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 **October 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.

Kathleen L. Casey served as SEC Commissioner
July 17, 2006 until August 5, 2011

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

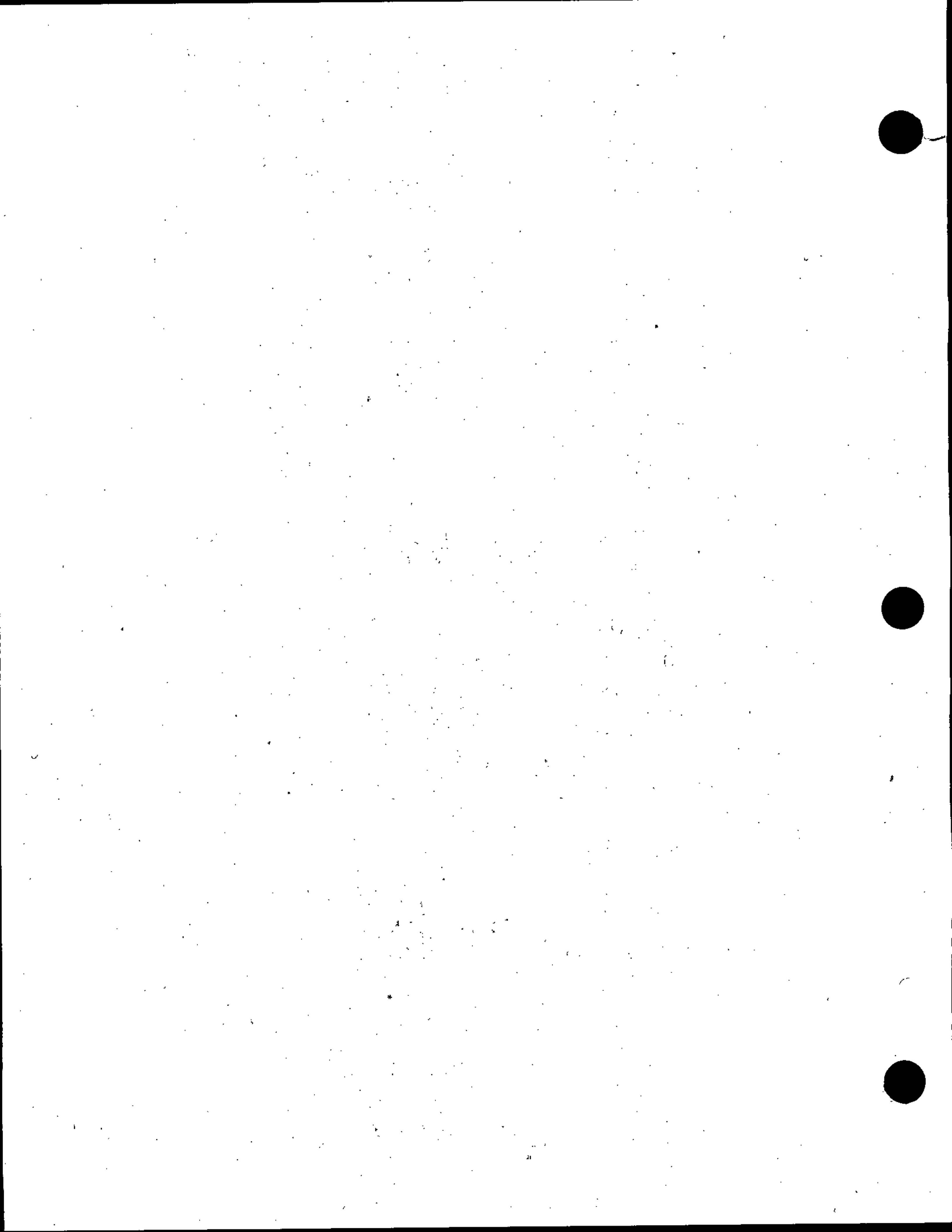
KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(6 Documents)



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65507 / October 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14580

In the Matter of **Intercom Systems, Inc.,** **International Management & Research Corp.,** **International Research & Development Corp. (n/k/a IRDC Estate, Inc.), and** **Ipix Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

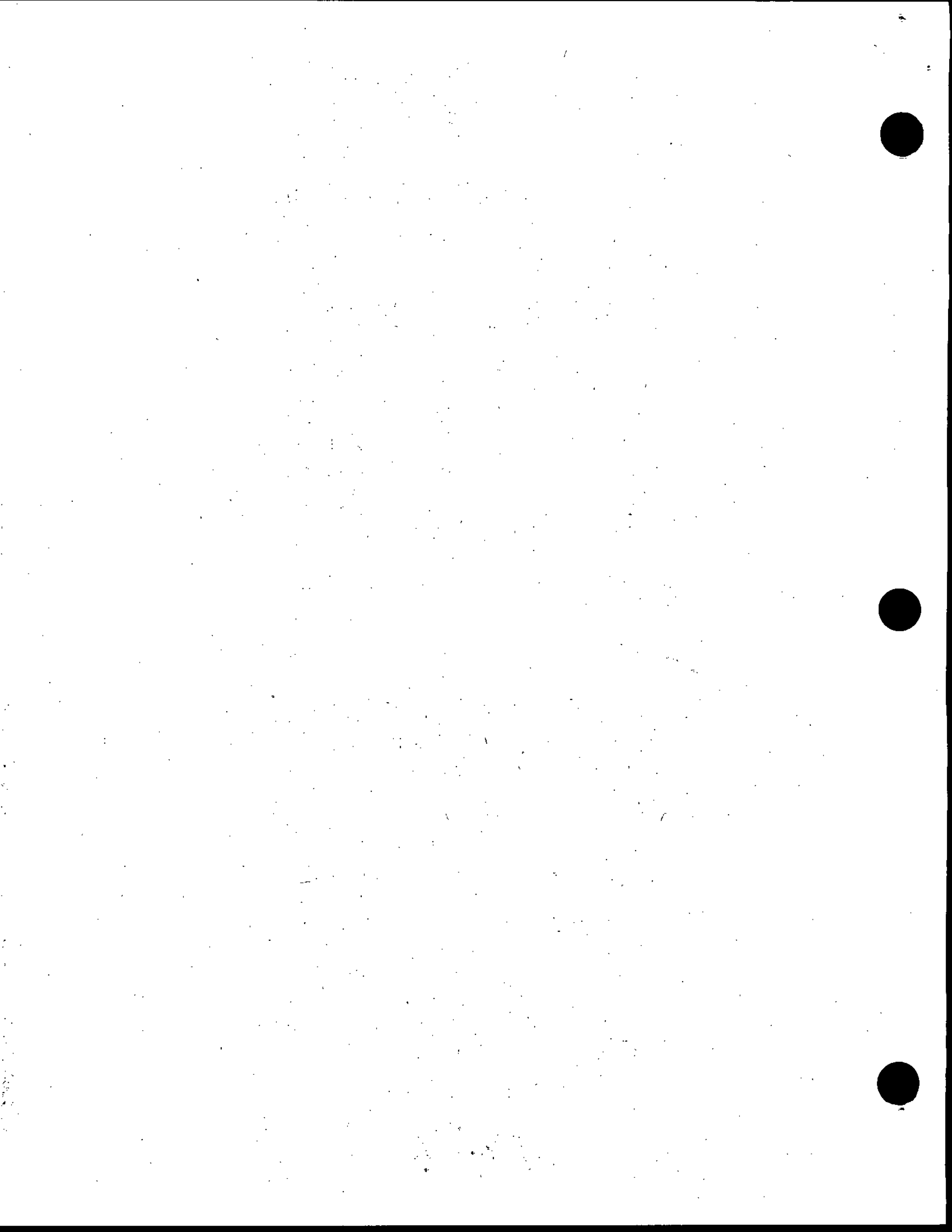
The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Intercom Systems, Inc., International Management & Research Corp., International Research & Development Corp. (n/k/a IRDC Estate, Inc.), and Ipix Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Intercom Systems, Inc. (CIK No. 723501) is a void Delaware corporation located in Marietta, Georgia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Intercom is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2003, which reported a net loss of over $55,000 for the prior twelve months.



2. International Management & Research Corp. (CIK No. 740892) is a Pennsylvania corporation located in Fort Washington, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Management 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, 1999, which reported a net loss of over $29,000 for the prior six months.

3. International Research & Development Corp. (n/k/a IRDC Estate, Inc.) CIK No. 51497) is a forfeited Delaware corporation located in Mattawan, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International Research is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1994.

4. Ipix Corp. (CIK No. 1088022) is a void Delaware corporation located in Reston, Virginia with a class of securities registered with the Commission pursuant to Section 12(g). Ipix is delinquent in its periodic filings, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2006, which reported a net loss of over $3,000 for the prior three months. On July 31, 2006, Ipix filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Eastern District of Virginia, and the case was still pending as of March 21, 2011.

B. DELINQUENT PERIODIC FILINGS

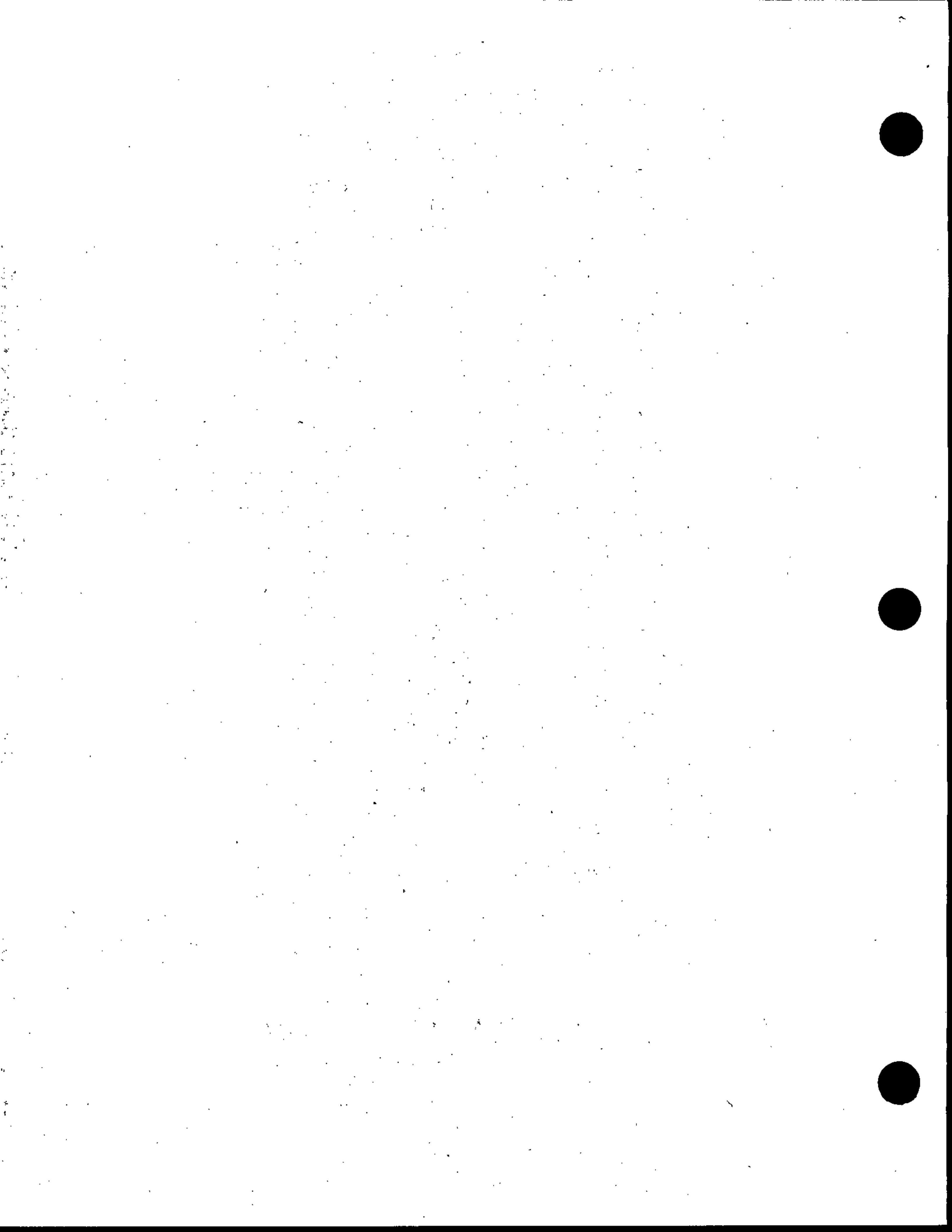
5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting 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].

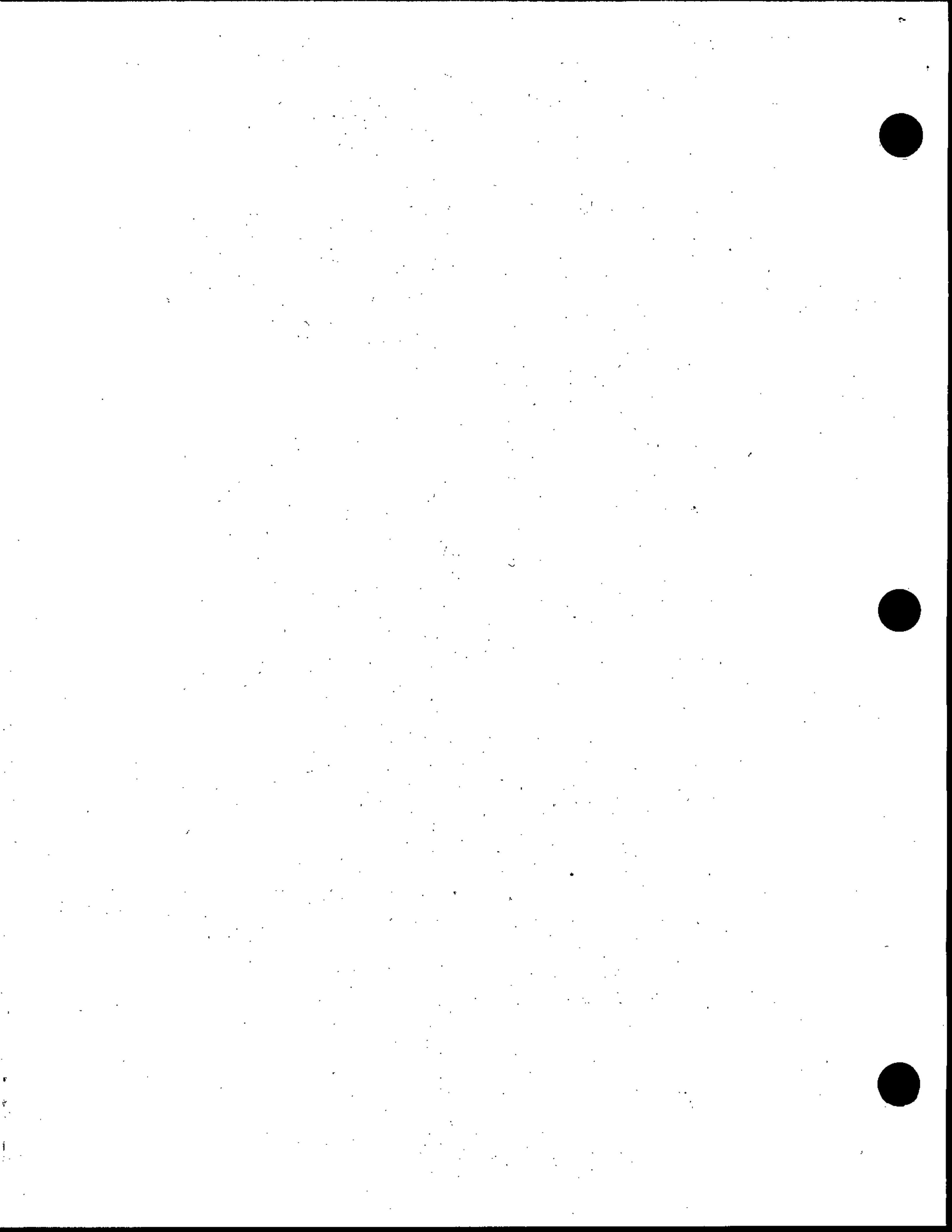
IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

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)].

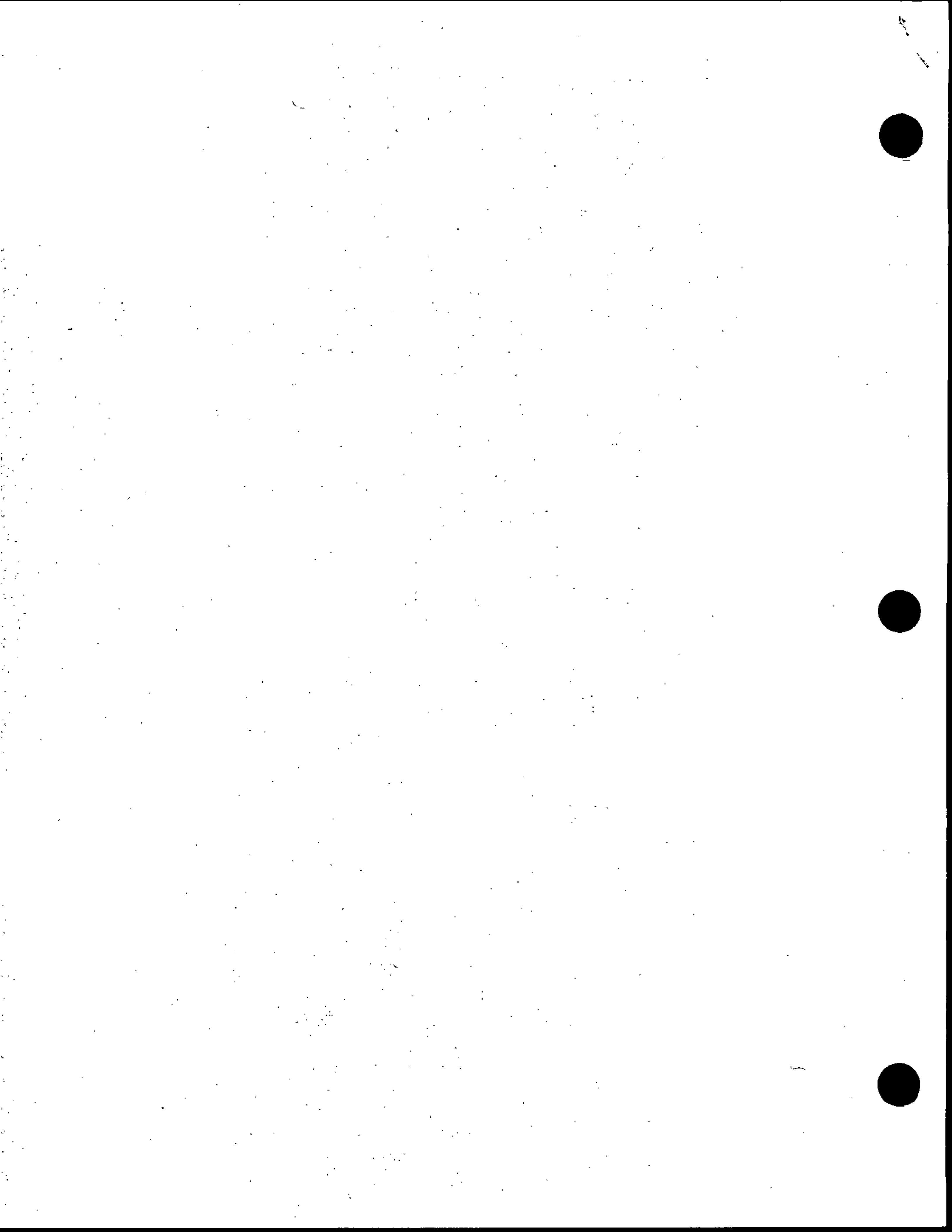
In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in 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



