived from or attributable to the party in interest and its affiliates?[219] Should another financial or other quantifiable standard be used in lieu of gross revenues? Why or why not?
- Should the Commission consider a timeframe other than one year to determine whether a representative is independent of the SBS Entity? Should the timeframe be two years, consistent with the pay to play provisions of proposed Rule 15Fh-6? Should some other timeframe be used? If so, what timeframe and why?
- Should the Commission consider a different approach to independence based on,

[219] See Exemption Procedures under Federal Pension Law, http://www.dol.gov/ebsa/publications/exemption_procedures.html ("While in certain cases the department has permitted an independent fiduciary to receive as much as 5% of its annual income from the party in interest and its affiliates, these cases have involved unusual circumstances, and the general standard of independence remains a 1% test.").

for example, audit committee independence standards under Section 10A(m)(3)[220] and Rule 10A-3(b),[221] or the concept of an "interested person" under Section 2(a)(1) of the Investment Company Act of 1940?[222] Why or why not? Should we consider other approaches? If so, which approaches and why?

- Should the Commission permit an independent representative that receives compensation from the proceeds of a security-based swap so long as the compensation is authorized by, and paid at the written direction of, the special entity? Why or why not?
- Should the Commission adopt a different definition of "independent representative of a special entity" for different types of special entities? For example, are there certain types of special entities, e.g., a State, State agency, city, county, municipality, or other political subdivision of a State, or a governmental plan as defined in Section 3 of ERISA, for which the Commission should define independence to require that the independent representative is not and has not been an associated person of the SBS Entity within the last two years and has not received any of its gross revenues, directly or indirectly from the SBS Entity or an associated person of the SBS Entity within the last two years?[223] What if the time period outlined in the prior sentence was limited to one year? Should this stricter

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220 15 U.S.C. 78j-1(m)(3).

221 17 CFR 240.10A-3(b).

222 15 U.S.C. 80a-2(a)(19).

223 See Exchange Act Sections 15F(h)(2)(C)(ii) (defining "special entity" to include "a State, State agency, city, county, municipality, or other political subdivision of a State") and 15F(h)(2)(C)(iv) (a governmental plan as defined in Section 3 of ERISA), Pub. L. 111-203, 124 Stat. 1376, 1789.

standard apply only with respect to special entities defined in clause (ii)? Are there any other classes of special entities to which this stricter standard should apply?

- Are there other standards of independence that would be more appropriate for independent representatives for special entities defined in clauses (ii) and (iv) of Section 15F(h)(2)(C) of the Exchange Act? Which standards and why?
- Are there certain types of relationships that, so long as they have been fully disclosed to the special entity and the special entity has consented to any conflicts of interest related thereto, should not be deemed to affect the independence of the representative? What types of relationships, and why? Are there some conflicts that are so significant that a special entity should not be able to consent to them? If so, what types of conflicts, and why?
- Is the interpretation of Section 15F(h)(5)(A)(i)(III) appropriate? Can and should independent representatives be required to be independent of the special entity entering into the security-based swap as well as independent of the SBS Entity? Why or why not? If an SBS Entity is relying on written representations from a special entity that is represented by an internal "independent representative," should the SBS Entity be required to also obtain such representations from someone other than the independent representative?
- How, if at all, should the recommendation by an SBS Entity of a particular independent representative or group of independent representatives be deemed to affect the independent judgment or decision-making of the representative? Please explain. If such a recommendation could be deemed to affect the independence of

a special entity, are there appropriate safeguards that should be required if an SBS Entity maintains a "preferred list" of independent representatives? What safeguards, and why?

c. Reasonable Basis to Believe the Qualifications of the Independent Representative

As noted above, proposed Rule 15Fh-5 would require the SBS Entity to reasonably determine that a special entity's independent representative is a "qualified independent representative." The requirements for being a "qualified independent representative" are drawn primarily from the statute and are described in the following sections. The Commission believes that an SBS Entity could use a variety of methods to establish a "reasonable basis" to believe that a special entity's "independent representative" is "qualified" for purposes of proposed Rule 15Fh-5.[224]

We preliminarily believe that, except as specifically noted below, an SBS Entity could rely on written representations regarding the various qualifications of the independent representative to form a reasonable basis to believe that the independent representative is "qualified."[225] Upon receiving such representations, the SBS Entity

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224 The SBS Entity may also be provided a copy of the representations that the independent representative provides to the special entity regarding its qualifications. In the absence of language precluding the SBS Entity from relying on the representations, the Commission preliminarily believes that the SBS Entity could rely on the representations to form a reasonable basis for its determinations to the same extent it could if the special entity had provided the representations to the SBS Entity. Furthermore, we do not believe that such reliance would constitute a "material business relationship" between the SBS Entity and independent representative.

225 In particular, absent the special circumstances described above, an SBS Entity would be permitted to rely on a representation that stated the independent representative:

(1) had sufficient knowledge to evaluate the transaction and risks; ;
(2) would undertake a duty to act in the best interests of the special entity;
(3) would make appropriate and timely disclosures to the special entity of material information concerning the security-based swap;

would be entitled to rely on them without further inquiry, absent special circumstances described below.

To solicit input on when it would no longer be appropriate for an SBS Entity to rely on such representations without further inquiry, the Commission is proposing for comment two alternative approaches. One approach would permit an SBS Entity to rely on a representation from a special entity for purposes of Rule 15Fh-5 unless it knows that the representation is not accurate. The second would permit an SBS Entity to rely on a representation unless the SBS Entity has information that would cause a reasonable person to question the accuracy of the representation.

Under either approach, an SBS Entity could not ignore information in its possession as a result of which the SBS Entity would know that a representation is inaccurate. In addition, under the second approach, an SBS Entity also could not ignore information that would cause a reasonable person to question the accuracy of a representation and, if the SBS Entity had such information, it would need to make further reasonable inquiry to verify the accuracy of the representation.

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(4) would provide written representations to the special entity regarding fair pricing and the appropriateness of the security-based swap; and

(5) in the case of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, was a fiduciary as defined in section 3(21) of that Act (29 U.S.C. 1002(21)); and

(6) in the case of a special entity defined in §§240.15Fh-2(e)(2) or (4), was a person that is subject to rules of the Commission, the CFTC or a self-regulatory organization subject to the jurisdiction of the Commission or the CFTC prohibiting it from engaging in specified activities if certain political contributions have been made.

It would not be appropriate, however, for an SBS Entity to rely on a general representation that merely states that the counterparty has a "qualified independent representative" for purposes of proposed Rule 15Fh-5.

The SBS Entity could also obtain a representation that that the independent representative was not subject to a statutory disqualification. However, as discussed below, the SBS Entity would also be expected to search publicly available databases such as BrokerCheck.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Commenters have suggested that an independent representative should be deemed "qualified" if it is "a sophisticated, professional adviser such as a bank, Commission-registered investment adviser, insurance company or other qualifying [Qualified Professional Asset Manager ("QPAM")] or INHAM for Special Entities subject to ERISA, a registered municipal advisor, or a similar qualified professional."[226] Should the Commission permit this presumption? If so, the Commission asks commenters to address specifically how regulated status would inform the determination as to whether an independent representative satisfies the qualification requirements of Section 15F(h)(5) and proposed Rule 15Fh-5. If the Commission were to adopt a presumption, should it apply equally for all regulated persons? Should the presumption instead be limited to certain types of regulated persons, ERISA fiduciaries, for example? Why, or why not? If the Commission does not permit the presumption, how, if at all, should the status of an independent representative be taken into account for purposes of determining whether the requirements of the proposed rule are satisfied?[227]
- Are there other approaches that the Commission should consider in permitting an SBS Entity to rely on a special entity's written representation that it has a

226 SIFMA/ISDA 2011 Letter.

227 See, e.g., Section II.D.4.c.iii (seeking comment on, among other things, whether an ERISA plan fiduciary should be deemed to act in the best interests of the special entity that is an employee benefit plan that is subject to regulation under ERISA).

"qualified independent representative"? If so, what alternative approaches, if any, would be feasible in terms of market practice and the advantages and disadvantages for SBS Entities and special entities?

- Should the Commission require that the SBS Entity obtain written representations regarding the qualifications of the independent representative directly from the independent representative? From both the independent representative and the special entity? Why or why not?
- Should the Commission allow an SBS Entity to rely on written representations the independent representative provides to the special entity? What constraints, if any, should be placed on such reliance? For example, should an explicit statement regarding the SBS Entity's use of the representations be required to be included in the documentation of the security-based swap? What are the respective advantages and disadvantages of the proposed approaches to guidance on when it would not be appropriate to rely on a special entity's written representations? Which alternative would strike the best balance among the potential disadvantages to market participants, the regulatory interest in appropriate independent representation for special entities, and the sound functioning of the security-based swap market? What, if any, other alternatives should the Commission consider and why?
- Should an SBS Entity be required to undertake further review or inquiry for particular categories of special entities? If so, what review or inquiry should be required in what circumstances?

- In light of the additional protections that are afforded special entities under the Dodd-Frank Act described in Section I.C.5 above, should an SBS Entity be required to undertake diligence or further inquiry before it can rely on any representation from a special entity concerning the qualifications of its representative? Why or why not? If such diligence or inquiry is not required, should an SBS Entity be permitted to rely on representations from the special entity only where the SBS Entity does not have information that would cause a reasonable person to question the accuracy of the representation? Why or why not? Would requiring such diligence or further inquiry – or allowing reliance on representations only in such a manner – unnecessarily limit the willingness or ability of SBS Entities to provide special entities with the access to security-based swaps for the purposes described in Section I.C.5 above? Why or why not? What, if any, other measures should be required in connection with an SBS Entity's satisfaction of the requirements of proposed Rule 15Fh-5?
- Are there other potential reasonable means of establishing that a special entity's independent representative has the requisite qualifications, other than written representations, for which the Commission should consider providing guidance? If so, what means should such guidance address and how?

i. Qualified Independent Representative -- Sufficient Knowledge to Evaluate Transaction and Risks

Proposed Rule 15Fh-5(a)(1) would require that the SBS Entity have a reasonable basis to believe that the independent representative has sufficient knowledge to evaluate the transaction and risks.[228] Industry groups have recognized that intermediaries should assess the sophistication of a counterparty – or its agent – including the counterparty's capability to understand the risk and return characteristics of the instrument.[229] The independent representative will play an important role in assessing and advising the special entity in this regard.[230]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission require the SBS Entity to reevaluate (or, as applicable require a new written representation regarding) the qualifications of the independent representative periodically? If so, how often? Should such reevaluation be required for specific types of security-based swaps or in certain circumstances? If so, with respect to which types and in what circumstances?

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[228] See Section 15F(h)(5)(A)(i)(I) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at15 U.S.C. 78o-10(h)(5)(A)(i)(I)). As noted above, an SBS Entity could rely on representations from the special entity to form this reasonable basis, as discussed in note 213 and related text.

[229] See CRMPG III Report at 57-59 (describing standards of sophistication for investors of high-risk complex financial instruments).

[230] See note 225, supra, and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

- Should the Commission specify particular facts or circumstances that might give rise to a requirement for further review or inquiry on the part of an SBS Entity, notwithstanding any representations from the counterparty? Why or why not? What facts or circumstances should be considered, if any?
- Should the Commission consider the development of a proficiency examination for independent representatives?[231] Should such testing requirement be mandatory? Should it apply to both in-house and third-party independent representatives? Why or why not?
- Should the Commission require that independent representatives be registered with the Commission as municipal advisors or investment advisers, or otherwise subject to regulation, such as banking regulation, for example?

ii. Qualified Independent Representative – No Statutory Disqualification

Proposed Rule 15Fh-5(a)(2) would require that the SBS Entity have a reasonable basis to believe that the independent representative is not subject to a statutory disqualification.[232] Although Exchange Act Section 15F(h) does not define "subject to a statutory disqualification," the term has an established meaning under Section 3(a)(39) of

[231] See Letter from Joseph A. Dear, Chief Investment Officer, California Public Employees' Retirement System et al., to David A. Stawick, Secretary, CFTC (Feb. 18, 2011) (suggesting that the CFTC consider an approach that would involve passage of a proficiency examination by the independent representative); Letter from Peter A. Shapiro, Managing Director, Swap Financial Group to David A. Stawick, Secretary, CFTC (Feb. 22, 2011); Letter from Frank Iacono, Partner, Riverside Risk Advisors LLC to David A. Stawick, Secretary, CFTC (Feb. 22, 2011). Comments submitted to the CFTC are available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=935t.

[232] See Section 15F(h)(5)(A)(i)(II) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(i)(II)). As noted above, an SBS Entity could rely on representations from the special entity to form this reasonable basis, as discussed in note 213 and related text. See discussion above in Section II.B.

the Exchange Act,[233] which defines circumstances that would subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, an SRO. Although Section 3(a)(39) would not literally apply here, we are proposing to define "subject to a statutory disqualification" for purposes of proposed Rule 15Fh-5 by reference to Section 3(a)(39) of the Exchange Act.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- What, if any, other "statutory disqualification" models or definitions should the Commission consider, and why?
- Should the Commission specify particular facts or circumstances that require further review or inquiry on the part of an SBS Entity, notwithstanding written representations received?
- Should the Commission require an SBS Entity to check publicly available databases, such as FINRA's BrokerCheck and the Commission's Investment Adviser Public Disclosure program, to determine whether an independent representative is subject to a statutory disqualification?[234] Why or why not? If so, which databases should be required to be consulted? Should such databases include sources outside the Commission and self-regulatory organizations, such as databases maintained by other regulators or federal or state officials? Why or

233 15 U.S.C. 78c(a)(39).

234 See, e.g., http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/index.htm , and http://www.adviserinfo.sec.gov/(S(b3d5ktvihzlhai45hknxzk45))/IAPD/Content/Search/iapd_Search.aspx.

why not? If so, which outside databases should be required to be consulted? Should the Commission require an SBS Entity to conduct any other type of inquiry to determine whether an independent representative is subject to a statutory disqualification? Why or why not?

iii. Qualified Independent Representative – Acting in the Best Interests of the Special Entity

Proposed Rule 15Fh-5(a)(3) would require that the SBS Entity have a reasonable basis to believe that the independent representative "undertakes a duty to act in the best interests" of the special entity.[235] As discussed above, we are not proposing to define "best interests." We also note that an independent representative may be subject to similar or additional obligations under other applicable law with respect to its activities on behalf of the special entity.[236]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the independent representative be required to be subject to some form of regulation (e.g., as an investment adviser or an ERISA plan fiduciary) under which the independent representative has a duty to act in the best interests of the special entity (or some similar requirement)?

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[235] See Section 15F(h)(5)(A)(i)(IV) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(i)(IV)). See note 225, supra, and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

[236] As noted above, depending on the circumstances, an independent representative may be an "investment adviser" within the meaning of Section 202(a)(11) of the Advisers Act, a "municipal advisor" within the meaning of Section 15B(e) of the Exchange Act, or a fiduciary for purposes of ERISA. A municipal advisor, for example, "shall be deemed to have a fiduciary duty to any municipal entity for whom such municipal advisor acts as a municipal advisor." 15 U.S.C. 78o-4(c)(1).

- Should an in-house independent representative be deemed to act in the best interests of the special entity by virtue of its employment with the special entity? Why or why not?
- Should an ERISA plan fiduciary, as defined under Section 3(21) of ERISA, that meets the standards of ERISA be deemed to act in the best interests of a special entity that is an employee benefit plan subject to regulation under ERISA, for purposes of the proposed rule? Should a QPAM?[237] An INHAM?[238] Why or why not?

iv. Qualified Independent Representative -- Appropriate Disclosures to Special Entity

Section 15F(h)(5)(A)(i)(V) requires that the SBS Entity comply with any rules promulgated by the Commission requiring the SBS Entity to have a reasonable basis to believe that the independent representative will make appropriate disclosures. The Dodd-Frank Act is silent concerning the content of these disclosures. Proposed Rule 15Fh-5(a)(4) would require that the SBS Entity have a reasonable basis to believe that the independent representative will make appropriate and timely disclosures to the special entity of material information regarding the security-based swap.[239]

Request for Comments

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[237] See Department of Labor Prohibited Transaction Exemption ("PTE") 84-14, 70 FR 49305 (Aug. 23, 2005); Amendment to PTE 84-14 for Plan Asset Transactions Determined by Independent Qualified Professional Asset Managers, 75 FR 38837 (July 6, 2010).

[238] See Department of Labor PTE 96-23, 61 FR 15975 (Apr. 10, 1996); Proposed Amendment to PTE 96-23 for Plan Asset Transactions Determined by In-House Asset Managers, 75 FR 33642 (proposed June 14, 2010).

[239] See note 225, supra, and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission impose specific requirements with respect to this obligation, such as the content of the disclosures that should be made by the independent representative? If so, what requirements and why? Should the "appropriate disclosures" include disclosures regarding the qualifications of the independent representative, in addition to disclosures regarding the security-based swap? Why or why not? Should such disclosures address other subjects not directly related to the security-based swap? Which ones and why?
- If the SBS Entity is not relying on written representations, should the Commission allow a presumption that an in-house independent representative, by virtue of its employment with the special entity, will make appropriate disclosures of material information to the special entity? Why or why not?
- Should the Commission also require that the SBS Entity have a reasonable basis to believe that the independent representative will make appropriate and timely disclosures to the special entity of any potential conflicts of interest that the representative may have in connection with the security-based swap transaction? Why or why not? Would such disclosures be considered part of the "best interests" undertaking of an independent representative? Why or why not?

v. Qualified Independent Representative – Written Representations

Proposed Rule 15Fh-5(a)(5) would require that the SBS Entity have a reasonable basis to believe that the independent representative will provide written representations to the special entity regarding fair pricing and the appropriateness of the security-based swap.[240] Commenters have suggested that a written representation "should be sufficient if the representation states that the representative is obligated, by law and/or contract, to review pricing and appropriateness with respect to any swap transaction in which the representative serves as such with respect to the plan."[241] We are not proposing a specific means by which this standard must be satisfied. We preliminarily believe, however, the approach described above would be reasonable. Another way for an SBS Entity to form a reasonable basis for its determination would be relying on a written representation that the independent representative will document the basis for its conclusion that the transaction was fairly priced and appropriate for the plan, and that the independent representative or the special entity will maintain that documentation in its records for an appropriate period of time, and make such records available to the plan upon request.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission impose specific requirements with respect to this obligation? If so, what requirements and why?

[240] See Section 15F(h)(5)(A)(i)(VI) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(i)(VI)). See note 225, supra, and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

[241] American Benefits Council Letter at 9.

vi. Qualified Independent Representative – ERISA Fiduciary

Proposed Rule 15Fh-5(a)(6) would require an SBS Entity to have a reasonable basis to believe that the independent representative, in the case of a special entity that is an employee benefit plan subject to ERISA, is a "fiduciary" as defined in section 3(21) of that Act (29 U.S.C. 1002).[242] None of the requirements set forth in the proposed rule is intended to limit, restrict, or otherwise affect the fiduciary's duties and obligations under ERISA.[243]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Should the Commission impose specific requirements with respect to this obligation? If so, what requirements and why?
- Should other independent representative qualifications under proposed Rule 15Fh-5(a)(1) be deemed satisfied if the independent representative in the case of employee benefit plans subject to ERISA, is a fiduciary as defined in section 3(21) of ERISA? If so, which requirements and why?

[242] See Section 15F(h)(5)(A)(i)(VII) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(i)(VII)). See note 225, supra, and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

[243] See notes 99, 198 and 189, supra, regarding the Department of Labor's proposal to amend definition of "fiduciary" for purposes of ERISA.

vii. Qualified Independent Representative – Subject to "Pay to Play" Prohibitions

We are proposing to include an additional requirement, not expressly addressed by the Dodd-Frank Act, that the SBS Entity have a reasonable basis for believing that the independent representative is subject to "pay to play" rules if the special entity is a State, State agency, city, county, municipality, or other political subdivision of a State, or a governmental plan, as defined in Section 3(32) of ERISA.[244] We believe that, unless exempted or excepted, an independent representative in these circumstances would likely be either a municipal advisor, or an investment adviser.[245] A registered municipal advisor would be subject to pay to play prohibitions under MSRB rules.[246] An investment adviser that is registered with the Commission would be subject to existing Commission rules regarding these practices.[247]

We do not, however, intend to prohibit other qualified persons from acting as independent representatives so long as those persons are similarly subject to pay to play

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[244] See Exchange Act Section 15F(h)(1)(C), Pub. L. 111-203, 124 Stat. 1376, 1789 (to be codified at 15 U.S.C. 78o-10(h)(1)(C)) (authorizing the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate"). For a discussion of abuses associated with pay to play practices, see Section II.D.5 below. See note 213 above and related text regarding an SBS Entity's reliance on a representation from the special entity to form this reasonable basis.

[245] See 15 U.S.C. 80b-2(a)(11) (defining "investment adviser"), and 15 U.S.C. 78o-4(3) (defining "municipal advisor"). Exchange Act Section 15B(4)(C) excludes from the definition of "municipal advisor" any investment adviser that is registered under the Advisers Act, and persons associated with the investment adviser who are providing investment advice." 15 U.S.C. 78o-4(4)(C).

[246] See, e.g. MSRB Notice 2011-04, Request for Comment on Pay to Play Rules for Municipal Advisors (Jan. 14, 2011) (requesting comment on a draft proposal to establish "pay to play" and related rules relating to municipal advisors and to make certain conforming changes to existing pay to play rules for brokers, dealers and municipal securities dealers).

[247] See, e.g., 17 CFR 275.206(4)-5 (prohibiting certain political contributions by investment advisers providing or seeking to provide investment advisory services to public pension plans and other government investors.

restrictions. As discussed in Section II.D.5 below, pay to play practices may result in significant harm to these types of special entities in connection with security-based swap transactions.[248] The concern is heightened here because of the fiduciary role that Congress has envisaged for independent representatives to special entities. In the case of independent representatives, the concern would be that a person might make contributions in order to be chosen as an independent representative (and obtain the fees commensurate with that role), and then not act as an impartial advisor with respect to the transaction. The proposed rule is intended to deter SBS Entities from participating, even indirectly, in such practices. Accordingly, proposed Rule 15Fh-5(a)(7) would require an SBS Entity to have a reasonable basis for believing that the independent representative is a person that is subject to rules of the Commission, the CFTC or an SRO subject to the jurisdiction of the Commission or the CFTC prohibiting it from engaging in specified activities if certain political contributions have been made, unless the independent representative is an employee of the special entity.[249]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Are there circumstances in which an independent representative that is advising a special entity that is a State, State agency, city, county, municipality, or other political subdivision of a State, or a governmental plan, as defined in Section

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[248] See note 32, supra.

[249] See Exchange Act Section 15B(e)(4), Pub. L. 111-203, 124 Stat. 1376, 1921-1922 (to be codified at 15 U.S.C 78o-4(e)(4)) (defining "municipal advisor" as a person "other than a municipal entity or an employee of a municipal entity" that engages in the specified activities).

3(32) of ERISA, other than an employee of the special entity, would not be subject to pay to play restrictions?

- Should the Commission consider a different requirement, for example, that the independent representative be subject to specific prohibitions, such as those described in Advisers Act Rule 206(4)-5 (prohibiting investment advisers that are registered, or required to be registered with the Commission, from providing or seeking to provide investment advisory services to public pension plans and other government investors when certain political contributions have been made)?
- Should the Commission require that the independent representative be a registered municipal advisor or Commission registered investment adviser?

d. Disclosure of Capacity

Proposed Rule 15Fh-5(b) would require that, before initiation of a security-based swap with a special entity, an SBS Dealer must disclose in writing the capacity or capacities in which it is acting.[250] An SBS Dealer that is acting as a counterparty but not an advisor to a special entity, for example, would need to make clear to the special entity the capacity in which it is acting (i.e., that it is acting as a counterparty, but not as an advisor).

Commenters have noted that a firm may be acting in multiple capacities in relation to a special entity, for example, as underwriter in a bond offering as well as counterparty to a security-based swap used to hedge the financing transaction.[251] In these circumstances, the SBS Dealer's duty to the special entity could vary depending upon the

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[250] See Section 15F(h)(5)(A)(2)(i) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at 15 U.S.C. 78o-10(h)(5)(A)(2)(i)).

[251] See Swap Financial Group Presentation at 55.

capacity in which it is acting, and so it is important for a special entity and its independent representative to understand the roles in which the SBS Dealer is acting.[252] The proposed rule, therefore, would require an SBS Dealer that engages in business, or has engaged in business within the last twelve months, with the counterparty in more than one capacity to disclose the material differences between such capacities in connection with the security-based swap and any other financial transaction or service involving the counterparty.[253]

We are proposing to apply the requirement in proposed Rule 15Fh-5(b) to SBS Dealers but not Major SBS Participants because the statutory requirement, by its terms, requires disclosure in writing of "the capacity in which the security-based swap dealer is acting."[254]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Are there specific capacities in which an SBS Dealer may act that merit more detailed types of disclosures? If so, which capacities, and what types of disclosures should be required? Should the Commission define in further detail the specific categories of "capacities" in which SBS Dealers may act that would

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[252] In the case of special entities that are municipal entities, MSRB Rule G-23 generally prohibits dealer-financial advisors from acting in multiple capacities in the same municipal securities transactions. See also MSRB Notice 2011-29 (May 31, 2011) (discussing rule amendment and interpretive notice).

[253] See proposed Rule 15Fh-5(b).

[254] We making this statement because the introductory clause of Section 15F(h)(5) imposes disclosure obligations on both SBS Dealers and Major SBS Participants and thus could be read to impose the capacity disclosure obligation on all SBS Entities. See Section 15F(h)(5)(A)(2)(ii) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1791 (to be codified at15 U.S.C. 78o-10(h)(5)(A)(2)(ii)). We also note that the obligation in the text of the statute does not require Commission rulemaking.

need to be disclosed under the proposed rule – e.g., as advisor, counterparty, underwriter, etc? If so, which capacities should be identified and disclosed?

- Should the Commission require similar disclosures by Major SBS Participants? Why or why not?
- Are there certain capacities for which disclosures should not be required? If so, which capacities, and why?
- Should the required disclosure be limited to other "capacities" within a timeframe other than twelve months? If so, what would be the appropriate time frame? Why?
- Should there be a de minimis exclusion from the required disclosure? If so, what would be an appropriate threshold? Are there certain "capacities" that should be disclosed regardless of the dollar amount involved?
- We understand that some SBS Dealers may utilize a single relationship point of contact to manage the multiple capacities in which they may act with regard to a special entity. Does this relationship management model increase the likelihood that the special entity would be confused as to the standard of conduct with which each associated person is required to comply? Should the SBS Dealer be required to disclose the material differences in capacities that are managed separate and apart from this centralized relationship point? If an SBS Dealer has information barriers in place between certain associated persons or affiliates, should the SBS Dealer still be required to disclose to the special entity any material differences in the capacities in which these associated persons are acting? Would these types of

information barriers impair the customer service that a special entity might otherwise receive?