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 20, 2011

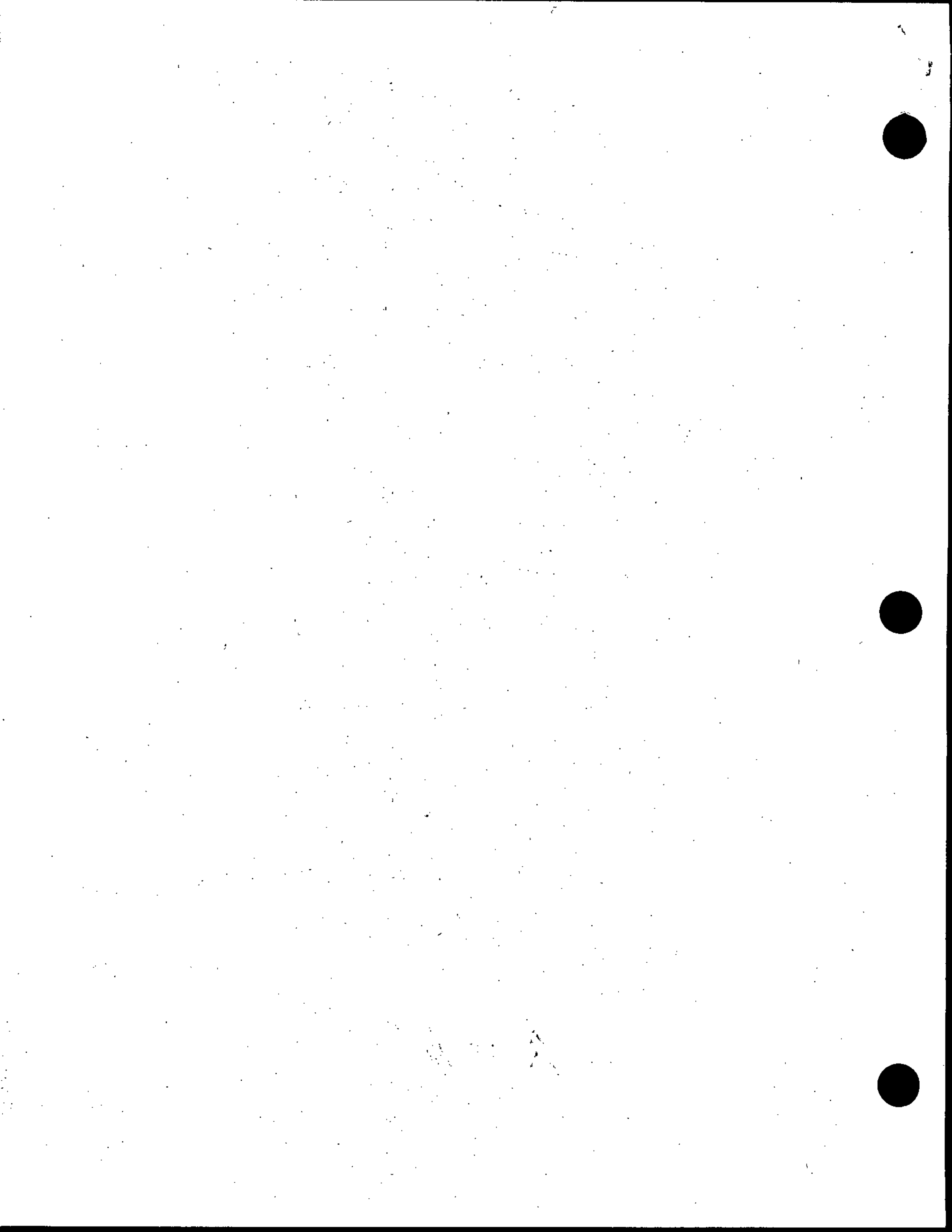
In the Matter of **ADS Media Group, Inc.,** **American Enterprise Development Corp., and** **Arcland Energy Corp.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of ADS Media 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 American Enterprise Development Corp. because it has not filed any periodic reports since the period ended September 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Arcland Energy Corp. because it has not filed any periodic reports since the period ended April 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 October 20, 2011, through 11:59 p.m. EDT on November 2, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65595 / October 20, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14595

In the Matter of ADS Media Group, Inc., American Enterprise Development Corp., and Arcland Energy 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 ADS Media Group, Inc., American Enterprise Development Corp., and Arcland Energy Corp.

II.

After an investigation, the Division of Enforcement alleges that:

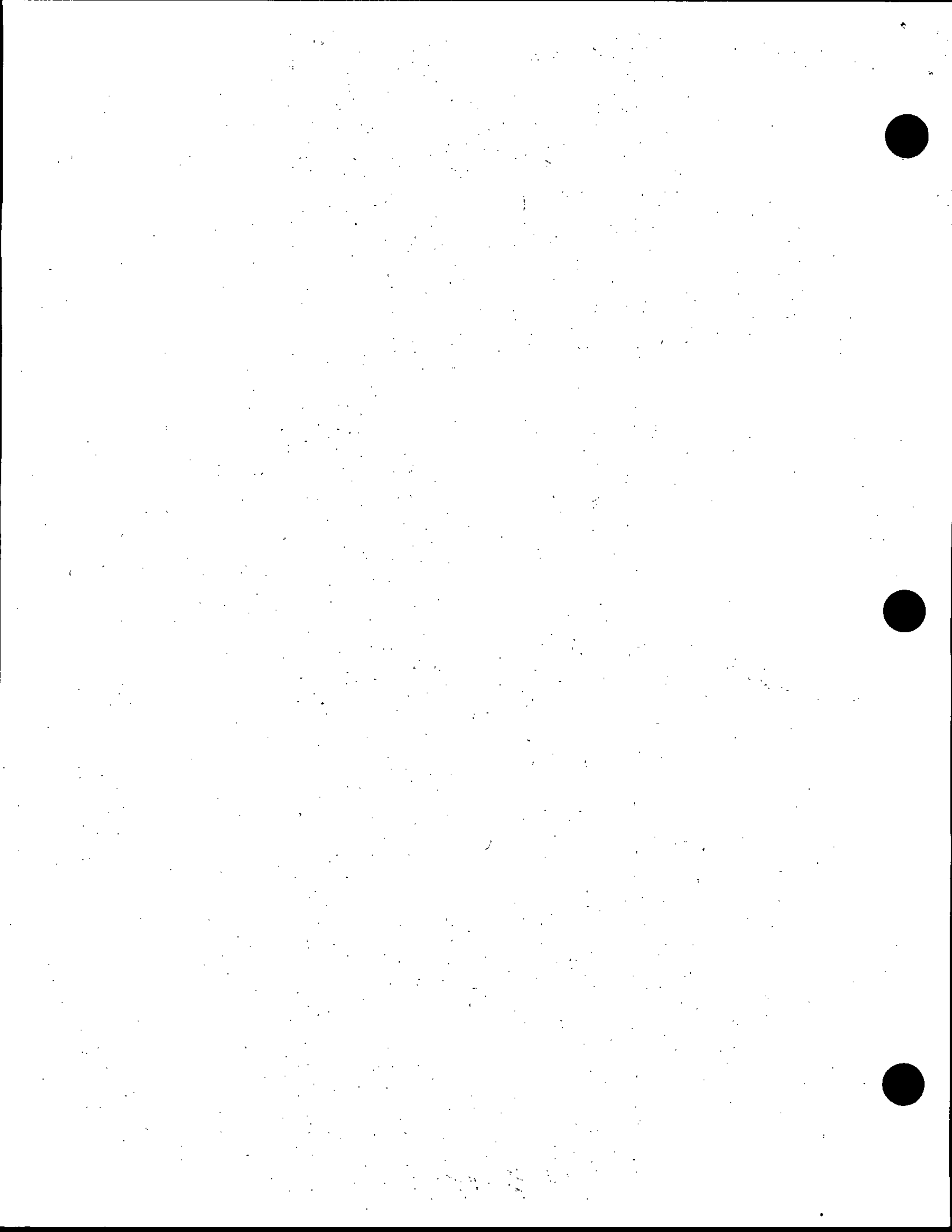
A. RESPONDENTS

1. ADS Media Group, Inc. ("AMGU") [1] (CIK No. 901899) is a Utah corporation located in San Antonio, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AMGU 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, 2008, which reported a net loss of $592,068 for the prior three months. As of October 18, 2011, the common stock of AMGU was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. American Enterprise Development Corp. ("AEND") (CIK No. 1136725) is a forfeited Texas corporation located in Carrollton, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AEND is

[1]The short form of each issuer's name is also its stock symbol.

3 of 6



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 $6,153,037 for the prior nine months. As of October 18, 2011, the common stock of AEND 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. Arcland Energy Corp. ("ACLY") (CIK No. 352912) is an expired Utah corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ACLY is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 30, 2008, which reported a net loss of $759,394 for the prior nine months. As of October 18, 2011, the common stock of ACLY 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

4. 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.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports

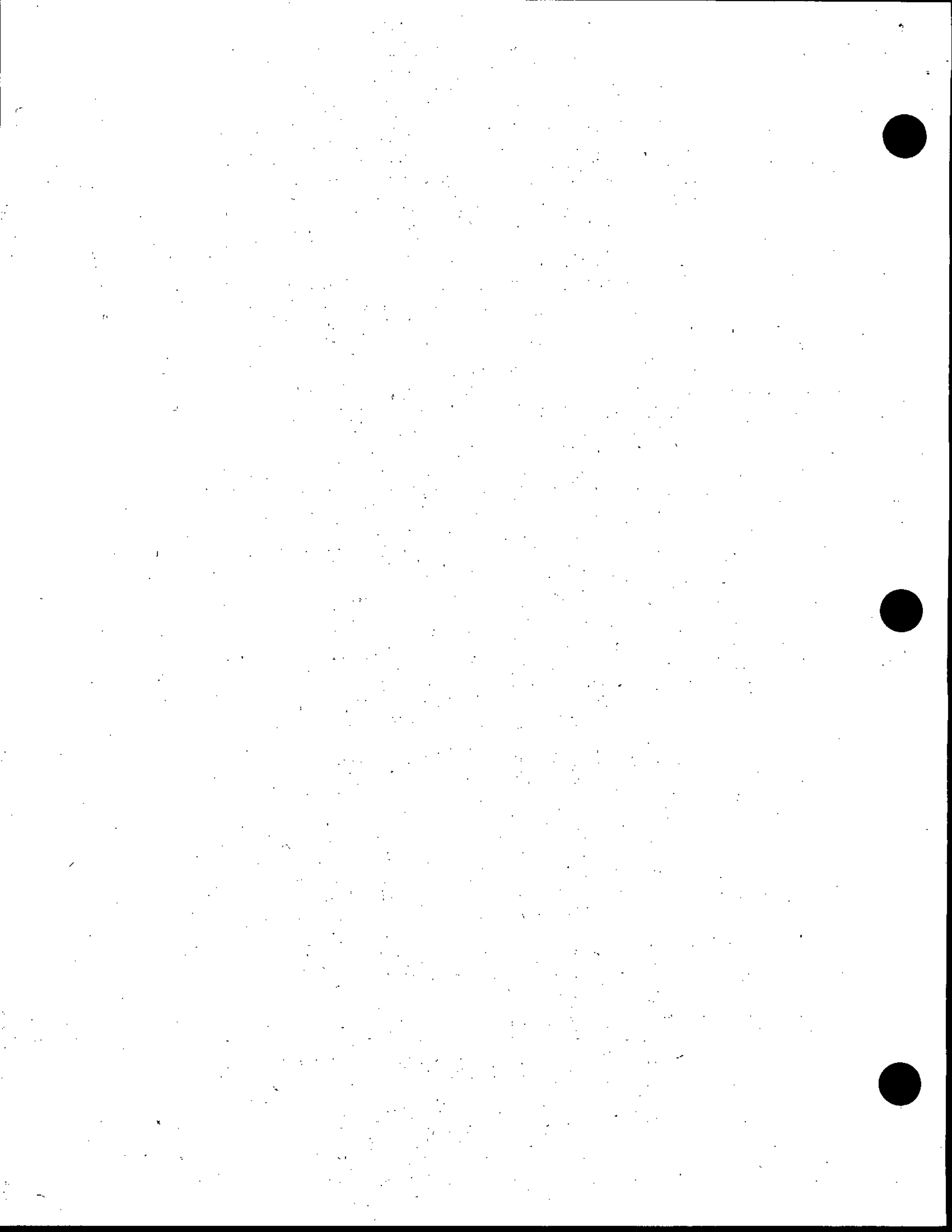
6. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

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

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

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



IV.

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

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

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

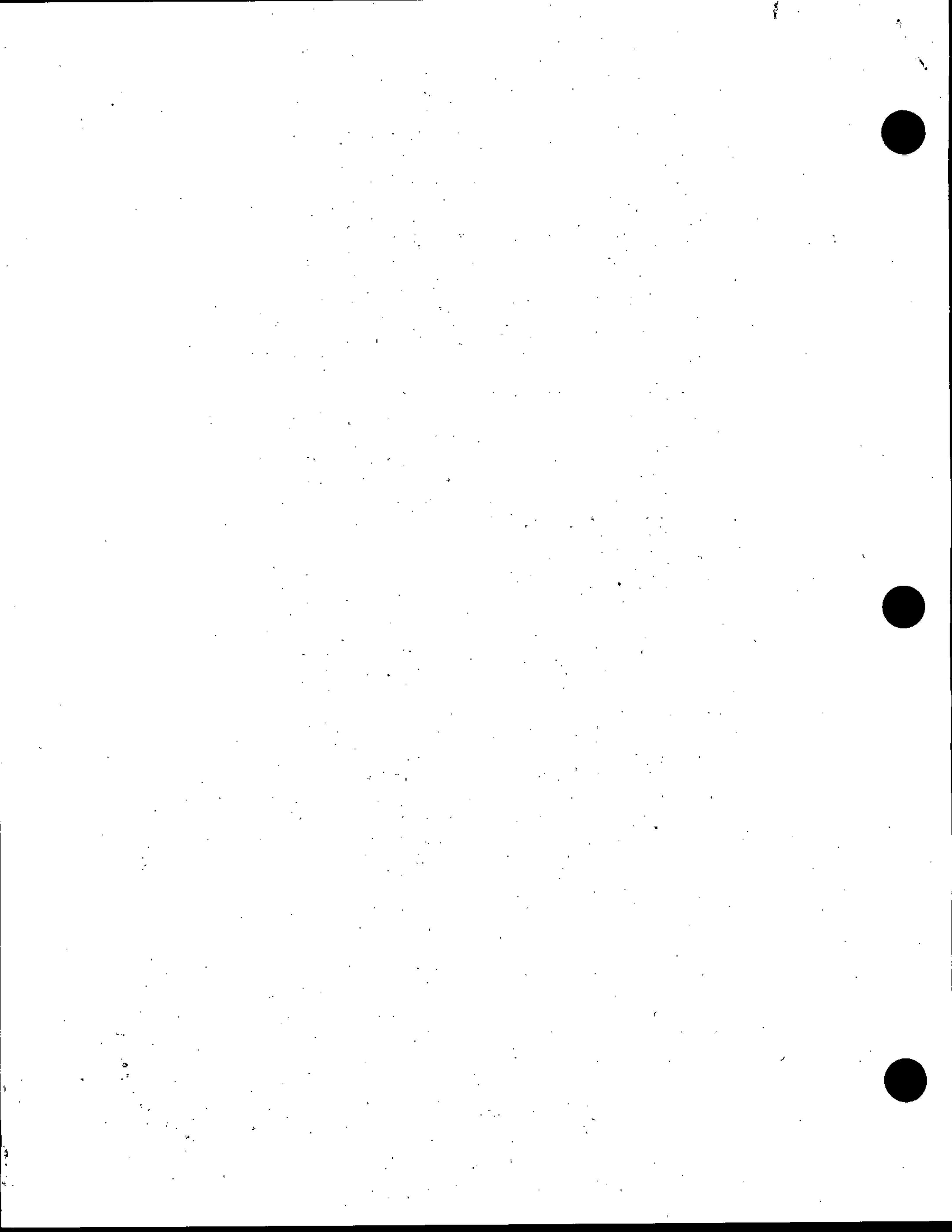
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65611 / October 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14601

In the Matter of Medarts Medical System, Inc., and New Fiber Cloth Technology, Inc. (f/k/a Park Hill Capital III), 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 Medarts Medical System, Inc., and New Fiber Cloth Technology, Inc. (f/k/a Park Hill Capital III).

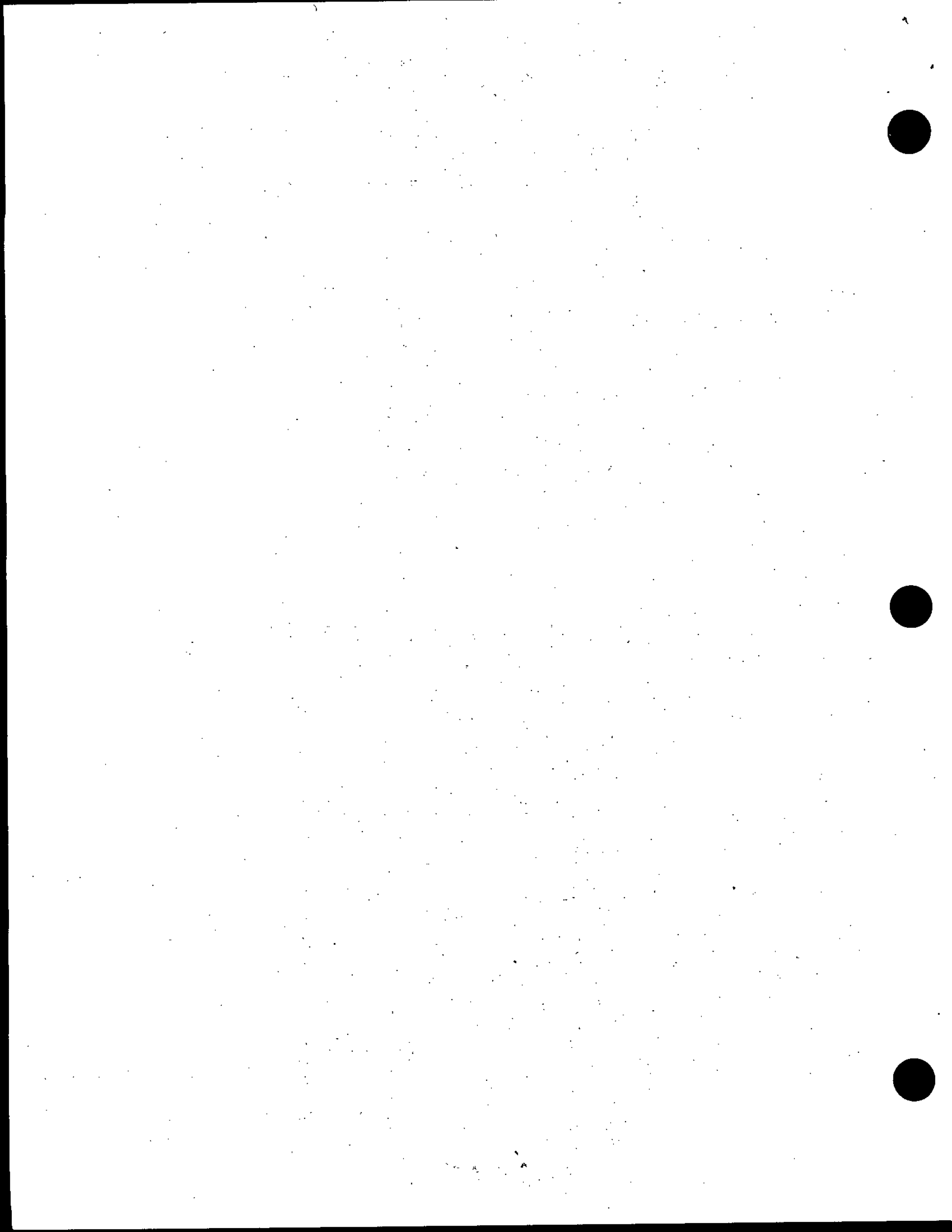
II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Medarts Medical System, Inc. (CIK No. 1309054) is a void Delaware corporation located in Xi'an, Peoples Republic of China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Medarts Medical System is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2006, which reported a net loss of over $3,200 for the prior nine months.

2. New Fiber Cloth Technology, Inc. (f/k/a Park Hill Capital III Corp.) (CIK No. 1107564) is a revoked Nevada corporation located in Wujiang City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New Fiber Cloth Technology is delinquent in its periodic filings with the



Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2007.

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

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

III.