- Are there any circumstances in which an affiliate of the SBS Dealer should be treated as an independent entity or third party, for the purposes of this disclosure rule?

6. Prohibition on Certain Political Contributions by SBS Dealers: Proposed Rule 15Fh-6

We are proposing a rule that would prohibit an SBS Dealer from engaging in security-based swap transactions with a "municipal entity" if certain political contributions have been made to officials of the municipal entity.[255] Pay to play occurs when persons seeking to do business with state and municipal governments make political contributions, or are solicited to make political contributions, to elected officials or candidates in order to influence the selection process.[256] In making such contributions,

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255 See Section 15F(h)(1)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1789, 15 U.S.C. 78o-10(h)(1)(D) (authorizing the Commission to prescribe business conduct standards that relate to "such other matters as the Commission determines to be appropriate").

The proposed restrictions would apply to dealings with a "municipal entity," which is defined in Exchange Act Section 15B(e)(8) (15 U.S.C. 78o-4(e)(8)) as: "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."

256 See, e.g., Blount v. SEC, 61 F. 3d 938 (D.C. Cir. 1995), cert. denied, 116 S. Ct. 1351 (1996) (holding that "underwriters' campaign contributions self-evidently create a conflict of interest in state and local officials who have power over municipal securities contracts and a risk that they will award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity"); Testimony of Martha Mahan Haines before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, Subcommittee on Securities, Insurance, and Investment (May 21, 2009) (stating that pay to play practices may result in an unqualified financial advisor being chosen because of his political contributions). See also Political Contributions by Certain Investment Advisers, supra, note 32 at notes 18 through 25, citing examples of more recent Commission and criminal actions against investment advisers and other parties for violations involving pay to play arrangements.

interested persons hope to benefit from officials who "award the contracts on the basis of benefit to their campaign chests rather than to the governmental entity."[257] Pay to play practices may take a variety of forms, including an SBS Dealer's direct contributions to government officials, an SBS Dealer's solicitation of third parties to make contributions or payments to government officials or political parties in the state or locality where the SBS Dealer seeks to provide services, or an SBS Dealer's payments to third parties to solicit (or as a condition of obtaining) security-based swap business.

In the context of security-based swaps, pay to play practices may result in municipal entities entering into transactions not because of hedging needs or other legitimate purposes, but rather because of campaign contributions given to an official with influence over the selection process. Where pay to play exists, SBS Dealers may compete for security-based swap business based on their ability and willingness to make political contributions, rather than on their merit or the merit of a proposed transaction. We believe these practices may result in significant harm to municipalities and others in connection with security-based swap transactions, just as they do in connection with other municipal securities transactions.[258]

By its nature, pay to play is covert because participants do not broadcast that contributions or payments are made or accepted for the purpose of influencing the selection of a financial services provider. As one court noted, "[w]hile the risk of corruption is

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257 Blount, 61 F.3d at 944-45.

258 See id. See SEC v. Larry P. Langford, Litigation Release No. 20545 (Apr. 30, 2008) and SEC v. Charles E. LeCroy, Litigation Release No. 21280 (Nov. 4, 2009) (charging Alabama local government officials and J.P. Morgan employees with undisclosed payments made to obtain municipal bond offering and swap agreement business from Jefferson County, Alabama). See also J.P. Morgan Securities Inc., Securities Act Release No. 9078 (Nov. 4, 2009) (instituting administrative and cease-and-desist proceedings against a broker-dealer that the Commission alleged was awarded bond underwriting and interest rate swap agreement business by Jefferson County in connection with undisclosed payments by employees of the firm).

obvious and substantial, actors in this field are presumably shrewd enough to structure their relations rather indirectly."[259] Consequently, pay to play practices are often hard to prove because it is difficult to prove that contributions were made for the purpose of obtaining government business, and that those contributions then drove the selection of a particular entity.

Absent implementation of specific rules prohibiting pay to play practices, it is likely such practices would continue undeterred, given that such practices pose a "collective action" problem.[260] That is, government officials who engage in pay to play practices may have an incentive to continue accepting contributions to support their campaigns, for fear of being disadvantaged relative to their opponents. In addition, SBS Dealers may have an incentive to participate out of concern that they may be overlooked if they fail to make contributions. Both the stealthy nature of these practices and the inability of markets to properly address them strongly support the need for a prophylactic measure to address them, such as proposed Rule 15Fh-6.[261]

Proposed Rule 15Fh-6 is modeled on, and intended to complement, existing restrictions on pay to play practices under Advisers Act Rule 206(4)-5, which imposes pay to play restrictions on investment advisers providing or seeking to provide investment advisory services to public pension plans and other government investors,[262]

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259 Blount v. SEC, 61 F.3d at 945.

260 As we explained in our release adopting Advisers Act Rule 206(4)-5, a collective action problem exists when participants who prefer to abstain from pay to play nonetheless feel compelled to participate due to concern that they will be locked out of the market unless they take part. See Political Contributions by Certain Investment Advisers, note 33, supra.

261 Cf. Blount, 61 F.3d at 945 ("no smoking gun is needed where, as here, the conflict of interest is apparent, the likelihood of stealth great, and the legislative purpose prophylactic").

262 17 CFR 275.206(4)-5. See Political Contributions by Certain Investment Advisers, note 32, supra. (adopting Advisers Act Rule 206(4)-5). See also Rules Implementing Amendments to the Investment

and under MSRB Rules G-37 and G-38, which impose pay to play restrictions on municipal securities dealers and broker-dealers engaging or seeking to engage in the municipal securities business. The proposed rule would create a comparable regulatory framework, as there are no existing federal pay to play restrictions that would apply to all SBS Dealers in their dealings with municipal entities. The proposed rule is intended to deter SBS Dealers from engaging in pay to play practices.

The proposed rule itself does not attempt to stamp out corruption by public officials or to regulate local elections, nor is it a ban on political contributions. Rather, the proposed rule would bar SBS Dealers from entering into contracts after they make contributions, with the aim of eliminating motivation to engage in pay to play.

We have closely drawn proposed Rule 15Fh-6 to accomplish its goal of preventing quid pro quo arrangements while avoiding unnecessary burdens on the protected speech and associational rights of SBS Dealers and their covered employees.[263] The proposed rule would address only direct contributions to officials – it is not intended in any way to impinge on a wide range of expressive conduct in connection with elections. It would be triggered only when a business relationship exists or will be established in the near future. It would target those employees of SBS Dealers whose contributions raise the greatest danger of quid pro quo exchanges, and it would cover only contributions to those government officials who would be the most likely targets of a quid pro quo because of their authority to influence the award of government contracts. Finally, the proposed rule

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Advisers Act of 1940, Investment Advisers Act Release No. 3110 (Nov. 19, 2010), 75 FR 77052 (Dec. 10, 2010) (proposing amendments to Investment Advisers Act Rule 206(4)-5).

263 The proposed rule is closely modeled on the MSRB Rule G-37 upheld by the Court of Appeals for the District of Columbia Circuit in Blount v. SEC, 61 F.3d at 947-48.

would not prevent anyone from making contributions at or below a specified de minimis level.

We are proposing to apply the requirements in proposed Rule 15Fh-6 to SBS Dealers but not to Major SBS Participants because we do not anticipate that Major SBS Participants would serve a dealer-type role in the market.[264]

a. Prohibitions

Proposed Rule 15Fh-6(b)(1) would generally make it unlawful for an SBS Dealer to offer to enter or to enter into a security-based swap with a municipal entity for a two-year period after the SBS Dealer or any of its covered associates makes a contribution to an official of the municipal entity.[265]

Proposed Rule 15Fh-6(b)(3)(i) would prohibit an SBS Dealer from paying a third party to solicit municipal entities to enter into a security-based swap, unless the third party is a "regulated person" that is itself subject to a pay to play restriction under applicable law.[266] We are concerned that the adoption of a rule addressing pay to play practices by security-based swap dealers would lead to the use of solicitors by security-

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264 See discussion in Section I.C.4, supra.

265 Proposed Rule 15Fh-6(a)(5) would define the term "official" of a municipal entity for purposes of the proposed rule to mean:

> a person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a municipal entity, if the office:
> (i) Is directly or indirectly responsible for, or can influence the outcome of, the selection of a security-based swap dealer or major security-based swap participant by a municipal entity; or
> (ii) Has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the selection of a security-based swap dealer or major security-based swap participant by a municipal entity.

266 Proposed Rule 15Fh-6(a)(7) would define "regulated person," for purposes of the rule, to mean generally a person that is subject to rules of the Commission, the CFTC or an SRO subject to the jurisdiction of the Commission or the CFTC prohibiting it from engaging in specified activities if certain political contributions have been made, or its officers or employees.

based swap dealers to circumvent the rule. Proposed Rule 15Fh-6(b)(3)(i) is intended to deter SBS Dealers from participating, even indirectly, in such practices.

Third, proposed Rule 15Fh-6(b)(3)(ii) would ban an SBS Dealer from soliciting or coordinating contributions to an official of a municipal entity with which the SBS Dealer is seeking to enter into, or has entered into a security-based swap, or payments to a political party of a state or locality with which the SBS Dealer is seeking to enter into, or has entered into, a security-based swap. These proposed prohibitions are similar to those contained in Advisers Act Rule 206(4)-5, and MSRB Rules G-37 and G-38.

Proposed Rule 15Fh-6(c) would make it unlawful for an SBS Dealer to do indirectly or through another person or means anything that would, if done directly, result in a violation of the prohibitions contained in the proposed rule.

b. <u>Two-Year "Time Out"</u>

Proposed Rule 15Fh-6(b)(1) would prohibit an SBS Dealer from offering to enter into, or entering into, a security-based swap with a municipal entity within two years after a contribution to an official of such municipal entity has been made by the SBS Dealer or any of its covered associates. We believe the two-year time out requirement strikes an appropriate balance, as it is sufficiently long to act as a deterrent but not so long as to be unnecessarily onerous. The two-year time out is consistent with the time out provisions contained in Advisers Act Rule 206(4)-5 and MSRB Rule G-37.

c. <u>Covered Associates</u>

Political contributions made to influence the selection of a firm are typically made not by the firm itself, but by officers and employees of the firm who have a stake in the business relationship with the municipal entity.[267] For this reason, the restrictions under proposed Rule 15Fh-6(b)(1) would apply to contributions by any "covered associate" of an SBS Dealer, which is defined to include: (i) any general partner, managing member or executive officer, or other person with a similar status or function;[268] (ii) any employee who solicits a municipal entity to enter into a security-based swap with the SBS Dealer and any person who supervises, directly or indirectly, such employee; and (iii) any political action committee controlled by the SBS Dealer or any of its covered associates.[269] This definition is consistent with a similar provision in Advisers Act Rule 206(4)-5.[270]

Because the proposed rule would attribute to a firm those contributions made by a person even prior to becoming a covered associate of the firm, SBS Dealers would need to "look back" in time to determine whether the time out applies when an employee becomes a covered associate. For example, if the contribution was made less than two years (or six months, as applicable) before an individual becomes a covered associate, the proposed rule would prohibit the firm from entering into a security-based swap with the relevant municipal entity until the two-year time out period has expired.

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267 See Political Contributions by Certain Investment Advisers, supra, note 33.

268 Proposed Rule 15Fh-6(a)(3) would define "executive officer" of an SBS Dealer to mean, for purposes of the rule:
- the president;
- any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);
- any other officer of the SBS Dealer who performs a policy-making function; or
- any other person who performs similar policy-making functions for the SBS Dealer.

269 Proposed Rule 15Fh-6(a)(2).

270 17 CFR 275.206(4)-5(f)(2).

d. Officials

The restrictions would apply when contributions are made to an "official" of a municipal entity. Proposed Rule 15Fh-6(a)(5) would define "official" to mean any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a municipal entity, if the office is directly or indirectly responsible for, or can influence the outcome of, the selection of an SBS Dealer by a municipal entity; or has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the selection of an SBS Dealer by a municipal entity.

e. Exceptions

i. De Minimis Contributions

The proposed rule would permit an individual who is a covered associate to make aggregate contributions without being subject to the two-year time out period, of up to $350 per election, for any one official for whom the individual is entitled to vote, and up to $150 per election, to an official for whom the individual is not entitled to vote.[271] We are proposing this two-tier approach because, while we recognize persons can have a legitimate interest in contributing to campaigns of people for whom they are unable to vote, we are concerned that contributions by covered associates living in distant jurisdictions may be less likely to be made for purely civic purposes. Accordingly, the proposed de minimis exception for contributions to candidates for whom a covered associate is not entitled to vote is lower than the de minimis exception for candidates for whom a covered associate is entitled to vote. We believe that the $150 exception for

271 Proposed Rule 15Fh-6(b)(2)(i).

contributions to a candidate for whom the covered associate is not entitled to vote is appropriate because of the more remote interest a covered associate is likely to have in contributing to such a person.

ii. New Covered Associates

The prohibitions of the proposed rule would not apply to contributions by an individual made more than six months prior to becoming a covered associate of the SBS Dealer, unless such individual solicits the municipal entity after becoming a covered associate.[272]

iii. Exchange and SEF Transactions

The prohibitions of proposed Rule 15Fh-6 would not apply to a security-based swap that is initiated by a municipal entity on a registered national securities exchange or SEF, for which the SBS Dealer does not know the identity of the counterparty at any time up to and including the time of execution of the transaction.[273]

f. Exception and Exemptions

We are proposing a provision that would provide an SBS Dealer a limited ability to cure the consequences of an inadvertent political contribution to an official for whom the covered associate is not entitled to vote. The exception would apply to contributions that, in the aggregate, do not exceed $350 to any one official per election. The SBS Dealer must have discovered the contribution that resulted in the prohibition within four months of the date of the contribution, and obtained the return of the contribution to the contributor within 60 calendar days of the date of discovery. In addition, an SBS Dealer

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272 Proposed Rule 15Fh-6(b)(2)(ii).

273 Proposed Rule 15Fh-6(a)(2)(iii).

would not be able to rely on this exception more than twice in any 12-month period, or more than once for any covered associate, regardless of the time between contributions.[274] This automatic exception mirrors similar provisions contained in Advisers Act Rule 206(4)-5 and MSRB Rule G-37.

The scope of this exception would be limited to the types of contributions we believe are less likely to raise pay to play concerns. The prompt return of the contribution would provide an indication that the contribution would not affect an official's decision to enter into a transaction with the SBS Dealer. The relatively small amount of the contribution, in conjunction with the other conditions of the exception, should help to mitigate concerns that the contribution was made for purposes of influencing the municipal entity's selection process. The restrictions on repeated triggering contributions should reinforce the need for effective compliance controls. Because the proposed exception would operate automatically, we preliminarily believe that it should be subject to conditions that are objective and limited in order to capture only those contributions that are less likely to raise pay to play concerns.

In addition, we are proposing a provision under which an SBS Dealer may apply to the Commission for an exemption from the two-year ban. In determining whether to grant the exemption, the Commission would consider, among other factors: (i) whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes of the Exchange Act; (ii) whether the SBS Dealer, (a) before the contribution resulting the prohibition was made, had adopted and implemented policies and procedures reasonably designed to prevent violations of the

274 Proposed Rule 15Fh-6(e)(1).

proposed rule, (b) prior to or at the time the contribution, had any actual knowledge of the contribution, and (c) after learning of the contribution, had taken all available steps to cause the contributor to obtain return of the contribution and such other remedial or preventative measures as may be appropriate under the circumstances; (iii) whether, at the time of the contribution, the contributor was a covered associate or otherwise an employee of the SBS Dealer, or was seeking such employment; (iv) the timing and amount of the contribution; (v) the nature of the election (e.g., state or local); and (vi) the contributor's intent or motive in making the contribution, as evidenced by the facts and circumstances surrounding the contribution.[275] This exemption is similar to the exemption-by-application provisions contained in Advisers Act Rule 206(4)-5 and MSRB Rule G-37.

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues:

- Do security-based swap transactions with municipal entities present the same risks of pay to play abuses as other securities transactions involving municipal securities dealers and investment advisers? If not, why not?
- Do the same risks of pay to play abuses exist when a Major SBS Participant, rather than an SBS Dealer, is seeking to enter into a security-based swap with a municipal entity? If not, why not? Should the proposed rule apply to Major SBS Participants, as well as to SBS Dealers? If so, why?

275 Proposed Rule 15Fh-6(e).

- Is the term "municipal entity" appropriately defined? If not, should the definition refer to "a State, State agency, city, county, municipality, or other political subdivision of a State, or any governmental plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002)" within the meaning of Exchange Act Section 15F(h)(2)(C)? Should the Commission use the definition of "government entity" from Advisers Act Rule 206(4)-5?[276] Should the Commission instead follow the approach of MSRB Rule G-37?[277]
- Should the requirements of proposed Rule 15Fh-6 be deemed satisfied if an SBS Dealer can establish that it is subject to other regulation that similarly prohibits it from engaging in security-based swap activities if certain political contributions have been made? Should an SBS Dealer's ability to rely on other regulation be conditioned on a Commission finding that the other regulation imposes substantially equivalent or more stringent restrictions than proposed Rule 15Fh-6 would impose on SBS Dealers, and that such other rules are consistent with the objectives of proposed Rule 15Fh-6? Why or why not?

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276 As used in 17 CFR 275.206(4)-5, the term "government entity" means any state or political subdivision of a state, including:

(i) Any agency, authority, or instrumentality of the state or political subdivision;
(ii) A pool of assets sponsored or established by the state or political subdivision or any agency, authority or instrumentality thereof, including, but not limited to a "defined benefit plan" as defined in section 414(j) of the Internal Revenue Code (26 U.S.C. 414(j)), or a state general fund;
(iii) A plan or program of a government entity; and
(iv) Officers, agents, or employees of the state or political subdivision or any agency, authority or instrumentality thereof, acting in their official capacity.

277 MSRB Rule G-37 references "the governmental issuer specified in [Section 3(a)(29) of the Exchange Act]" which would include "a State or any political subdivision thereof, or any municipal corporate instrumentality of one more States."

- Proposed Rule 15Fh-6(b)(3)(i) is intended to prevent SBS Dealers from participating, even indirectly, in pay to play practices. What would be the advantages and disadvantages of such an approach? Is there another approach that the Commission should consider? Are there differences between the operations of SBS Dealers and other securities firms that would make the third-party solicitor provision unnecessary? If so, what are they? Would the provision impose any collection of information obligations? If so, what would they be? What would be the costs and benefits of this approach?

E. Chief Compliance Officer: Proposed Rule 15Fk-1

Section 15F(k) of the Exchange Act requires an SBS Entity to designate a chief compliance officer ("CCO"), and imposes certain duties and responsibilities on that CCO. Proposed Rule 15Fk-1 would codify the provisions of Exchange Act Section 15F(k) with some modifications based on the current compliance obligations applicable to CCOs of other Commission-regulated entities. The proposed requirements underscore the central role that sound compliance programs play to ensure compliance with the Exchange Act and rules and regulations thereunder applicable to security-based swaps.[278]

Proposed Rule 15Fk-1(a) would require an SBS Entity to designate a CCO on its registration form, and proposed Rule 15Fk-1(b) would impose certain duties on the CCO. Proposed Rule 15Fk-1(b)(1) would require that the CCO report directly to the board of directors, a body performing a function similar to the board, or to the senior officer of the SBS Entity.[279] Proposed Rule 15Fk-1(b)(2) would require the CCO to review the

278 See FINRA Rule 3130.

279 See Section 15F(k)(2)(A) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(A)).

compliance of the SBS Entity with respect to the requirements in Section 15F of the Exchange Act and the rules and regulations thereunder.[280] Rule 15Fk-1(b)(2) would further require that, as part of the CCO's obligation to review compliance by the SBS Entity, the CCO establish, maintain, and review policies and procedures that are reasonably designed to achieve compliance by the SBS Entity with Section 15F of the Exchange Act and the rules and regulations thereunder.[281]

Proposed Rule 15Fk-1(b)(3) would require that the CCO, in consultation with the board of directors, a body performing a function similar to the board, or the senior officer of the organization, resolve conflicts of interest that may arise.[282] We understand that the primary responsibility for the resolution of conflicts generally lies with the business units within the SBS Entities. As a result, we would anticipate that the CCO's role with respect to such resolution and mitigation of conflicts of interest would include the recommendation of one or more actions, as well as the appropriate escalation and reporting with respect to any issues related to the proposed resolution of potential or actual conflicts of interest, rather than decisions relating to the ultimate final resolution of

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280 See Section 15F(k)(2)(B) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(B)).

281 The requirement to establish, maintain and review policies and procedures reasonably designed to achieve compliance with Section 15F of the Exchange Act and the rules thereunder is based on FINRA Rule 3130, which requires certification that a member has in place processes to "establish, maintain, and review policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations." Similar requirements appear in Rule 38a-1(a)(1) under the Investment Company Act of 1940, 17 CFR 270.38a-1(a)(1) (requiring registered investment companies to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation of the Federal Securities laws by the fund"); and Advisers Act Rule 206(4)-7(a), 17 CFR 275.206(4)-7(a) (requiring registered investment advisers to "[a]dopt and implement written policies and procedures reasonably designed to prevent violation, by you and your supervised persons, of the [Advisers] Act, and the rules that the Commission has adopted under the [Advisers] Act").

282 See Section 15F(k)(2)(C) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(C)).

such conflicts. Under proposed Rule 15Fk-1(b)(4), the CCO would be responsible for administering each policy and procedure that is required to be established pursuant to Section 15F of the Act and the rules and regulations thereunder.[283] The Commission would expect that a CCO should be competent and knowledgeable regarding Section 15F of the Exchange Act and the rules and regulations thereunder, and should be empowered with full responsibility and authority to execute his or her responsibilities.

Proposed Rule 15Fk-1(b)(5) would require the CCO to establish, maintain and review policies and procedures reasonably designed to ensure compliance with the provisions of the Exchange Act and the rules and regulations thereunder relating to the SBS Entity's business as an SBS Entity.[284] The title of CCO does not, in and of itself, carry supervisory responsibilities. Consistent with current industry practice, we generally would not expect a CCO appointed in accordance with proposed Rule 15Fk-1 to have supervisory responsibilities outside of the compliance department. Accordingly, absent facts and circumstances that establish otherwise, we generally would not expect that a CCO would be subject to a sanction by the Commission for failure to supervise other SBS Entity personnel. Moreover, a CCO who does have supervisory responsibilities could rely on the provisions of proposed Rule 15Fh-3(h)(3), under which a person associated with an SBS Entity shall not be deemed to have failed to reasonably supervise another person if such other person is not subject to the CCO's supervision, or if: (i) the SBS Entity has established and maintained written policies and procedures, and a

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283 See Section 15F(k)(2)(D) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(D)).

284 See Section 15F(k)(2)(E) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(E)).

documented system for applying those policies and procedures, that would reasonably be expected to prevent and detect, insofar as practicable, any violation of the federal securities laws and the rules and regulations thereunder relating to its business as an SBS Entity; and (ii) the supervising person has reasonably discharged the duties and obligations required by the written policies and procedures and documented system, and did not have a reasonable basis to believe that the written policies and procedures and documented system were not being followed.[285]

Proposed Rule 15Fk-1(b)(6) would require the CCO to establish, maintain and review policies and procedures reasonably designed to remediate promptly non-compliance issues identified by the CCO.[286] Proposed Rule 15Fk-1(b)(7) would require the CCO to establish and follow procedures reasonably designed for management response and resolution of non-compliance issues.[287]

Proposed Rule 15Fk-1(c)(1) would require that the CCO annually prepare and sign a report describing the compliance policies and procedures (including the code of ethics and conflicts of interest policies) and compliance of the SBS Entity with the Exchange Act and rules and regulations thereunder relating to its business as an SBS Entity.[288] Proposed Rule 15Fk-1(c)(2) would require that each compliance report also

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285 Cf. Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2204 (Dec. 17, 2003), 68 FR 74714 (Dec. 24, 2003) at note 78.

286 See Section 15F(k)(2)(F) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(F)).

287 See Section 15F(k)(2)(G) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1793 (to be codified at 15 U.S.C. 78o-10(k)(2)(G)).

288 See Section 15F(k)(3)(A) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1794 (to be codified at 15 U.S.C. 78o-10(k)(3)(A)). We believe that there is a drafting error in the reference in Section 15F(k)(3)(A) of the Exchange Act to compliance of the "major swap participant" in this provision, and are proposing to apply the requirement with respect to the compliance of the "major security-based swap participant."

contain, at a minimum: a description of the SBS Entity's enforcement of its policies and procedures relating to its business as an SBS Entity; any material changes to the policies and procedures since the date of the preceding compliance report; any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the SBS Entity to incorporate such recommendation; and any material compliance matters identified since the date of the preceding compliance report.[289] Proposed Rule 15Fk-1(e)(4) would define "material compliance matter" to mean any compliance matter about which the board of directors of the SBS Entity would reasonably need to know to oversee the compliance of the SBS Entity, and that involves, without limitation, a violation of the federal securities laws relating to its business as an SBS Entity by the SBS Entity or its officers, directors, employees or agents; a violation of the policies and procedures of the SBS Entity relating to its business as an SBS Entity; or a weakness in the design or implementation of the policies and procedures of the SBS Entity relating to its business as an SBS Entity.[290]

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[289] This requirement is modeled on a similar requirement for chief compliance officers under Investment Company Act Rule 38a-1(4), 17 CFR 270.38a-1(a)(4). The report under the Investment Company Act, however, is not required to be filed with the Commission.

The Commission is proposing a similar requirement for chief compliance officers of security-based swap data repositories. See Security-Based Swap Data Repository Registration, Duties and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010) ("SDR Registration Release") (proposing Exchange Act Rule 13n-11(d)(1)).

[290] This definition is modeled on the definition of "material compliance matter" in Investment Company Act Rule 38a-1(e)(2), 270.38a-1(e)(2). The Commission proposed a similar definition in its rule governing chief compliance officers of security-based swap data repositories. See SDR Registration Release (proposing Exchange Act Rule 13n-11(b)(6)).

Proposed Rule 15Fk-1(c)(2)(ii)(D) would require the CCO to certify, under penalty of law, the accuracy and completeness of the report.[291] Proposed Rule 15Fk-1(c)(2)(ii)(A) would require that the CCO's annual report accompany each appropriate financial report of the SBS Entity that is required to be furnished or filed with the Commission.[292] To allow the annual report to accompany each appropriate financial report within the required timeframe, proposed Rule 15Fk-1(c)(2)(ii)(B) would require the CCO to provide a copy of the required annual report to the board of directors, the audit committee and the senior officer of the SBS Entity at the earlier of their next scheduled meeting or within 45 days of the date of execution of the certification.[293]

Proposed Rule 15Fk-1(c)(2)(ii)(C) would require that the CCO's annual report include a written representation that the chief executive officer(s) (or equivalent officers) has/have conducted one or more meetings with the CCO in the preceding 12 months, the subject of which addresses the SBS Entity's processes to comply with the obligations of the CCO as set forth in the proposed rules and in Exchange Act Section 15F.[294] To comply with the proposed rule, the subject of the meeting(s) between the chief executive officer and the CCO referenced in the written representation must include: (1) the matters that are the subject of the CCO's annual report; (2) the SBS Entity's compliance efforts with the provisions of Section 15F and the provisions of the Exchange Act and the rules

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[291] See Section 15F(k)(3)(B)(ii) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1794 (to be codified at 15 U.S.C. 78o-10(k)(3)(B)(ii)).

[292] See Section 15F(k)(3)(B)(i) of the Exchange Act, Pub. L. 111-203, 124 Stat. 1376, 1794 (to be codified at 15 U.S.C. 78o-10(k)(3)(B)(i)).

[293] Id. This timeframe is the same as that provided by FINRA Rule 3130(c) (regarding certification of compliance processes).

[294] See FINRA Rule 3130.

and regulations thereunder relating to its business as an SBS Entity as of the date of such a meeting; and (3) significant compliance problems under Section 15F and plans in emerging business areas relating to its business as an SBS Entity.[295] Although not required by the Dodd-Frank Act, we believe that an annual compliance meeting would help to ensure and comprehensive compliance policies.[296] Under proposed Rule 15Fk-1(c)(2)(iii), if compliance reports are separately bound from the financial statements, the compliance reports shall be accorded confidential treatment to the extent permitted by law.

Finally, proposed Rule 15Fk-1(d) would require that the compensation and removal of the CCO be approved by a majority of the board of directors of the SBS Entity. We are proposing this measure, which is not required by the Dodd-Frank Act, to promote the independence and effectiveness of the CCO. We have proposed a similar requirement for the CCOs of security-based swap data repositories[297] and of investment companies and business development companies.[298] As we explained in proposing other CCO requirements, we are concerned that an entity's commercial interests might discourage a CCO from making forthright disclosure to the board or senior officer about any compliance failures. To help address this potential conflict of interest, the Commission preliminarily believes that only the board of directors of the SBS Entity

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[295] This requirement is modeled on the obligations for broker-dealers under FINRA rules. See Supplementary Material .04 to FINRA Rule 3130, Content of Meetings between Chief Executive Officer and Chief Compliance Officer.

[296] See Exchange Act Sections 15F(h)(1)(B) (authorizing the Commission to prescribe duties for diligent supervision), and 15F(h)(3)(D) (providing authority to prescribe business conduct standards). Pub. L. 111-203, 124 Stat. 1376, 1789 and 1790 (to be codified at 15 U.S.C. 78o-10(h)(1)(B) and 78o-10(h)(3)(D)).

[297] See SDR Registration Release (proposing Exchange Act Rule 13n-11(a)).

[298] See 17 CFR 270.38a-1(a)(4).

should be able to set the CCO's compensation or remove an individual from the CCO position.[299]

Request for Comments

The Commission requests comments generally on all aspects of this provision. In addition, we request comments on the following specific issues::

- Would a CCO of an SBS Entity have difficulty discharging any of these obligations? If so, why?
- Should the Commission consider additional obligations to be imposed on a CCO of an SBS Entity? If so, which ones and why?
- Should the Commission define circumstances in which a CCO may report to a senior officer rather than to the board of directors? If so, what should those circumstances be? Why?
- Do any of the CCO obligations conflict with current obligations imposed on a CCO and, if so, why?
- Would the timing of the annual report create any problems for SBS Entities?
- Should the compliance report be furnished rather than filed with the Commission? Why or why not?
- Should the Commission permit a CCO to qualify its report by certifying, under penalty of law, that a report is accurate and complete "in all material respects"? Why or why not? Is there another approach the Commission should consider to appropriately balance the practical need for SBS Entities to attract and retain

[299] See SDR Registration Release (discussing proposed Exchange Act Rule 13n-11(a)).

qualified CCOs with the statutory provision to require CCOs to certify their reports under penalty of law?

- Should the Commission require the chief executive officer or another senior officer to certify the report, similar to the compliance certification required under FINRA Rule 3130, instead of or in addition to the CCO?[300] Why or why not?
- How, if at all, would the proposed CCO requirements – including those that are not expressly addressed by the Dodd-Frank Act, e.g., the proposed requirements that the CCO meet with the chief executive officer and that the compensation of the CCO be set by the Board – alter the role and function that CCOs may play within SBS Entities? Do the proposed requirements promote an effective compliance function while avoiding undue constraints on a firm's discretion in

[300] FINRA Rule 3130 requires the CEO to certify that:

1. The Member has in place processes to:
   (A) establish, maintain and review policies and procedures reasonably designed to achieve compliance with applicable FINRA rules, MSRB rules and federal securities laws and regulations;
   (B) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and
   (C) test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with FINRA rules, MSRB rules and federal securities laws and regulations.
2. The undersigned chief executive officer(s) (or equivalent officer(s)) has/have conducted one or more meetings with the chief compliance officer(s) in the preceding 12 months, the subject of which satisfy the obligations set forth in FINRA Rule 3130.
3. The Member's processes, with respect to paragraph 1 above, are evidenced in a report reviewed by the chief executive officer(s) (or equivalent officer(s)), chief compliance officer(s), and such other officers as the Member may deem necessary to make this certification. The final report has been submitted to the Member's board of directors and audit committee or will be submitted to the Member's board of directors and audit committee (or equivalent bodies) at the earlier of their next scheduled meetings or within 45 days of the date of execution of this certification.
4. The undersigned chief executive officer(s) (or equivalent officer(s)) has/have consulted with the chief compliance officer(s) and other officers as applicable (referenced in paragraph 3 above) and such other employees, outside consultants, lawyers and accountants, to the extent deemed appropriate, in order to attest to the statements made in this certification.

organizing its business, including that compliance function? Why or why not? How, if at all, could the proposed requirements be altered to provide SBS Entities and CCOs greater flexibility in implementing an effective compliance function?

- If the CCO reports to a senior officer, should the senior officer have the ability to remove the CCO? Should the senior officer have the ability to determine the compensation of the CCO? Under what circumstances and why? If the CCO reports to the board of directors, should the compliance meeting(s) required under proposed Rule 15Fk-1(c)(2)(i)(C) be held between the CCO and the board of directors or a committee of independent directors instead of with the senior officer?
- Should the board or audit committee be required to review the annual compliance report and approve any CCO-recommended remedial steps? Should the board or audit committee be required to authorize alternative remedial steps that the board or audit committee determines are more appropriate than those in the annual compliance report? Should the Commission require the SBS Entity to report to the Commission any alternative remedial steps taken? Why or why not?

III. Request for Comments

A. Generally

The Commission requests comments on all aspects of the proposed rules. The Commission particularly requests comment on the general impact the proposals would have on the market for security-based swaps and on the behavior of participants in that market. The Commission also seeks comment on the proposals as a whole, including their interaction with the other provisions of the Dodd-Frank Act and their advantages and disadvantages when considered in total. In addition, the Commission seeks comment on the following specific issues:

- Do the proposed rules clearly define the obligations to be imposed on SBS Dealers or Major SBS Participants? Are there clarifications or instructions to the proposed requirements that would be beneficial to make? If so, what are they, and what would be the benefits of adopting them?
- Do the proposed rules (considered individually and in their entirety) provide an efficient and effective way to implement the requirements of the Dodd-Frank Act relating to the business conduct of SBS Entities? Why or why not? Are the requirements under the proposed rules appropriately tailored so that the requirements of the Dodd-Frank Act can be met consistent with an SBS Entity's maintaining an economically viable business? Why or why not?
- Do the proposed rules (considered individually and in their entirety) give full effect to the additional protections for special entities contemplated by the statute while avoiding restrictions on SBS Entities that would unduly limit their willingness or ability to provide special entities with access to security-based swaps? Why or why not? How and to what extent will the proposed rules (considered individually and in their entirety) affect the ability of special entities to engage in security-based swaps? How and to what extent will the proposed rules (considered individually and in their entirety) afford special entities the protections contemplated by the Dodd-Frank Act in connection with their security-based swap transactions?

- Would the proposed rules require disclosure of information that that commenters believe should not, or need not, be disclosed? If so, what information, and what are the problems associated with its disclosure?
- Do any proposed requirements conflict with any existing requirement, including any requirement currently imposed by an SRO, such that it would be impracticable or impossible for an SBS Entity that is a member of an SRO to meet both obligations? If so, which one(s) and why?
- Should an SBS Entity be permitted to establish compliance with the proposed business conduct standards by demonstrating compliance with other regulatory standards that impose substantially similar requirements?
- Should any proposed requirements be modified with respect to security-based swaps that are traded on a registered SEF or on a registered national securities exchange? If so, which requirements should be modified, and why?
- Should any proposed requirements be modified with respect to security-based swaps that are cleared but not SEF- or exchange-traded? If so, which requirements and why?
- Should any proposed requirements for SBS Entities be modified? If so, which requirements and why? Should different standards apply to SBS Dealers and Major SBS Participants?
- Should any additional business conduct requirements be imposed on SBS Entities? If so, which requirements and why? Should different standards apply to SBS Dealers and Major SBS Participants? Under what circumstances, and why?

- Should any additional proposed requirements be modified when the counterparty is an SBS Dealer, a Major SBS Participant, a swap dealer or a major swap participant? Another type of market intermediary?
- Are there other counterparties for which certain proposed SBS Entity requirements should be modified? If so, which requirements, in what circumstances, and why?
- Should the Commission delay the compliance date of any of the proposed requirements to allow additional time to comply with those requirements? If so, which requirements, and how much additional time?

B. Consistency with CFTC Approach

The CFTC has proposed rules related to business conduct standards for swap dealers and major swap participants as required under Section 731 of the Dodd-Frank Act.[301] Understanding that the Commission and the CFTC regulate different products, participants and markets and thus, appropriately may take different approaches to various issues, we nevertheless are guided by the objective of establishing consistent and comparable requirements. Accordingly, we request comments generally on (i) the impact of any differences between the Commission and CFTC approaches to business conduct regulation in this area, (ii) whether the Commission's proposed business conduct regulations should be modified to conform to the proposals made by the CFTC, and (iii) whether any business conduct requirements proposed by the CFTC, but not proposed by the Commission, should be adopted by the Commission.

Request for Comments

[301] See CFTC External Business Conduct Release, supra, note 16.

The Commission requests comments generally on all aspects of the proposed rules as they relate to CFTC rules and regulations. In addition, we request comments on the following specific issues:

- Do the regulatory approaches under the Commission's proposed rulemaking pursuant to Section 764 of the Dodd-Frank Act and the CFTC's proposed rulemaking pursuant to Section 731 of the Dodd-Frank Act result in duplicative or inconsistent obligations for market participants that are subject to both regulatory regimes, or result in gaps or different levels of regulation between those regimes? If so, in what ways should such duplication, inconsistencies or gaps be addressed?
- Are the approaches proposed by the Commission and the CFTC to regulate business conduct comparable? If not, why?
- Are there approaches that would make the regulation more comparable? If so, what?
- Would be appropriate for us to adopt any particular requirements proposed by the CFTC that differ from our proposal? If so, which ones?
- Should the Commission require SBS Entities to perform periodic portfolio reconciliations in which they exchange terms and valuations of each security-based swap with their counterparty and also resolve any discrepancies within a specified period of time?[302] If so, how frequently should portfolio reconciliations be performed and within what time period should all discrepancies be resolved? Should any specific policies and procedures be proposed regarding the method of

302 The CFTC has proposed to require periodic portfolio reconciliations. See Confirmation, Portfolio Reconciliation and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants, 75 FR 81519 (Dec. 28, 2010).

performing a portfolio reconciliation? Should the Commission require any specific policies and procedures regarding the method of valuing security-based swaps for purposes of performing a portfolio reconciliation? Please explain the current market practice among dealers for performing portfolio reconciliations.

- Should the Commission require SBS Entities to periodically perform portfolio compressions in which the SBS Entity wholly or partially terminates some or all of its security-based swaps outstanding with a counterparty and replaces those security-based swaps with a smaller number of security-based swaps whose combined notional value is less than the combined notional value of the original security-based swaps included in the exercise?[303] If not, why not? Should the Commission require SBS Entities to periodically perform portfolio compressions among multiple counterparties? If not, why not? Please explain the current market practice among dealers for performing portfolio compressions.

We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

IV. Paperwork Reduction Act

Certain provisions of the proposed rules would impose new "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[304] The Commission is submitting the proposed collections of information 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 titles for these collections are "Business Conduct

[303] The CFTC has proposed to require periodic portfolio compressions. Id.

[304] 44 U.S.C. 3501 et seq.

Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants" and "Designation of Chief Compliance Officer of Security-Based Swap Dealers and Major Security-Based Swap Participants." 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 proposed collections of information.

A. Summary of Collections of Information

1. Verification of Status

Proposed Rule 15Fh-3(a) would require an SBS Entity to verify that a counterparty, whose identity is known to the security-based swap dealer or a major security-based swap participant prior to the execution of the transaction, meets the eligibility standards for an ECP and whether the counterparty is a special entity. We expect that in order to verify the status of the counterparty, an SBS Entity would likely obtain written representations from the counterparty, conduct due diligence as part of its "diligence checklist" or as required by its internal policies and procedures, or some combination thereof, based upon prior dealings, if any, with the counterparty.

2. Disclosures by SBS Entities

Proposed Rule 15Fh-3(b) would require an SBS Entity to disclose to any counterparty (other than an SBS Entity, swap dealer, or major swap participant) information reasonably designed to allow the counterparty to assess: (1) the material risks and characteristics of a security-based swap; and (2) any material incentives or conflicts of interest that the SBS Entity may have in connection with the security-based swap. The proposed rule would also require that to the extent that these disclosures are not provided in writing prior to the execution of the transaction, the SBS Entity would be required to provide the counterparty with a written version of the disclosure no later than the time of delivery of the trade acknowledgement for the transaction.[305] Proposed Rule 15Fh-3(c) would require an SBS Entity to disclose to any counterparty (other than an SBS Entity, swap dealer, or major swap participant) the daily mark of the security-based swap. Proposed Rule 15Fh-3(d) would require an SBS Entity, before entering into a security-based swap with a counterparty other than an SBS Entity, swap dealer or major swap participant, to determine whether the security-based swap is subject to the mandatory clearing requirements of Section 3C(a) of the Exchange Act and disclose the determination to the counterparty, as well as clearing alternatives available to the counterparty. To the extent that the disclosures required by proposed Rule 15Fh-3(d) are not provided in writing prior to the execution of the transaction, the SBS Entity would be required to provide the counterparty with a written record of the disclosure no later than the delivery of the trade acknowledgement for the transaction.

3. Know Your Counterparty and Recommendations

Proposed Rule 15Fh-3(e) would require an SBS Dealer to establish, maintain and enforce policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the SBS Dealer prior to the execution of the transaction. The essential facts would be: (1) facts required to comply with applicable laws, regulations and rules; (2) facts required to implement the SBS Dealer's credit and operational risk management policies in connection with

305 The Commission is separately required to propose a rule regarding reporting and recordkeeping requirements for SBS Entities. See Exchange Act Section 15F(f)(2), Pub. L. 111-203, 124 Stat. 1376, 1788 (to be codified at 15 U.S.C. 78o-10(f)(2)) ("The Commission shall adopt rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants").

transactions entered into with such counterparty; (3) information regarding the authority of any person acting for such counterparty; and (4) if the counterparty is a special entity, such background information regarding the independent representative as the SBS Dealer reasonably deems appropriate.

Proposed Rule 15Fh-3(f)(1) would require an SBS Dealer to have a reasonable basis to believe: (i) based on reasonable diligence, that the recommended security-based swap or trading strategy involving a security-based swap is suitable for at least some counterparties; and (ii) that a recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty. To establish a reasonable basis for a recommendation, an SBS Dealer would need to have or obtain relevant information regarding the counterparty, including the counterparty's investment profile, trading objectives, and its ability to absorb potential losses associated with the recommended security-based swap or trading strategy. Under proposed Rule 15Fh-3(f)(2), an SBS Dealer would fulfill its suitability obligation in proposed Rule 15Fh-3(f)(1) with respect to a particular counterparty if: (1) the SBS Dealer reasonably determines that the counterparty (or its agent) is capable of independently evaluating the investment risks related to the security-based swap or trading strategy; (2) the counterparty (or its agent) affirmatively represents that it is exercising its independent judgment in evaluating the recommendation; and (3) the SBS Dealer discloses to the counterparty that it is acting in its capacity as a counterparty and is not undertaking to assess the suitability of the security-based swap or trading strategy. The representations to document this "institutional suitability" must be in writing. The requirements of proposed Rule 15Fh-3(f) would not apply if the counterparty is an SBS Entity, swap dealer or major swap participant.[306] An SBS Dealer that is recommending a security-based swap or trading strategy involving a security-based swap to a special entity would be deemed to have satisfied its obligations pursuant to proposed Rule 15Fh-3(f) with respect to the special entity if: (1) the SBS Dealer is acting as an advisor to the special entity and complies with the requirements of proposed Rule 15Fh-4(b); or (2) the SBS Dealer is deemed not to be acting as an advisor to the special entity pursuant to proposed Rule 15Fh-2(a).[307]

4. Fair and Balanced Communications

Proposed Rule 15Fh-3(g) would require that an SBS Entity communicate with its counterparties in a fair and balanced manner based on principles of fair dealing and good faith. The proposed rule would require, among other things, that any statement of potential opportunities or advantages be balanced by a statement of the corresponding risks with the same degree of specificity.

5. Supervision

Proposed Rule 15Fh-3(h) would require an SBS Entity to establish, maintain and enforce a system to supervise, and to diligently supervise, its business and its associated persons with a view to preventing violations of the applicable federal securities laws and the rules and regulations thereunder relating to its business as an SBS Entity. The proposed rule would require the SBS Entity to designate a qualified person with supervisory responsibility for each type of business for which registration as an SBS Entity would be required. The SBS Entity would be required to: designate at least one supervisor; use reasonable efforts to determine all supervisors are qualified; establish,

[306] Proposed Rule 15Fh-3(f)(1).

[307] Proposed Rule 15Fh-3(f)(3).

maintain and enforce written policies and procedures that are reasonably designed to achieve compliance with applicable securities laws, rules and regulations; and establish and maintain written policies and procedures to comply with the duties set forth in Section 15F(j) of the Exchange Act. Such written policies and procedures would be required to include, at a minimum, procedures for: review of security-based swap transactions; review of internal and external written communications; periodic review of the business; reasonable investigation of the background of associated persons; monitoring employee personal accounts away from the firm; a description of the supervisory system, including identification of the supervisory personnel and their scope of supervisory responsibility; preventing a supervisor from supervising his or her own activities or supervising an employee who determines the supervisor's compensation or continued employment; and preventing the standard of supervision from being reduced due to conflicts of interest with the person being supervised. These supervisory requirements are similar to existing supervision requirements for registered broker-dealers.

6. SBS Dealers Acting as Advisors to Special Entities

Proposed Rule 15Fh-4(b) would require an SBS Dealer acting as an advisor to make reasonable efforts to obtain such information as it considers necessary to make a reasonable determination that a security-based swap or trading strategy involving a security-based swap is in the best interests of the special entity. The information that would be required to be collected to make this determination includes, but is not limited to: the authority of the special entity to enter into the transaction; the financial status and future funding needs of the special entity; the tax status of the special entity; the investment or financing objectives of the special entity; the experience of the special entity with respect to security-based swap transactions generally and of the type and complexity being recommended; whether the special entity has the financial capability to withstand changes in market conditions during the term of the security-based swap; and other relevant information. In order for an SBS Dealer to establish that it is not acting as an advisor under proposed Rule 15Fh-2(a): (1) the special entity must represent in writing that the special entity will not rely on advice provided by the SBS Dealer and the special entity will rely on the advice of a qualified independent representative; (2) the SBS Dealer must have a reasonable basis to believe that the special entity has a qualified independent representative; and (3) the SBS Dealer must disclose to the special entity that the SBS Dealer would not be undertaking to act in the best interest of the special entity, as otherwise required by Section 15F(h)(4) of the Exchange Act. This proposed Rule 15Fh-4(b) would not apply if the transaction is executed on a SEF or an exchange and the SBS Dealer does not know the identity of the counterparty at the time of the transaction.

7. SBS Entities Acting as Counterparties to Special Entities

Proposed Rule 15Fh-5 would require an SBS Entity to have a reasonable basis to believe that the special entity has an independent representative that is independent of the SBS Entity and that meets certain specified qualifications, including that the independent representative: has sufficient knowledge to evaluate the transaction and related risks; is not subject to a statutory disqualification; undertakes a duty to act in the best interests of the special entity; makes appropriate and timely disclosures to the special entity of material information concerning the security-based swap; will provide written representations to the special entity regarding fair pricing and appropriateness of the security-based swap; in the case of employee benefit plans subject to ERISA, is a fiduciary as defined in Section 3(21) of ERISA; and in the case of a State, State agency, city, county, municipality, other political subdivision of a State, or governmental plan, is subject to restrictions on certain political contributions. An SBS Entity could reasonably rely on written representations to form a reasonable basis to believe an independent representative meets certain of these qualifications. An SBS Entity would need to engage in reasonable due diligence for any qualification for which it could not reasonably rely on representations. In addition, with respect to the independence of the independent representative, the SBS Entity would need to undertake some additional inquiry, such as review of the SBS Entity's own books and records.

Proposed Rule 15Fh-5(b) would require that, before the initiation of a security-based swap, an SBS Dealer disclose in writing the capacity in which the SBS Dealer is acting. If the SBS Dealer is acting in more than one capacity with respect to the counterparty or has acted in more than one capacity with respect to the counterparty in the last twelve months, it must also disclose the material differences among such capacities. Proposed Rule 15Fh-5 would not apply if the transaction is executed on a SEF or an exchange and the SBS Entity does not know the identity of the counterparty at any time up to and including execution of the transaction.[308]

8. Political Contributions

Proposed Rule 15Fh-6 would prohibit an SBS Dealer from offering to enter into, or entering into security-based swaps with a municipal entity within two years after any

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308 Proposed Rule 15Fh-5(c).

contribution by the SBS Dealer or its covered associates to an official of such municipal entity, subject to certain exceptions. In order to determine compliance with the rule, the SBS Dealer would need to maintain certain records of contributions by the SBS Dealer and any of its covered associates.[309] The SBS Dealer would also need to collect information regarding contributions by its covered associates made within the six months prior to becoming covered associates.

9. Chief Compliance Officer

Proposed Rule 15Fk-1 would require an SBS Entity to designate an individual to serve as CCO. Under proposed Rule 15Fk-1, the CCO would be responsible for, among other things: reviewing the compliance by the SBS Entity with the security-based swap requirements described in Section 15F of the Exchange Act; promptly resolving any conflicts of interest, in consultation with the board or the senior officer; administering policies and procedures required under Section 15F of the Exchange Act; establishing, maintaining and reviewing policies and procedures reasonably designed to ensure compliance with the Exchange Act and the rules and regulations thereunder relating to its business as an SBS Entity; establishing, maintaining and reviewing policies and procedures reasonably designed to remediate promptly non-compliance issues identified by the CCO; and establishing and following procedures reasonably designed for the prompt handling, management response, remediation, retesting, and resolution of non-compliance issues. The CCO would also be required under proposed Rule 15Fk-1 to submit annual compliance reports accompanying each appropriate financial report of the SBS Entity that is required to be furnished to or filed with the Commission and the board

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309 See notes 169 and 305, supra, regarding reporting and recordkeeping requirements generally for SBS Entities.

of directors and audit committee (or equivalent bodies) of the SBS Entity. These annual compliance reports are required to include a description of: (1) the compliance by the SBS Entity with the Exchange Act and rules and regulations thereunder relating to its business as an SBS Entity; (2) each policy and procedure of the SBS Entity described above; (3) the SBS Entity's enforcement of the policies and procedures relating to its business as an SBS Entity; (4) any material changes to the policies and procedures since the date of the prior report; (5) any recommendations for material changes to the policies and procedures as a result of the annual review, the rationale for the recommendations, and whether such recommendations would be incorporated; and (6) any material compliance matters. The compliance report must also include a written representation that the senior officer has conducted one or more meetings with the CCO in the preceding 12 months, and a certification that the compliance report is accurate and complete.

B. Proposed Use of Information

1. Verification of Status

Proposed Rule 15Fh-3(a) would require an SBS Entity to determine whether its counterparty is an ECP before the execution of a security-based swap other than on a registered national securities exchange or SEF. An SBS Entity would use this information to comply with Section 6(l) of the Exchange Act (15 U.S.C. 78(f)(l)), which prohibits a person from entering into a security-based swap with a counterparty that is not an ECP other than on a national securities exchange. We are not proposing to specify the means by which SBS Entities satisfy this requirement. The proposed rule also would require the SBS Entity to determine whether a counterparty is a special entity. An SBS Entity would use this information, in turn, to determine the need to comply with the requirements applicable to dealings with special entities under proposed Rules 15Fh-4(b) and 15Fh-5. In addition to assisting the CCO in determining compliance with the statute and proposed rules, this collection of information would be used by the Commission staff in its examination and oversight program.

2. Disclosures by SBS Entities

The disclosures required to be provided by SBS Entities to a counterparty (other than an SBS Entity or a swap dealer or major swap participant) would help the counterparty understand the material risks and characteristics of a particular security-based swap, as well as the material incentives or conflicts of interest that the SBS Entity may have in connection with the security-based swap. As a result, these disclosures would assist the counterparty in assessing the transaction. The disclosures would provide counterparties with a better understanding of the expected performance of the security-based swap under various market conditions. They would also give counterparties additional transparency and insight into the pricing and collateral requirements of security-based swaps. Proposed Rule 15Fh-3(d) would require SBS Entities to notify counterparties of the clearing alternatives available to them. In addition to assisting the SBS Entity with its internal supervision and the CCO to determine compliance with the statute and proposed rules, this collection of information would be used by the Commission staff in its examination and oversight program.

3. Know Your Counterparty and Recommendations

These collections of information would help an SBS Dealer to comply with applicable laws, regulations and rules. They would also assist an SBS Dealer in effectively dealing with the counterparty, including by making recommendations that are appropriate for the counterparty, and by collecting information from the counterparty necessary for the SBS

Dealer's credit and risk management purposes. These collections of information would also assist an SBS Dealer in determining whether it would be reasonable to rely on various representations from a counterparty and evaluating the risks of trading with that counterparty. The information would also assist the CCO in determining that the SBS Entity had policies and procedures reasonably designed to obtain and retain essential facts concerning each known counterparty and to make suitable recommendations to its counterparties. The Commission staff would also use these collections of information in its examination and oversight program.