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

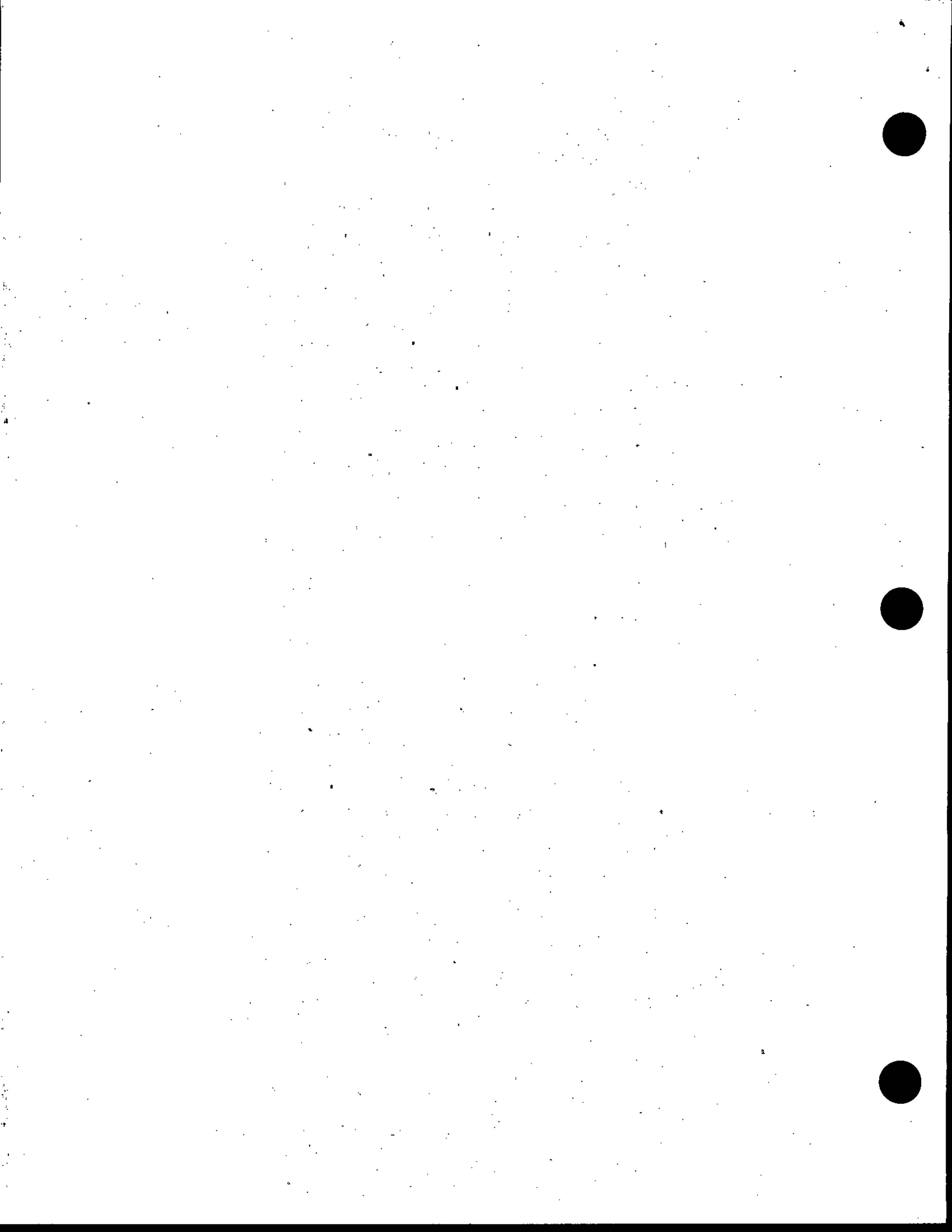
A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

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

IV.

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

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



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

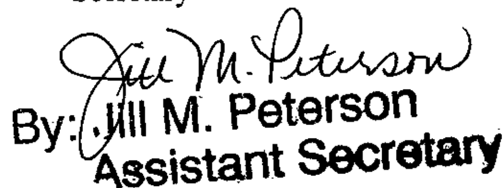
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

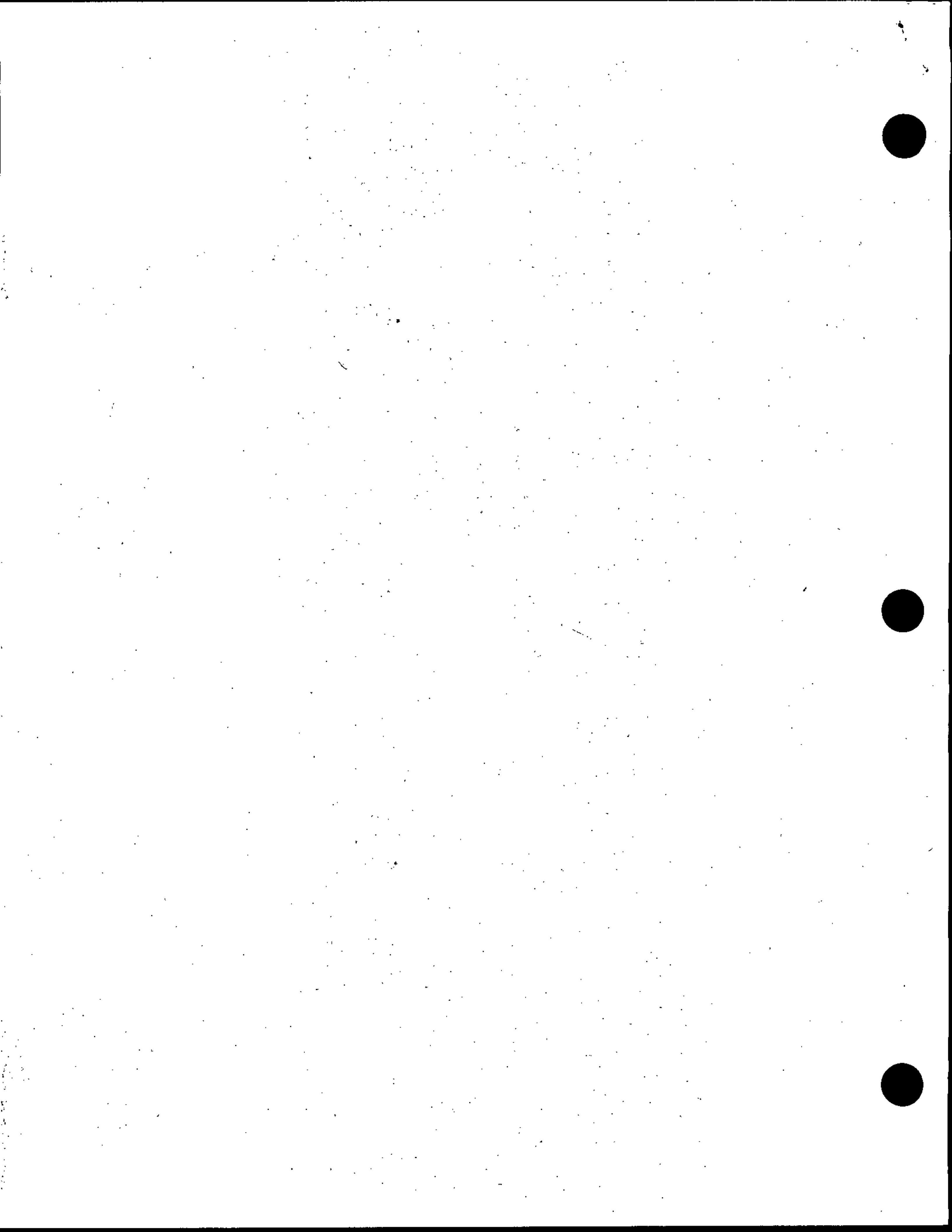
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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

By the Commission.

Elizabeth M. Murphy
Secretary





UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65640 / October 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14604

In the Matter of Accesspoint Corp., Aero Performance Products, Inc., Apex Resources Group, Inc., Aradyme Corp., Bancroft Uranium, Inc., Fightersoft Multimedia Corp., Fortress Financial Group, Inc., and Global Aircraft Solutions, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Accesspoint Corp., Aero Performance Products, Inc., Apex Resources Group, Inc., Aradyme Corp., Bancroft Uranium, Inc., Fightersoft Multimedia Corp., Fortress Financial Group, Inc., and Global Aircraft Solutions, Inc.

II.

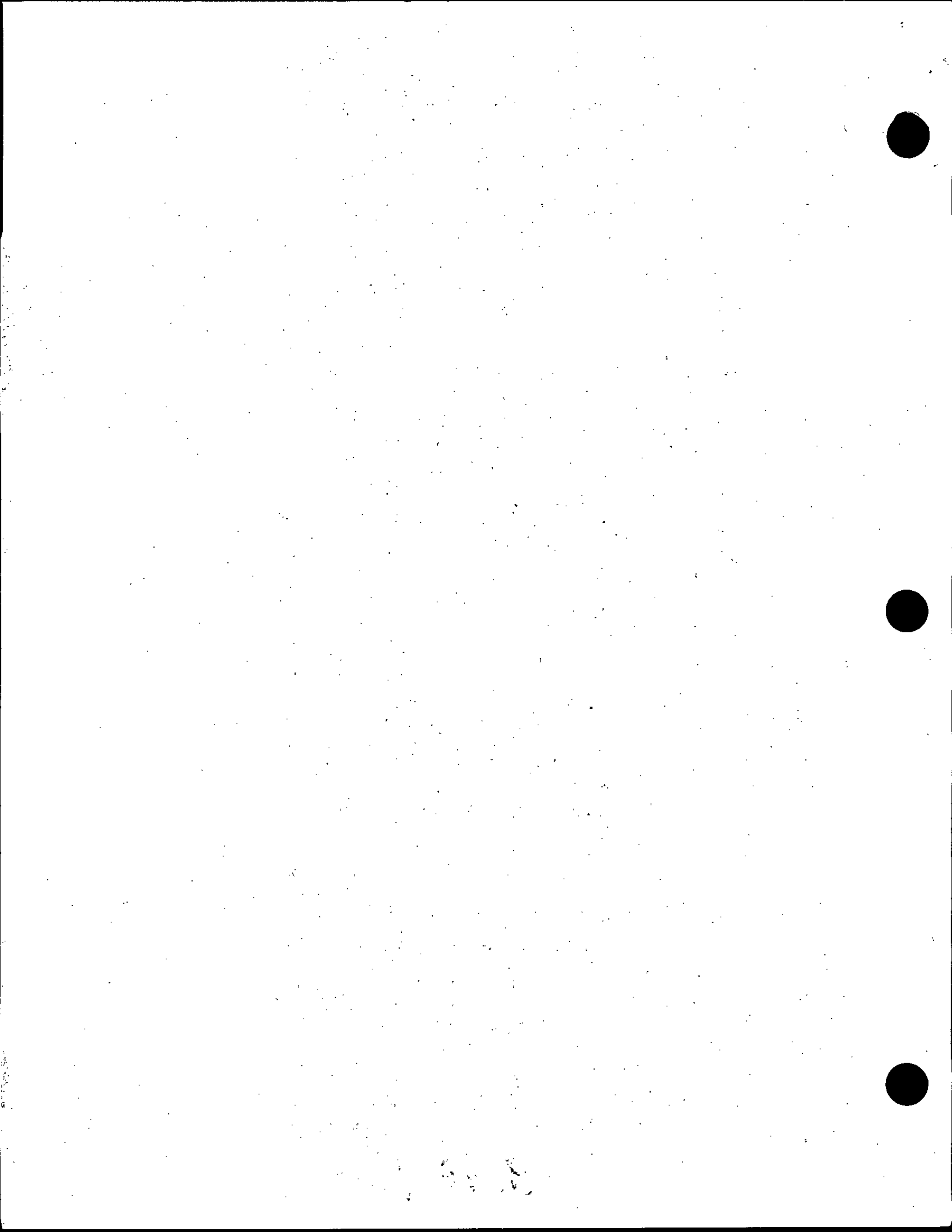
After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Accesspoint Corp. ("ASAP") [1] (CIK No. 1104174) is a Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ASAP is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form

[1] The short form of each issuer's name is also its stock symbol.

5 of 6



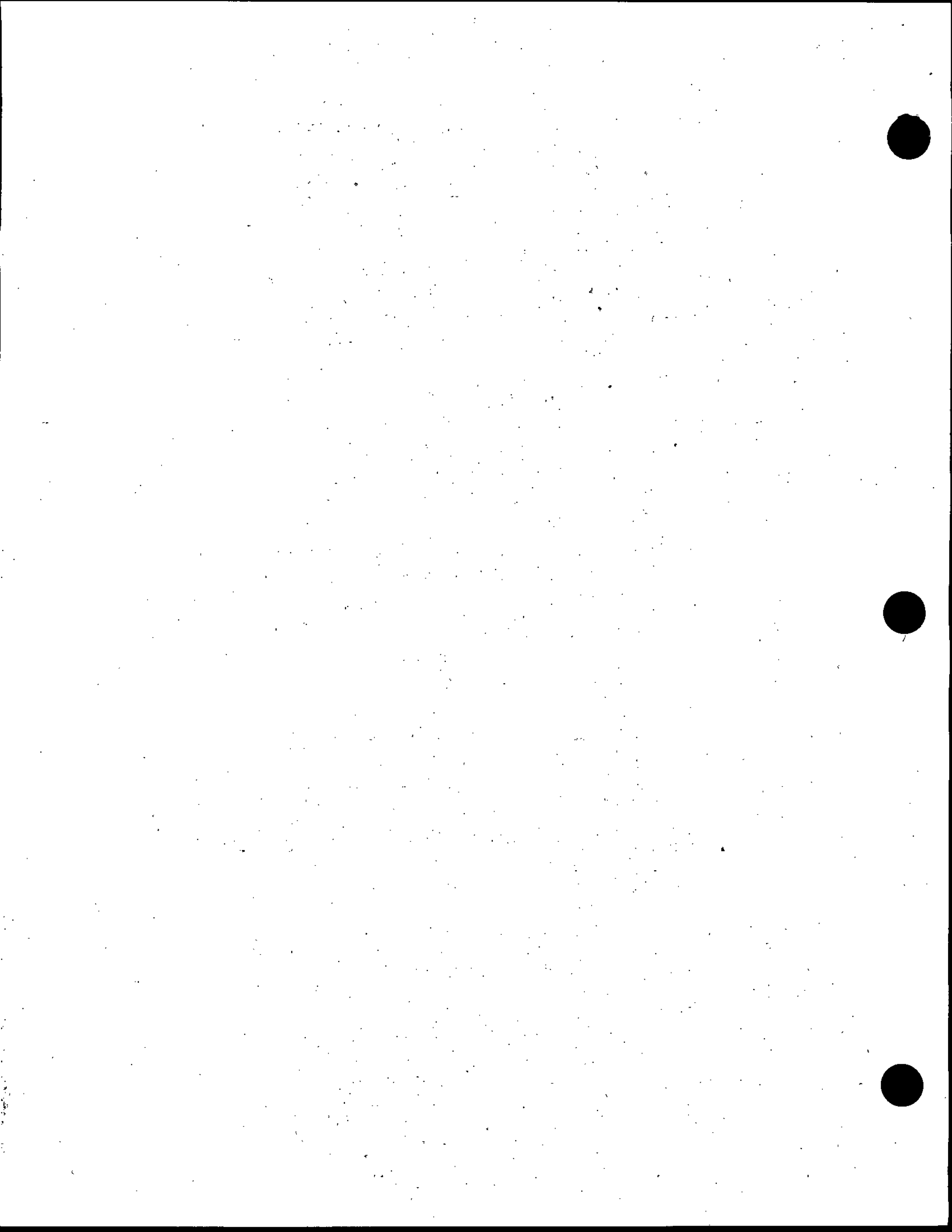
10-QSB for the period ended September 30, 2005, which reported a net loss of $297,775 for the prior nine months. As of October 24, 2011, the common stock of ASAP was quoted on OTC Link, had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

2. Aero Performance Products, Inc. ("AERP") (CIK No. 1160598) is a revoked Nevada corporation located in Bluffdale, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AERP 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, 2009, which reported a net loss of $512,201 for the prior nine months. On September 29, 2008, AERP consented to the entry of an order that it cease and desist from committing or causing any violations and any future violations of Sections 17(g), 18(a), 18(d) and 18(i) of the Investment Company Act of 1940 and Rule 17g-1 thereunder, and also permanently suspending its exemption under Regulation E under the Investment Company Act of 1940. *Aero Performance Products, Inc.*, Admin. Proc. File No. 3-13259 (Sept. 29, 2008). As of October 24, 2011, the common stock of AERP 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. Apex Resources Group, Inc. ("APXR") (CIK No. 742248) is a Utah corporation located in Butte, Montana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). APXR 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 $415,992 for the prior nine months. As of October 24, 2011, the common stock of APXR 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. Aradyme Corp. ("ADYE") (CIK No. 1123580) is an expired Utah corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ADYE 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, 2007, which reported a net loss of $625,548 for the prior nine months. As of April 19, 2011, the common stock of ADYE 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. Bancroft Uranium, Inc. ("BCFT") (CIK No. 1170103) is a revoked Nevada corporation located in Scottsdale, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BCFT 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 $5,761,583 for the prior nine months. As of October 24, 2011, the common stock of BCFT 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. Fightersoft Multimedia Corp. ("FTMC") (CIK No. 1343557) 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). FTMC 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 August 31, 2008, which reported a net loss of $23,230 for the prior six months. As of October 24, 2011, the common stock of FTMC was quoted on OTC Link, had three market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

7. Fortress Financial Group, Inc. ("FFGO") (CIK No. 802206) is a Wyoming corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FFGO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2005, which reported a net loss of $1,757,919 for the prior nine months. As of October 24, 2011, the common shares of FFGO were quoted on OTC Link, had eight market makers, and were eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

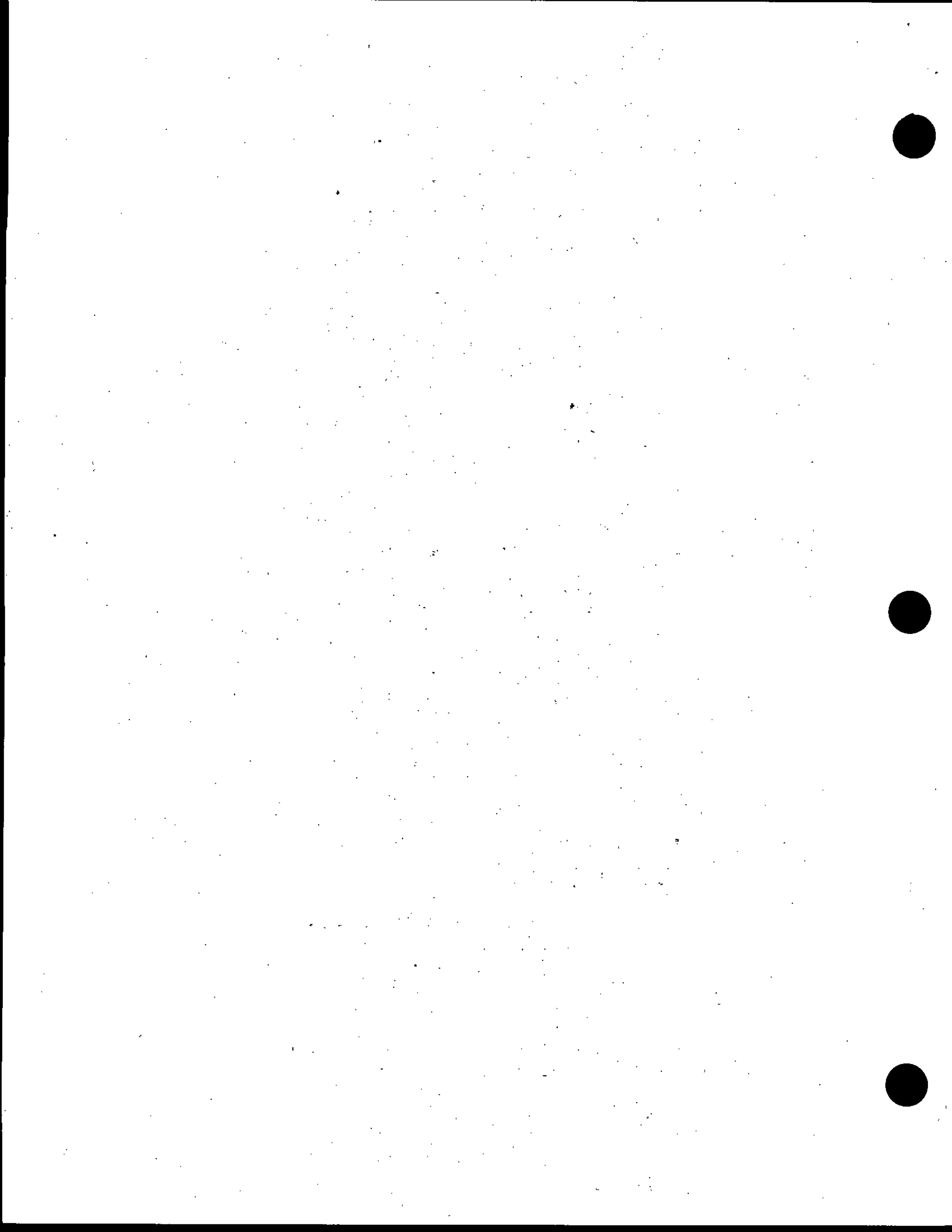
8. Global Aircraft Solutions, Inc. ("GACFQ") (CIK No. 854171) is a defaulted Nevada corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GACFQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $7,381,683 for the prior nine months. On January 30, 2009, GACFQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Arizona, which was still pending as of October 24, 2011. As of October 24, 2011, the common stock of GACFQ was quoted on OTC Link, had nine market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

9. 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.