4. Fair and Balanced Communications

This collection of information concerning the risks of a security-based swap would assist an SBS Entity in communicating with counterparties in a fair and balanced manner. It would also assist an SBS Dealer in making suitable recommendations to counterparties, and assist the CCO in ensuring that the SBS Entity is communicating with counterparties in a fair and balanced manner based on principles of fair dealing and good faith. The receipt of information in a fair and balanced manner would assist the counterparty in making more informed investment decisions. The Commission staff would also use this collection of information in its examination and oversight program.

5. Supervision

The collection of information in connection with the establishment, maintenance and enforcement of a supervisory system would assist an SBS Entity in achieving compliance with all applicable securities laws, rules and regulations. The CCO may use these collections of information in discharging his or her duties under proposed Rule 15Fk-1 and determining whether remediation efforts are required. The collection of information would also be useful to supervisors in understanding and carrying out their supervisory responsibilities. The

Commission staff would also use this collection of information in its examination and oversight program.

6. SBS Dealers Acting as Advisors to Special Entities

Certain information that would be collected under proposed Rule 15Fh-4(b) would assist an SBS Dealer that is acting as an advisor to a special entity to act in the best interests of the special entity. Other information collected under proposed Rule 15Fh-2(a) could assist an SBS Dealer seeking to establish that it is not acting as an advisor to a special entity. The collections of information would assist a CCO in determining compliance with the provisions of the Exchange Act by the SBS Dealer. The Commission staff would also use this collection of information in its examination and oversight program.

7. SBS Entities Acting as Counterparties to Special Entities

The information that would be collected under Proposed Rule 15Fh-5(a) would assist an SBS Entity in forming a reasonable basis that the special entity has an independent representative that meets the requirements of the rule. Disclosures under proposed Rule 15Fh-5(b) regarding the capacity in which an SBS Dealer is operating would reduce confusion by a special entity as to whether an SBS Dealer would be acting in the interests of the special entity or as a counterparty or principal on the other side of a transaction to the special entity with potentially adverse interests. These collections of information would also assist the CCO in determining compliance with the provisions of the Exchange Act by the SBS Entity. The Commission staff would also use this collection of information in its examination and oversight program.

8. Political Contributions

Proposed Rule 15Fh-6 is intended to deter SBS Dealers from participating, even indirectly, in pay to play practices. The information that would be collected under this proposed rule would assist the SBS Dealer and the Commission in verifying this deterrence. The proposed rule would also assist the chief compliance officer in determining compliance with the provisions of the Exchange Act by an SBS Dealer. The Commission staff would use this collection of information in its examination and oversight program.

9. Chief Compliance Officer

The information that would be collected under proposed Rule 15Fk-1 would assist the CCO in overseeing and administering compliance by the SBS Entity with the provisions of the Exchange Act and the rules and regulations thereunder relating to its business as an SBS Entity. The Commission staff would also use this collection of information in its examination and oversight program.

C. Respondents

The Commission preliminarily believes, based on data obtained from DTCC and conversations with market participants, that approximately 50 entities may fit within the definition of security-based swap dealer,[310] and as many as 10 entities may need to determine whether they come within the definition of major security-based swap participant.[311] The Commission does not expect that more than five entities will be major security-based swap participants. Accordingly, we are using this estimate for the purposes of calculating the reporting burdens. Further, because prior to the Dodd-Frank Act, market participants have not had to distinguish between swaps and security-based

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310 Depending on capital and other requirements for SBS Dealers and how businesses choose to respond to such requirements, the actual number of SBS Dealers may be significantly fewer. See also Definitions Release.

311 See Definitions Release.

swaps for regulatory purposes, the Commission preliminarily believes that the majority of firms that may register as SBS Entities (approximately 35) also will be engaged in the swaps business, and will register with the CFTC as swap dealers or major swap participants. As a result, these entities would also be subject to the business conduct standards applicable to swap dealers and major swap participants. In addition, a broker-dealer may seek to register as an SBS Dealer so that it can enter into security-based swaps as a principal with customers who, among other things, may be holding securities positions and may wish to hedge those positions with security-based swaps. The Commission estimates that approximately 16 registered broker-dealers will also register as SBS Dealers.[312] Finally, the costs of registration and associated regulation may cause an entity that is not otherwise registered with the CFTC or the Commission to structure its business so as to not have to register as an SBS Entity. Consequently, the Commission estimates that fewer than eight firms not otherwise registered with the CFTC or the Commission will register as SBS Entities.

The Commission preliminarily believes, based on information currently available to it, that there are and would continue to be approximately 8,500 market participants, of which approximately 1,200 are special entities.[313] Based upon the number of municipal advisors that have registered with the Commission, we estimate there will be

[312] Id.

[313] The estimate is based on available market data for November 2006 – September 2010 provided by DTCC. Commission staff has identified approximately 8,567 market participants and approximately 1,200 special entities during this time period, but we are using 8,500 market participants and 1,200 special entities as estimates for these purposes to allow for market participants and special entities that trade less frequently, no longer trade or trade under multiple designations. For the purposes of these estimates, we have included foreign pension plans and 501(c)(3) organizations generally within the category of special entity.

approximately 325 third-party independent representatives for special entities.[314] The Commission also estimates that approximately 95% of special entities would use a third-party independent representative in their security-based swap transactions.[315] As a result, for the purposes of calculating reporting burdens, the Commission estimates that the remaining 5% of special entities, or 60 special entities, have employees who currently negotiate on behalf of, and advise, the special entity regarding security-based swap transactions and could likely fulfill the obligations of the independent representative.[316] Consequently, the Commission estimates a total of 385 potential independent representatives.[317] The Commission seeks comment on its estimates as to the number of participants in the security-based swap market that would be required to comply with the business conduct standards pursuant to proposed Rules 15Fh-1 through 15Fh-6 and proposed Rule 15Fk-1.

D. Total Annual Reporting and Recordkeeping Burdens

Proposed Rules15Fh-1 to 15Fh-6 are intended to be very similar, to the extent practical, to the business conduct standards that would apply to swap dealers or major

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314 As of April 15, 2011, approximately 307 entities that are registered as municipal advisors with the Commission indicated that they expected to provide advice with respect to swaps. We expect that many of these municipal advisors will also act as independent representatives for other special entities. We also expect that some number of these municipal swap advisors will limit their services to swaps and not security-based swaps. The Commission therefore estimates that approximately 325 municipal swap advisors will act as independent representatives to special entities with respect to security-based swaps, we solicit comments as to the accuracy of this information.

315 The estimate is based on available market data for November 2006 – September 2010 provided by DTCC that indicates approximately 95% of special entities used third-party investment advisers in connection with security-based swap transactions.

316 Id.

317 The estimate is based on the following calculation: 325 third-party independent representatives + 60 in-house independent representatives

swap participants pursuant to the CFTC's proposed business conduct rules.[318] As a result, to the extent the SBS Entity complies with the CFTC's business conduct standards, the Commission expects there would be relatively little additional burden to comply with the requirements under the Commission's proposed business conduct standards.[319] A number of these standards are based on existing FINRA rules and, accordingly, the Commission expects that the estimated 16 SBS Entities that are also registered as broker-dealers are already complying with a number of these requirements. We expect that some SBS Dealers will be banks.[320] Banking agencies, such as the Office of the Comptroller of the Currency, have issued guidance to national banks that engage in financial derivatives transactions regarding business conduct procedures, and, accordingly, we expect that the banks that may register as SBS Entities are also already complying with these requirements.[321] In addition, to the extent that the requirements in proposed Rules 15Fh-3 and 15Fh-5 reflect industry best practices, a respondent that is already following industry best practices would already be collecting much, if not all, of this information, and would have systems in place to collect such information. We recognize that entities may need to modify existing practices and systems to comply with the specific requirements of the proposed rules. Further, while the Commission does not have information as to the number of SBS Entities that have already implemented these best practices, we

318 See CFTC External Business Conduct Release, supra, note 16.

319 However, because the CFTC has not yet adopted final rules, we are using estimates that assume the CFTC rules are not in place and that the registrants have incurred a de novo burden to comply with the Commission rules.

320 The estimate is based on available market data for November 2006 – September 2010, the Commission estimates that approximately 240 banks executed security-based swaps during this time. The Commission anticipates that some, but not all of these banks will likely register as SBS Dealers.

321 See Risk Management of Financial Derivatives, Office of Comptroller of the Currency Banking Circular No. 277 (Oct. 27, 1993).

understand that most of the large SBS Dealers have implemented many of the recommended best practices, and we have considered this information in developing its estimates. In addition, the Commission notes that regulation of the security-based swap markets, including by means of these proposed rules, could impact market participant behavior.

1. Verification of Status

As discussed above, for the purposes of these requirements, the Commission estimates that approximately 55 SBS Entities would be required to verify whether a counterparty is an ECP or special entity, as required by proposed Rule 15Fh-3(a). This requirement is the same for the business conduct standards proposed by the CFTC.[322] The Commission also believes that many SBS Entities would not incur significant additional expense, because they already collect this information as part of their "due diligence checklists." Some respondents may simply update their existing due diligence checklists. The Commission expects that to the extent an SBS Entity does not have an existing mechanism in place to determine the eligibility of the counterparty and whether it is a special entity, the SBS Entity may engage outside counsel to prepare for collecting this information. The Commission conservatively estimates that SBS Entities would need to engage outside counsel to review existing process and develop initial processes, if necessary, at a cost of \$400 per hour for an average of 15 hours per respondent, resulting in a total outside initial cost burden of \$6,000 for each of these SBS Entities.[323] The

[322] See CFTC External Business Conduct Release, 75 FR at 80658. Accordingly, the SBS Entities that would also be registered as a swap dealer or major swap participant with the CFTC would have verification procedures for engaging in swaps.

[323] The estimate is based on the Commission's experiences in similar matters such as a registrant's determination regarding whether an investor is an accredited investor for the purposes of Regulation D. The same estimate for the hourly cost for legal services was used by the Commission in the proposed

Commission preliminarily believes, based on information currently available to it, that there are and would continue to be a total of approximately 8,500 market participants.[324] The Commission estimates that the SBS Entities would take initially 1 hour per transaction to collect the information for an initial aggregate burden of approximately 47,000 hours or an average of approximately 855 hours per SBS Entity.[325]

2. Disclosures by SBS Entities

The estimates in this paragraph reflect the Commission's experience with burden estimates for similar disclosure requirements and as a result of our discussions with market participants.[326] Pursuant to proposed Rule 15Fh-3(b), (c), and (d), SBS Entities would be required to provide certain disclosures to market participants. It is our understanding that most of the large SBS Dealers already provide their counterparties disclosures similar to those that would be required under proposed Rules 15Fh-3(b) and (c). Given that the material characteristics are generally included in the documentation of a security-based swap, such as the master agreement, credit support annex, trade confirmation or other documents, the Commission does not anticipate that any additional

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consolidated audit trail rule. Consolidated Audit Trail, Exchange Act Release No. 62174, 75 FR 32556 (June 8, 2010).

324 See note 313, supra, regarding the estimate for the number of market participants.

325 The estimate is based on the number of unique SBS Dealer to non-SBS Dealer trading relationships identified in the market data for November 2006 – September 2010 provided by DTCC. This estimate includes each SBS Dealer affiliate with the same non-SBS Dealer entity as a separate trading relationship. As a result, this number may overestimate the actual number of trading relationships with non-SBS Dealers.

326 See Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments, Securities Act Release No. 7386 (Jan. 31, 1997), 62 FR 6044 (Feb. 10, 1997).

burden will be required for the disclosure of material characteristics.[327] For other required disclosures relating to material risks, incentives or conflicts of interest, the Commission anticipates that many SBS Entities would revise existing disclosures and tailor them to this context. For example, many SBS Dealers provide a statement of potential risks related to investing in certain security-based swaps in documents describing such instruments.

In some cases, such as disclosures about the daily mark for a cleared security-based swap, the proposed rules contemplate receiving the core valuation information from an external source with only limited administrative handling expected to be necessary to pass the disclosure to counterparties. For uncleared, security-based swaps, the Commission preliminarily believes that the SBS Entities may need to slightly modify the models used for calculating variation margin to calculate the daily mark required by proposed Rule 15Fh-3(c) for uncleared security-based swaps. The Commission does not currently have an expectation of the proportion of security-based swaps that will be cleared as a result of the Dodd-Frank Act and the rules promulgated thereunder.[328] Existing accounting standards and other disclosure requirements under the Exchange Act, such as FASB Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures, or Item 305 of Regulation S-K, already require the description of the methodology and assumptions with respect to models used in the derivatives context.

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327 To the extent that disclosure of material characteristics is initially provided orally, the additional burden of providing a written version of the disclosure at or before delivery of the trade confirmation will be considered in connection with the overall reporting and recordkeeping burdens of the SBS Entity. See notes 160 and 305, supra.

328 The Commission has obtained data from DTCC on new and assigned CDS trades in U.S. dollars during the month of November 2010 for ICE Trust. Cleared CDS trades were 5.24% by notional amount of all new or assigned single name trades, and 20.69% by notional amount of all new or assigned index trades.

The Commission preliminarily believes that SBS Entities will use internal staff to revise existing disclosures to comply with proposed Rules 15Fh-3(b) and (c) and assist in preparing language to comply with proposed Rule 15Fh-3(d) regarding the clearing options available for the particular security-based swap. The Commission also anticipates that disclosures of material risks for similar types and classes of security-based swaps would be similar and subsequent transactions will require much less time to review and revise applicable disclosures.

Because the Commission is unaware of any definitive data regarding how many SBS Entities currently provide these disclosures, the Commission has conservatively estimated that all SBS Entities would require additional time to provide at least some of these disclosures. The Commission estimates that there has been an average of approximately 400,000 new security-based swap contracts traded annually between an SBS Dealer and a counterparty that is not an SBS Dealer, and these security-based swaps would likely require these disclosures.[329] In view of the factors discussed in the Cost-Benefit Analysis section and elsewhere in this release, the Commission recognizes that the time required to develop an infrastructure to provide these disclosures would vary significantly depending on, among other factors, the complexity and nature of the SBS Entity's security-based swap business, its market risk management activities, its existing disclosure practices, and other applicable regulatory requirements. Under the proposed rule, SBS Entities could use, where appropriate, standardized formats to make certain

[329] Available market data for November 2006 – September 2010 provided by DTCC indicated approximately 4,000,000 transactions between SBS Entities and non-SBS Entities during that time period. Of these, approximately 40% (or 1,600,000) are new trades; the remaining are assignments and terminations, which may not require the same level of disclosure. To obtain an approximate average annual number of transactions, we divided 1,600,000 transactions by 47 (months) and multiplied by 12 and rounded to 400,000.

required disclosures of material information to their counterparties, and to include such disclosures in a master or other written agreement between the parties, if agreed by the parties. The Commission recognizes that some disclosures particularized to the transaction would likely be necessary to adequately meet all of an SBS Entity's disclosure obligations. The Commission also expects that because the reporting burden generally would require refining or revising existing disclosure processes, that the disclosures would be prepared internally.

As a result, the Commission estimates that SBS Entities would initially require three persons from trading and structuring, three persons from legal, two persons from operations, and four persons from compliance, for 100 hours each. This team would analyze the changes necessary to comply with the new disclosure requirements, including the redesign of current compliance systems if necessary, and the creation of functional requirements and system specifications for any systems development work that may be needed to automate the disclosure process.[330] This would amount to an initial cost burden of 66,000 hours.[331] Following the initial analysis and specifications development effort, the Commission estimates that half of these persons would be required to spend 20 hours annually to re-evaluate and modify the disclosures and system requirements as necessary, amounting to an ongoing annual burden of 6,600 hours.[332] The Commission also estimates that to create and maintain an information technology infrastructure to the specifications identified by the team above, each SBS Entity would require, on average,

[330] Some SBS Entities may choose to utilize in-house counsel to review, revise and prepare these disclosures. The Commission does not currently have an estimate as to the proportion of SBS Entities that would use outside counsel, but has considered the alternative in developing its estimates.

[331] The estimate is based on the following calculation: (55 SBS Entities) x (12 persons) x (100 hours).

[332] The estimate is based on the following calculation: (55 SBS Entities) x (6 persons) x (20 hours).

eight full-time persons for six months of systems development, programming and testing, amounting to a total initial burden of 440,000 hours.[333] The Commission further estimates that maintenance of the system will require two full-time persons for a total of ongoing burden of 220,000 hours annually.[334]

3. Know Your Counterparty and Recommendations

Proposed Rules 15Fh-3(e) and (f) are based on existing FINRA rules.[335] However, the "know your counterparty" requirement in proposed Rule 15Fh-3(e) would also require an SBS Dealer to consider its credit and operational risk management policies in determining the information to collect from its counterparty. If the SBS Dealer is a counterparty to a special entity, proposed Rule 15Fh-3(e) would also require the SBS Dealer to obtain and retain a record of the relevant background of the independent representative.[336] The Commission expects that given the institutional nature of the participants involved in security-based swaps, most SBS Dealers would obtain the representations in proposed Rule 15Fh-3(f)(2) or proposed Rule 15Fh-3(f)(3)(ii) to comply with proposed Rule 15Fh-3(f).

In addition, many SBS Dealers already collect this type of information in connection with their due diligence checklists. Banking agencies have also issued

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[333] The estimate is based on the following calculation: (55 SBS Entities) x (4 persons) x (2000 hours).

[334] The estimate is based on the following calculation: (55 SBS Entities) x (2 persons) x (2000 hours)

[335] See note 26, supra, regarding FINRA Rules 2090 and 2111 (effective July 9, 2012).

[336] To the extent that an SBS Dealer is a registered broker or dealer, it should already have processes and procedures in place to comply with similar requirements with respect to other securities. See FINRA Rule 2090 (requiring broker-dealers to know and retain essential facts, "concerning every customer and concerning the authority of each person acting on behalf of such customer").

guidance to national banks regarding similar procedures.[337] However, the Commission does not currently have an estimate of how many SBS Entities are expected to be subject to this banking guidance.[338] The Commission also preliminarily believes that other SBS Dealers generally already create and maintain these records under prudent recordkeeping procedures. However, as is true in the broker-dealer context, because each SBS Dealer is likely to tailor its procedures to its particular corporate culture and existing policies and procedures, we expect that the practices of SBS Dealers in complying with the proposed rule would vary greatly. In addition, the SBS Dealer may collect the information required at various points in the relationship with its counterparty, including at the establishment of the account, periodic updates, or with the execution of each security-based swap. The Commission has considered all of the foregoing in preparing the estimate regarding reporting burdens.

The estimates in this paragraph reflect the Commission's experience with and burden estimates for similar collections of information, as well as our discussions with market participants.[339] The Commission preliminarily believes that most SBS Dealers currently have policies and procedures in place for knowing their counterparties, either through due diligence checklists or for compliance with FINRA standards. The Commission estimates that, on average, these records would require each SBS Dealer to spend approximately three to five hours initially to review existing policies and procedures and document the collection of information necessary to comply with its

[337] See Risk Management of Financial Derivatives, Office of Comptroller of the Currency Banking Circular No. 277 (Oct. 27, 1993).

[338] See note 320, supra, regarding banks engaged in security-based swaps.

[339] See Books and Records Requirements for Brokers and Dealers under the Securities Exchange Act of 1934, Exchange Act Release No. 44992 (Oct. 26, 2001), 67 FR 58284 (Nov. 2, 2001).

"know your counterparty" obligations for a total initial burden of 250 hours.[340] The Commission also estimates an SBS Dealer would spend an average of approximately 30 additional minutes each year per unique non-SBS Dealer counterparty to assess whether the SBS Dealer is in compliance with the requirements to make suitable recommendations, a total ongoing burden of approximately 23,500 hours annually,[341] or an average of 470 hours annually per SBS Dealer.[342] The Commission also believes that many SBS Dealers will not incur significant additional expense because they already collect this information as part of current practices.[343]

The Commission expects that much of the information relating to the background and experience of the independent representative is already included in the marketing materials of the third-party independent representatives and as a result, would only require a minimal amount of time for the independent representative to provide to the special entity and/or SBS Dealer.

4. Fair and Balanced Communications

Proposed Rule 15Fh-3(g)(3) would require that statements of potential opportunities must be balanced by an equally detailed statement of corresponding risks. In addition, we note that some risk disclosures would already be addressed in proposed Rule 15Fh-3(b) discussed above, which would require an SBS Entity to disclose the

[340] The Commission is conservatively using the high end of the range for the purposes of estimating these reporting burdens.

[341] The estimate is based on the following calculation: (47,000 transactions with non-SBS Dealer counterparties) x 30 minutes / 60 minutes. See note 325 regarding the number of transactions with non-SBS Dealer counterparties.

[342] To the extent that the SBS Dealer is unfamiliar with the counterparty, the Commission would expect a greater time burden and as an SBS Dealer becomes more familiar with the particular counterparty, the Commission would expect a lesser time burden. As a result, we use 30 minutes as an average estimate.

[343] See Sections IV.C and D.

material risks of the transaction, the burden for which is discussed above. We expect this discussion of material risks of the transaction to be included in the documentation for the security-based swap. Furthermore, proposed Rule 15Fh-3(g) is based on existing FINRA rules so for the 16 registered broker-dealers that are expected to register as SBS Entities, they already would be subject to similar requirements with respect to other securities pursuant to NASD Rules 3010 and 3012. In addition, for the SBS Entity's own risk management purposes, currently for certain products, its existing marketing materials already include a general statement of risks that accompany a general description of the security-based swap. For the remaining 39 SBS Entities, the Commission assumes that SBS Entities would likely send their existing marketing materials to outside counsel for review and comment. As a result, the Commission estimates that each SBS Entity will likely incur $6,000 in legal costs, or $234,000 in the aggregate initial burden, to draft or review statements of potential opportunities and corresponding risks in the marketing materials for equity swaps, credit default swaps and total return swaps, which comprise the vast majority of security-based swaps.[344] For more bespoke transactions, the cost of outside counsel to review the marketing materials will depend on the complexity, novelty and nature of the product, but the Commission would expect a much longer review for more novel products.

5. Supervision

Proposed Rule 15Fh-3(h) is based on existing FINRA rules so to the extent that an SBS Entity is a registered broker-dealer, we expect that the SBS Entity would already

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344 The Commission estimates the review of the marketing materials for each of these categories would require 5 hours of outside counsel time at a cost of $400 per hour. This estimate also assumes that each SBS Entity engages in all three categories of transactions.

be complying with similar requirements with respect to other securities pursuant to NASD Rules 3010 and 3012.[345] Broker-dealers presently maintain lists of principals or branch managers responsible for supervising each of their offices pursuant to NASD 3010 and 3012 and other applicable SRO rules, and that they also have lists of associated persons who operate out of each office location. These rules currently require a broker-dealer to have supervisory systems in place that include similar obligations to achieve compliance with applicable securities laws, regulations and rules.[346] Banking agencies have also issued guidance to national banks regarding similar procedures.[347]

The estimates in this paragraph reflect the foregoing information and the Commission's experience with and burden estimates for similar collections of information. While each of the policies and procedures required by proposed Rule 15Fh-3(h) will vary in exact cost, the Commission estimates that such policies and procedures would require an average of 210 hours per respondent per policy and procedure to prepare and implement,[348] or an average of 1890 burden hours per SBS Entity, resulting in an aggregate initial burden of 103,950 hours.[349] The Commission also expects that many SBS Entities would engage outside counsel to assist them in preparing for the

345 See Section II.C.6.

346 See NASD Rule 3010.

347 See Risk Management of Financial Derivatives, Office of Comptroller of the Currency Banking Circular No. 277 (Oct. 27, 1993).

348 See SDR Registration Release .

349 The estimate is based on the following calculation: (210 hours) x (9 policies and procedures) x (55 SBS Entities).

collection of information required under this rule at a rate of $400 per hour[350] for an average of 450 hours per respondent for a minimum of nine policies and procedures,[351] resulting in an outside initial cost burden of $180,000 per respondent or an aggregate initial cost of $9,900,000. Once these policies and procedures are established, the Commission estimates, that on average each SBS Entity would spend approximately 540 hours (approximately 60 hours per policy and procedure[352]) each year to maintain these policies and procedures, yielding a total ongoing annual burden of approximately 29,700 hours (55 SBS Entities x 540 hours). Based on the Commission's experience in other contexts, the Commission preliminarily believes that this maintenance of policies and procedures will be conducted internally.[353]

6. SBS Dealers Acting as Advisors to Special Entities

Consistent with the requirements of proposed Rule 15Fh-2(a), parties have generally included representations in standard security-based swap documentation that both counterparties are acting as principals and that the counterparty is not relying on any communication from the SBS Dealer as investment advice. Under proposed Rule 15Fh-5, the SBS Dealer is required to have a reasonable basis to believe that the special entity has a qualified independent representative. The reporting burdens for this reasonable basis belief requirement are analyzed below in connection with the discussion of reporting burdens of "SBS Entities Acting as Counterparties to Special Entities." In

350 See SDR Registration Release. The same estimate for the hourly cost for legal services was used by the Commission in the proposed consolidated audit trail rule. Consolidated Audit Trail, Exchange Act Release No. 62174 (May 26, 2010), 75 FR 32556 (June 8, 2010).

351 See SDR Registration Release.

352 Id.

353 Id.

addition, we believe that parties are likely to provide the necessary representations and disclosures under proposed Rule 15Fh-2(a) so that the SBS Dealer would not fall within the definition of acting as an advisor, particularly for transactions in which the SBS Dealer is the counterparty to the transaction. Accordingly, we believe for these transactions that it is unlikely the SBS Dealer will be required to collect the information to determine the best interests of the special entity. Based on consultations by the Commission staff with market participants, the Commission preliminarily believes that the 50 SBS Dealers would each need approximately five hours to revise the existing representations to comply with this requirement or an aggregate initial burden of 250 hours. The Commission preliminarily believes that once each of the SBS Dealers has revised the language of the representation, such language would become part of the standard security-based swap documentation and, accordingly, there would be no further ongoing associated burden.

For transactions in which the SBS Dealer is not the counterparty and chooses to act as an advisor, the Commission estimates that an SBS Entity would require approximately 20 hours to collect the requisite information from each special entity for an aggregate initial burden of approximately 4,000 hours.[354]

7. SBS Entities Acting as Counterparties to Special Entities

When a special entity is a counterparty to a security-based swap, proposed Rule 15Fh-5 would require that an SBS Entity must have a reasonable basis for believing that

[354] The estimate is based on available market data for November 2006 – September 2010 provided by DTCC that indicates 201 trading relationships between SBS Dealers and special entities that do not have a third-party investment adviser. For the purposes of estimating these reporting burdens, we approximate the number of trading relationships between SBS Dealers and special entities at 200. This estimate includes the following calculation: (20 hours) x (200 trading relationships).

the special entity has an independent representative that: (1) has sufficient knowledge to evaluate the transaction and risks; (2) is not subject to a statutory disqualification; (3) undertakes a duty to act in the best interests of the special entity; (4) makes appropriate and timely disclosures to the special entity of material information concerning the security-based swap; (5) will provide written representations to the special entity regarding fair pricing and the appropriateness of the security-based swap; (6) in the case of employee benefit plans subject to ERISA, is a fiduciary as defined in section 3(21) of that Act (29 U.S.C. 1002(21)); and (7) in the case of a special entity defined in §§240.15Fh-2(e)(2) or (4) and a non-employee, third-party independent representative, is a person that is subject to rules of the Commission, the CFTC, or an SRO subject to the jurisdiction of the Commission or the CFTC, that prohibit it from engaging in specified activities if certain political contributions have been made. The Commission expects that written representations are likely to form much of the basis of the SBS Entity's belief as to the qualifications of the independent representative. The Commission also expects that in connection with its own prudent business practices the SBS Entity would confirm the status of whether the independent representative is subject to statutory disqualifications by a search on BrokerCheck or any other database available to it.[355] Furthermore, the SBS Entity is likely to have procedures in place to determine whether any of its associated persons are subject to a statutory disqualification, which it could likely use or modify.[356] The Commission preliminarily believes that the burden to determine that the independent representative is independent of the SBS Entity would likely depend on the

355 See Section II.D.5.c.ii and solicitation for comments thereunder.

356 See Section 15F(b)(6) of the Exchange Act. Pub. L. 111-203, 124 Stat. 1376, 1785 (to be codified at 15 U.S.C. 78o-10(b)(6)).

size of the independent representative, the size of the SBS Entity and the volume of transactions in which each is engaged. The estimates in this paragraph reflect the Commission staff's discussions with market participants. The Commission preliminarily believes that each SBS Entity initially would require written representations regarding each independent representative, but would only require updates with respect to the representations in subsequent dealings. The Commission does not currently have data regarding the number of independent representatives with which each SBS Entity interacts. As a result, for the purposes of these estimates the Commission has assumed that each SBS Entity would interact with approximately 150 third-party independent representatives and 30 in-house independent representatives, and that each SBS Entity, on average, would initially require approximately 15 hours per independent representative to collect the information necessary to comply with this requirement, or an aggregate initial burden of 148,500 hours (15 hours x 180 independent representatives x 55 SBS Entities). In addition, the Commission estimates that subsequent transactions with third-party, non-employee independent representatives would likely require an average of approximately 10 hours annually to update these representations and verifications or an aggregate initial burden of 82,500 hours (10 hours x 150 independent representatives x 55 SBS Entities). The Commission solicits comments as to the accuracy of this information.

The collection of information by the SBS Entity, would also impose some burden on the independent representatives to collect the information and provide the information to the SBS Entity and/or the special entities. The estimates in this paragraph reflect the Commission staff's discussions with market participants. The Commission expects that the main burden for the independent representatives is likely providing the representations on which the SBS Entity can rely. As a result, the Commission conservatively estimates that the reporting burden will likely be approximately 1 hour for each transaction of an annual average of 8,300 transactions[357] for the estimated 60 in-house independent representatives, equivalent to an average burden of approximately 138 hours per year per in-house independent representative.

With respect to third-party independent representatives, the Commission does not expect that any additional information would need to be collected pursuant to proposed Rule 15Fh-5(a)(6) because the independent representative would have undertaken this analysis under ERISA to confirm that it is subject to the fiduciary standards of ERISA and to determine whether it falls within one of the "prohibited transaction exemptions" promulgated by the Department of Labor. Similarly, under proposed Rule 15Fh-5(a)(7), the independent representative would have already determined whether it is subject to pay to play prohibitions to comply with those prohibitions. With respect to the transaction-specific requirements in proposed Rule 15Fh-5(a)(4) to (5), the Commission preliminarily believes that the reporting burden for the independent representative would likely consist of providing written representations to the SBS Entity and/or the special entity it represents. The Commission preliminarily believes that the burden on the independent representative to determine that it is independent of the SBS Entity would likely depend on the size of the independent representative, the size of the SBS Entity and the volume of transactions in which each is engaged. The estimates in this paragraph

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357 The estimate is based on available market data for November 2006 – September 2010 provided by DTCC that indicates 32,521 transactions during that time that involve special entities trading without an investment adviser. To obtain an approximate annual average number of transactions based on this data, we divided 32,521 transactions by 47 months and multiplied by 12 months and rounded to 8,300.

reflect the foregoing and the Commission staff's discussions with market participants. As a result, the Commission conservatively estimates that the reporting burden would likely average approximately 20 hours for each of the approximately 1,000 unique trading relationships between SBS Entities and special entities using a third-party independent representative for an aggregate initial burden of 20,000 hours or an average of approximately 62 hours for each of the estimated 325 third party independent representatives.[358]

8. Political Contributions

As noted above, the Commission estimates there will be approximately 50 SBS Dealers and has conservatively estimated that all of them will provide, or will seek to provide, security-based swap services to municipal entities. In addition, SBS Dealers' covered associates would also need to collect and provide the information required by the proposed rule to the SBS Dealer. The estimates herein take into account the burden of the covered associates and the SBS Dealers. These estimates reflect the Commission's experience with and burden estimates for similar requirements, as well as our discussions with market participants.[359] The Commission estimates that it would take, on average, approximately 185 hours per SBS Dealer and a total initial burden of 9,250 hours[360] to collect the information regarding the political contributions of the SBS Dealers and their covered associates.

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[358] The estimate is based on available market data for November 2006 – September 2010 provided by DTCC that indicates approximately 1,000 unique trading relationships between SBS Entities and special entities using a third-party investment adviser during that time.

[359] See Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 2910 (July 1, 2010), 75 FR 41018, 41061- 41065 (July 14, 2010).

[360] The estimate is based on the following calculation: (185 hours x 50 SBS Dealers)

Additionally, we expect some SBS Dealers may incur one-time costs to establish or enhance current systems to assist in their compliance with the proposed rule. These costs would vary widely among firms. Some SBS Dealers may not incur any system costs if they determine a system is unnecessary due to the limited number of employees they have or the limited number of municipal entity counterparties they have. Like other large firms, SBS Dealers likely already have devoted significant resources to automating compliance and reporting with existing applicable prohibitions on certain political contributions, and the proposed rule could cause them to enhance their existing systems that had originally been designed to comply with MSRB Rules G-37 and G-38 and Advisers Act Rule 206(4)-5. We believe that the cost of enhancing such a system could range from the tens of thousands of dollars for simple reporting systems, to hundreds of thousands of dollars for complex systems.[361]

9. Chief Compliance Officer

Under proposed Rule 15Fk-1, an SBS Entity's CCO would be responsible for, among other things, establishing policies and procedures reasonably designed: to ensure compliance by the SBS Entity with the Exchange Act and the rules and regulations thereunder relating to its business as an SBS Entity; to remediate promptly noncompliance issues identified by the CCO; and for prompt handling, management response, remediation, retesting, and resolution of noncompliance issues. As described above, the Commission estimates that a total of 55 respondents would be subject to this requirement. Based on the Commission's experience with and burden estimates for

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[361] See Political Contributions by Certain Investment Advisers, note 33, supra (adopting Advisers Act Rule 206(4)-5).).

similar collections of information,[362] it estimates that on average the establishment and administration of the policies and procedures required under proposed Rule 15Fk-1 would require 630 hours to create and 180 hours to administer per year per respondent, for a total burden of 34,650 hours initially and 9,900 hours per year on average, on an ongoing basis. The Commission estimates that a total of $60,000 in outside legal costs will be incurred as a result of this burden per respondent, for a total initial outside cost burden of $3,300,000.[363]

A CCO would also be required under proposed Rule 15Fk-1 to prepare and submit annual compliance reports to the Commission and the SBS Entity's board of directors. Based upon the Commission's estimates for similar annual reviews by CCOs, the Commission estimates that these reports would require on average 92 hours per respondent per year.[364] Thus, the Commission estimates an ongoing annual burden of 5,060 hours.[365] Because the report will be submitted by an internal CCO, the Commission does not expect any external costs associated therewith. The Commission solicits comments as to the accuracy of this information and these estimates.

E. Collection of Information is Mandatory

The collections of information relating to verification of the status of the counterparty would be mandatory for all SBS Entities. The collections of information

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362 See SDR Registration Release (citing Regulation NMS: Final Rules and Amendments to Joint Industry Plans, Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005)); Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011).

363 This figure is the result of an estimated $400 per hour cost for outside legal services times 150 hours for 3 policies and procedures for 55 respondents. See SDR Registration Release.

364 See Compliance Programs of Investment Companies and Investment Advisers, Investment Advisers Act Release No. 2107, 68 FR 7038 (Feb. 11, 2003); SDR Registration Release; Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011).

365 The estimate is based on the following calculation: (92 hours) x (55 SBS Dealers).

relating to disclosures by SBS Entities would be mandatory for all SBS Entities. The collections of information relating to knowing the counterparty and for suitability obligations would be mandatory for all SBS Dealers. The collection of information relating to fair and balanced communications would be mandatory for all SBS Entities. The collections of information relating to supervision would be mandatory for all SBS Entities. The collection of information relating to acting as an advisor to a special entity would be mandatory for all SBS Dealers. The collection of information relating to SBS Entities acting as counterparties to special entities would be mandatory for all SBS Entities. The collection of information relating to pay to play restrictions would be mandatory for all SBS Dealers. The collection of information relating to CCO obligations would be mandatory for all SBS Entities.

F. Responses to Collection of Information Will Be Kept Confidential

The Commission preliminarily believes the collection of information pursuant to proposed Rules 15Fh-3 to 15Fh-6 and 15Fk-1 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").

G. Request for Comment

We invite comment on these estimates. Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- evaluate whether the proposed collection of information is necessary for the performance of our functions, including whether the information will have practical utility;

- evaluate the accuracy of our estimates of the burdens of the proposed collections of information;
- determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and
- evaluate whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements of the proposed rules should direct them to (1) 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 (2) Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-XX-XX. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, with reference to File No. S7-XX-XX, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Cost-Benefit Analysis

The Commission is sensitive to the costs and benefits imposed by its rules. The proposed rulemaking is intended to implement the requirements under Section 15F(h) of the Exchange Act as added by Section 764(a) of the Dodd-Frank Act concerning external business conduct standards for SBS Entities. Section 15F of the Exchange Act provides the Commission with both mandatory and discretionary rulemaking authority to impose business conduct requirements on SBS Entities in their dealings with counterparties, including special entities. In addition to the reporting burdens associated with certain of the proposed rules described in Section IV.D above, the discussion below focuses on other potential costs and benefits of the decisions made by the Commission, together with the other agencies, to fulfill the mandates of the Dodd-Frank Act within its permitted discretion. As part of this analysis, we do not consider the costs and benefits of the mandates of the Dodd-Frank Act itself.[366]

As discussed in Section I.C.3, in addition to business conduct requirements expressly addressed by Title VII of the Dodd-Frank Act, we are proposing for comment certain other business conduct requirements for SBS Dealers that we preliminarily believe further the principles that underlie the Dodd-Frank Act. These include details of the daily mark for uncleared security-based swaps; certain disclosures related to the provision of a daily mark for uncleared security-based swaps; certain "know your counterparty" and suitability obligations for SBS Dealers; provisions intended to prevent SBS Dealers and independent representatives of special entities from engaging in certain "pay to play" activities; certain minimum requirements for the annual compliance reports

[366] The Paperwork Reduction Act analysis in Section IV.D., however, describes collections of information under the proposed rules, regardless of whether the rules are proposed pursuant to mandatory or discretionary authority.

to be provided by the CCO; and a requirement of board approval for decisions related to compensation or removal of the CCO.

A. Costs and Benefits of Rules Relating to Daily Mark

Section 15F(h)(3)(B)(iii) of the Exchange Act requires the Commission to adopt rules requiring the disclosure to counterparties of the daily mark. For cleared security-based swaps, upon request from the counterparty, the rule must require an SBS Entity to provide the daily mark, which under proposed Rule 15Fh-3(c) would be the daily end of day settlement price received from the appropriate clearing agency. For uncleared security-based swaps, the rules must require the SBS Entity to provide the daily mark. However, the method for computing the daily mark is not provided in the statute. Proposed Rule 15h-3(c)(2) would require that the SBS Entity meet this disclosure requirement for any uncleared security-based swap by providing the midpoint between the bid and offer, or the calculated equivalent thereof, as of the close of business unless the parties agree in writing otherwise. The SBS Entity would also be required to disclose the data sources and describe the methodology and assumptions used to prepare the daily mark. The provision of a daily mark along with the data sources, assumptions, and methodology used in its preparation, should provide a useful reference point for the counterparty.

In the absence of current valid quotes from which to calculate the mid-market price, a model would be used to estimate the daily mark. When markets are illiquid the mark provided by a model may provide a better estimate of the value of the security-based swap than a stale market price. However, the mark would only be as good as the model from which it is derived and security-based swap market participants would need to evaluate the data sources, methodology and assumptions employed to fully appreciate model-derived daily marks. Further, the model price would not necessarily reflect the price at which the security-based swap could be executed. While the market-wide disclosure of these marks could raise the quality of the model-derived daily marks, there would likely be variability in the models and data sources, methodology and assumptions, leading to different daily marks being established for similar security-based swaps. As a result, security-based swap market participants that consider the daily mark as one indicator in the reporting of their positions might present different values for similar security-based swap market positions on their respective balance sheets.

Potential limitations of a model-based daily mark notwithstanding, counterparties to SBS Entities will benefit from a good faith effort by SBS Entities to value uncleared SBS transactions. Daily marks will allow counterparties to better understand their financial relationships with SBS Entities and provide a frequently updated basis for variation margin requirements. And although daily marks would not necessarily represent a price at which at a counterparty could enter or exit the position, it would provide a meaningful reference point against which to assess, among other things, the calculation of variation margin for a security-based swap or portfolio of security-based swaps, and otherwise inform the counterparty's understanding of its financial relationship with the SBS Entity. Moreover, because SBS Entities would be required to provide the same valuation to all of their counterparties, and because counterparties could interact with multiple SBS Entities, counterparties would be assured of equal treatment and would have the ability to observe when valuations differ among SBS Entities.

The costs to SBS Entities of providing daily marks should be minimal other than the disclosure burdens previously described. Proper risk management at SBS Entities entails assessing end-of-day values. In this respect, an SBS Entity would simply be passing along a valuation similar to one that the SBS Entity currently performs, even without a rule requiring disclosure.

B. Costs and Benefits of Rules Concerning Verification of Counterparty Status, Knowing Your Counterparty, and Recommendations of Security-Based Swaps or Trading Strategies

Proposed Rule 15Fh-3(a)(2) would require an SBS Entity to verify whether a counterparty is a special entity before entering into a security-based swap with that counterparty. Although the Dodd-Frank Act does not require an SBS Entity to verify whether a counterparty is a special entity, we are mindful that Congress established a set of additional provisions addressing solely the interactions between SBS Entities and special entities in connection with security-based swaps, and we preliminarily believe that such verification would help to ensure that these counterparties do, in fact, receive the benefit of such provisions, as well as our proposed rules thereunder. The verification requirement would not apply if an SBS Entity is entering into a transaction with a special entity on a SEF or an exchange and for which the SBS Entity does not know the identity of the counterparty.

Proposed Rule 15Fh-3(e) would establish a "know your counterparty" requirement for SBS Dealers that would require an SBS Dealer to obtain and retain a record of essential facts regarding a counterparty that are necessary for conducting business with such a counterparty. The "essential facts concerning a counterparty" are those required to (1) comply with applicable laws, regulations and rules; (2) implement the SBS Dealer's credit and operational risk management policies in connection with transactions entered into with such counterparty; (3) information regarding the authority of any person acting for such counterparty; and (4) if the counterparty is a special entity, such background information regarding the independent representative as the SBS Dealer reasonably deems appropriate. To the extent that the SBS Dealer does not already collect and retain this information as a part of its normal course of business, this requirement would increase the cost to the SBS Dealer of entering into security-based swaps. The increased cost is likely to be reflected in the terms offered to the counterparty. To the extent that an SBS Dealer is unable to recover the added costs from the counterparty, the rule would provide a disincentive for recommending bespoke transactions.

Proposed Rule 15Fh-3(f) would require that the SBS Dealer have a reasonable basis to believe: (i) based on reasonable diligence, that the recommended security-based swap or trading strategy involving a security-based swap is suitable for at least some counterparties; and (ii) that a recommended security-based swap or trading strategy is suitable for the counterparty based on relevant information the SBS Dealer has or has obtained regarding the counterparty, including the counterparty's investment profile, trading objectives and its potential to absorb losses associated with the recommended security-based swap or trading strategy. This requirement could potentially benefit counterparties by requiring that an SBS Dealer recommend only suitable security-based swaps or trading strategies. While the proposed requirement that an SBS Dealer know essential facts regarding its counterparties to evaluate the suitability of trades for its counterparties would be a responsibility that would go beyond disclosure of material risks and so, could increase the costs to SBS Dealers in transacting with counterparties, particularly for counterparties with which an SBS Dealer has had no prior transactions, we anticipate that SBS Dealers would seek to rely on proposed Rule 15Fh-3(f)(2), which would allow an SBS Dealer to fulfill its obligations with respect to a particular counterparty if (1) the SBS Dealer reasonably determined that the counterparty, or the counterparty's agent to whom the counterparty has delegated decision making authority, is capable of exercising independent judgment, (2) the counterparty or agent affirmatively represented that it is exercising independent judgment in evaluating the recommendations, and (3) the SBS Dealer disclosed that it was acting in its capacity as a counterparty and was not undertaking to assess the suitability of the security-based swap or trading strategy for the counterparty. This provision would benefit counterparties by helping to ensure that they are in fact capable of exercising independent judgment in evaluating security-based swaps and trading strategies.

Some SBS Dealers may already have an obligation to make suitable recommendations of a security-based swap or trading strategy through other regulatory regimes to which they may be subject. For example, FINRA imposes a suitability requirement on recommendations by broker-dealers. Municipal securities dealers also have a suitability obligation when recommending municipal securities transactions to a customer. Federally regulated banks have a suitability obligation as well when acting as broker-dealers in connection with the purchase or sale of government securities. Proposed rule 15Fh-3(f) would subject SBS Dealers to similar suitability requirements. In addition, the suitability obligation would not apply to an SBS Dealer in dealings with an SBS Entity, swap dealer, or major swap participant.

One potential concern is that relatively unsophisticated counterparties would not qualify for the exception that would be provided by proposed Rule 15Fh-3(f)(2) and that the costs to SBS Dealers associated with determining suitability may be sufficiently large or difficult to assess given that SBS Dealers would choose not to engage in over-the-counter security-based swaps with certain counterparties, particularly less sophisticated counterparties. However, our analysis of the credit default swaps market over the four years prior to the passage of the Dodd-Frank Act finds that non-institutional counterparties generally have third-party representation. In particular, as previously noted, more than 95% of all trades by special entities are executed through third party investment advisers, and the remaining trades are predominantly by large, well known endowments and pension plans who would generally be characterized as sophisticated security-based swap market participants. Moreover, all counterparties may nonetheless be able to enter into security-based swaps that are traded on a registered national securities exchange, even if they are unable to find a SBS Dealer to enter a bespoke security-based swap.

C. Costs and Benefits of Rules Relating to Political Contributions by Certain SBS Entities and Independent Representatives of Special Entities

Proposed Rule 15Fh-6 would prohibit SBS Dealers from engaging in security-based swap transactions with a "municipal entity" if certain political contributions have been made to officials of such entities. The proposed rule is similar to rules adopted by the MSRB in Rule G-37: Political Contributions and Prohibitions on Municipal Securities Business and G-38: Solicitation of Municipal Securities Business, and by the

Commission in Advisers Act Rule 206(4)-5: Political Contributions by Certain Investment Advisers.[367]

Proposed Rule 15Fh-5(a)(7) would include in the list of qualifications for a "qualified independent representative" that the independent representative is subject to rules of the Commission, the CFTC, or a self-regulatory organization subject to the jurisdiction of the Commission or the CFTC, that prohibit it from engaging in specified activities if certain political contributions have been made. The proposed rule would not apply if the independent representative was an employee of the special entity.

The proposed rules should yield several direct and indirect benefits. The proposed rules are intended to address pay to play relationships that interfere with the legitimate process by which "municipal entities" and other special entities enter into security-based swaps to mitigate risk. The proposed rules should reduce the occurrence of fraudulent conduct resulting from pay to play. Addressing pay to play practices would help protect public pension plans, investments by the public in government-sponsored savings and retirement plans and programs, and taxpayers by addressing situations in which the municipal entity, in part based on a conflict of interest, enters into a security-based swap that may be without merit or for which there exists a better alternative. Allocative efficiency would be enhanced if special entities enter into security-based swaps based on hedging needs or the characteristics of the security-based swap rather than any influence from pay to play, either from the SBS Dealer or the independent representative.

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367 Political Contributions by Certain Investment Advisers, Investment Advisers Act Release No. 2910, 75 FR 41018, 41061- 41065 (July 14, 2010). Many of the economic issues associated with rules relating to political contributions by SBS entities are similar to those relating to investment advisers addressed in Rule 206(4)-5.

These proposed rules would encourage (1) SBS Dealers to compete for the business of municipal entities based on the merits of the transaction rather than their ability or willingness to make political contributions, and (2) independent representatives to compete based on their qualifications, service, and cost. Taxpayers may benefit from the rule because they would enjoy the benefits of appropriate risk management or investment strategies that make use of security-based swaps, and they might otherwise bear the financial burden of bailing out a municipal entity that had entered into an inappropriate security-based swap because of pay to play practices. The proposed rule may also lower transaction costs paid by "municipal entities" since it would not be necessary for SBS Dealers to recover expenses incurred by pay to play practices.[368]

Proposed Rule 15Fh-6 would require an SBS Dealer to incur costs to monitor contributions it and its covered associates make and to establish procedures to comply with the rule. The initial and ongoing compliance costs imposed by the proposed rule would vary significantly among firms, depending on a number of factors. These factors include the number of covered associates of the SBS Dealer, the degree to which compliance procedures are automated (including policies and procedures that could require pre-clearance), and the extent to which the SBS Dealer has a preexisting policy under its code of ethics or compliance program. A smaller SBS Dealer, for example, would likely have a small number of covered associates, and thus expend fewer resources to comply with the proposed rule.

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368 Academic research provides evidence that gross spreads on negotiated bid deals for municipal bonds were reduced following adoption of a pay to play rule prohibiting investment houses that make political contributions from selling bonds from that city/state for two years. See Alexander W. Butler, Larry Fauver, and Sandra Mortal, Corruption, Political Connections, and Municipal Finance, 22 The Review of Financial Studies 2873 (2009).

An SBS Dealer subject to the proposed rule would develop compliance procedures to monitor the political contributions made by the SBS Dealer and its covered associates. We estimate that the costs imposed by the proposed rule would be higher initially, as firms establish and implement procedures and systems to comply with the rule. We expect that compliance expenses would then decline to a relatively constant amount in future years, and that annual expenses would likely be lower for smaller SBS Dealers as the systems and processes should be less complex than for larger SBS Dealers.

An SBS Dealer with municipal entity counterparties, as well as covered associates of the SBS Dealer, also may be less likely to make contributions to government officials, including candidates, at or above the *de minimis* level, potentially resulting in less funding by SBS Dealers and their covered associates for these officials' campaigns. Under the rule, SBS Dealers and covered associates would be subject to new limitations regarding which campaigns they may support and the amounts that they may contribute. In addition, these same persons would be prohibited from soliciting others to contribute or from coordinating contributions to government officials, including candidates, or payments to political parties in certain circumstances. These limitations, and any additional prohibitions imposed by firms that choose to adopt more restrictive policies or procedures, could be perceived by the individuals subject to them as a cost in the sense that they limit those individuals' ability to give direct contributions to certain candidates above the *de minimis* level.

An SBS Dealer that becomes subject to the prohibitions of the proposed rule would be prohibited from offering to enter into, or entering into, a security-based swap with a particular municipal entity counterparty, which would result in a direct loss to the

SBS Dealer of revenues and profits relating to that government counterparty. However, this prohibition would likely result in a reallocation as to which SBS Dealer would generate these revenues and profits, not an overall loss to the market. The two-year time out could also limit the number of SBS Dealers able to offer to enter into or enter into security-based swap contracts with potential municipal entity counterparties.

D. Costs and Benefits Relating to the Specification of Minimum Requirements of the Annual Compliance Report and the Requirement of Board Approval of Compensation or Removal of a Chief Compliance Officer

Section 15F(k) of the Exchange Act requires an SBS Entity to designate a CCO, and imposes certain duties and responsibilities on that CCO. Proposed Rule 15Fk-1 would incorporate the provisions of Exchange Act Section 15F(k) in addition to certain provisions that are based on the current and proposed compliance obligations applicable to CCOs of other Commission-regulated entities.

The submission of the CCO's annual compliance report as required by the proposed rule would help the Commission monitor the compliance activities of SBS Entities. This report would also assist the Commission in carrying out its oversight of SBS Entities by providing the Commission with the information necessary to review compliance with rules relating to external business conduct.

Section 15Fk-1(2)(A) of the Exchange Act requires that the CCO report directly to the board or the senior officer of the SBS Entity. Proposed Rule 15Fk-1(d) would also require that the compensation and removal of the CCO would require the approval of a majority of the board of directors of the SBS Entity. The elevation of compensation and termination decisions to the board should reduce the inherent conflict of interest that arises when such decisions are made by individuals whose compliance with applicable law and regulations the CCO is responsible for monitoring. The potential separation of general supervisory responsibility of the CCO, which may reside with the senior officer of the SBS Entity, from the responsibility for compensation decisions may reduce the quality of those decisions.

In addition to the time involved with the reporting burdens, the direct costs of $3,300,000 in the aggregate associated with the submission of the annual compliance report are discussed in more detail in Section IV.D.9 above.

Request for Comments

The Commission also seeks comment on the accuracy of any of the benefits and costs it has identified and/or described above. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits. Because the structure of the security-based swaps market and the behavior of its market participants is likely to change after the effective date of the Dodd-Frank Act and implementation of the Commission's rules promulgated thereunder, the impact of, and the costs and benefits that may result from proposed Rules 15Fh-1 through 15Fh-6 and 15Fk-1 may change over time. As commenters review the proposed rules, we urge them to consider generally the role that regulation may play in fostering or limiting the development of the market for security-based swaps.

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

Section 3(f) of the Exchange Act requires that the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. [369] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, consider the effect such rules would have on competition.[370] Section 23(a)(2) of the Exchange Act also prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

Security-based swaps are currently executed and traded in the OTC market, with five large commercial banks representing 97% of the total U.S. banking industry notional amounts outstanding of derivatives.[371] The gross notional amount of credit default swaps as of the end of 2009 was approximately $30 trillion.[372]

Section 15F(h) of the Exchange Act as added by Section 764(a) of the Dodd-Frank Act provides the Commission with both mandatory and discretionary rulemaking authority to impose business conduct requirements on SBS Entities in their dealings with counterparties, including special entities.[373] The proposed rules to implement business

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369 15 U.S.C. 78c(f).