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.

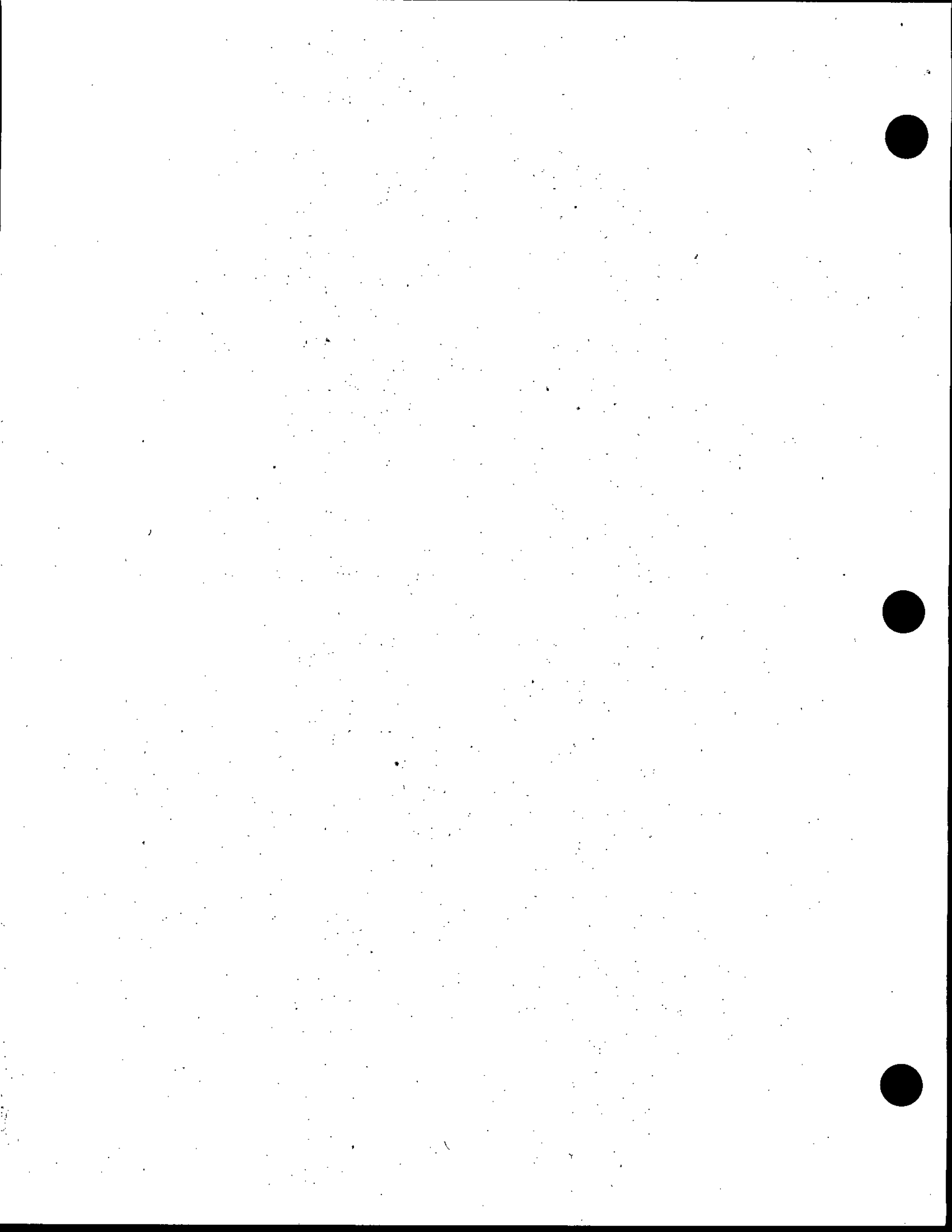
IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules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



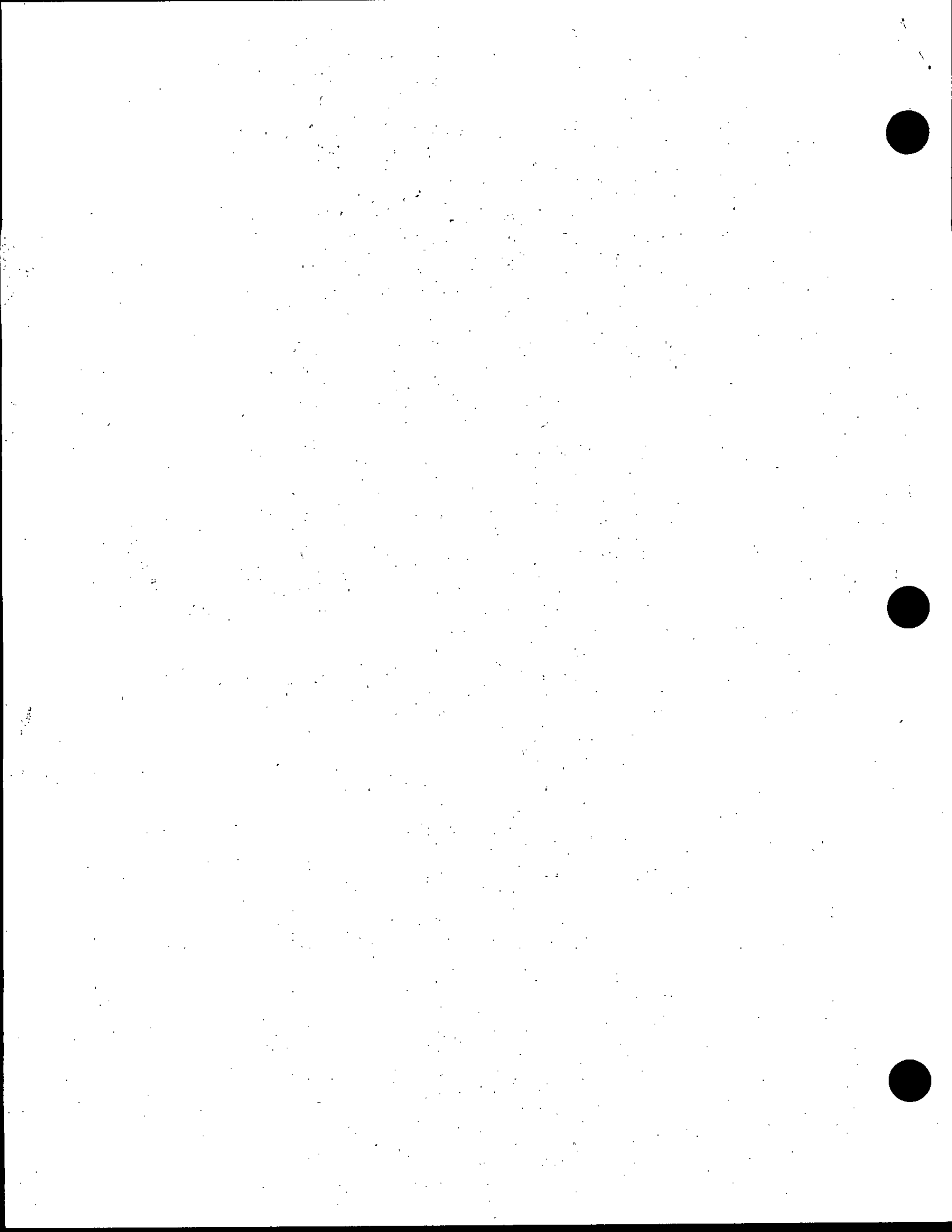
In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in 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
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 27, 2011

In the Matter of **Accesspoint Corp.,** **Aero Performance Products, Inc.,** **Apex Resources Group, Inc.,** **Aradyme Corp.,** **Bancroft Uranium, Inc.,** **Fightersoft Multimedia Corp.,** **Fortress Financial Group, Inc., and** **Global Aircraft Solutions, 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 Accesspoint Corp. because it has not filed any periodic reports since the period ended September 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Aero Performance Products, Inc. because it has not filed any periodic reports since the period ended March 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Apex Resources 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 Aradyme Corp. 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 Bancroft Uranium, 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 Fightersoft Multimedia Corp. because it has not filed any periodic reports since the period ended August 31, 2008.

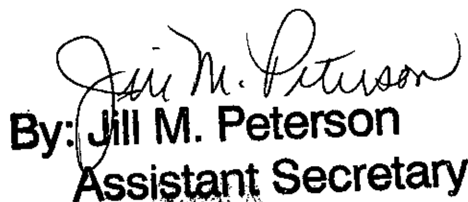
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Fortress Financial Group, Inc. because it has not filed any periodic reports since the period ended September 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Global Aircraft Solutions, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

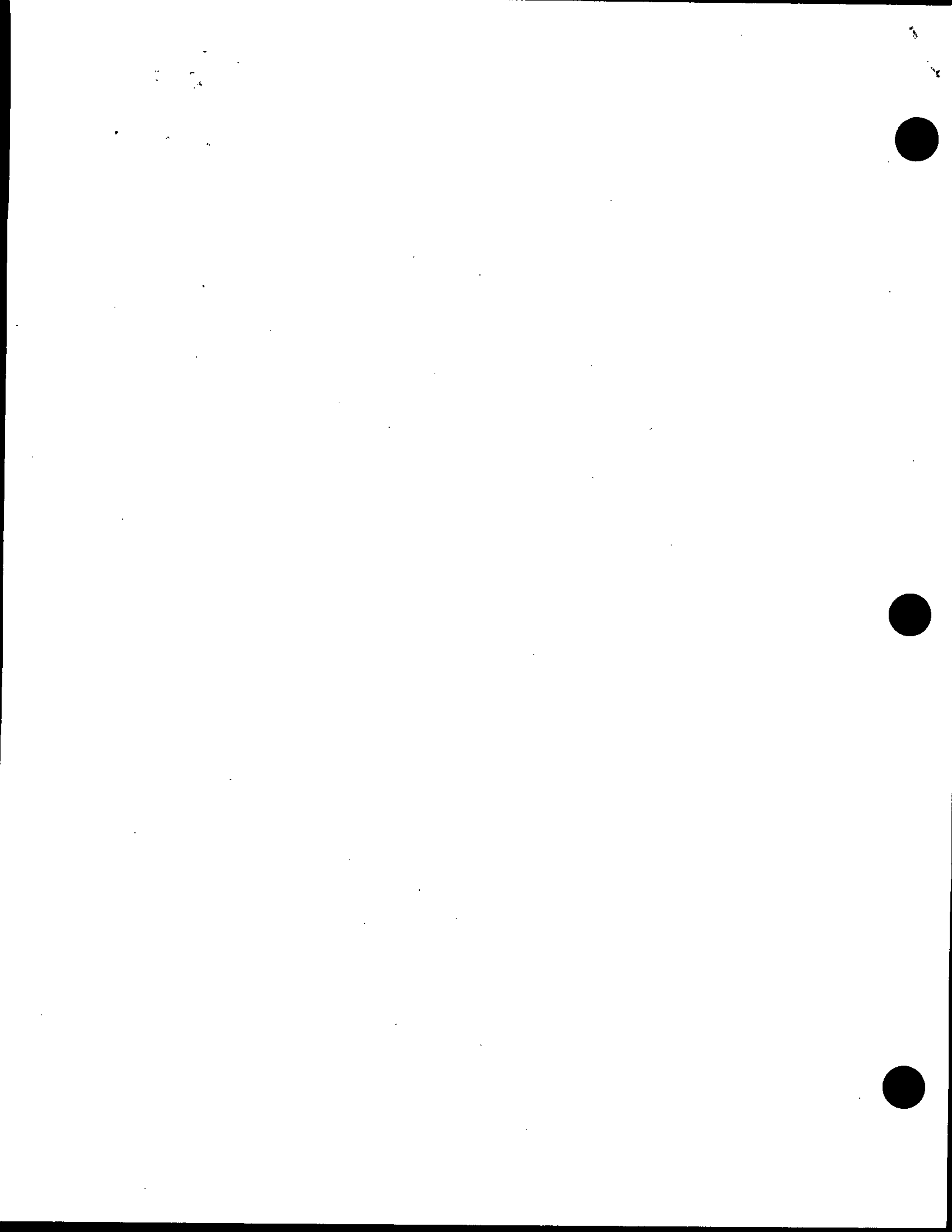
The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on October 27, 2011, through 11:59 p.m. EST on November 9, 2011.

By the Commission.

Elizabeth M. Murphy
Secretary



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 **October 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:

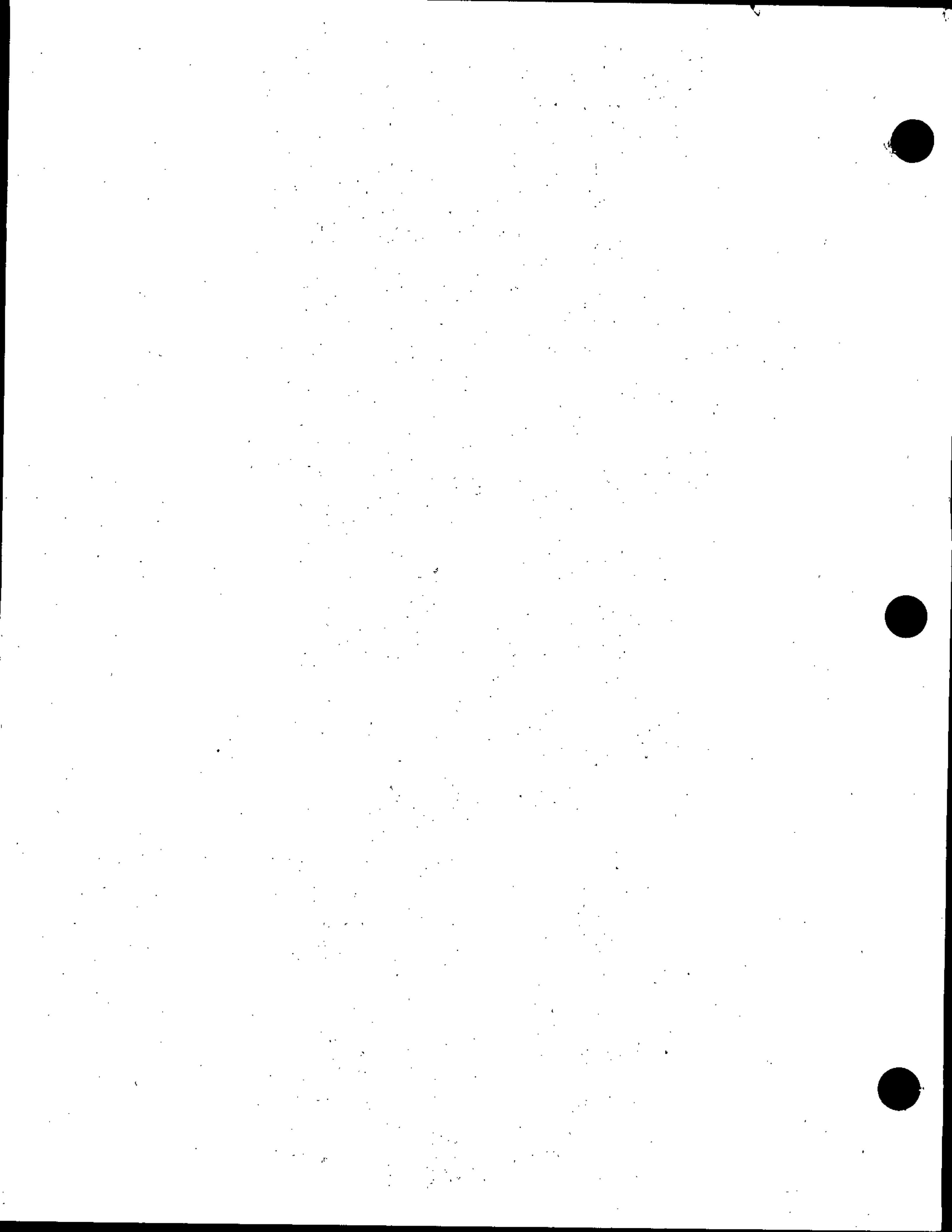
MARY L. SCHAPIRO, CHAIRMAN

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

(49 Documents)



UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65466 / October 3, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3325 / October 3, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14575

In the Matter of **THOMAS Y. JIMENEZ (CPA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

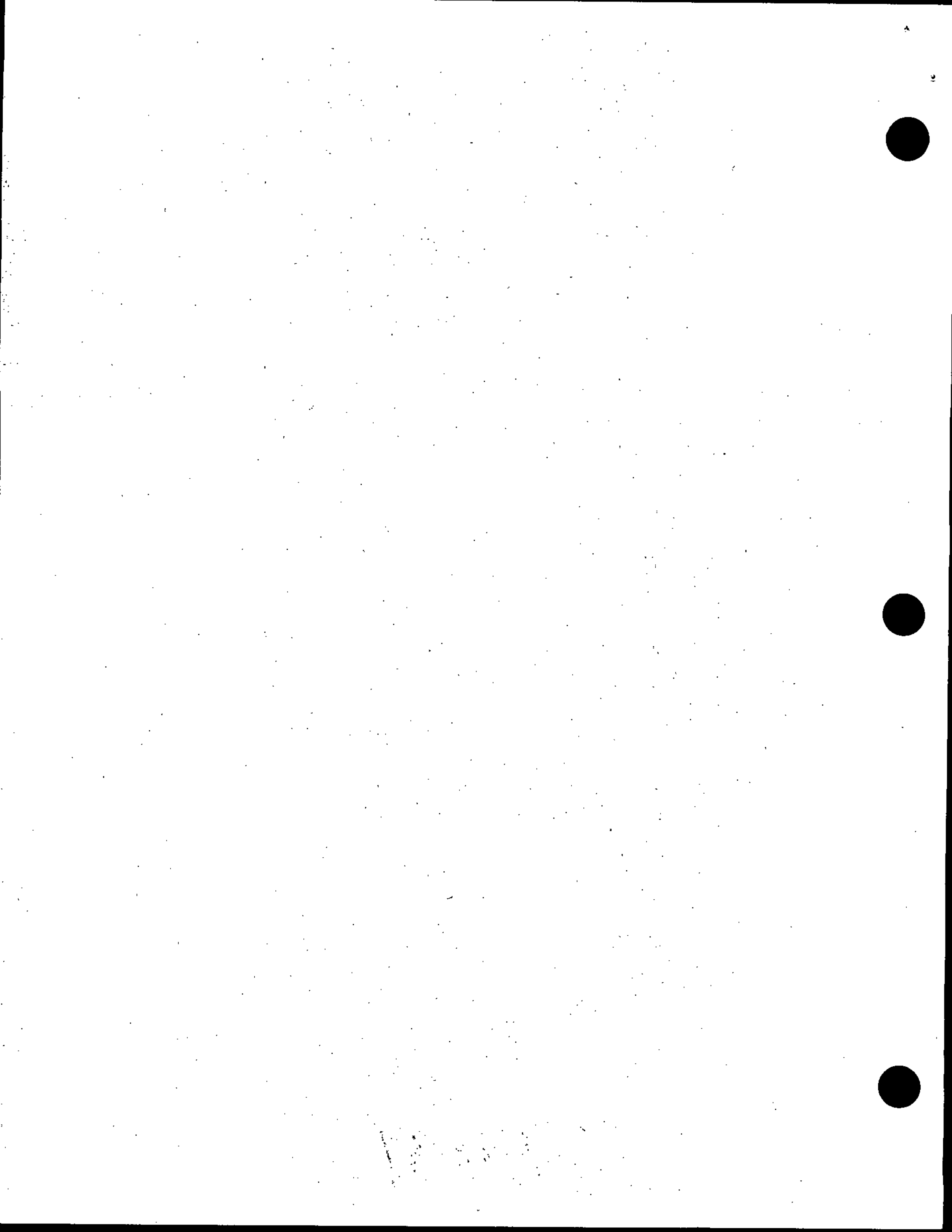
The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Thomas Y. Jimenez ("Respondent" or "Jimenez") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

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

[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.



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

III.