370 15 U.S.C. 78w(a)(2).

371 See Office of the Comptroller of the Currency, Quarterly Report on Bank Trading and Derivatives Activities, First Quarter 2010.

372 Data available at http://www.isda.org/statistics/pdf/ISDA-Market-Survey-results1987-present.xls.

373 See Exchange Act Section 15F(h)(2)(C), 15 U.S.C. 78o-10(h)(2)(C).

conduct requirements would apply to all SBS Entities. Therefore the Commission preliminarily believes that the effect on competition among SBS Entities would be small. The Commission also preliminarily believes that the proposed business conduct standards for SBS Entities, including those for disclosure of material risks and for fair and balanced communications, would reduce information asymmetries between SBS Entities and their counterparties. The reduction of information asymmetries should promote price efficiency, promote more informed decision-making, and reduce the incidence of fraudulent or misleading representations.

Proposed Rule 15Fh-3(e) would require an SBS Dealer to use reasonable due diligence to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the SBS Dealer prior to the execution of the transaction and the authority of any person acting for such counterparty. Proposed Rule 15h-3(f) would require that the SBS Dealer have a reasonable basis to believe: (i) based on reasonable diligence, that the recommended security-based swap or trading strategy involving a security-based swap is suitable for at least some counterparties; and (ii) that a recommended security-based swap or trading strategy is suitable for the counterparty based on information the SBS Dealer has obtained through reasonable due diligence regarding the counterparty's investment profile, and the potential risks and rewards associated with the recommended security-based swap or trading strategy.

Requiring SBS Dealers to evaluate the suitability of trades for counterparties is a responsibility that goes beyond disclosure of material risks and would further increase the costs to SBS Dealers in transacting with counterparties, particularly for counterparties with which the SBS Dealer has had no prior transactions. These costs are likely to be largest when the SBS Dealer is dealing directly with small, relatively unsophisticated counterparties where a greater level of inquiry would be required. If these costs result in SBS Dealers refraining from interacting with these counterparties, and these counterparties are otherwise unable to enter into security-based swaps and lose access to risk management methods that employ security-based swaps, the suitability requirement may come at a net cost to these counterparties and would place them at a disadvantage relative to larger, more sophisticated competitors. To the extent that these counterparties do not participate in the security-based swap market as a result of these costs, liquidity could drop, increasing the hedging costs and ultimately the cost of raising capital. However, as we noted previously, current market practices reveal that relatively few counterparties enter into security-based swap agreements with an SBS Dealer without third-party representation, particularly among special entities. As a result of this third-party representation and the SBS Dealer's ability to fulfill its suitability obligations by making the determination that a counterparty's agent is capable of independently evaluating investment risk, we do not believe that market access is likely to be restricted, even for small, relatively unsophisticated counterparties. Rather, we believe that it is possible that suitability requirements would add to the integrity of, and codify, current market practices, which can in some circumstances enhance the protections for such counterparties.

The practices that are proposed in the rules would also help regulators perform their functions in an effective manner. The resulting increase in market integrity would likely affect capital formation in our capital markets positively.

Request for Comments

The Commission also seeks comment on the accuracy of any of the competitive effects it has identified and/or described above. The Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such effects. Because the structure of the security-based swaps market and the behavior of its market participants is likely to change after the effective date of the Dodd-Frank Act and implementation of the Commission's rules promulgated thereunder, the impacts that may result from proposed Rules 15Fh-1 through 15Fh-6 and 15Fk-1 may change over time. As commenters review the proposed rules, we urge them to consider generally the role that regulation may play in fostering or limiting the development of the market for security-based swaps.

VII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[374] the Commission must advise the OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of $100 million or more (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 Rules 15Fh-1 through 15Fh-7 and 15Fk-1 on the economy on an annual basis, any potential

[374] 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).

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 Act Certification

The Regulatory Flexibility Act ("RFA")[375] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[376] of the Administrative Procedure Act,[377] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[378] Section 605(b) of the RFA states that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not have a significant economic impact on a substantial number of small entities.[379]

For purposes of Commission rulemaking in connection with the RFA, a small entity includes: (i) when used with reference to an "issuer" or a "person," other than an investment company, an "issuer" or "person" that, on the last day of its most recent fiscal year, had total assets of $5 million or less,[380] 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

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375 5 U.S.C. 601 et seq.

376 5 U.S.C. 603(a).

377 5 U.S.C. 551 et seq.

378 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (Jan. 28, 1982), 47 FR 5215 (Feb. 4, 1982).

379 See 5 U.S.C. 605(b).

380 See 17 CFR 240.0-10(a).

year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[381] 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.[382] With respect to investment companies in connection with the RFA, the term "small business" or "small organization" means an investment company that, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.

A. Market Participants in Security-Based Swaps

Based on the Commission's existing information about the security-based swap market, the Commission preliminarily believes that the security-based swap market, while broad in scope, is largely dominated by large entities such as those that would be covered by the "security-based swap dealer" definition and their large institutional customers.[383] Under current law, all security-based swap market participants are effectively required to be "eligible contract participants."[384] The basic thresholds under the definition of eligible contract participant are currently $10 million in total assets for

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[381] See 17 CFR 240.17a-5(d).

[382] See 17 CFR 240.0-10(c).

[383] See supra notes 4 and 5.

[384] Otherwise, the security-based swap would either be a security subject to the federal securities laws, including a registration requirement under the Securities Act, or an illegal future, depending on its economic terms and the security, commodity or other asset that it references. In practice, this has meant that such transactions do not occur.

natural persons, and $25 million in total assets for corporations and other legal entities.[385] Because the definition of "small entity" requires that issuers or persons other than broker-dealers and investment companies must have total assets of $5 million or less, by definition they cannot be eligible contract participants. Based on its knowledge of registered broker-dealers and feedback from industry participants about the security-based swap markets, the Commission preliminarily believes that registered broker-dealers that participate, or will participate after the Dodd-Frank Act becomes effective, in the security-based swap markets exceed the threshold defining when broker-dealers are "small entities" set out above. Finally, based on its review of data provided by the Warehouse Trust Company, a subsidiary of the Depository Trust and Clearing Corporation, to the Commission, and feedback from industry participants, the Commission preliminarily believes that investment companies that participate in the security-based swap markets exceed the threshold defining when investment companies are "small businesses" or "small organizations" set out above. Thus, the Commission preliminarily believes it is unlikely that the proposed business conduct standards rules would have a significant economic impact on a substantial number of small entities.

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[385] Note that the definition of "eligible contract participant" has been amended by Congress in Section 721(a)(9) of the Dodd-Frank Act. See Pub. L. 111-203, 124 Stat. 1376, 1660, §721(a)(9) (to be codified at 7 U.S.C. 1a(18)). See also Definitions Release at 42 (explaining that this amendment has the effect of "(1) raising a threshold that governmental entities may use to qualify as [eligible contract participants], 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 [eligible contract participants] with a discretionary investment standard." but noting that for individuals, while the threshold remains $10 million, under the amended definition this amount would be based on discretionary investments rather than total assets).

B. Certification

In the Commission's preliminary view, the proposed rules would not have a significant economic impact on a substantial number of small entities. For the foregoing reasons, the Commission certifies that these proposed rules 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 illustrate and support the extent of the impact.

BUSINESS CONDUCT STANDARDS FOR SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS

Statutory Authority

Pursuant to the Act and, particularly, Sections 2, 3(b), 3C, 9, 10, 11A, 15, 15F, 17(a) and (b), and 23(a) thereof (15 U.S.C. 78b, 78c(b), 78i(i), 78i(j), 78j, 78k-1, 78o, 78o-10, 78q(a) and (b), and 78w(a)), the Commission is proposing a new series of rules, Rules 15Fh-1 through 15Fh-6, and Rule 15Fk-1, to address the business conduct obligations of security-based swap dealers and major security-based swap participants.

List of Subjects

17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of the Proposed Rule

For the reasons set forth in the preamble, the Securities and Exchange Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations, as follows:

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

1. The 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, 78b, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78o-4, 78o-10, 78p, 78q, 78s, 78u-5, 78w, 78x, 78dd (b) and (c), 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.

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Sections 240.15Fh-1 through 240.15Fh-6 and 240.15Fk-1 are also issued under sec. 943, Pub. L. No. 111-203, 124 Stat. 1376.

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2. Add §§240.15Fh-1 through 240.15Fh-6, and §240.15Fk-1 to read as follows:

§240.15Fh-1 Scope.

Sections 240.15Fh-1 through 240.15Fh-6, and 240.15Fk-1 are not intended to limit, or restrict, the applicability of other provisions of the federal securities laws, including but not limited to Section 17(a) of the Securities Act of 1933 and Sections 9 and 10(b) of the Act, and rules and regulations thereunder, or other applicable laws and rules and regulations. Sections 240.15Fh-1 through 240.15Fh-6, and 240.15Fk-1 apply, as relevant, in connection with entering into security-based swaps and continue to apply, as appropriate, over the term of executed security-based swaps.

§240.15Fh-2 Definitions.

As used in §§240.15Fh-1 through 240.15Fh-6:

(a) Act as an advisor to a special entity. A security-based swap dealer *acts as an advisor to a special entity* when it recommends a security-based swap or a trading strategy that involves the use of a security-based swap to the special entity, unless:

(1) The special entity represents in writing that:

(i) The special entity will not rely on recommendations provided by the security-based swap dealer; and

(ii) The special entity will rely on advice from a qualified independent representative as defined in §240.15Fh-5(a); and

(2) The security-based swap dealer has a reasonable basis to believe that the special entity is advised by a qualified independent representative as defined in §240.15Fh-5(a); and

(3) The security-based swap dealer discloses to the special entity that it is not undertaking to act in the best interest of the special entity, as otherwise required by Section 15F(h)(4) of the Act.

(b) Eligible contract participant means any person as defined in Section 3(a)(66) of the Act.

(c) Independent representative of a special entity

(1) A representative of a special entity must be independent of the security-based swap dealer or major security-based swap participant that is the counterparty to a proposed security-based swap.

(2) A representative of a special entity is independent of a security-based swap dealer or major security-based swap participant if the representative does not have a relationship with the security-based swap dealer or major security-based swap participant, whether compensatory or otherwise, that reasonably could affect the independent judgment or decision-making of the representative.

(3) A representative of a special entity will be deemed to be independent of a security-based swap dealer or major security-based swap participant if:

(i) The representative is not and, within one year, was not an associated person of the security-based swap dealer or major security-based swap participant; and

(ii) The representative has not received more than ten percent of its gross revenues over the past year, directly or indirectly from the security-based swap dealer or major security-based swap participant.

(d) Security-based swap dealer or major security-based swap participant includes, where relevant, an associated person of the security-based swap dealer or major security-based swap participant.

(e) Special entity means:

(1) A Federal agency;

(2) A State, State agency, city, county, municipality, or other political subdivision of a State ;

(3) Any employee benefit plan, as defined in section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002);

(4) Any governmental plan, as defined in section 3(32) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(32)); or

(5) Any endowment, including an endowment that is an organization described in section 501(c)(3) of the Internal Revenue Code of 1986.

(f) A person is subject to a statutory disqualification for purposes of §240.15Fh-5 if that person would be subject to a statutory disqualification under the provisions of Section 3(a)(39) of the Act.

§240.15Fh-3 Business conduct requirements.

(a) Counterparty Status.

(1) Eligible contract participant. A security-based swap dealer or a major security-based swap participant shall verify that a counterparty whose identity is known to the security-based swap dealer or a major security-based swap participant prior to the execution of the transaction meets the eligibility standards for an eligible contract participant, before entering into a security-based swap with that counterparty other than on a registered national securities exchange or registered security-based swap execution facility.

(2) Special entity. A security-based swap dealer or a major security-based swap participant shall verify whether a counterparty whose identity is known to the security-based swap dealer or a major security-based swap participant prior to the execution of the transaction is a special entity, before entering into a security-based swap with that counterparty.

(b) Disclosure. Before entering into a security-based swap, a security-based swap dealer or major security-based swap participant shall disclose to the counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant, information concerning the security-based swap in a manner reasonably designed to allow the counterparty to assess:

(1) Material risks and characteristics. The material risks and characteristics of the particular security-based swap, including, but not limited to, the material factors that influence the day-to-day changes in valuation, the factors or events that might lead to significant losses, the sensitivities of the security-based swap to those factors and conditions, and the approximate magnitude of the gains or losses the security-based swap will experience under specified circumstances.

(2) Material incentives or conflicts of interest. Any material incentives or conflicts of interest that the security-based swap dealer or major security-based swap participant may have in connection with the security-based swap, including any compensation or other incentives from any source other than the counterparty in connection with the security-based swap to be entered into with the counterparty.

(3) Record. The security-based swap dealer or major security-based swap participant shall make a written record of the non-written disclosures made pursuant to this subsection (b), and provide a written version of these disclosures to its counterparties in a timely manner, but in any case no later than the delivery of the trade acknowledgement of the particular transaction pursuant to §240.15Fi-1.

(c) Daily Mark. A security-based swap dealer or major security-based swap participant shall disclose the daily mark to the counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant, which shall be:

(1) For a cleared security-based swap, upon the request of the counterparty, the daily end-of-day settlement price that the security-based swap dealer or major security-based swap participant receives from the appropriate clearing agency; and

(2) For an uncleared security-based swap, the midpoint between the bid and offer, or the calculated equivalent thereof, as of the close of business, unless the parties agree in writing otherwise to a different time, on each business day during the term of the security-based swap. The daily mark may be based on market quotations for comparable security-based swaps, mathematical models or a combination thereof. The security-based swap dealer or major security-based swap participant shall also disclose its data sources and a description of the methodology and assumptions used to prepare the daily mark, and promptly disclose any material changes to such data sources, methodology and assumptions during the term of the security-based swap.

(d) Disclosure Regarding Clearing Rights. A security-based swap dealer or major security-based swap participant shall disclose the following information to a counterparty, other than a security-based swap dealer, major security-based swap participant, swap dealer or major swap participant:

(1) For security-based swaps subject to clearing requirement. Before entering into a security-based swap subject to the clearing requirement under Section 3C(a) of the Act, a security-based swap dealer or major security-based swap participant shall:

(i) Disclose to the counterparty the names of the clearing agencies that accept the security-based swap for clearing, and through which of those clearing agencies the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap; and

(ii) Notify the counterparty that it shall have the sole right to select which of the clearing agencies described in paragraph (d)(1)(i) shall be used to clear the security-based swap.

(2) For security-based swaps not subject to clearing requirement. Before entering into a security-based swap not subject to the clearing requirement under Section 3C(a) of the Act, a security-based swap dealer or major security-based swap participant shall:

(i) Determine whether the security-based swap is accepted for clearing by one or more clearing agencies;

(ii) Disclose to the counterparty the names of the clearing agencies that accept the security-based swap for clearing, and whether the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap through such clearing agencies; and

(iii) Notify the counterparty that it may elect to require clearing of the security-based swap and shall have the sole right to select the clearing agency at which the security-based swap will be cleared, provided it is a clearing agency at which the security-based swap dealer or major security-based swap participant is authorized or permitted, directly or through a designated clearing member, to clear the security-based swap.

(3) Record. The security-based swap dealer or major security-based swap participant shall make a written record of the non-written disclosures made pursuant to this subsection (d), and provide a written version of these disclosures to its counterparties in a timely manner, but in any case no later than the delivery of the trade acknowledgement of the particular transaction pursuant to §240.15Fi-1.

(e) Know Your Counterparty. Each security-based swap dealer shall establish, maintain and enforce policies and procedures reasonably designed to obtain and retain a record of the essential facts concerning each counterparty whose identity is known to the security-based swap dealer, that are necessary for conducting business with such counterparty. For purposes of this section, the *essential facts concerning a counterparty* are:

(1) Facts required to comply with applicable laws, regulations and rules;

(2) Facts required to implement the security-based swap dealer's credit and operational risk management policies in connection with transactions entered into with such counterparty;

(3) Information regarding the authority of any person acting for such counterparty; and

(4) If the counterparty is a special entity, such background information regarding the independent representative as the security-based swap dealer reasonably deems appropriate.

(f) Recommendations of Security-Based Swaps or Trading Strategies.

(1) A security-based swap dealer that recommends a security-based swap or trading strategy involving a security-based swap to a counterparty, other than a security-

based swap dealer, major security-based swap participant, swap dealer, or major swap participant, must have a reasonable basis to believe:

(i) Based on reasonable diligence, that the recommended security-based swap or trading strategy involving a security-based swap is suitable for at least some counterparties; and

(ii) That a recommended security-based swap or trading strategy involving a security-based swap is suitable for the counterparty. To establish a reasonable basis for a recommendation, a security-based swap dealer must have or obtain relevant information regarding the counterparty, including the counterparty's investment profile, trading objectives, and its ability to absorb potential losses associated with the recommended security-based swap or trading strategy.

(2) A security-based swap dealer may also fulfill its obligations under paragraph (f)(1) with respect to a particular counterparty if:

(i) The security-based swap dealer reasonably determines that the counterparty, or an agent to which the counterparty has delegated decision-making authority, is capable of independently evaluating investment risks with regard to the relevant security-based swap or trading strategy involving a security-based swap;

(ii) The counterparty or its agent affirmatively represents in writing that it is exercising independent judgment in evaluating the recommendations of the security-based swap dealer; and (iii)The security-based swap dealer discloses that it is acting in its capacity as a counterparty, and is not undertaking to assess the suitability of the security-based swap or trading strategy for the counterparty.

(3) A security-based swap dealer will be deemed to have satisfied its obligations under paragraph (f)(1) with respect to a special entity if:

(i) The security-based swap dealer is acting as an advisor to the special entity and complies with the requirements of §240.15Fh-4(b); or

(ii) The security-based swap dealer is deemed not to be acting as an advisor to the special entity pursuant to §240.15Fh-2(a).

(g) Fair and Balanced Communications. A security-based swap dealer or major security-based swap participant shall communicate with counterparties in a fair and balanced manner based on principles of fair dealing and good faith. In particular:

(1) Communications must provide a sound basis for evaluating the facts with regard to any particular security-based swap or trading strategy involving a security-based swap;

(2) Communications may not imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast; and

(3) Any statement referring to the potential opportunities or advantages presented by a security-based swap shall be balanced by an equally detailed statement of the corresponding risks.

(h) Supervision.

(1) In general. A security-based swap dealer or major security-based swap participant shall establish, maintain and enforce a system to supervise, and shall

diligently supervise its business and its associated persons, with a view to preventing violations of the provisions of applicable federal securities laws and the rules and regulations thereunder relating to its business as a security-based swap dealer or major security-based swap participant, respectively.

(2) Minimum requirements. The system required by paragraph (g)(1) shall be reasonably designed to achieve compliance with applicable securities laws and the rules and regulations thereunder, and at a minimum, shall provide for:

(i) The designation of at least one person with authority to carry out the supervisory responsibilities of the security-based swap dealer or major security-based swap participant for each type of business in which it engages for which registration as a security-based swap dealer or major security-based swap participant is required;

(ii) The use of reasonable efforts to determine that all supervisors are qualified and meet standards of training, experience, and competence necessary to effectively supervise the security-based swap activities of the persons associated with the security-based swap dealer or major security-based swap participant;

(iii)Establishment, maintenance and enforcement of written policies and procedures addressing the supervision of the types of security-based swap business in which the security-based swap dealer or major security-based swap participant is engaged that are reasonably designed to achieve compliance with applicable securities laws and the rules and regulations thereunder, and that include, at a minimum:

(A) Procedures for the review by a supervisor of transactions for which registration as a security-based swap dealer or major security-based swap participant is required;

(B) Procedures for the review by a supervisor of incoming and outgoing written (including electronic) correspondence with counterparties or potential counterparties and internal written communications relating to the security-based swap dealer's or major security-based swap participant's business involving security-based swaps;

(C) Procedures for a periodic review, at least annually, of the security-based swap business in which the security-based swap dealer or major security-based swap participant engages that is reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable federal securities laws and regulations;

(D) Procedures to conduct a reasonable investigation regarding the character, business repute, qualifications, and experience of any person prior to that person's association with the security-based swap dealer or major security-based swap participant;

(E) Procedures to consider whether to permit an associated person to establish or maintain a securities or commodities account in the name of, or for the benefit of such associated person, at another security-based swap dealer, broker, dealer, investment adviser, or other financial institution; and if permitted, procedures to supervise the trading at the other security-based swap dealer, broker, dealer, investment adviser, or financial institution, including the receipt of duplicate confirmations and statements related to such accounts;

(F) A description of the supervisory system, including the titles, qualifications and locations of supervisory persons and the specific responsibilities of each person with respect to the types of business in which the security-based swap dealer or major security-based swap participant is engaged;

(G) Procedures prohibiting an associated person who performs a supervisory function from supervising his or her own activities or reporting to, or having his or her compensation or continued employment determined by, a person or persons he or she is supervising; and

(H) Procedures preventing the standards of supervision from being reduced due to any conflicts of interest of a supervisor with respect to the associated person being supervised.

(iv) Written policies and procedures reasonably designed, taking into consideration the nature of such security-based swap dealer's or major security-based swap participant's business, to comply with the duties set forth in Section 15F(j) of the Act.

(3) Failure to supervise. A security-based swap dealer or major security-based swap participant or an associated person of a security-based swap dealer or major security-based swap participant shall not be deemed to have failed to diligently supervise any other person, if such other person is not subject to his or her supervision, or if:

(i) The security-based swap dealer or major security-based swap participant has established and maintained written policies and procedures, and a documented system for applying those policies and procedures, that would reasonably be expected to prevent and detect, insofar as practicable, any violation of the federal securities laws and the rules and regulations thereunder relating to security-based swaps; and

(ii) The security-based swap dealer or major security-based swap participant, or associated person of the security-based swap dealer or major security-based swap participant, has reasonably discharged the duties and obligations required by the written policies and procedures and documented system and did not have a reasonable basis to believe that the written policies and procedures and documented system were not being followed.

(4) Maintenance of written supervisory procedures. A security-based swap dealer or major security-based swap participant shall:

(i) Promptly amend its written supervisory procedures as appropriate when material changes occur in applicable securities laws or rules or regulations thereunder, and when material changes occur in its business or supervisory system; and

(ii) Promptly communicate any material amendments to its supervisory procedures throughout the relevant parts of its organization.

§240.15Fh-4 Special requirements for security-based swap dealers acting as advisors to special entities.

(a) In general. It shall be unlawful for a security-based swap dealer or major security-based swap participant:

(1) To employ any device, scheme, or artifice to defraud any special entity or prospective customer who is a special entity;

(2) To engage in any transaction, practice, or course of business that operates as a fraud or deceit on any special entity or prospective customer who is a special entity; or

(3) To engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative.

(b) A security-based swap dealer that acts as an advisor to a special entity regarding a security-based swap shall comply with the following requirements:

(1) Duty. The security-based swap dealer shall have a duty to act in the best interests of the special entity.

(2) Reasonable Efforts. The security-based swap dealer shall make reasonable efforts to obtain such information that the security-based swap dealer considers necessary to make a reasonable determination that a security-based swap or trading strategy involving a security-based swap is in the best interests of the special entity. This information shall include, but not be limited to:

(i) The authority of the special entity to enter into a security-based swap;

(ii) The financial status of the special entity, as well as future funding needs;

(iii)The tax status of the special entity;

(iv) The investment or financing objectives of the special entity;

(v) The experience of the special entity with respect to entering into security-based swaps, generally, and security-based swaps of the type and complexity being recommended;

(vi) Whether the special entity has the financial capability to withstand changes in market conditions during the term of the security-based swap; and

(vii) Such other information as is relevant to the particular facts and circumstances of the special entity, market conditions and the type of security-based swap or trading strategy involving a security-based swap being recommended.

(3) Exemption. The requirements of this §240.15Fh-4(b) shall not apply with respect to a security-based swap if:

(i) The transaction is executed on a registered security-based swap execution facility or registered national securities exchange; and

(ii) The security-based swap dealer does not know the identity of the counterparty, at any time up to and including execution of the transaction.

§240.15Fh-5 Special requirements for security-based swap dealers and major security-based swap participants acting as counterparties to special entities.

(a) A security-based swap dealer or major security-based swap participant that offers to enter into or enters into a security-based swap with a special entity must have a reasonable basis to believe that special entity has a qualified independent representative. For these purposes, a qualified independent representative is an independent representative that:

(1) Has sufficient knowledge to evaluate the transaction and risks;

(2) Is not subject to a statutory disqualification;

(3) Undertakes a duty to act in the best interests of the special entity;

(4) Makes appropriate and timely disclosures to the special entity of material information concerning the security-based swap;

(5) Will provide written representations to the special entity regarding fair pricing and the appropriateness of the security-based swap; and

(6) In the case of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, is a fiduciary as defined in section 3(21) of that Act (29 U.S.C. 1002(21)); and

(7) In the case of a special entity defined in §§240.15Fh-2(e)(2) or (4), is a person that is subject to rules of the Commission, the Commodity Futures Trading Commission or a self-regulatory organization subject to the jurisdiction of the Commission or the Commodity Futures Trading Commission prohibiting it from engaging in specified activities if certain political contributions have been made, provided that this paragraph (7) shall not apply if the independent representative is an employee of the special entity.

(b) Before initiation of a security-based swap with a special entity, a security-based swap dealer shall disclose to the special entity in writing the capacity in which the security-based swap dealer is acting and, if the security-based swap dealer engages in business, or has engaged in business within the last twelve months, with the counterparty in more than one capacity, the security-based swap dealer shall disclose the material differences between such capacities in connection with the security-based swap and any other financial transaction or service involving the counterparty.

(c) The requirements of this §240.15Fh-5 shall not apply with respect to a security-based swap if:

(1) The transaction is executed on a registered security-based swap execution facility or registered national securities exchange; and

(2) The security-based swap dealer or major security-based swap participant does not know the identity of the counterparty, at any time up to and including execution of the transaction.

§240.15Fh-6 Political contributions by certain security-based swap dealers.

(a) Definitions. For the purposes of this section:

(1) The term contribution means any gift, subscription, loan, advance, or deposit of money or anything of value made:

(i) For the purpose of influencing any election for state or local office;

(ii) For payment of debt incurred in connection with any such election; or

(iii) For transition or inaugural expenses incurred by the successful candidate for state or local office.

(2) The term covered associate means:

(i) Any general partner, managing member or executive officer, or other person with a similar status or function;

(ii) Any employee who solicits a municipal entity to enter into a security-based swap with the security-based swap dealer and any person who supervises, directly or indirectly, such employee; and (iii)A political action committee controlled by the security-based swap dealer or by a person described in paragraphs (c)(2)(i) and (c)(2)(ii) of this section.

(3) The term executive officer of a security-based swap dealer means:

(i) The president;

(ii) Any vice president in charge of a principal business unit, division or function (such as sales, administration or finance);

(iii) Any other officer of the security-based swap dealer who performs a policy-making function; or

(iv)Any other person who performs similar policy-making functions for the security-based swap dealer.

(4) The term municipal entity is defined in Section 15B(e)(8) of the Act.

(5) The term official of a municipal entity means any person (including any election committee for such person) who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of a municipal entity, if the office:

(i) Is directly or indirectly responsible for, or can influence the outcome of, the selection of a security-based swap dealer by a municipal entity; or

(ii) Has authority to appoint any person who is directly or indirectly responsible for, or can influence the outcome of, the selection of a security-based swap dealer by a municipal entity.

(6) The term payment means any gift, subscription, loan, advance, or deposit of money or anything of value.

(7) The term regulated person means:

(i) A person that is subject to rules of the Commission, the Commodity Futures Trading Commission or a self-regulatory organization subject to the jurisdiction of the Commission or the Commodity Futures Trading Commission prohibiting it from engaging in specified activities if certain political contributions have been made, or its officers or employees;

(ii) A general partner, managing member or executive officer of such person, or other individual with a similar status or function; or

(iii)An employee of such person who solicits a municipal entity for the security-based swap dealer and any person who supervises, directly or indirectly, such employee.

(8) The term solicit means a direct or indirect communication by any person with a municipal entity for the purpose of obtaining or retaining an engagement related to a security-based swap.

(b) Prohibitions and Exceptions.

(1) It shall be unlawful for a security-based swap dealer to offer to enter into, or enter into, a security-based swap, or a trading strategy involving a security-based swap, with a municipal entity within two years after any contribution to an official of such municipal entity was made by the security-based swap dealer, or by any covered associate of the security-based swap dealer.

(2) The prohibition in paragraph (b)(1) does not apply:

(i) If the only contributions made by the security-based swap dealer \to an official of such municipal entity were made by a covered associate:

(A) To officials for whom the covered associate was entitled to vote at the time of the contributions, if the contributions in the aggregate do not exceed $350 to any one official per election; or

(B) To officials for whom the covered associate was not entitled to vote at the time of the contributions, if the contributions in the aggregate do not exceed $150 to any one official, per election;

(ii) To a security-based swap dealer as a result of a contribution made by a natural person more than six months prior to becoming a covered associate of the security-based swap dealer, however, this exclusion shall not apply if the natural person, after becoming a covered associate, solicits the municipal entity on behalf of the security-based swap dealer to offer to enter into, or to enter into, security-based swap, or a trading strategy involving a security-based swap; or

(iii) With respect to a security-based swap that is initiated by a municipal entity on a registered national securities exchange or registered security-based swap execution facility and the security-based swap dealer does not know the identity of the counterparty to the transaction at any time up to and including execution of the transaction.

(3) No security-based swap dealer or any covered associate of the security-based swap dealer shall:

(i) Provide or agree to provide, directly or indirectly, payment to any person to solicit a municipal entity to offer to enter into, or to enter into, a security-based swap or any trading strategy involving a security-based swap with that security-based swap dealer unless such person is a regulated person; or

(ii) Coordinate, or solicit any person or political action committee to make, any:

(A) Contribution to an official of a municipal entity with which the security-based swap dealer is offering to enter into, or has entered into, a security-based swap security-based swap, or a trading strategy involving a security-based swap; or

(B) Payment to a political party of a state or locality with which the security-based swap dealer is offering to enter into, or has entered into, a security-based swap security-based swap, or a trading strategy involving a security-based swap.

(c) Circumvention of Rule. No security-based swap dealer shall, directly or indirectly, through or by any other person or means, do any act that would result in a violation of paragraph (a) or (b) of this section.

(d) Requests for Exemption. The Commission, upon application, may conditionally or unconditionally exempt a security-based swap dealer from the prohibition under paragraph (a)(1) of this section. In determining whether to grant an exemption, the Commission will consider, among other factors:

(1) Whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes of the Act;

(2) Whether the security-based swap dealer:

(i) Before the contribution resulting in the prohibition was made, adopted and implemented policies and procedures reasonably designed to prevent violations of this section;

(ii) Prior to or at the time the contribution which resulted in such prohibition was made, had no actual knowledge of the contribution; and

(iii) After learning of the contribution:

(A) Has taken all available steps to cause the contributor involved in making the contribution which resulted in such prohibition to obtain a return of the contribution; and

(B) Has taken such other remedial or preventive measures as may be appropriate under the circumstances;

(3) Whether, at the time of the contribution, the contributor was a covered associate or otherwise an employee of the security-based swap dealer, or was seeking such employment;

(4) The timing and amount of the contribution which resulted in the prohibition;

(5) The nature of the election (e.g., state or local); and

(6) The contributor's apparent intent or motive in making the contribution that resulted in the prohibition, as evidenced by the facts and circumstances surrounding the contribution.

(e) Prohibitions Inapplicable.

(1) The prohibitions under paragraph (b) of this section shall not apply to a contribution made by a covered associate of the security-based swap dealer if:

(i) The security-based swap dealer discovered the contribution within 120 calendar days of the date of such contribution;

(ii) The contribution did not exceed $350; and

(iii)The covered associate obtained a return of the contribution within 60 calendar days of the date of discovery of the contribution by the security-based swap dealer.

(2) A security-based swap dealer may not rely on paragraph (1) of this section more than twice in any 12-month period.

(3) A security-based swap dealer may not rely on paragraph (1) of this section more than once for any covered associate, regardless of the time between contributions.

* * * * *

§240. 15Fk-1 Designation of Chief Compliance Officer for security-based swap dealers and major security-based swap participants.

(a) In General. A security-based swap dealer and major security-based swap participant shall designate an individual to serve as a chief compliance officer on its registration form.

(b) Duties. The chief compliance officer shall:

(1) Report directly to the board of directors or to the senior officer of the security-based swap dealer or major security-based swap participant;

(2) Review the compliance of the security-based swap dealer or major security-based swap participant with respect to the security-based swap dealer and major security-based swap participant requirements described in Section 15F of the Act, and the rules and regulations thereunder, where the review shall include

establishing, maintaining, and reviewing written policies and procedures reasonably designed to achieve compliance with Section 15F of the Act and the rules and regulations thereunder, by the security-based swap dealer or major security-based swap participant;

(3) In consultation with the board of directors or the senior officer of the security-based swap dealer or major security-based swap participant, promptly resolve any conflicts of interest that may arise;

(4) Be responsible for administering each policy and procedure that is required to be established pursuant to Section 15F of the Act and the rules and regulations thereunder;

(5) Establish, maintain and review policies and procedures reasonably designed to ensure compliance with the Act and the rules and regulations thereunder relating to its business as a security-based swap dealer or major security-based swap participant;

(6) Establish, maintain and review policies and procedures reasonably designed to remediate promptly non-compliance issues identified by the chief compliance officer through any:

(i) Compliance office review;

(ii) Look-back;

(iii) Internal or external audit finding;

(iv) Self-reporting to the Commission and other appropriate authorities; or

(v) Complaint that can be validated; and

(7) Establish and follow procedures reasonably designed for the prompt handling, management response, remediation, retesting, and resolution of non-compliance issues.

(c) Annual Reports.

(1) In general. The chief compliance officer shall annually prepare and sign a report that contains a description of:

(i) The compliance of the security-based swap dealer or major security-based swap participant with respect to the Act and the rules and regulations thereunder relating to its business as a security-based swap dealer or major security-based swap participant; and

(ii) Each policy and procedure of the security-based swap dealer or major security-based swap participant described in paragraph (b)~~,~~ (including the code of ethics and conflict of interest policies).

(2) Requirements.

(i) Each compliance report shall also contain, at a minimum, a description of:

(A) The security-based swap dealer or major security-based swap participant's enforcement of its policies and procedures relating to its business as a security-based swap dealer or major security-based participant;

(B) Any material changes to the policies and procedures since the date of the preceding compliance report;

(C) Any recommendation for material changes to the policies and procedures as a result of the annual review, the rationale for such recommendation, and whether such policies and procedures were or will be modified by the security-based swap dealer or major security-based swap participant to incorporate such recommendation; and

(D) Any material compliance matters identified since the date of the preceding compliance report.

(ii) A compliance report under paragraph (1) also shall:

(A) Accompany each appropriate financial report of the security-based swap dealer or major security-based swap participant that is required to be furnished to or filed with the Commission pursuant to Section 15F of the Act and rules and regulations thereunder;

(B) Be submitted to the board of directors and audit committee (or equivalent bodies) and the senior officer of the security-based swap dealer or major security-based swap participant at the earlier of their next scheduled meeting or within 45 days of the date of execution of the required certification;

(C) Include a written representation that the chief executive officer(s) (or equivalent officer(s)) has/have conducted one or more meetings with the chief compliance officer(s) in the preceding 12 months, the subject of which addresses the obligations in this section, including:

(1) The matters that are the subject of the compliance report;

(2) The SBS Entity's compliance efforts as of the date of such a meeting; and

(3) Significant compliance problems and plans in emerging business areas relating to its business as a security-based swap dealer or major security-based swap participant; and

(D) Include a certification that, under penalty of law, the compliance report is accurate and complete.

(iii) Confidentiality. If compliance reports are separately bound from the financial statements, the compliance reports shall be accorded confidential treatment to the extent permitted by law.

(d) Compensation and Removal. The compensation and removal of the chief compliance officer shall require the approval of a majority of the board of directors of the security-based swap dealer or major security-based swap participant.

(e) Definitions. For purposes of this rule, references to:

(1) The board or board of directors shall include a body performing a function similar to the board of directors.

(2) The senior officer shall include the chief executive officer or other equivalent officer.

(3) Complaint that can be validated shall include any written complaint by a counterparty involving the security-based swap dealer or major security-based swap participant or person associated with a security-based swap dealer or major security-based swap participant that can be supported upon reasonable investigation.

(4) A material compliance matter means any compliance matter about which the board of directors of the security-based swap dealer or major security-based swap

participant would reasonably need to know to oversee the compliance of the security-based swap dealer or major security-based swap participant, and that involves, without limitation:

(i) A violation of the federal securities laws relating to its business as a security-based swap dealer or major security-based swap participant, by the firm or its officers, directors, employees or agents;

(ii) A violation of the policies and procedures relating to its business as a security-based swap dealer or major security-based swap participant by the firm or its officers, directors, employees or agents; or

(iii)A weakness in the design or implementation of the policies and procedures relating to its business as a security-based swap dealer or major security-based swap participant.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: June 29, 2011

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9228 / June 29, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64767 / June 29, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3227 / June 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14445

In the Matter of

RAYMOND JAMES & ASSOCIATES, INC. AND RAYMOND JAMES FINANCIAL SERVICES, INC.

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) 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 8A of the Securities Act of 1933 ("Securities Act"), Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), against Raymond James & Associates, Inc. ("RJ&A") and Raymond James Financial Services, Inc. ("RJFS") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Exchange Act, and Section 203(e) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

Respondents offered and sold to some of their customers financial instruments known as auction rate securities ("ARS") while not accurately characterizing or while failing to adequately disclose the true nature and risks associated with these investments. ARS are bonds or preferred stock whose liquidity depends upon sufficient demand at periodic securities auctions. Although Respondents' ARS trade confirmations, sent after customers purchased ARS, disclosed the risk that these auctions could fail and that Respondents were not obliged to ensure their success, at the point-of-sale, some of Respondents' registered representatives and financial advisers improperly described ARS as safe, liquid alternatives to money market funds and other cash-like investments, without adequately disclosing the auction process or the risk of illiquidity if these auctions failed. On February 13, 2008, a significant number of ARS auctions failed, resulting in an overall market collapse that left thousands of investors, including Respondents' customers, holding ARS that they have not been able to liquidate. By engaging in the conduct described herein, Respondents violated Section 17(a)(2) of the Securities Act.

Respondents

1. Respondent RJ&A, a Florida corporation headquartered in St. Petersburg, Florida, is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of the Financial Industry Regulatory Authority ("FINRA"). RJ&A is also an investment adviser registered with the Commission pursuant to Section 203(a) of the Advisers Act.

2. Respondent RJFS, a Florida corporation headquartered in St. Petersburg, Florida, is a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act and is a member of FINRA. RJFS was also registered with the Commission as an investment adviser pursuant to Section 203(a) of the Advisers Act until December 2009.

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

Facts

Description of ARS

3. ARS are bonds or preferred stock which provide for interest rates or dividend yields that are periodically reset through auctions, typically held every seven, twenty-eight, or thirty-five days. ARS are usually issued with maturities of thirty years, but the maturities can range from five years to perpetuity. ARS yields are determined at the periodic auctions during which the ARS are auctioned at par. ARS typically can be bought or sold only at one of these periodic auctions.

4. Under the typical procedures for an auction for ARS, investors who wished to purchase ARS at an auction submitted a bid which included the minimum interest or dividend rate that the investors would accept. Holders of ARS could either choose to keep their securities until the next auction or submit an offer to sell their ARS. An auction agent collected all of the bids and offers for a particular auction.

5. The final rate at which all of the ARS offered for sale were sold was the "clearing rate" that applied to that particular ARS until the next auction. Bids with the lowest rate and then successively higher rates were accepted until all of the sell orders were filled. The clearing rate was the lowest rate bid sufficient to cover all of the securities for sale in the auction.

6. If there were not enough bids to cover the securities offered for sale in an auction, then an auction would fail. In a failed auction, investors who want to sell securities are not able to do so, and hold their ARS until at least the next auction. In this event, the issuer pays the holders a maximum rate or "penalty" rate. These rates might be higher or lower than the prior clearing rate or market rates on similar products.

Respondents' Roles in the ARS Market

7. To facilitate the auction process, the issuers of the ARS selected one or more broker-dealers to underwrite the offering and/or manage the auction process. In many instances, these broker-dealers submitted their own bids to prevent the auctions from failing, maintain an orderly market, or set a clearing rate.

8. Respondent RJ&A acted as an underwriter of single-issuer municipal auction rate securities ("MARS"). RJ&A managed the auctions of MARS it underwrote and of MARS underwritten by other broker-dealers. Additionally, RJ&A submitted bids in the auctions it managed to prevent them from failing, to maintain an orderly market, or to set a clearing rate. Respondent RJFS did not underwrite or act as an auction manager for ARS, and did not at any time submit bids in auctions.

9. Respondents RJ&A and RJFS also acted as agents, on a solicited and unsolicited basis, for their customers by submitting customers' orders to purchase and sell two other ARS products: auction rate preferred securities backed by a pool of municipal bonds ("ARPS"); and taxable auction rate securities, which were variable rate perpetual preferred stock issued by closed-

end funds ("TARS"). As distributing or "downstream" broker-dealers for the ARPS and TARS, Respondents did not submit bids in these auctions.

<u>Collapse of the ARS Market and the Effect on Respondents' Customers</u>

10. In the early part of 2008, many of the broker-dealers that acted as underwriters of the ARS offerings or as lead managers for the ARS auctions stopped submitting their own bids in support of the ARS auctions. As a result, by February 13, 2008, the ARS market began to experience widespread auction failures, leaving investors throughout the industry unable to sell their ARS holdings.

11. From February 13, 2008, through the present, the ARS market continues to experience widespread failures, making many ARS holdings illiquid. Some ARS have been redeemed by their issuers since that time. However, numerous investors, including some of Respondents' customers, currently hold ARS that they have been unable to sell through the auction process and have not yet been redeemed by the issuers.

<u>Purchases of ARS by Respondents' Customers</u>

12. Prior to the middle of February 2008, Respondents' registered representatives and financial advisers sold ARS to customers through telephone, email, and other interstate communications. Some of Respondents' representatives and financial advisers made inaccurate comparisons between ARS and other investments, such as money market funds, telling customers that ARS were "cash equivalents," "the same as cash," and "highly liquid." Respondents' representatives and financial advisers did not accurately characterize the investment nature of ARS since ARS are highly complex securities that are very different from money market funds, as evidenced by, among other things, the dependence of ARS on successful auctions for liquidity.

13. Respondents' ARS trade confirmations, sent after customers purchased ARS, disclosed the risk that these auctions could fail and that Respondents were not obliged to ensure their success. Nevertheless, Respondents did not provide customers with adequate and complete disclosures regarding the complexity of the auction process including failing to adequately disclose to customers that Respondent RJ&A managed the auctions of the MARS and that RJ&A routinely bid in MARS auctions to prevent a failed auction, maintain an orderly market, or set a particular clearing rate. For example, some of Respondents' representatives and financial advisers did not adequately disclose to customers that their ARS could become illiquid for an indeterminate period of time in the event of an auction failure.

14. Respondents should have known that their registered representatives and financial advisers marketed ARS to customers as highly liquid and as an alternative to cash or money market funds without adequately disclosing that ARS are complex securities that may become illiquid.

15. Currently, numerous customers who purchased ARS through Respondents prior to the collapse of the ARS market in the middle of February 2008 hold hundreds of millions of dollars in illiquid ARS. Most of these customers hold ARPS or TARS for which Respondents acted in a downstream capacity.

Violations

16. As a result of the conduct described above, Respondents willfully[2] violated Section 17(a)(2) of the Securities Act, which makes it unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly, to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Undertakings

17. Respondents have undertaken to purchase Eligible ARS held by Eligible Customers, and other measures, as specified under the terms set forth below. In determining whether to accept Respondents' Offers, the Commission has considered these undertakings.

A. Key Definitions

1. Eligible Auction Rate Securities. As used in these undertakings, "Eligible ARS" shall mean auction rate securities that were purchased at Respondents on or before February 13, 2008 and that have failed at auction at least once since February 13, 2008. Notwithstanding the foregoing definition, the term "Eligible ARS" shall not include ARS that were purchased at Respondents in accounts owned, managed or advised by or through correspondent broker-dealers or unaffiliated registered investment advisers.

2. Eligible Customers. As used in these undertakings, "Eligible Customers" shall mean the current and former account owners who purchased Eligible ARS at Respondents on or before February 13, 2008, did not transfer such Eligible ARS away from Respondents prior to January 1, 2006, and held those securities on February 13, 2008. Provided, however, the term "Eligible Customers" shall not include customers who resolved their ARS claims through arbitration proceedings or negotiated settlements with Respondents. The term "Eligible Customers" also shall not include ARS customers who acted as institutional money managers and did not hold ARS in RJ&A or RJFS accounts (collectively, the "Institutional Money Managers").

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[2] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

a. Respondents will use their best efforts to provide the Institutional Money Managers, within nine (9) months of the date of this Order, opportunities to liquidate their Eligible ARS including, but not limited to, facilitating issuer redemptions, restructurings, and through other reasonable means. Although Respondents are required to use their best efforts to liquidate Eligible ARS owned by the Institutional Money Managers, the Respondents are not obligated to purchase the securities.

b. Respondents will use their best efforts to identify and locate customers who purchased Eligible ARS at Respondents but who transferred such Eligible ARS away from Respondents prior to January 1, 2006. Respondents will provide any such customers the Offer Notices described in Section C.1., below, the Acceptance and Purchase Procedures described in Section D., below, and the other terms described in Sections E., F., and G., below.

B. Customer Notification -- Customer Assistance Line and Internet Page. No later than two (2) business days after the date of this Order, Respondents shall establish: 1) a dedicated toll-free telephone assistance line, with appropriate staffing, to provide information and to respond to questions concerning the terms of this Order; and 2) a public Internet page on their corporate Web site(s), with a prominent link to that page appearing on Respondents' relevant homepage(s), to provide information concerning the terms of this Order and, via an e-mail address or other reasonable means, to respond to questions concerning the terms of this Order. Respondents shall maintain the telephone assistance line and Internet page for at least nine (9) months from the date of this Order.

C. Respondents' Offer to Purchase Eligible ARS

1. Offer Notices.

a. First Offer Notice. No later than thirty (30) days after the date of this Order, Respondents shall offer to purchase, at par plus accrued and unpaid dividends/interest, Eligible ARS from Eligible Customers ("Purchase Offer"), and explain what the Eligible Customers must do to accept, in whole or in part, the Purchase Offer. Respondents shall also inform the Eligible Customers of the relevant terms of this Order and any other material issues regarding the Eligible Customers' rights.

b. Second Offer Notice. To the extent that any Eligible Customers have not responded to the Purchase Offer on or before forty-five (45) days before the end of the applicable Offer Period (defined below), Respondents shall provide any such Eligible Customers a second written notice informing them again of the Respondents' Purchase Offer, the relevant terms of this Order and any other material issues regarding the Eligible Customers' rights.

2. Offer Period. For Eligible Customers, the Purchase Offer shall remain open for a period of seventy-five (75) days from the date on which Respondents sent the First Offer Notice ("Offer Period").

D. Acceptance and Purchase Procedures

1. Eligible Customer Acceptance. Eligible Customers may accept Respondents' Purchase Offer by notifying Respondents in writing at any time before midnight, Eastern Time, on the last day of the Offer Period, or such later date and time as may be extended by Respondents. An acceptance must be received by Respondents prior to the expiration of the Offer Period, or such later date as may be extended by Respondents and the Commission staff.

2. Purchase Notice. For those Eligible Customers who accept Respondents' Purchase Offer within the Offer Period, Respondents shall send those Eligible Customers a notice ("Purchase Notice"), indicating when ("Purchase Date") and how Respondents will purchase their Eligible ARS.

3. Eligible Customers' Right to Revoke. Eligible Customers may revoke their acceptance of Respondents' Purchase Offer up until Respondents purchase an Eligible Customer's Eligible ARS.

4. Purchases Relating to Eligible Customers Who Accept the Purchase Offer. For those Eligible Customers who accept Respondents' Purchase Offer, Respondents shall purchase their Eligible ARS no later than five (5) business days following expiration of the Offer Period.

5. Purchases Relating to Eligible Customers Who Transferred Their Eligible ARS Away from Respondents. Respondents' purchase obligations described above apply equally to those Eligible Customers who accept Respondents' Purchase Offer within the Offer Period, but who have since transferred their Eligible ARS away from Respondents.

a. Respondents' purchase obligations to these Eligible Customers shall be contingent on: (1) Respondents receiving reasonably satisfactory assurance from the financial services firm currently holding the Eligible Customer's Eligible ARS that the bidding rights associated with the Eligible ARS will be transferred to the Respondents; (2) the Eligible Customer reactivating their former account with Respondents; and (3) the transfer of the Eligible ARS to the Eligible Customer's former account with Respondents.

b. Respondents shall use their best efforts to identify, contact and assist such Eligible Customers to reactivate their former account at Respondent and to transfer the Eligible ARS to such account, and shall not charge such Eligible Customers any fees relating to or in connection with the transfer to Respondents or custodianship by Respondents of such Eligible ARS.

E. Reimbursement for Related Loan Expenses. Respondents shall use their best efforts to identify Eligible Customers who took out loans from Respondents after February 13, 2008 secured by Eligible ARS that were not successfully auctioning at the time the loan was taken and who paid interest associated with the ARS-based portion of those loans in excess of the total interest and dividends received on the Eligible ARS during the duration of the loan. Respondents shall reimburse such customers for the excess expense, plus reasonable interest thereon. Such reimbursement shall occur no later than seventy-five (75) days after the date of this Order.

F. Relief for Eligible Customers Who Sold Or Redeemed Below Par. Respondents shall use their best efforts to identify any Eligible Customers who: (1) purchased Eligible ARS at Respondents on or before February 13, 2008; and (2) subsequently sold those Eligible ARS below par between February 13, 2008 and the date of this Order (referred to as "Below Par Sellers"). Within seventy-five (75) days of the date of this Order, Respondents shall pay any such identified Below Par Sellers the difference between par and the price at which the Below Par Seller sold or redeemed the Eligible ARS, plus reasonable interest thereon. Respondents shall promptly pay any such Below Par Seller identified thereafter.

G. Consequential Damages Claims.

1. Special Arbitration Procedures. Respondents shall consent to participate, at the election of an Eligible Customer, in the special arbitration procedures announced by FINRA on December 16, 2008, and available on their website at http://www.finra.org/web/groups/arbitrationmediation/@arbmed/documents/arbmed/p117445.pdf for the exclusive purpose of arbitrating an Eligible Customer's claim for consequential damages against Respondents related to the customer's investment in Eligible ARS. As explained by the special arbitration procedures, the following shall apply:

a. Forum Fees. Respondents will pay all forum fees associated with the arbitration.

b. Burden of Proof. Eligible Customers shall bear the burden of proving by a preponderance of the evidence the existence and amount of consequential damages suffered as a result of the illiquidity of the Eligible ARS. Although they may defend themselves against consequential damage claims, Respondents shall not argue against liability for the illiquidity of the underlying Eligible ARS position or use as part of their defense any decision by the Eligible Customer not to borrow money from Respondents.

c. Eligible Customers Who Previously Arbitrated or Settled. Eligible Customers who previously arbitrated or previously settled and released claims relating to their Eligible ARS are not eligible to participate in the special arbitration procedures.

d. Other Damages. Eligible Customers who elect to use the special arbitration procedures provided for within this subparagraph shall not be eligible for punitive damages, or any other type of damages other than consequential damages. Eligible Customers proceeding under the special arbitration procedures may not recover as consequential damages any attorneys' fees incurred in connection with the arbitration or any related mediation proceeding.

H. Other Proceedings/Relief. All Eligible Customers who avail themselves of the relief provided pursuant to this Order may pursue any remedies against Respondents available under the law subject to any defenses Respondents may have. However, those customers that elect to utilize the special arbitration procedures set forth above are limited to the remedies available in that process and may not bring or pursue a claim relating to ARS in another forum.

I. Reports and Meetings

1. Beginning with the month ended after the date of this Order and continuing through the month ended nine (9) months from the date of this Order, Respondents shall submit bi-monthly written reports and a final written report detailing Respondents' progress with respect to their undertakings. Each report shall be submitted within forty-five (45) days of the end of the month in which the report is required to Chedly C. Dumornay, Esq., U.S. Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131, or as directed in writing by the Commission Staff.

2. Beginning one hundred and twenty (120) days after the date of this Order, Respondents shall confer at least quarterly with the Commission staff to discuss their progress with respect to these undertakings. Such quarterly progress reports shall continue for nine (9) months from the date of this Order.

3. The reporting and conference deadlines set forth above may be amended or modified with agreement from the Commission Staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents Raymond James & Associates, Inc. and Raymond James Financial Services, Inc.'s Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondents Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act;

B. Respondents Raymond James & Associates, Inc. and Raymond James Financial Services, Inc. are censured; and

C. The Commission is not imposing a penalty against Respondents at this time. However, in the event the Division of Enforcement ("Division") believes that Respondents have not complied with their undertakings as more fully described above, the Division may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider the appropriateness of a penalty; and (2) seek an order directing payment of up to the maximum civil penalty allowable under the law. In determining whether to impose a penalty, the Commission will take into consideration its traditional criteria in determining whether to assess civil penalties, including the extent to which Respondents have satisfied their undertakings and cooperated with the Commission and other regulators in their investigations. Respondents may not, by way of defense to any such petition: (1) contest the findings in this Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3228 / June 29, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14446

In the Matter of **Ahmad Haris Tajyar,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

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

III.