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

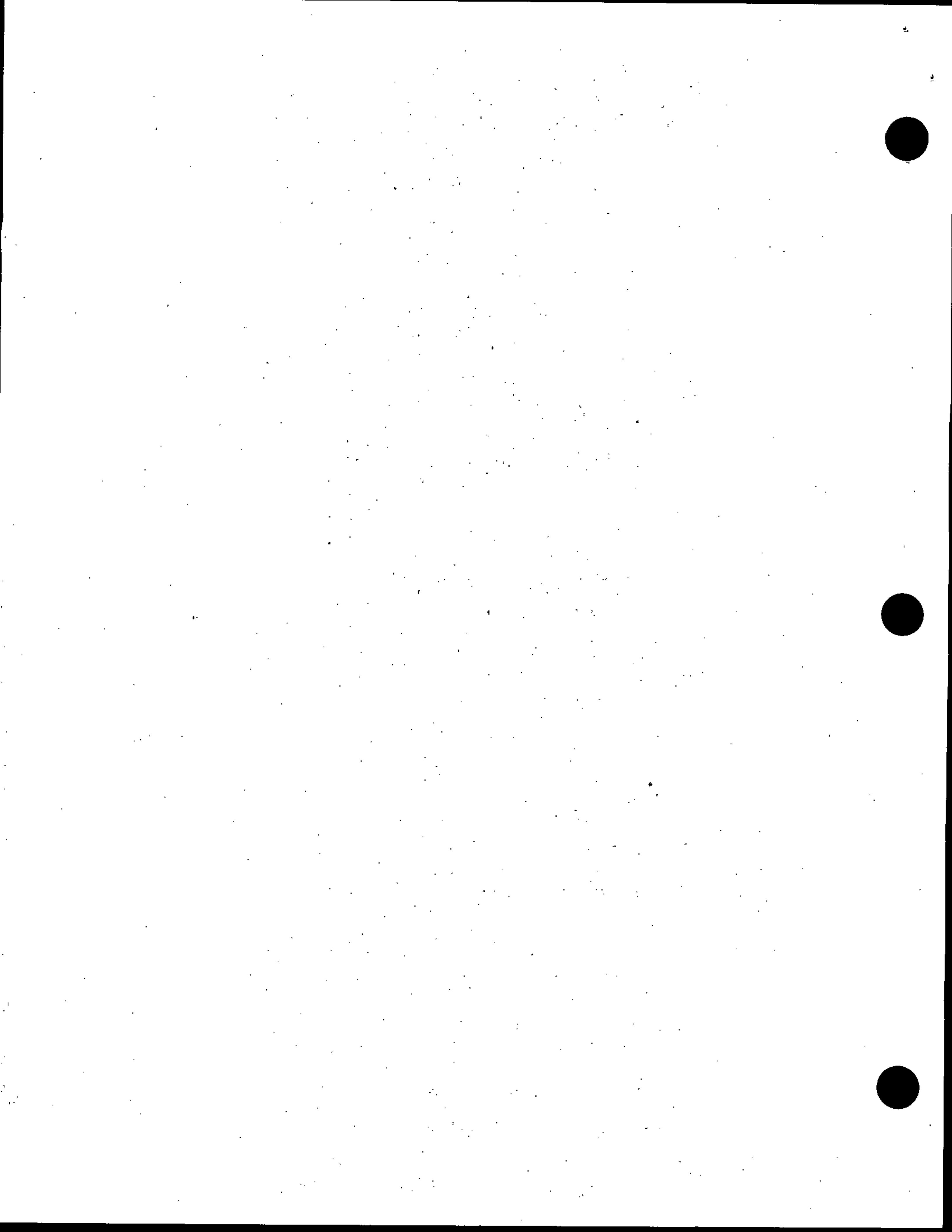
1. Thomas Y. Jimenez ("Jimenez") was chief financial officer of GlobeTel Communications Corp. and its predecessor from October 1999 until April 2006, when he retired. Jimenez is a CPA currently licensed in New York State, although the license has lapsed. Jimenez, 49, is a resident of Broward County, Florida.

2. GlobeTel Communications Corp. ("GlobeTel") was a Delaware corporation with securities registered pursuant to Sections 12(b) or 12(g) and with a headquarters in Pembroke Pines, Florida during the relevant time period.

3. On May 1, 2008, the Commission filed a complaint against Jimenez in the civil action now entitled Securities and Exchange Commission v. GlobeTel Communications, et al., Civil Action 08-cv-60646. On November 12, 2008, the Court consolidated that civil action into Civil Action 07-cv-61693. On March 24, 2009, the Court granted the Commission's motion to amend and filed a First Amended Complaint in that consolidated action. On June 5, 2009, the Commission filed a Second Amended Complaint.

4. On March 19, 2010, the Court entered a judgment by consent against Jimenez, that permanently enjoined him from future violations of the securities laws, including Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and that imposed an officer and director bar.

5. The Commission's First Amended Complaint and Second Amended Complaint alleged that Jimenez created millions of dollars in false invoices in 2002-04 and knew or should have known that other GlobeTel agents and officers were creating millions of dollars in false invoices in 2004-06. The complaints allege that Jimenez approved or caused entries in GlobeTel's financial records based on those invoices resulting in GlobeTel reporting, *inter alia*, materially false revenue in filings from at least November 2002 through December 2007. They also allege that, from about September 2004 until March 2006, Jimenez made or approved entries in GlobeTel's general ledger that eliminated the accounts receivable and liabilities caused by the false invoices even though there was no basis for making the entries and the entries were inconsistent with generally accepted accounting principles.



IV.

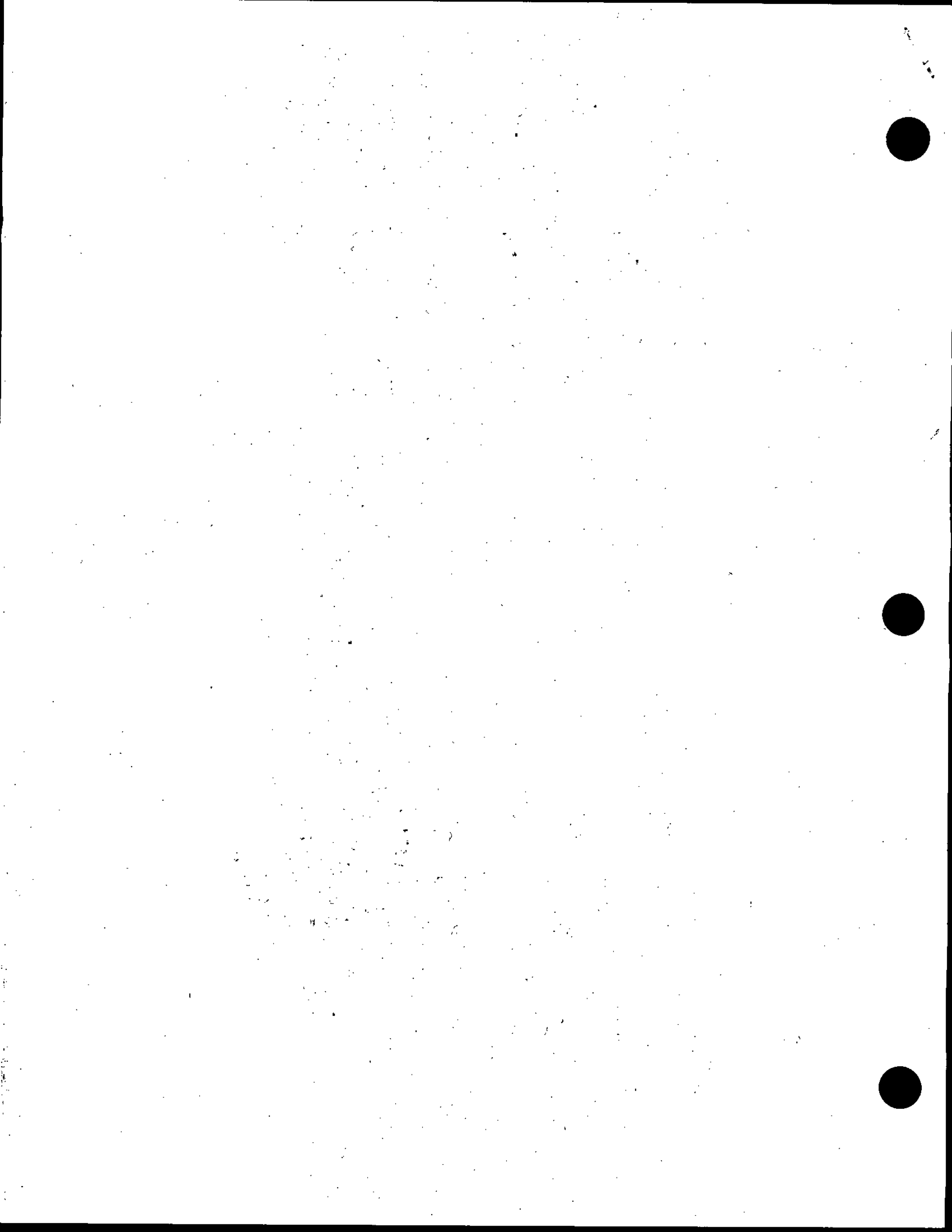
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Jimenez's Offer.

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

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary



Commissioner Walter
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3298 / October 5, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14577

In the Matter of

STEVEN FORTUNA,

Respondent.

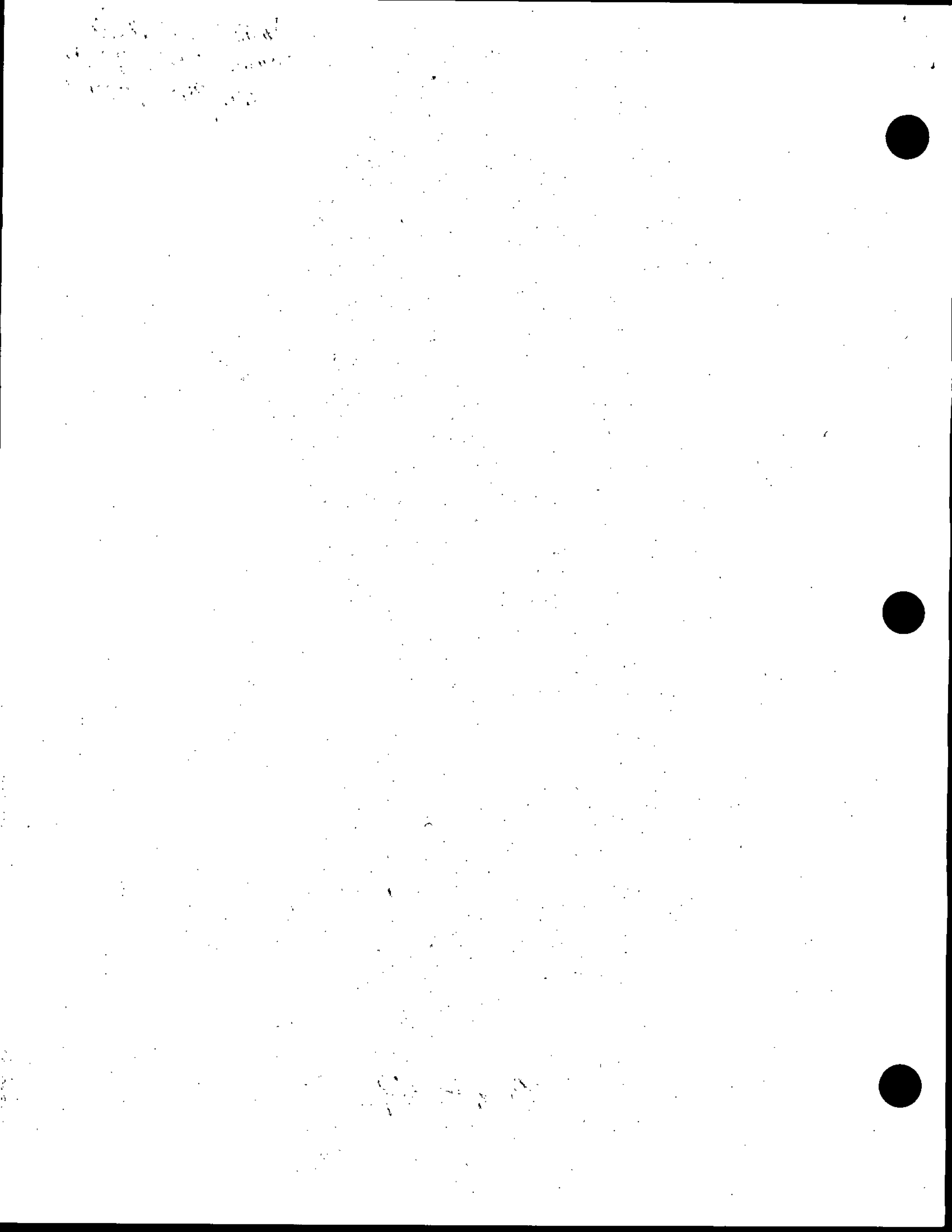
ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

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 Steven Fortuna ("Fortuna" 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:

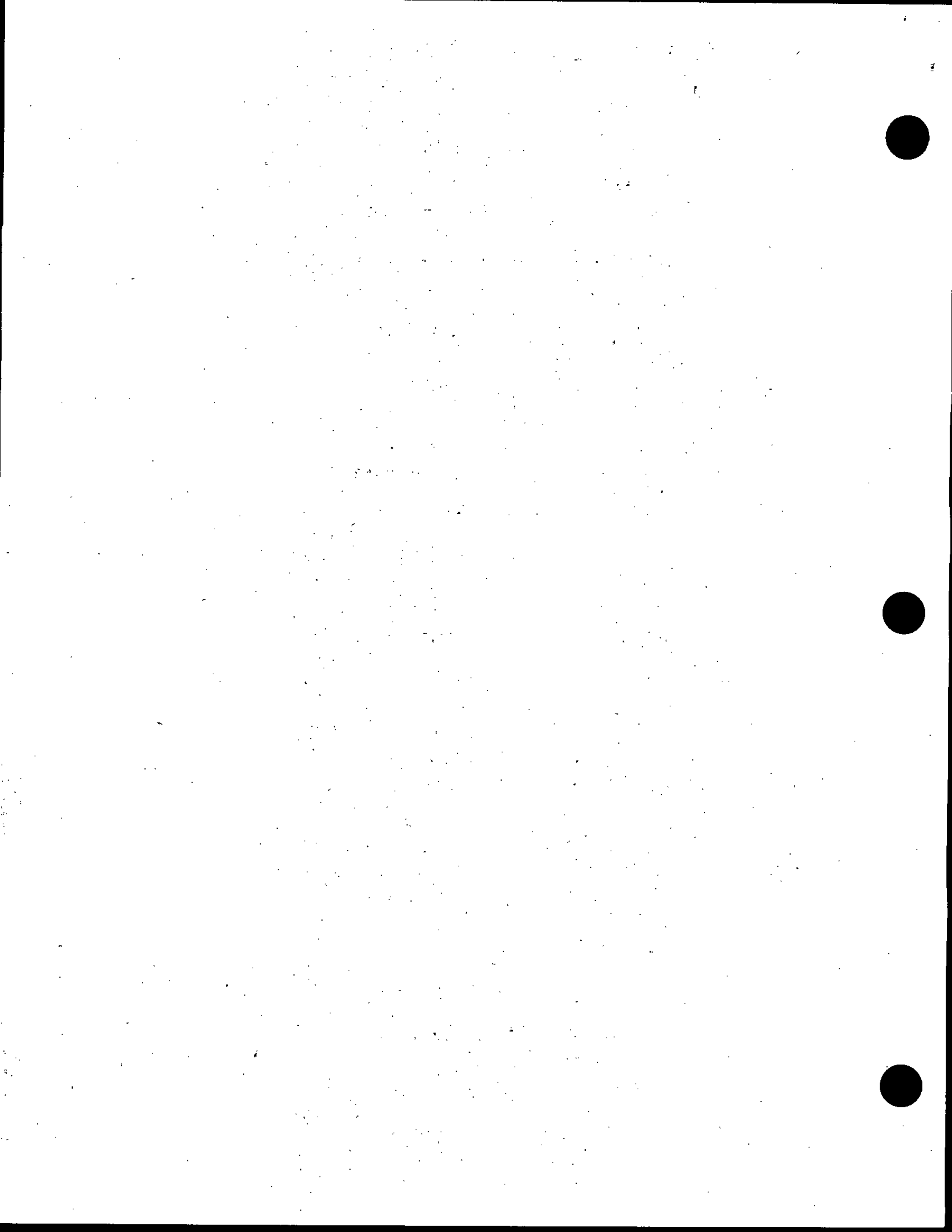
1. Fortuna is a resident of Westwood, Massachusetts. Fortuna is a co-founder and principal of S2 Capital Management, LP ("S2 Capital"), which was an unregistered, New York based hedge fund investment adviser. Prior to starting S2 Capital, Fortuna was a portfolio manager at Stratix Asset Management. S2 Capital served as the investment adviser to the hedge fund S2 Capital Fund, LP. Fortuna has held Series 7, 63, 86 and 87 licenses.

2. On November 5, 2009, the Commission filed an Amended Complaint in the civil action SEC v. Galleon Management, LP, et al., Civil Action No. 1:09-CV-8811 (SDNY), naming Fortuna as a defendant. On September 30, 2011, the Court entered an order permanently enjoining Fortuna, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleged that, in connection with the purchase, offer or sale of securities, Fortuna knew, recklessly disregarded, or should have known, that the 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 Fortuna is liable for the trading that occurred in S2 Capital funds because he effectuated trades on behalf of S2 Capital, controlled S2 Capital and/or unlawfully tipped inside information to S2 Capital.

4. On October 20, 2009, Fortuna pled guilty to one count of securities fraud and three counts 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. Steven Fortuna, 10-CR-01003 (SDNY).

5. The counts of the criminal information to which Fortuna pled guilty alleged, inter alia, that Fortuna, 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 Fortuna's Offer.

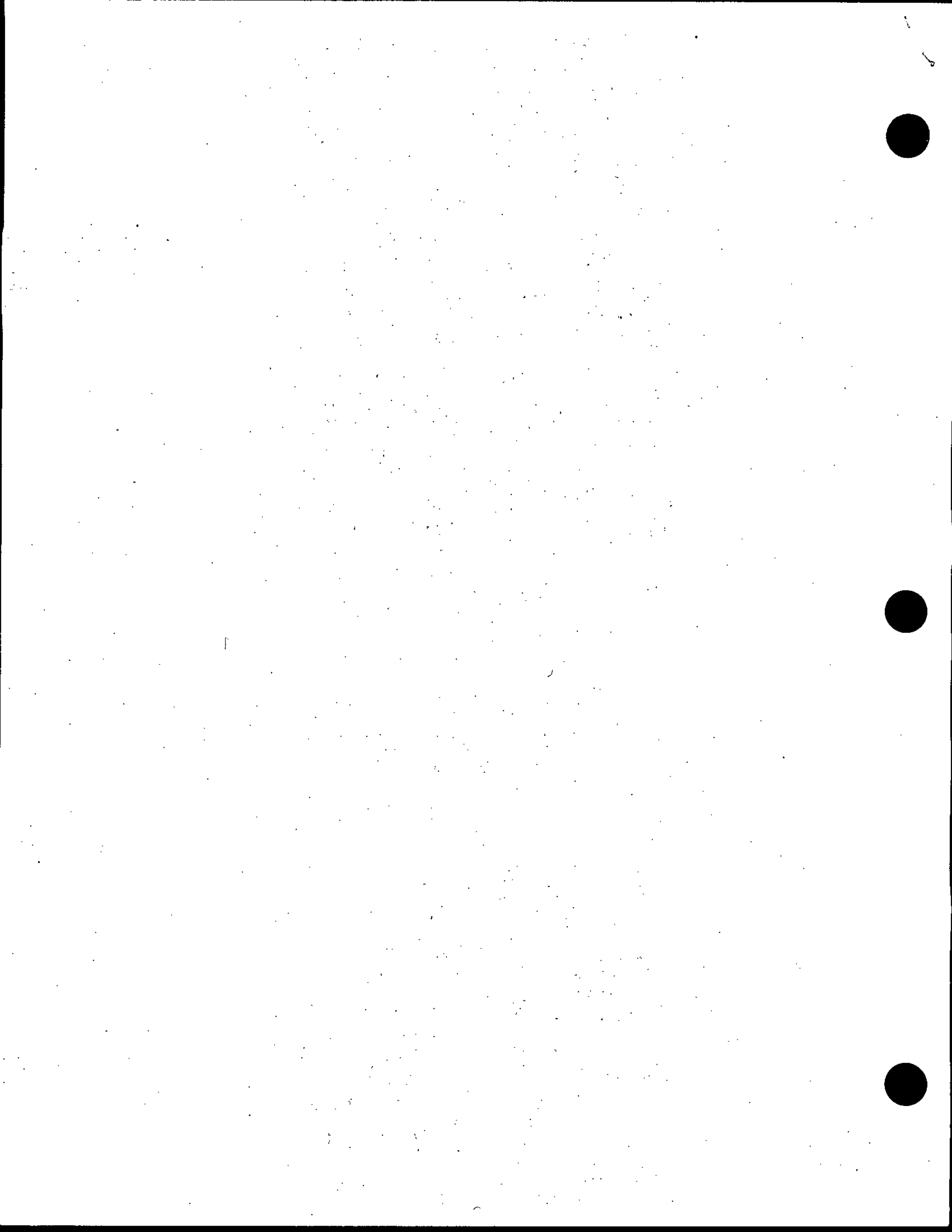
Accordingly, it is hereby ORDERED:

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

Elizbeth M. Murphy
Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65490 / October 6, 2011

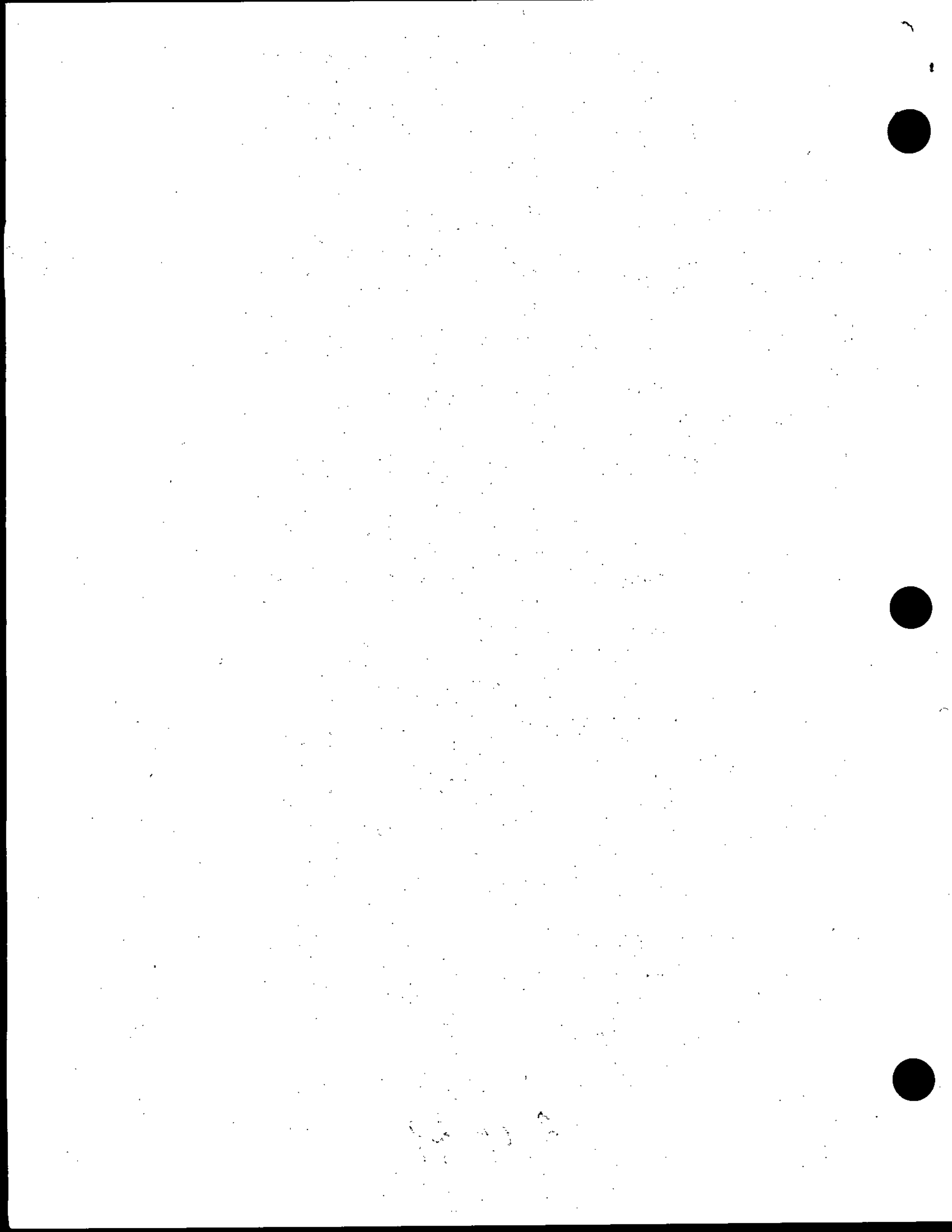
ADMINISTRATIVE PROCEEDING
File No. 3-12868

In the Matter of PacketPort.com, Inc., Ronald Durando, MicrophaseCorp., Robert H. Jaffe, Gustave Dotoli, M. Christopher Agarwal, and Theodore Kunzog Respondents.	NOTICE OF PROPOSED PLAN OF DISTRIBUTION AND OPPORTUNITY FOR COMMENT

Notice is hereby given, pursuant to Rule 1103 of the Securities and Exchange Commission's ("Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103, that the Division of Enforcement has filed with the Commission the proposed plan ("Distribution Plan") for the distribution of monies in this matter. On October 18, 2007, the Commission issued an Order Instituting Cease and Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 against PacketPort.com, Inc., Ronald Durando, Microphase Corp., Robert H. Jaffe, Gustave Dotoli, M. Christopher Agarwal, and Theodore Kunzog (collectively "Respondents") for violating the registration, disclosure, and anti-touting provisions of the federal securities laws in this matter (Securities Act Rel. No. 8858).

OPPORTUNITY FOR COMMENT

Pursuant to this Notice, all interested parties are advised that they may obtain a copy of the Distribution Plan from the Commission's public website, http://www.sec.gov, or by submitting a written request to Nichola L. Timmons, Assistant Chief Litigation Counsel, United States Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5631. Further, all persons desiring to comment on the Distribution Plan may submit their comments, in writing, within 30 days of the date of this Notice:



1. to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090;

2. by using the Commission's Internet comment form (http://www.sec.gov/litigation/admin.shtml); or

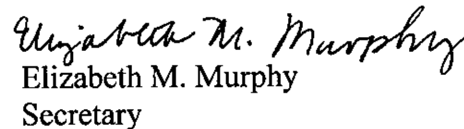
3. by sending an e-mail to rule-comments@sec.gov.

Comments submitted by e-mail or via the Commission's website should include "Administrative Proceeding File Number 3-12868" in the subject line. Comments received will be available to the public. Persons should only submit information that they wish to make publicly available.

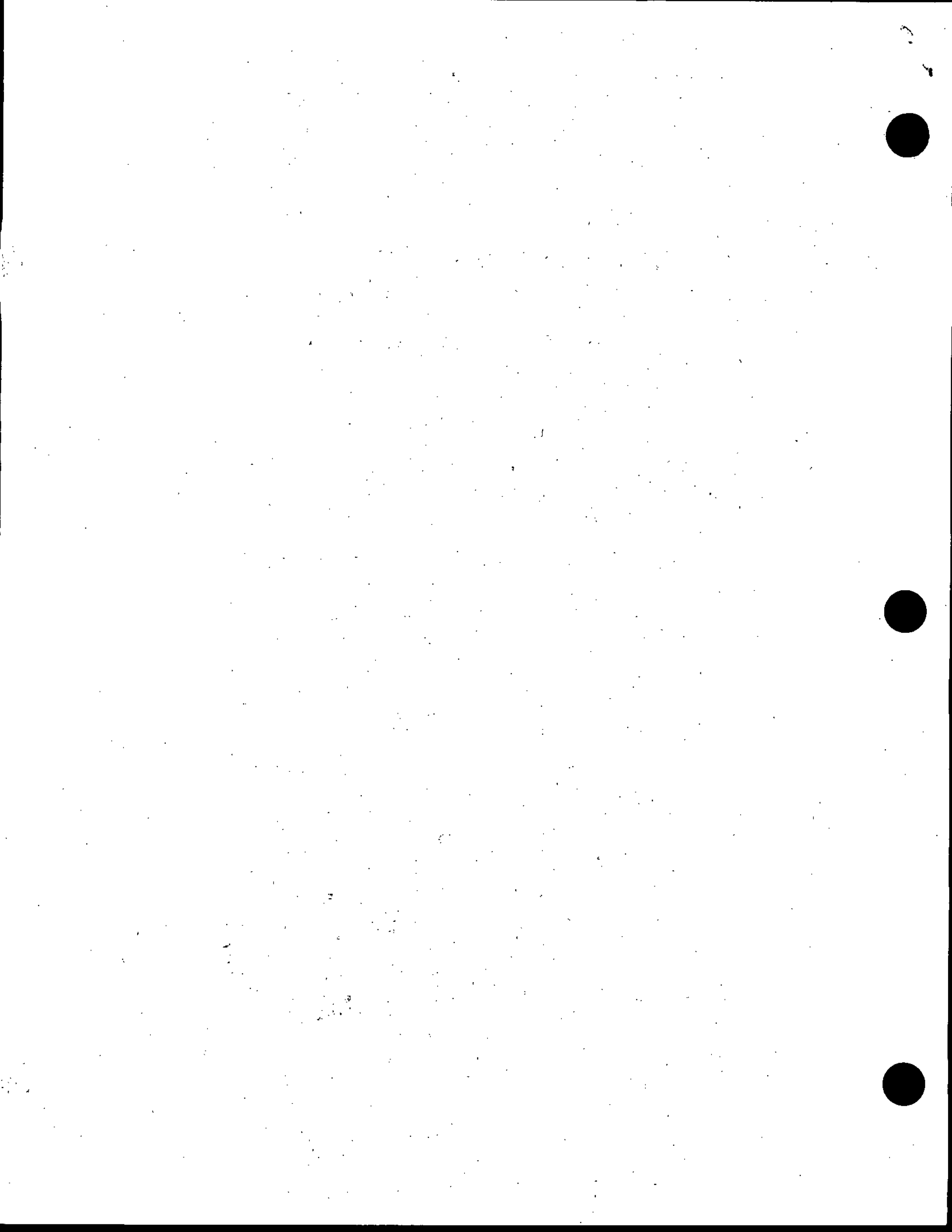
THE DISTRIBUTION PLAN

The Distribution Plan provides for distribution of $1,075,000.00 in disgorgement paid by Respondents, plus any accumulated interest, less fees, expenses and any federal, state, or local taxes on the interest. The proposed distribution plan will allocate monies on a pro rata basis to investors who purchased shares of PacketPort.com stock from December 13, 1999 through April 11, 2000 and who incurred more than de minimis losses as calculated by the Fund Administrator.

By the Commission.



Elizabeth M. Murphy
Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65498 / October 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-12868

In the Matter of PacketPort.com, Inc., Ronald Durando, MicrophaseCorp., Robert H. Jaffe, Gustave Dotoli, M. Christopher Agarwal, and Theodore Kunzog Respondents.	ORDER APPOINTING A FUND ADMINISTRATOR AND APPROVING ADMINISTRATOR BOND

On October 18, 2007, the Commission issued an Order Instituting Cease and Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 against PacketPort.com, Inc., Ronald Durando, Microphase Corp., Robert H. Jaffe, Gustave Dotoli, M. Christopher Agarwal, and Theodore Kunzog (collectively "Respondents") for violating the registration, disclosure, and anti-touting provisions of the federal securities laws in this matter (Securities Act Rel. No. 8858). The Order provided for the payment of disgorgement in the amount of $150,000 by Ronald Durando, $700,000 by Microphase Corp., $125,000 by Robert H. Jaffe, and $100,000 by Gustave Dotoli, totaling $1,075,000. Respondents have paid $1,075,000 to the Commission comprising the Disgorgement Fund, which will be distributed to investors harmed by the Respondents' conduct.

The Distribution Plan proposes Rust Consulting, Inc. ("Rust Consulting") as the Fund Administrator, and sets forth, among other things, procedures for distributing funds from the Disgorgement Fund to investors; procedures for the administration of the Disgorgement Fund, including provisions for filing tax returns; and a proposed timeframe for the termination of the Disgorgement Fund.

Rule 1105(c) of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1105(c), requires the administrator of a plan to post a bond. Specifically, Rule 1105(c) states, "If the administrator is not a Commission employee, the administrator shall be required to obtain a bond in the manner prescribed in 11 U.S.C. §322, in an amount to be

approved by the Commission." In accordance with Rule 1105(c), Rust Consulting will obtain a bond in the amount of $1,075,000, the full amount ordered to be paid by Respondents.

The Division of Enforcement requests that the Commission appoint Rust Consulting as the Fund Administrator, and approve the Fund Administrator's bond requirement.

Accordingly, pursuant to Rules 1105(a) and (c) of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1105, IT IS HEREBY ORDERED that Rust Consulting is appointed as the Fund Administrator and that the bond requirement of the Fund Administrator is approved.

By the Commission.

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9265 / October 6, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65501 / October 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14578

In the Matter of

HANSEN MEDICAL, INC.,

Respondent.

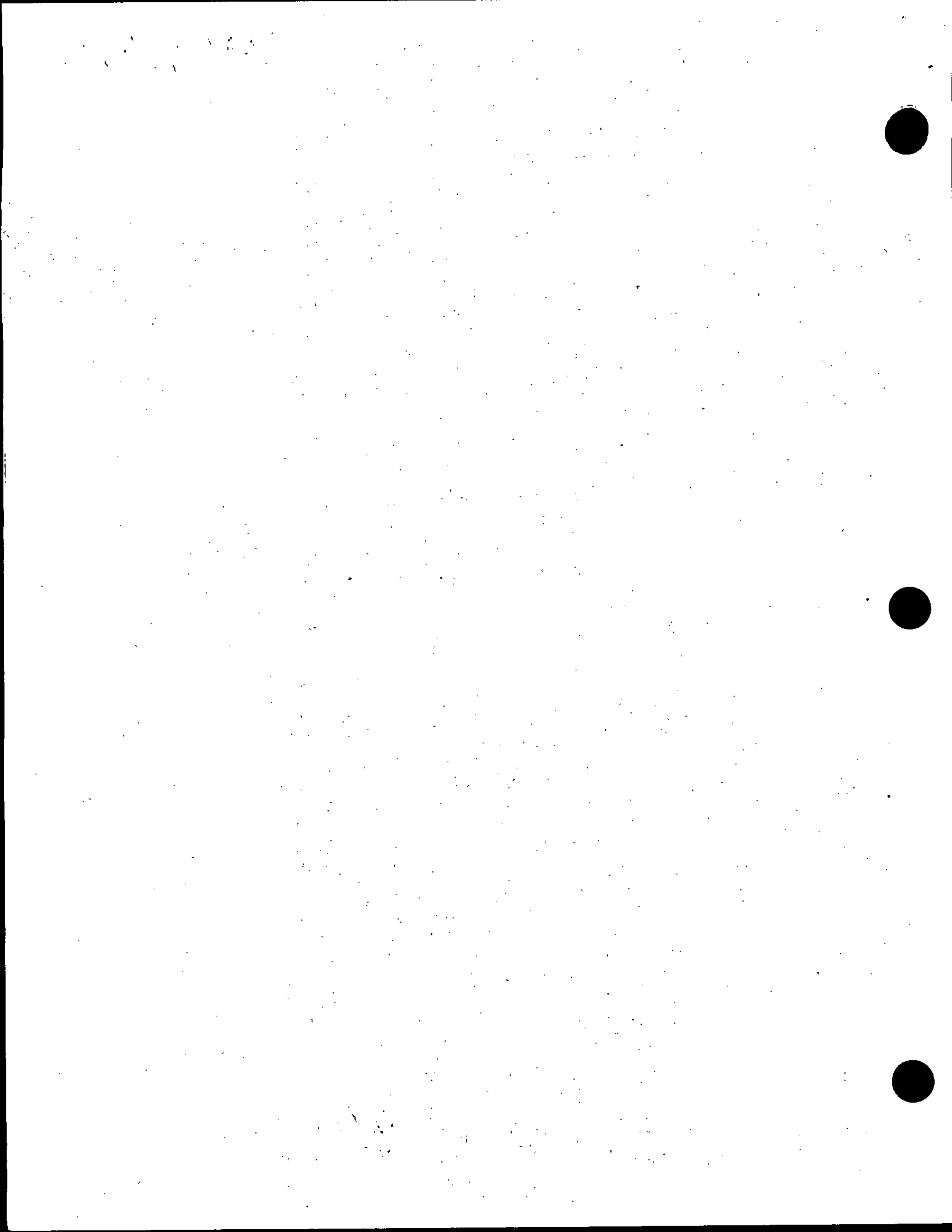
ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Hansen Medical, Inc. ("Hansen" 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 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.



III.

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

Summary

1. This matter involves false financial reporting and related violations of the federal securities laws by Hansen Medical, Inc., a medical equipment company based in Mountain View, California. On four separate occasions in 2008 and 2009, Hansen's top sales executives were involved in fraudulent sales transactions, causing the company to report quarterly revenue to investors that had been improperly and materially overstated.

2. Under Generally Accepted Accounting Principles ("GAAP") and the company's own policies, Hansen could recognize revenue only when a sale was complete – which, for most transactions, meant that the company's complex medical equipment had been installed in the hospital and training had been provided to at least one physician who would be operating it. Facing intense pressure to make sales and facilitate Hansen's ability to raise capital from investors, these sales executives engaged in myriad tricks to make it falsely appear that sales had been completed. For example, on multiple occasions, Hansen personnel "installed" the equipment at the customer site before the customer was ready for it, and then, unbeknownst to company finance personnel and auditors, immediately dismantled the equipment and put it in storage until months later. In another instance, when the required training could not be provided to a customer's physicians by quarter end, Hansen personnel forged a doctor's signature and provided the falsified training form to the company's finance personnel to allow revenue recognition.

3. In August 2009, one of the fraudulent transactions was brought to light by an anonymous whistleblower. On November 19, 2009, following an internal investigation, Hansen announced the filing of restated financial results for the years ended December 31, 2007 and 2008, and the first two quarters of fiscal year 2009.

Respondent

4. **Hansen Medical, Inc.** is a medical equipment company incorporated in Delaware and headquartered in Mountain View, California. Hansen's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the NASDAQ Global Market under the ticker symbol HNSN.

---

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

Facts

A. Background

5. Hansen was founded in 2002, and had its Initial Public Offering of stock in 2006. In May 2007, Hansen received Food and Drug Administration approval for its product, a complex piece of medical equipment, known as the Sensei Robotic Catheter System ("Sensei system"), sold primarily to hospitals for use in cardiac surgical procedures. Hansen recognized revenue on its first domestic Sensei system in June 2007.

6. From 2007 through at least November 2009, Hansen based its revenue recognition policy on American Institute of Certified Public Accountants, Statement of Position 97-2, *Software Revenue Recognition* (hereafter "SOP 97-2"), because Hansen determined that software was more than incidental to the functioning of its Sensei system. Under Hansen's policy, in order to recognize revenue on certain types of transactions, the Sensei system had to be delivered to the customer, installed (usually at the customer site), and at least one physician had to be trained to use the Sensei system. As the installation and training services were not deemed to be perfunctory, Hansen's revenue recognition policy for these transactions was to defer the entire amount of the revenue on its Sensei sales until Hansen had completed both physician training and installation for its customers.

7. Most of Hansen's sales contracts for Sensei systems required Hansen to install the systems at the customer site, which could take up to two days' time due to the complexity of the equipment and the battery of tests that Hansen would run to ensure the systems were in good working order. In addition, most of Hansen's sales contracts required the company to provide training to at least one physician who intended to use the Sensei system, which included having the physician travel to Hansen facilities in either Mountain View, California or Cleveland, Ohio.

8. As evidence that installation had been completed, Hansen's field services group, which was responsible for installing Sensei systems at a customer site, would submit to Hansen's finance department an installation completion form that was signed by the Hansen installer and a representative from Hansen's customer. As evidence that physician training had been completed, Hansen's clinical group, which was responsible for conducting physician training, would submit to Hansen's finance department a training acknowledgment form signed by the Hansen trainer and the physician. These completed forms were included in the revenue recognition files that were reviewed by Hansen's finance group and the company's outside auditors to allow them to determine whether and when Hansen could recognize revenue on particular sales transactions.

9. In June 2008, Hansen created a new officer-level position and hired a new Senior Vice President of Commercial Operations who was responsible for overseeing Hansen's sales organization as well as Hansen's field services group and clinical group.

B. Hansen Reported Materially Inflated Revenue In Its Financial Statements for the Third Quarter of 2008 Due To Incomplete Delivery of Its Product

10. In September 2008, Hansen was engaged in negotiations with a customer hospital (hereinafter "Hospital A") to sell the hospital a Sensei system. On September 15, 2008, Hospital A agreed to pay Hansen $700,000 to acquire a Sensei system. Per Hansen's revenue recognition policy, Hansen had to complete several requirements, including installation of the Sensei system at Hospital A, before Hansen could recognize revenue on the sale.

11. The terms of the contract between Hospital A and Hansen required that delivery and installation be completed by the end of September 2008. On September 18, 2008, Hospital A informed Hansen that it needed time to prepare its lab for the equipment, that it was overwhelmed with installations and that it had to prioritize its delivery schedules. Therefore, Hospital A requested that Hansen delay installation of the Sensei system by four months, which was well past the end of Hansen's third quarter 2008. Hansen sales executives, however, including Hansen's Senior Vice President of Commercial Operations and Hansen's Vice President of Sales, wanted to have the system installed by September 30, 2008 so that Hansen could recognize revenue on the sale in that quarter.

12. On or about September 19, 2008, Hansen sales executives, including the Senior Vice President of Commercial Operations and Hansen's Vice President of Sales, participated in a conference call with Hospital A management. During the call, the Hansen sales executives pressured Hospital A to accept delivery of the system by September 30, 2008 even though the hospital's lab was under construction. To overcome the hospital's objections about taking the Sensei system before the lab was ready, Hansen sales executives agreed that Hansen's field services group would install the Sensei system before September 30, 2008, immediately de-install the system, place it into storage at the hospital, and come back months later when the lab was ready to re-install the system. Hansen personnel further agreed to absorb all of the costs associated with the re-installation of the Sensei system.

13. On September 26, 2008, Hansen personnel "installed" the Sensei system at Hospital A, but then immediately de-installed the system and placed it into storage at the hospital. Hansen recognized approximately $700,000 in revenue for the sale in the third quarter ended September 30, 2008. Under GAAP, it was inappropriate for Hansen to recognize revenue on the transaction in the third quarter of 2008 because Hansen's delivery of the product was temporary and was nothing more than form over substance. As of September 30, 2008, Hansen still had outstanding obligations to the hospital to re-install the equipment at a later date at Hansen's cost.

14. On November 5, 2008, Hansen filed with the Commission its Form 10-Q for the quarter ended September 30, 2008. The financial statements included in Hansen's Form 10-Q improperly reported $700,000 in revenue from the sale to Hospital A. As a result, Hansen reported materially inflated product revenue in its financial statements.

15. Neither Hansen's finance personnel, who were responsible for making determinations about revenue recognition on the sale, nor Hansen's outside auditors knew that Hansen had further obligations to re-install the equipment at Hansen's cost on a future date. In the

spring of 2009, months after Hansen recognized revenue on the sale, Hansen personnel completed Hansen's delivery obligations by re-installing the Sensei system at Hansen's expense at Hospital A.

C. Hansen Reported Materially Inflated Revenue In Its Financial Statements for the Fourth Quarter of 2008 Due to Two Improper Sales Transactions Totaling More Than $1.3 Million

i. Hansen's Financing Efforts

16. In December 2008 and through Hansen's first quarter of 2009 ending March 31, 2009, Hansen was seeking investment funds to provide operating capital for the company. During this period, Hansen had an effective registration statement, filed with the Commission in March 2008, in which it was offering to sell up to $75,000,000 of newly-issued Hansen common stock. Hansen management, including Hansen's senior sales executives, believed that Hansen needed to show strong Sensei system sales to attract potential investors.

17. On December 19, 2008, less than two weeks before Hansen's 2008 fiscal year end, Hansen's Senior Vice President of Commercial Operations sent an email to the Hansen sales organization. In the message, he chastised his subordinates for creating a situation that is "not acceptable from a senior sales team." He noted that "this is a very important quarter with additional funding on the line for Hansen" and, therefore, "it is imperative that we find a way to finish in an acceptable manner." He then tallied up the potential transactions in the sales pipeline and threatened the team that "finish[ing] below 12 systems [sales]" would jeopardize the company's current funding efforts or require layoffs. He signed the email "Grumpy Santa." Two improper sales transactions described below followed shortly thereafter.

ii. Hansen Personnel Falsify Key Documents Required for Revenue Recognition in a December 2008 Sales Transaction

18. In the spring of 2008, a customer hospital (hereinafter "Hospital B") agreed to purchase a Sensei system for $660,000, but had to wait for certain approvals from the State of Connecticut before it could complete the purchase. Hansen's Senior Vice President of Commercial Operations was anxious to have the transaction with Hospital B close before the end of 2008 so that Hansen could report revenue from the sale. Thus, on December 24, 2008, one week before Hansen's fiscal year end, he threatened Hospital B with a price increase if the transaction did not close in 2008. On December 27, 2008, Hospital B informed Hansen's Senior Vice President of Commercial Operations that the State of Connecticut had supplied the necessary approvals to allow Hospital B to purchase the Sensei system.

19. As part of the sales contract with Hospital B, and in order to recognize revenue on the sale, Hansen was obligated to provide training on the Sensei system to at least one Hospital B physician who planned to use the equipment. Hansen was also obligated to install the system at Hospital B. Both training and installation were necessary to fulfill the "delivery" requirement under Hansen's revenue recognition policy. As of December 28, 2008, no Hospital B doctors had been trained on the Hansen equipment, and the lab in which Hospital B intended to use the Sensei system was not ready to accommodate the installation of the Sensei system. Hansen's senior sales

executives, including the Senior Vice President of Commercial Operations and the Vice President of Sales, were aware of the training and installation issues.

20. With only three business days left in Hansen's fourth quarter 2008, Hansen personnel were unable to schedule a training session for the Hospital B doctors that would occur before the end of December 2008, thereby allowing the company to recognize revenue on the transaction that quarter. To recognize revenue in the fourth quarter of 2008, despite the lack of required training, Hansen's Senior Vice President of Commercial Operations and Hansen's Vice President of Sales, devised a plan to falsify the training paperwork.

21. To that end, on December 30, 2008, one day before the end of Hansen's 2008 fiscal year, a Hansen clinical training employee emailed the Hospital B doctors requesting their signatures on required physician training forms, acknowledging they had been trained even though they had not. The Hansen employee promised that Hansen would provide the physicians with training sometime in 2009. Although the clinical training employee was concerned about possible patient safety issues with falsely certifying that a doctor had been trained on the Sensei system, senior Hansen sales executives directed the employee to make the request.

22. When the Hospital B doctors did not respond to the Hansen employee's email on December 30, Hansen personnel forged the signature of one of the Hospital B doctors on the training acknowledgement form. The form was then provided to Hansen personnel responsible for assembling Hansen's revenue recognition files. Thereafter, Hansen recognized $660,000 on the sale to Hospital B in its financial statements for the fourth quarter of 2008. At the time revenue was recognized, neither Hansen's finance department nor its outside auditors knew that the physician training form had been falsified. Under GAAP, and Hansen's revenue recognition policy, Hansen should not have recognized revenue on the sale as of December 31, 2008 because Hansen had not completed physician training.

23. In addition to the issues with the physician training form for Hospital B, Hansen also failed to complete installation of the Sensei system before the end of the fourth quarter 2008. Specifically, Hansen service personnel temporarily "installed" the Sensei system at Hospital B on December 31, 2008, the last day of Hansen's fiscal year, but within minutes of the installation, Hansen personnel began de-installing the system. It was then placed into storage because the lab in which Hospital B intended to use the Sensei system was not prepared for the installation of the equipment. Hansen sales executives had committed to re-install the Sensei system at a later date in 2009 at Hansen's expense when the lab in which Hospital B intended to use the system was ready. Under GAAP, it was inappropriate for Hansen to recognize revenue on the transaction in the fourth quarter of 2008 because Hansen's delivery of the product was temporary, like the third quarter 2008 Hospital A deal, and was nothing more than form over substance. As of December 31, 2008, Hansen still had outstanding obligations to the hospital to completely re-install the equipment at Hansen's cost. Neither Hansen's finance personnel, who were responsible for making determinations about revenue recognition on the sale, nor Hansen's outside auditors knew that Hansen had further obligations to re-install the equipment at Hansen's cost. Hansen ultimately re-installed the Sensei system in July 2009.

iii. A Hansen Executive Enters Into an Undisclosed Oral Side Agreement in a December 2008 Sales Transaction

24. In a second December 2008 transaction, a customer hospital (hereinafter "Hospital C") sought to purchase a Sensei system, but did not have sufficient funds. To complete the transaction by the end of 2008, Hansen's Senior Vice President of Commercial Operations negotiated with a third party leasing company to buy the system from Hansen and lease it to Hospital C. On December 22, 2008, the leasing company purchased a Sensei system from Hansen for $650,000, and then entered into a leasing arrangement with Hospital C.

25. Under the terms of the lease, Hospital C was required to pay $20,000 per month in leasing fees, but had the right to return the system to the leasing company in six months with the payment of a minimal $90,000 restocking fee. Under the leasing company's contract with Hansen, the leasing company did not have the right to return the Sensei system to Hansen if the hospital elected not to continue the lease. As a result of these terms, the leasing company expressed concern to Hansen's Senior Vice President of Commercial Operations about the financial risk the leasing company was undertaking if Hospital C returned the Sensei system.

26. To minimize the leasing company's risk, Hansen's Senior Vice President of Commercial Operations orally agreed that Hansen would take care of the leasing company if the hospital returned the system. Hansen's Senior Vice President of Commercial Operations did not inform Hansen's finance department about his oral agreement with the leasing company. In fact, the Senior Vice President of Commercial Operations falsely confirmed in a March 2009 letter to Hansen's outside audit firm that he had disclosed all oral agreements with respect to sales that occurred in December 2008.

27. Thereafter, Hansen recognized approximately $650,000 in revenue on the sale to the leasing company in its financial statements for Hansen's fourth quarter ended December 31, 2008.

28. Under GAAP, it was improper for Hansen to recognize revenue on the sale because Hansen had not transferred all of the risks and rewards of ownership of its Sensei system to the leasing company. To the contrary, the oral side agreement that Hansen would take care of the leasing company if the hospital returned the equipment created future obligations for Hansen, including the possibility that it would have to accept a return of the product or help find another buyer.

29. Ultimately, Hospital C returned the Sensei system to the leasing company in the fall of 2009. At this time, the leasing company principal informed a Hansen executive of his oral side agreement with the Senior Vice President of Commercial Operations. Hansen agreed to take the Sensei system back and refunded the leasing company $500,000 of its purchase price.

D. Hansen Reports Inflated Revenues In Its 2008 Form 10-K As A Result of the Fraudulent Hospital A, Hospital B and Hospital C Transactions

30. On March 16, 2009, Hansen filed with the Commission its Form 10-K for the fiscal year ended December 31, 2008. The financial statements filed with Hansen's Form 10-K included

$1,310,000 in improperly reported revenue for the fourth quarter of 2008 from the sales to Hospital B and Hospital C. In addition, Hansen's Form 10-K for the fiscal year 2008 included inflated annual revenues as a result of the improperly reported revenues from the Hospital A, Hospital B, and Hospital C transactions.

31. In April 2009, Hansen filed a supplemental prospectus with the Commission as part of the company's offer to sell Hansen common stock to the public. The prospectus incorporated by reference Hansen's Form 10-K for the fiscal year ended December 31, 2008. On April 22, 2009, Hansen sold more than 11.5 million shares of its common stock to investors, resulting in approximately $35 million in net proceeds to the company.

E. Hansen Reported Materially Inflated Revenue In Its Financial Statements for the First Quarter of 2009 Due To Incomplete Delivery of Its Product

32. On March 12, 2009, as the end of Hansen's first quarter of 2009 drew near, Hansen's Senior Vice President of Commercial Operations sent Hansen's sales force an email that he signed "Mr. Nervous." In the email, the Senior Vice President noted the importance of the Q1 '09 results to the company's funding prospects and made clear that he expected to complete at least 10 Sensei system sales by the end of the first quarter.

33. One of those anticipated sales was to a customer hospital (hereinafter "Hospital D"). In the final days of the quarter, another Hansen sales executive requested that Hospital D sign the contract and accept installation of the system, stating in an email, "I can't stress enough how important this sale is to our organization. We are in the middle of a $50 million funding round. Therefore, everyone in the organization was counting on this sale." This sales executive also emailed another Hospital D executive on March 27, 2009, offering to discount the system price if it would help close the deal, and stating "this sale is critical to our organization as we are in the middle of a $50 million funding round. It is more important for me to hit a unit number than it is to achieve a specific sales price."

34. Hansen's sales executives, including Hansen's Senior Vice President of Commercial Operations and Hansen's Vice President of Sales, rushed to complete the Hospital D transaction on March 31, 2009, the last day of Hansen's first quarter. Hansen personnel and Hospital D were still negotiating key terms of the contract until late in the evening of March 31. On March 31, 2009, Hospital D agreed to pay $550,000 for a Sensei system.

35. Hospital D had not completed renovations to the lab where it intended to install the Sensei system as of March 31, 2009. Therefore, on March 31, Hansen "installed" the system in the lab, but, at the hospital's request, Hansen personnel immediately de-installed the system and placed it in storage at the hospital.

36. Hansen recognized approximately $550,000 in revenue for the Hospital D sale in the first quarter ended March 31, 2009. Under GAAP, it was inappropriate for Hansen to recognize revenue on the transaction in the first quarter of 2009 because Hansen's delivery of the product was temporary and was nothing more than form over substance. As of March 31, 2009, Hansen still had outstanding obligations to re-install the equipment at a later date at Hansen's cost.

37. On May 8, 2009, Hansen filed with the Commission its Form 10-Q for the quarter ended March 31, 2009. The financial statements filed with Hansen's Form 10-Q included $550,000 in improperly reported revenue from the sale to Hospital D. As a result, Hansen reported materially inflated product revenue in its financial statements.

38. Neither Hansen's finance personnel, who were responsible for making determinations about revenue recognition on the sale, nor Hansen's outside auditors knew that Hansen had further obligations to re-install the equipment at Hansen's cost. In the second quarter of 2009, Hansen recognized revenue on the sale after Hansen personnel completed Hansen's delivery obligations by re-installing the Sensei system at Hospital D at Hansen's expense.

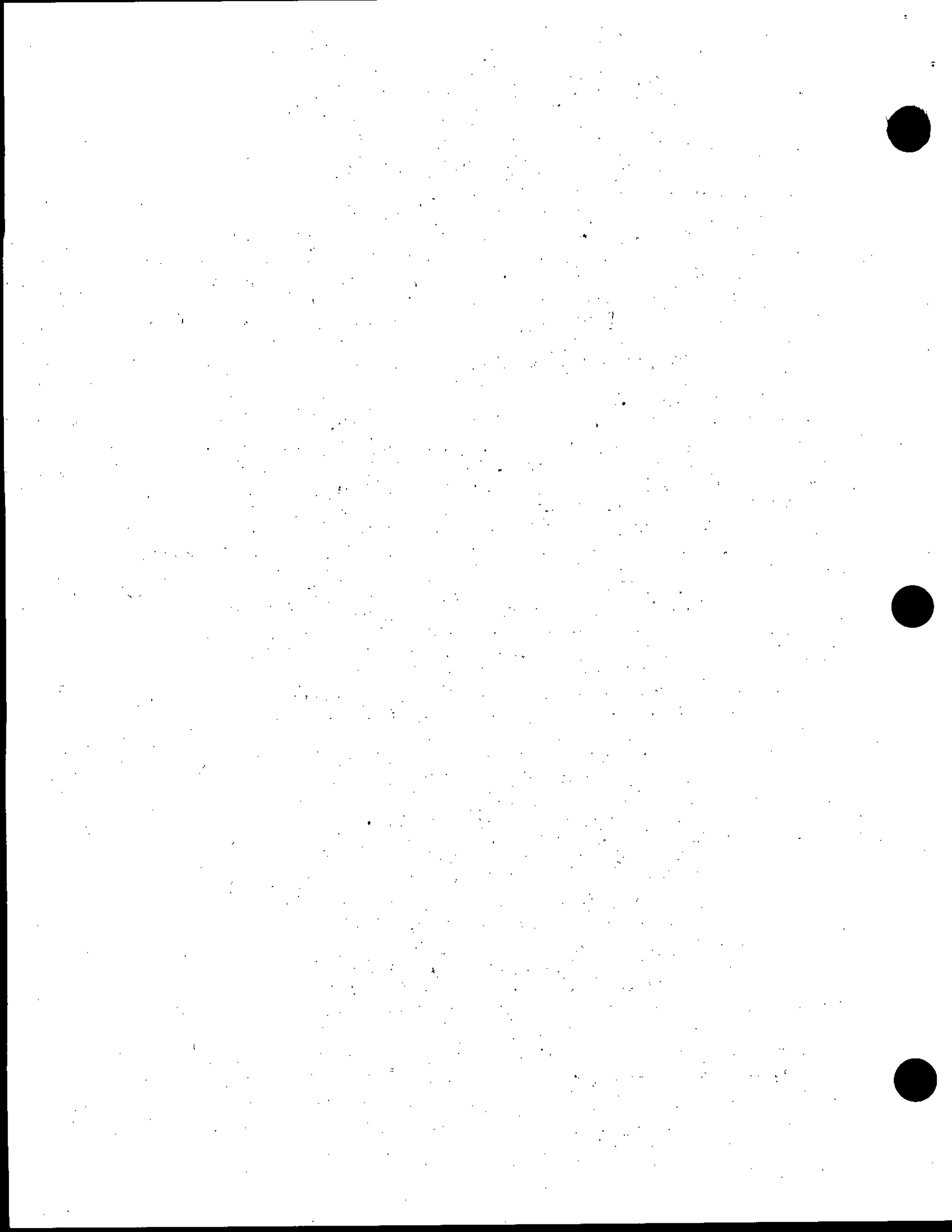
F. Hansen's Restatement And Subsequent Events

39. In August 2009, Hansen received an anonymous whistleblower complaint, reporting the falsified physician training form in the sales transaction with Hospital B. In response to the complaint, Hansen's audit committee engaged outside legal counsel to conduct an internal investigation. The internal investigation examined not only the forgery in the Hospital B sale, but was also expanded to include a review of sales transactions completed by Hansen from June 2007 (when Hansen recognized revenue from its first domestic product sale) to June 2009. In October 2009, as a result of information gathered in the internal investigation, Hansen requested the resignation of its Senior Vice President of Commercial Operations and terminated the employment of its Vice President of Sales.

40. Following the internal investigation, Hansen announced in Forms 8-K, filed on October 19, 2009 and November 10, 2009, that it intended to issue restated financial statements for the fiscal years ended December 31, 2007 and 2008, for each of the quarters in 2008, and for the first two quarters in 2009. On November 16, 2009, Hansen filed restated financial statements for those periods after determining that revenue from multiple sales transactions had been improperly reported. Included within the restated transactions were the four specific fraudulent transactions discussed in detail above.

Hansen's Remedial Efforts

41. After Hansen's violations came to light in August 2009, Hansen promptly undertook significant remedial efforts. These efforts included undertaking an internal investigation, requesting the resignation of Hansen's Senior Vice President of Commercial Operations and terminating the employment of its Vice President of Sales for their respective roles in the problematic sales transactions, and taking other personnel action as a result of the misconduct. Hansen also reorganized the management structure of the company so that the sales, clinical and field service teams no longer reported to the same supervising officer, which was intended to ensure that each team has the proper oversight. In addition, Hansen issued oral and written reprimands to eight Hansen employees for their respective failures of judgment that contributed to Hansen's misstatement of revenue. Hansen has also provided increased and improved training to all Hansen employees regarding their ethical obligations and the company's revenue recognition policies, and implemented additional corporate governance and internal control policies, including controls relating to revenue recognition. Hansen has also implemented



a revised compensation structure for Hansen's sales group that is intended to separate commission payments from achieving revenue recognition on sales transactions.

42. In determining to accept the Offer, the Commission considered the significant remedial acts Hansen promptly undertook, Hansen's voluntary disclosure of these matters to the Commission, and cooperation afforded to the Commission staff.

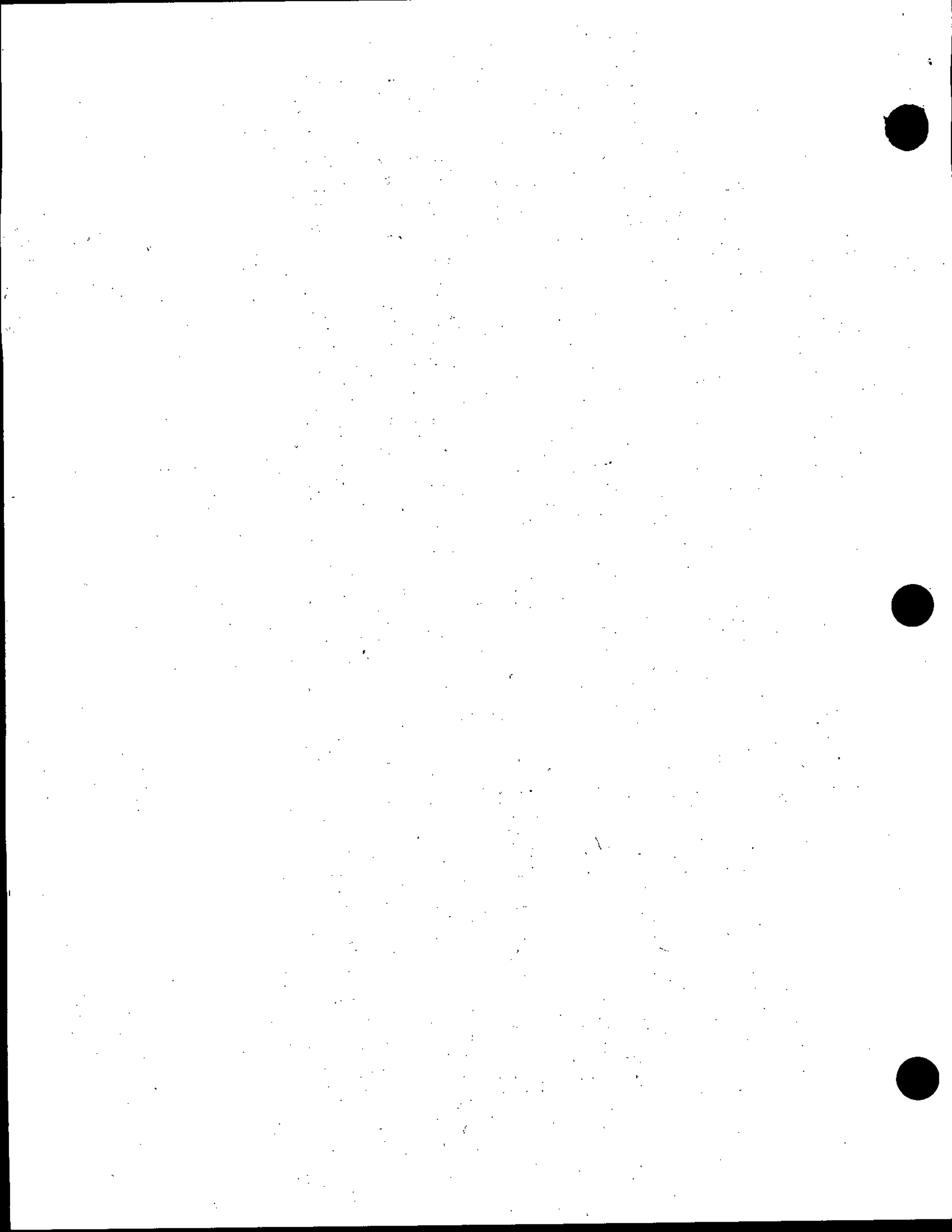
Violations

Hansen Medical, Inc. Violated Sections 17(a)(2) and 17(a)(3) of the Securities Act

43. As a result of the conduct described above, Hansen violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. In the offer or sale of securities, Section 17(a)(2) makes it unlawful "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;" and Section 17(a)(3) proscribes "any transaction, practice, or course of business which operates or would operate as a fraud or deceit on the purchaser." Violations of Sections 17(a)(2) and 17(a)(3) may be established by a showing of negligence. Aaron v. SEC, 446 U.S. 680, 697 (1980); SEC v. Glt. Dain Rauscher, Inc., 254 F.3d 852, 856 (9th Cir. 2001).

Hansen Medical, Inc. 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

44. As a result of the conduct described above, Hansen 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 by filing inaccurate periodic reports with the Commission, by failing to make and keep accurate books and records, and by failing to devise and maintain an adequate system of accounting controls.



IV.

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

Accordingly, it is hereby ORDERED that:

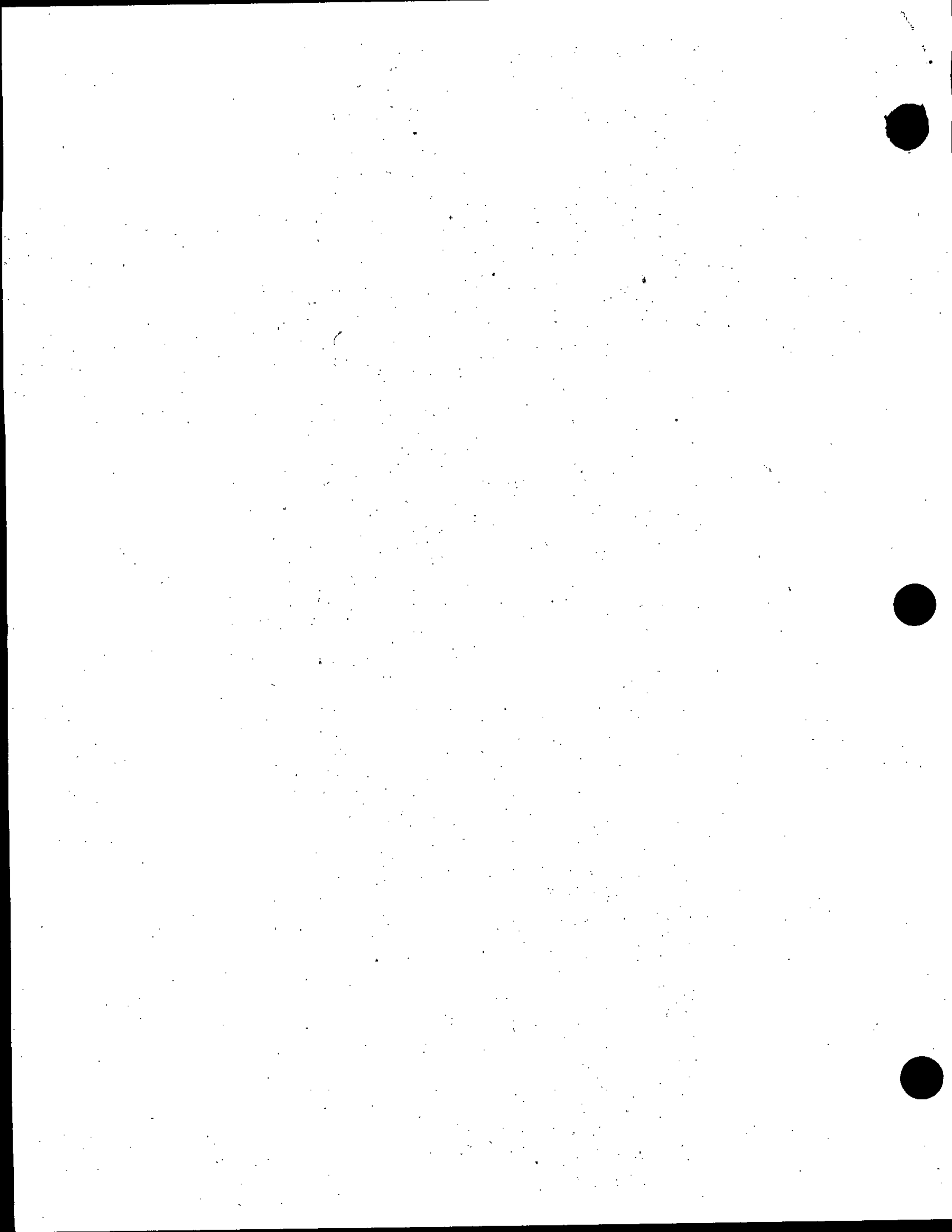
Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Hansen Medical, Inc. cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, and Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary



Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65506 / October 6, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14579

In the Matter of **Aampro Group, Inc. (n/k/a First Capital Trust, Inc.),** **Adagio Acquisition I, Inc.,** **Adagio Acquisition II, Inc.,** **Adagio Acquisition III, Inc.,** **Beaconsfield II, Inc.,** **Beaconsfield III, Inc., and** **Boston Communications Group, Inc. (n/k/a Xius Holding Corp.),** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

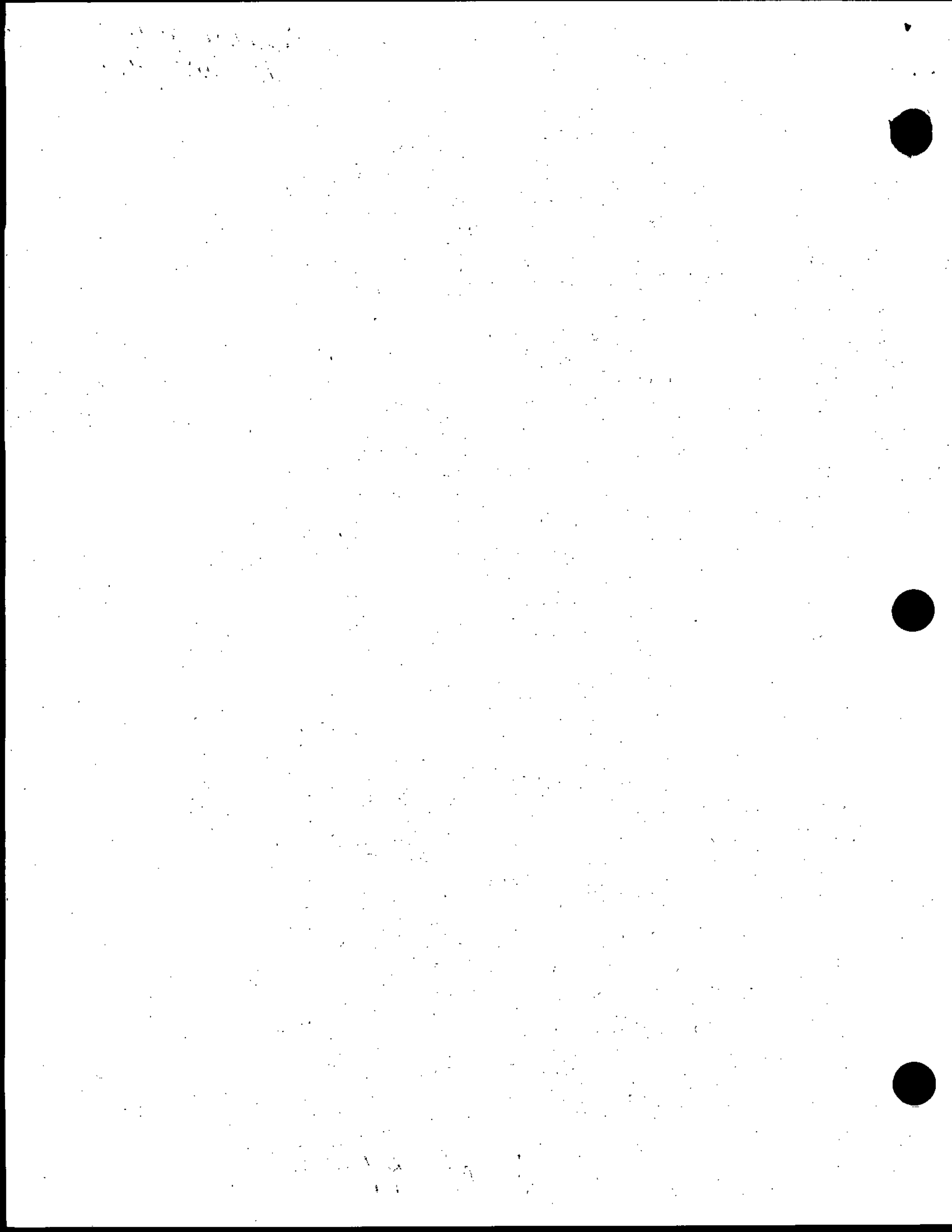
The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Aampro Group, Inc. (n/k/a First Capital Trust, Inc.), Adagio Acquisition I, Inc., Adagio Acquisition II, Inc., Adagio Acquisition III, Inc., Beaconsfield II, Inc., Beaconsfield III, Inc., and Boston Communications Group, Inc. (n/k/a Xius Holding Corp.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Aampro Group, Inc. (n/k/a First Capital Trust, Inc.) (CIK No. 1116139) is a revoked Nevada corporation located in Peapack, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aampro Group



is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2007, which reported a net loss of over $385,000 for the prior six months. As of October 3, 2011, the company's stock (symbol "APGO") was traded on the over-the-counter markets.

2. Adagio Acquisition I, Inc. (CIK No. 1328999) 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). Adagio Acquisition I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2006, which reported a net loss of over $31,000 for the prior nine months.

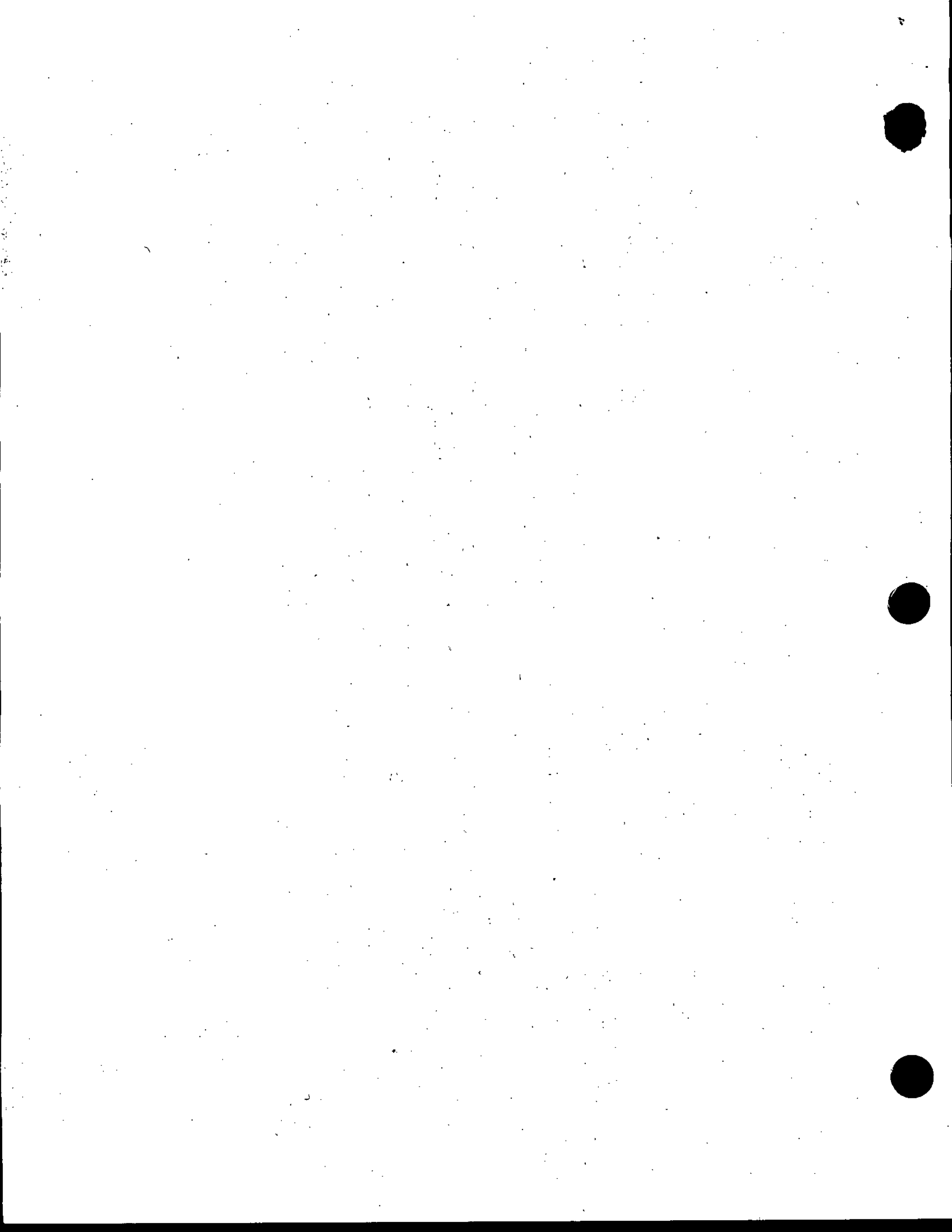
3. Adagio Acquisition II, Inc. (CIK No. 1329000) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Adagio Acquisition II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2006, which reported a net loss of over $23,000 for the prior nine months.

4. Adagio Acquisition III, Inc. (CIK No. 1329001) 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). Adagio Acquisition III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2006, which reported a net loss of over $23,000 for the prior nine months.

5. Beaconsfield II, Inc. (CIK No. 1323924) is a void Delaware corporation located in Buffalo, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Beaconsfield II 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 $7,000 for the prior three months.

6. Beaconsfield III, Inc. (CIK No. 1323925) is a void Delaware corporation located in Buffalo, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Beaconsfield III 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 $7,000 for the prior three months. The company's stock is not publicly quoted or traded.

7. Boston Communications Group, Inc. (n/k/a Xius Holding Corp.) (CIK No. 1012887) is a Massachusetts corporation located in Bedford, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Boston Communications Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2006.



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,

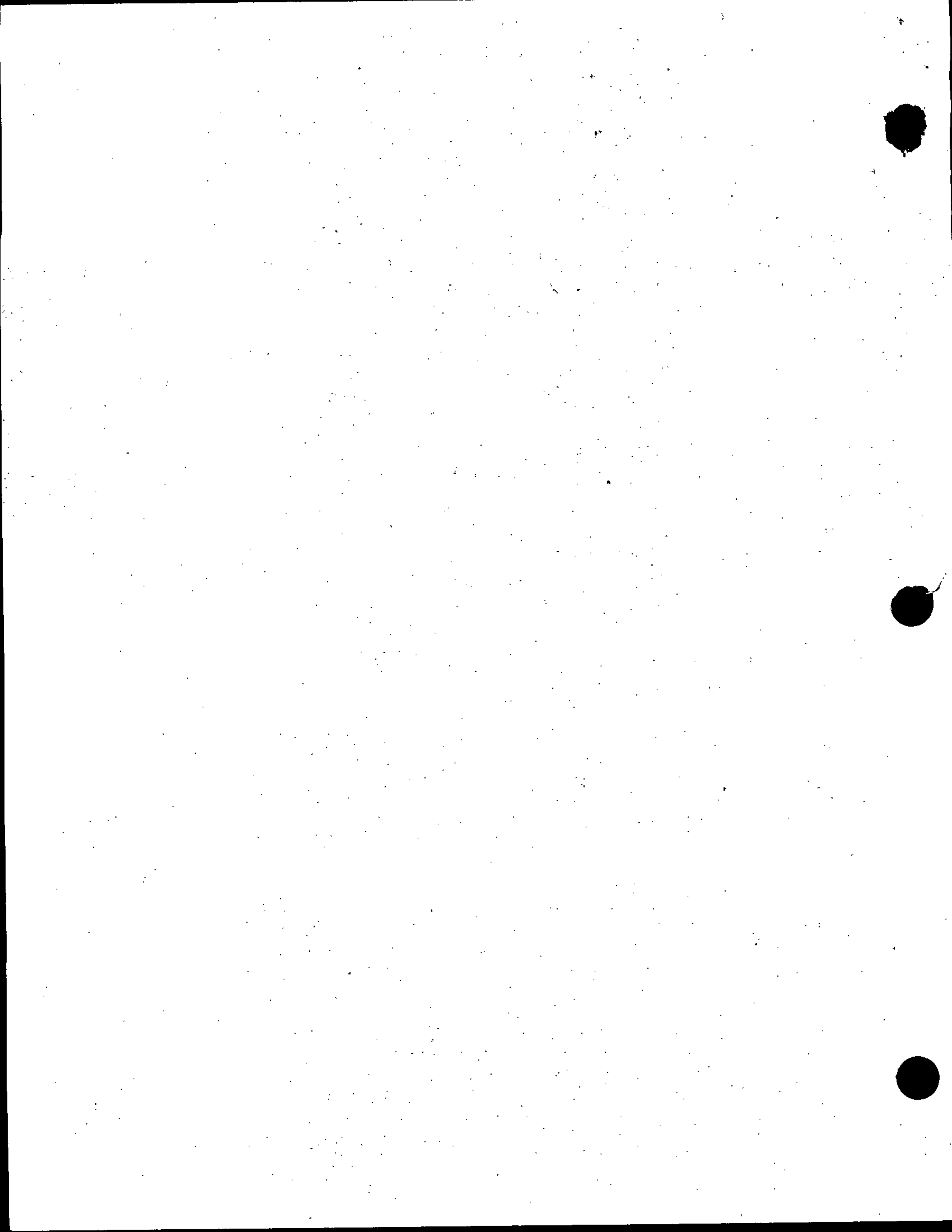
B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor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