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

1. Tajyar operated an unregistered hedge fund named Dionysus Capital, LP ("Dionysus"), a Delaware limited partnership formed in January 2004, whose general partner, Dionysus Management, LLC, was controlled by Tajyar and acted as an investment adviser to Dionysus. Tajyar, 35 years old, is a resident of Encino, California.

2. On April 27, 2011, a judgment was entered by consent against Tajyar, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Ahmad Haris Tajyar, et al., Civil Action Number CV 09-03988 JFW (PJWx), in the United States District Court for the Central District of California.

3. The Commission's complaint alleges that Tajyar was tipped with and used material nonpublic information to trade in his own accounts and in accounts held in the name of Dionysus in advance of five corporate announcements, thereby realizing illegal trading profits of approximately $924,000. The complaint further alleges that Tajyar tipped his cousin, Omar Ahmad Tajyar, who also traded in advance of the announcements and realized illegal profits of approximately $312,000. Additionally, the complaint alleges that either Tajyar or his cousin Omar Ahmad Tajyar tipped or traded in the account of Vispi B. Shroff, an associate of Tajyar, in advance of three of the announcements, as a result of which Shroff made unlawful profits of approximately $207,000.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Tajyar be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical ratings organization.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-29711; File No. 812-13914]

J.P. Morgan Securities LLC, et al.; Notice of Application and Temporary Order

June 29, 2011

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

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against J.P. Morgan Securities LLC ("J.P. Morgan Securities") on June 29, 2011 by the United States District Court for the Southern District of New York ("Injunction"), until the Commission takes final action on an application for a permanent order. Applicants also have applied for a permanent order.

Applicants: J.P. Morgan Securities; Bear Stearns Asset Management Inc. ("BSAM"); Bear Stearns Health Innoventures Management, L.L.C. ("BSHIM"); BSCGP Inc. ("BSCGP"); Constellation Growth Capital LLC ("Constellation"); Constellation Ventures Management II, LLC ("Constellation II"); Highbridge Capital Management, LLC ("Highbridge"); JF International Management Inc. ("JFIMI"); JPMorgan Asset Management (UK) Limited ("JPMAMUK"); JPMorgan Distribution Services, Inc. ("JPMDS"); J.P. Morgan Institutional Investments, Inc. ("JPMII"); J.P. Morgan Investment Management Inc. ("JPMIM"); J.P. Morgan Latin America Management Company, LLC ("JPMLAM"); J.P. Morgan Partners, LLC ("JPMP"); J.P. Morgan Private Investments Inc. ("JPMPI"); OEP Co-Investors Management II, Ltd. ("OEP II"); OEP Co-Investors Management III, Ltd.

("OEP III", and together with OEP II, the "OEP Entities"); Security Capital Research & Management Incorporated ("Security Capital"); Sixty Wall Street GP Corporation ("Sixty Wall GP"); Sixty Wall Street Management Company, LLC ("Sixty Wall Management"); and Technology Coinvestors Management, LLC ("TCM") (collectively, the "Applicants").[1]

Filing Date: The application was filed on June 21, 2011 and amended on June 29, 2011.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on July 25, 2011, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: J.P. Morgan Securities, 338 Madison Avenue, New York, NY 10179; BSAM, BSHIM, BSCGP, Constellation II, JPMII, JPMIM, JPMLAM, JPMP, JPMPI, Sixty Wall GP, Sixty Wall Management, and TCM, 270 Park Avenue, New York, NY 10017; Constellation and Highbridge, 49 West 57th Street, 32nd Floor, New York, NY 10019; JFIMI, 21st Floor, Chater House, 8 Connaught Road Central, Hong Kong; JPMAMUK, 125 London Wall, London, UK EC2Y5AJ; JPMDS, 1111

[1] Applicants request that any relief granted pursuant to the application also apply to any other company of which J.P. Morgan Securities is or may become an affiliated person within the meaning of Section 2(a)(3) of the Act (together with the Applicants, the "Covered Persons").

Polaris Pkwy, Columbus, Ohio 43240; OEP Entities, 320 Park Avenue, 18th Floor, New York, NY 10022; and Security Capital, 10 South Dearborn Street, Suite 1400, Chicago, IL 60603.

For Further Information Contact: Laura J. Riegel, at (202) 551-6873, or Dalia Osman Blass, Branch Chief, at (202) 551-6821 (Division of Investment Management, Office of Investment Company Regulation).

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

Applicants' Representations:

1. Each of the Applicants (other than Constellation and Highbridge) is either directly or indirectly a wholly-owned subsidiary of J.P. Morgan Chase & Co. ("JPMC"). Each of Constellation and Highbridge is an indirect, majority-owned subsidiary of JPMC. JPMC is a financial services holding company whose businesses provide a broad range of financial services. J.P. Morgan Securities is registered as a broker-dealer under the Securities Exchange Act of 1934, as amended ("Exchange Act") and is registered as an investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). J.P. Morgan Securities does not currently serve as an investment adviser, sub-adviser, depositor or principal underwriter (as defined in section 2(a)(29) of the Act) for any of the registered investment companies ("Funds") or employees' securities companies ("ESCs", and included in the term Funds), as defined in section 2(a)(13) of the Act. BSAM is registered as an investment adviser under the Advisers Act and serves as investment

adviser or sub-adviser to various Funds, including as general partner that provides investment advisory services to various ESCs.[2] BSHIM, BSCGP, Constellation II, the OEP Entities and TCM serve as general partners that provide investment advisory services to various ESCs. Constellation serves as a sub-adviser to various ESCs. Highbridge, JFIMI, JPMAMUK, JPMIM, JPMPI, and Security Capital are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to various Funds. JPMLAM, JPMP, Sixty Wall GP and Sixty Wall Management are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to ESCs. JPMDS is registered as a broker-dealer under the Exchange Act and serves as principal underwriter to certain Funds. JPMII is registered as a broker-dealer under the Exchange Act and serves as placement agent to certain Funds.[3]

2. On June 29, 2011, the United States District Court for the Southern District of New York entered a judgment, which included the Injunction, against J.P. Morgan Securities ("Final Judgment") in a matter brought by the Commission.[4] The conduct of J.P. Morgan Securities alleged in the Complaint involved an offering of a largely synthetic collateralized debt obligation ("CDO") whose portfolio consisted primarily of credit default swaps referencing other CDO securities. The Complaint alleged that J.P. Morgan Securities represented in marketing materials that the collateral manager selected the

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[2] Every Applicant that is a general partner that provides investment advisory services to one or more ESCs believes, for purposes of the application, that it is performing a function that falls within the definition of "investment adviser" in section 2(a)(20) of the Act.

[3] JPMII serves as placement agent to JPMorgan Institutional Trust with respect to three series. JPMorgan Institutional Trust is an open-end investment company registered under the Act, but its shares are not registered under the Securities Act of 1933, as amended. JPMII believes, for purposes of the application, that it performing a function that falls within the definition of "principal underwriter" in Section 2(a)(29) of the Act.

[4] U.S. Securities and Exchange Commission v. J.P. Morgan Securities LLC (f/k/a J.P Morgan Securities Inc.) Case No. 1:11-cv-04206-RMB (S.D.N.Y. June 29, 2011).

CDO's investment portfolio but failed to disclose that a hedge fund that purchased the subordinated notes (or "equity"), which also took the short position on roughly half of the portfolio assets, played a significant role in the selection process. The Final Judgment would restrain and enjoin J.P. Morgan Securities from violating sections 17(a)(2) and 17(a)(3) of the Securities Act. Without admitting or denying any of the allegations in the Complaint, except as to personal and subject matter jurisdiction, J.P. Morgan Securities consented to the entry of the Final Judgment and other equitable relief including certain undertakings.

<u>Applicants' Legal Analysis</u>:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of a security, or in connection with activities as an underwriter, broker or dealer, from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company. Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that J.P. Morgan Securities is an affiliated person of each of the other Applicants within the meaning of section 2(a)(3) of the Act. Applicants state that the entry of the Injunction results in Applicants being subject to the disqualification provisions of section 9(a) of the Act.

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) if it is established that these provisions, as applied to the applicants, are unduly or disproportionately severe or that the applicants' conduct has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a temporary and permanent order exempting them and other Covered Persons from the disqualification provisions of section 9(a) of the Act.

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of the Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the alleged conduct giving rise to the Injunction did not involve any of the Applicants acting in the capacity of investment adviser, sub-adviser or depositor for any Fund (including as general partner providing investment advisory services to ESCs) or as principal underwriter for any registered open-end company, registered unit investment trust or registered face-amount certificate company. Applicants also state that to the best of their knowledge, none of the current directors, officers, or employees of the Applicants that are involved in providing services as investment adviser or sub-adviser of the Funds (including as general partner providing investment advisory services to ESCs) or principal underwriter for any registered open-end company (or any other persons in such roles during the time period covered by the Complaint) participated

in the conduct alleged in the Complaint to have constituted the violations that provide a basis for the Injunction. Applicants further represent that the personnel at J.P. Morgan Securities who participated in the conduct alleged in the Complaint to have constituted the violations that provided a basis for the Injunction have had no, and will not have any, involvement in providing advisory, depositary (including as general partner providing investment advisory services to ESCs) to the Funds or principal underwriting services to any registered open-end company, registered unit investment trust, or registered face-amount certificate company on the behalf of the Applicants or other Covered Persons. Applicants also represent that because the personnel of the Applicants (other than those at J.P. Morgan Securities) did not participate in the conduct alleged in the Complaint to have constituted the violations that provide a basis for the Injunction, the shareholders of those Funds were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser or principal underwriter. Applicants state that the alleged conduct did not involve any Fund or the assets of any Fund.

5. Applicants state that their inability to continue to provide investment advisory and subadvisory services to the Funds (including as general partner providing investment advisory services to ESCs) and principal underwriting services to any registered open-end company would result in potential hardship for the Funds and their shareholders. Applicants state that they will, as soon as reasonably practical, distribute written materials, including an offer to meet in person to discuss the materials, to the boards of directors of the Funds ("Boards") (excluding, for this purpose, the ESCs) for which the Applicants serve as investment adviser, investment sub-adviser or principal underwriter, including the directors who are not "interested persons," as defined in section

2(a)(19) of the Act, of such Funds, and their independent legal counsel, if any, describing the circumstances that led to the Injunction and any impact on the Funds, and the application. Applicants state they will provide the Boards with the information concerning the Injunction and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

6. Applicants also state that, if they were barred from providing services to the Funds, the effect on their businesses and employees would be severe. Applicants state that they have committed substantial resources to establishing expertise in providing advisory and distribution services to Funds. Applicants further state that prohibiting them from providing such services would not only adversely affect their businesses, but would also adversely affect about 940 employees who are involved in those activities. Applicants also state that disqualifying certain Applicants from continuing to provide investment advisory services to the ESCs is not in the public interest or in the furtherance of the protection of investors. Because the ESCs have been formed for certain key employees, officers and directors of JPMC and its affiliates, it would not be consistent with the purposes of the ESC provisions of the Act or the terms and conditions of the ESC orders to require another entity not affiliated with JPMC to manage the ESCs. In addition, participating employees of JPM and its affiliates likely subscribed for interests in the ESCs with the expectation that the ESCs would be managed by an affiliate of JPMC.

7. Certain of the Applicants previously have applied for and received exemptions under section 9(c) as the result of conduct that triggered section 9(a) of the Act, as described in greater detail in the application.

Applicants' Condition:

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

Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the condition in the application, from June 29, 2011, until the Commission takes final action on their application for a permanent order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT of 1933
Release No. 9229 / June 29, 2011

In the Matter of **J.P. Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.),** **Respondent.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(2) & 602(b)(4) DISQUALIFICATION PROVISIONS**

I.

Respondent J.P. Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.) ("J.P. Morgan Securities" or "Respondent") has submitted a letter, dated June 17, 2011, requesting a waiver of the Rule 602(c)(2) and Rule 602(b)(4) disqualifications from the exemption from registration under Regulation E arising from Respondent's settlement of an injunctive action commenced by the Commission.

II.

On June 21, 2011, the Commission filed a civil injunctive action in the U.S. District Court for the District of Columbia charging Respondent with violating Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"). The conduct of J.P. Morgan Securities alleged in the complaint involved an offering of a largely synthetic CDO whose portfolio consisted primarily of credit default swaps referencing other CDO securities. In its complaint, the Commission alleged that J.P. Morgan Securities represented in marketing materials that the collateral manager selected the CDO's investment portfolio but failed to disclose that the hedge fund that purchased the subordinated notes (or "equity"), which also took the short position on roughly half of the portfolio's assets, played a significant role in the selection process. On June 29, 2011, pursuant to Respondent's consent, the U.S. District Court for the District of Columbia entered a Final Judgment permanently enjoining Respondent from violating Sections 17(a)(2) and (3) of the Securities Act.

III.

Rule 602(b)(4) makes the Regulation E exemption unavailable for the securities of small business investment company issuers or business development company issuers if such issuer or any of its affiliates is subject to a court order entered within the past five years "permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of securities." 17 C.F.R. § 230.602(b)(4). Rule 602(c)(2) makes this exemption unavailable for the securities of any issuer if, among other things, any investment adviser or underwriter of the securities to be offered is "temporarily or permanently restrained or enjoined by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or arising out of such person's conduct as an underwriter, broker, dealer or investment adviser." 17 C.F.R. § 230.602(c)(2). Rule 602(e) of the Securities Act provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in Respondent's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Final Judgment.

Accordingly, IT IS ORDERED, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rules 602(b)(4) and 602(c)(2) under the Securities Act resulting from the entry of the Final Judgment is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Commissioner Paredes
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9230 / June 29, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 64774 / June 29, 2011

In the Matter of **JPMorgan Chase & Co.,** **Respondent.**	**ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO JPMORGAN CHASE & CO. AND ITS AFFILIATES**

JPMorgan Chase & Co. ("JPMorgan") has submitted a letter on behalf of itself and its affiliates, dated June 22, 2011, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from a settlement of an injunctive action filed by the Commission against JPMorgan's subsidiary, J.P. Morgan Securities LLC (f/k/a J.P. Morgan Securities Inc.)("J.P. Morgan Securities" or "Defendant").

On June 21, 2011, the Commission filed a civil injunctive action in U.S. District Court for the Southern District of New York charging Defendant with violating the antifraud provisions of the federal securities laws. The conduct of J.P. Morgan Securities alleged in the complaint in the Action involved an offering of a largely synthetic CDO whose portfolio consisted primarily of credit default swaps referencing other CDO securities. The complaint alleged that J.P. Morgan Securities represented in marketing materials that the collateral manager selected the CDO's investment portfolio but failed to disclose that the hedge fund that purchased the subordinated notes (or "equity"), which also took the short position on roughly half of the portfolio's assets, played a significant role in the selection process. On June 29, 2011, pursuant to Defendant's consent, the Southern District of New York entered a Final Judgment permanently enjoining Defendant from violating Sections 17(a)(2) and (3) of the Securities Act, requiring Defendant to pay disgorgement and a penalty, and requiring Defendant to comply with specified remedial undertakings.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the federal securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Based on the representations set forth in JPMorgan's letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Judgment is appropriate and should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to JPMorgan and its affiliates resulting from the entry of the Judgment is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 200

[Release No. 34-64778]

Delegation of Authority to the Director of its Division of Enforcement

Agency: Securities and Exchange Commission.

Action: Final rule.

SUMMARY: The Commission is amending its rules to delegate authority to the Director of the Division of Enforcement to disclose information that could reasonably be expected to reveal the identity of a whistleblower ("whistleblower identifying information") to those persons to whom disclosure may be made without loss of confidentiality under the whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

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

FOR FURTHER INFORMATION CONTACT: Kenneth H. Hall, Assistant Chief Counsel, 202 551-4936, Office of Chief Counsel, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6553.

SUPPLEMENTARY INFORMATION:

Section 922 of the Dodd-Frank Act, Pub. L. No 111-203, 124 Stat. 1376, 1841 (2010), added Section 21F to the Securities Exchange Act of 1934, 15 U.S.C. 78u-6, which creates a new program authorizing the Commission to make monetary awards to whistleblowers who provide the Commission with "original information" that leads to the successful enforcement of a "covered judicial or administrative action" or a "related action," as those terms are defined in Section 21F(a), 15 U.S.C. 78u-6(a). Awards may be paid in connection with original information concerning any violation of the federal securities laws, and may range from 10 to 30 percent of the amounts collected as monetary sanctions imposed in the covered judicial or administrative action brought by the Commission or in related actions brought by other entities identified in the statute.

To protect the identity of whistleblowers, Section 21F(h)(2)(A), 15 U.S.C. 78u-6(h)(2)(A) provides that, except as otherwise permitted by that subsection, the Commission "shall not disclose any information, including information provided by a whistleblower to the Commission, which could reasonably be expected to reveal the identity of a whistleblower." Such information may be disclosed by the Commission under Section 21F(h)(2)(A) to those entities identified in Section 21F(h)(2)(D)(i), 15 U.S.C. 78u-6(h)(2)(D)(i), "when necessary to accomplish the purposes of [the Securities Exchange Act] and to protect investors." Otherwise, such information may be disclosed by the Commission only in accordance with the provisions of the Privacy Act of 1974, 5 U.S.C. 552a, "unless and until required to be disclosed to a defendant or respondent in connection with a public proceeding instituted by the Commission or any entity described in [Section 21F(h)(2)(D)(i)]."

Whistleblower identifying information may be disclosed by the Commission to the following entities listed in Section 21F(h)(2)(D)(i): the Attorney General of the United States; an appropriate regulatory authority; a self-regulatory organization; a State attorney general in connection with any criminal investigation; any appropriate State regulatory authority; the Public Company Accounting Oversight Board; a foreign securities authority; or a foreign law enforcement authority. Domestic entities to which the Commission discloses such information "shall maintain such information as confidential in accordance with the requirements established under [Section 21F(h)(2)(A]." Section 21F(h)(2)(D)(ii)(I), 15 U.S.C. 78u-6(h)(2)(D)(ii)(I). Foreign securities authorities and foreign law enforcement authorities to which the Commission discloses such information "shall maintain such information in accordance with such assurances of confidentiality as the Commission determines appropriate." Section 21F(h)(2)(D)(ii)(II), 15 U.S.C. 78u-6(h)(2)(D)(ii)(II).

The Commission is delegating authority to the Director of the Division of Enforcement to disclose whistleblower identifying information to the entities described in Section 21F(h)(2)(D), in accordance with the restrictions of Section 21F(h)(2)(A) and (D). The delegation will increase investor protection by facilitating administration of the whistleblower award program and the investigations and actions by those agencies and authorities that may receive whistleblower identifying information pursuant to this delegation.

Administrative Law Matters:

The Commission finds, in accordance with the Administrative Procedure Act ("APA") (5 U.S.C. 553(b)(3)(A)), that this amendment relates solely to agency organization, procedure, or practice and does not relate to a substantive rule. Accordingly, the provisions of the APA regarding notice of the proposed rulemaking, opportunities for public participation, and publication of the amendment prior to its effective date, 5 U.S.C. 553, are not applicable. For the same reason, and because this amendment does not substantively affect the rights or obligations of non-agency parties, the provisions of the Small Business Regulatory Enforcement Fairness Act, 5 U.S.C. 804(3)(C), are not applicable. Additionally, the provisions of the Regulatory Flexibility Act, which apply only when notice and comment are required by the APA or other law, 5 U.S.C. 603, are not applicable. Further, because the amendment imposes no new burdens on parties in investigations, the Commission does not believe it will have any anti-competitive effects for purposes of Section 23(a)(2) of the Securities Exchange Act, 15 U.S.C. 78w(a)(2). Finally, this amendment does not contain any collection of information requirements as defined by the Paperwork Reduction Act of 1980, as amended. Accordingly, the amendment is effective [Insert date of publication in the Federal Register].

List of Subjects in 17 CFR Part 200

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

Text of Amendment

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

PART 200—ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The authority citation for part 200, subpart A, continues to read in part as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Section 200.30-4 is amended by adding paragraph (a)(16) to read as follows:

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

* * * * *

(a) * * *

(16) To disclose information, in accordance with Section 21F(h)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u-6(h)(2)), that would reveal, or could reasonably be expected to reveal, the identity of a whistleblower.

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By the Commission

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: June 30, 2011

Commissioner Casey not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 64776 / June 30, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3297 / June 30, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14447

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

I.

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

II.

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

III.

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

Summary

From January 2006 through March 2007, LaBarge did not keep accurate books and records or implement and maintain sufficient internal controls regarding its use of estimates of completion costs for certain long-term production contracts. LaBarge used these estimates to determine its cost of sales and net earnings, which it disclosed in the periodic reports that it filed with the Commission. LaBarge's internal controls lapses and inaccurate books and records resulted in LaBarge filing certain inaccurate periodic reports in 2006 and 2007. As a result, LaBarge violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

Respondent

1. LaBarge, Inc., a Delaware corporation headquartered in St. Louis, Missouri, designs and manufactures electronics components for use in military, aviation, and other industrial equipment. LaBarge's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act, and its preferred stock purchase rights are registered with the Commission pursuant to Section 12(g) of the Exchange Act. LaBarge's common stock trades on the American Stock Exchange. LaBarge's fiscal year ends on the Sunday closest to June 30.

Facts

2. As a public company, LaBarge is required to fairly, accurately, and timely report its financial results and condition. To ensure fair and accurate reports, the federal securities laws and the Commission's regulations require public companies, such as LaBarge, to prepare and present their reports and financial statements in conformity with Generally Accepted Accounting Principles ("GAAP"). Financial statements filed with the Commission that are not prepared in accordance with GAAP are presumed to be misleading or inaccurate.[1] LaBarge represented in its Commission filings that its financial statements complied with GAAP.

3. LaBarge's estimates of completion costs for certain long-term production contracts have a significant effect on its financial results. During 2006 and 2007, four of LaBarge's six plants manufactured pursuant to long-term production contracts. These plants, referred to as the CAS plants within LaBarge, generated as much as two-thirds of LaBarge's reported revenue and net earnings during 2006 and 2007. Consistent with GAAP, LaBarge utilizes the units-of-delivery variation of the percentage-of-completion method when determining the cost of goods sold and gross profits to recognize on long-term contracts.[2] This

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[1] Regulation S-X, 17 C.F.R. 210.4-01(a)(1).

[2] FASB Accounting Standards Codification ("ASC") Topic 605-35 (including the former American Institute of Certified Public Accountants' Statement of Position 81-1, "*Accounting for Performance of Construction-Type and Certain Production-Type Contracts*").

requires LaBarge to periodically make reasonably dependable and accurate estimates concerning the remaining costs needed to complete each long-term contract. GAAP requires LaBarge to recognize changes in these estimates when they become known.[3] If the remaining completion costs are underestimated, the costs of goods sold will generally be underreported (and vice versa).

4. LaBarge acknowledged the importance of these estimates to its reported financial results in its annual statements and the notes to its financial statements. For example, LaBarge explained that, "For contracts accounted for using the percentage of completion method, management's estimates of material, labor and overhead costs on long-term contracts are critical to the Company."

5. In 2006 and 2007, the personnel at each of the CAS plants prepared estimates of completion costs for the long-term contracts in production at each plant. The plant personnel prepared these estimates at completion (referred to within LaBarge as "EACs") in Excel spreadsheets outside of LaBarge's accounting system and then manually entered the results into LaBarge's centralized accounting system from which LaBarge generated its financial statements. The accuracy of LaBarge's financial statements depended on the plant personnel accurately calculating reasonable EACs and then timely entering them into the accounting system without error.

6. In 2006 and 2007, LaBarge did not have adequate internal controls to ensure that the plant personnel calculated EACs correctly, updated EACs on a timely basis, or documented the reasons supporting changes made to EACs. LaBarge also did not have adequate internal controls to ensure that plant personnel correctly entered EAC information into the accounting system. Further, LaBarge did not provide the plant personnel with sufficient guidance regarding when an initial EAC had to be completed on a contract.

7. LaBarge also did not comply with its internal controls in 2006 and 2007. For example, on multiple occasions, including the second quarter of fiscal year 2007, plant personnel did not hold mandatory meetings to update and review EACs and/or did not document decisions made at those meetings. On other occasions, plant personnel did not recognize cumulative catch-up adjustments necessitated by changes to EACs. LaBarge often did not detect these lapses because it did not sufficiently verify compliance with its internal controls.

8. Because LaBarge did not implement adequate internal controls and sufficiently enforce or verify compliance with its existing internal controls, its plant personnel entered EACs into the accounting system that were inaccurate and/or were not supported by contemporaneous documentation. As a result, LaBarge misstated its financial statements for the second quarter of fiscal year 2006. Specifically, LaBarge reported net earnings for the second quarter of fiscal year 2006 of $2,663,000, which were overstated by as much as $193,000 or 7.8%. LaBarge filed these financial statements with the Commission in its periodic reports throughout its fiscal year 2006.

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[3] FASB ASC Topic 605-35; Codification of Staff Accounting Bulletins, Topic 13(A)(4)(b).

9. Because LaBarge did not implement adequate internal controls and sufficiently enforce or verify compliance with its internal controls, its plant personnel did not make changes to EACs on a timely basis. As a result, LaBarge misstated its financial statements for the second quarter of fiscal year 2007. Specifically, LaBarge reported net earnings for the second quarter of fiscal year 2007 of $3,197,000, which were overstated by as much as $244,000 or 8.3%. LaBarge filed these financial statements with the Commission in its periodic reports throughout its fiscal year 2007.

Violations

10. LaBarge filed materially inaccurate reports with the Commission as described above. As a result, LaBarge violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-13 and 12b-20 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and periodic reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

11. LaBarge did not implement and maintain adequate internal controls relating to its cost estimates for long-term contracts as described above. As a result, LaBarge violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

12. LaBarge did not maintain contemporaneous documentation supporting its changes to cost estimates on long-term contracts and it failed to keep books and records that accurately reflected its assets as described above. As a result, LaBarge violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent LaBarge, Inc. cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 promulgated thereunder.

B. Pursuant to Section 21B of the Exchange Act, Respondent LaBarge, Inc. shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $200,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies LaBarge, Inc. as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Robert Burson, Senior Associate Regional Director, Chicago Regional Office, Division of Enforcement, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

June 30, 2011

IN THE MATTER OF BASIN WATER, INC. File No. 500-1	: : : : :	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Basin Water, Inc. ("Basin") because of questions regarding the accuracy of assertions by Basin, and by others, in periodic filings with the Commission concerning, among other things, the company's current financial condition because it has not filed any periodic reports since the period ended March 31, 2009.

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT, on June 30, 2011 through 11:59 p.m. EDT, on July 14, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary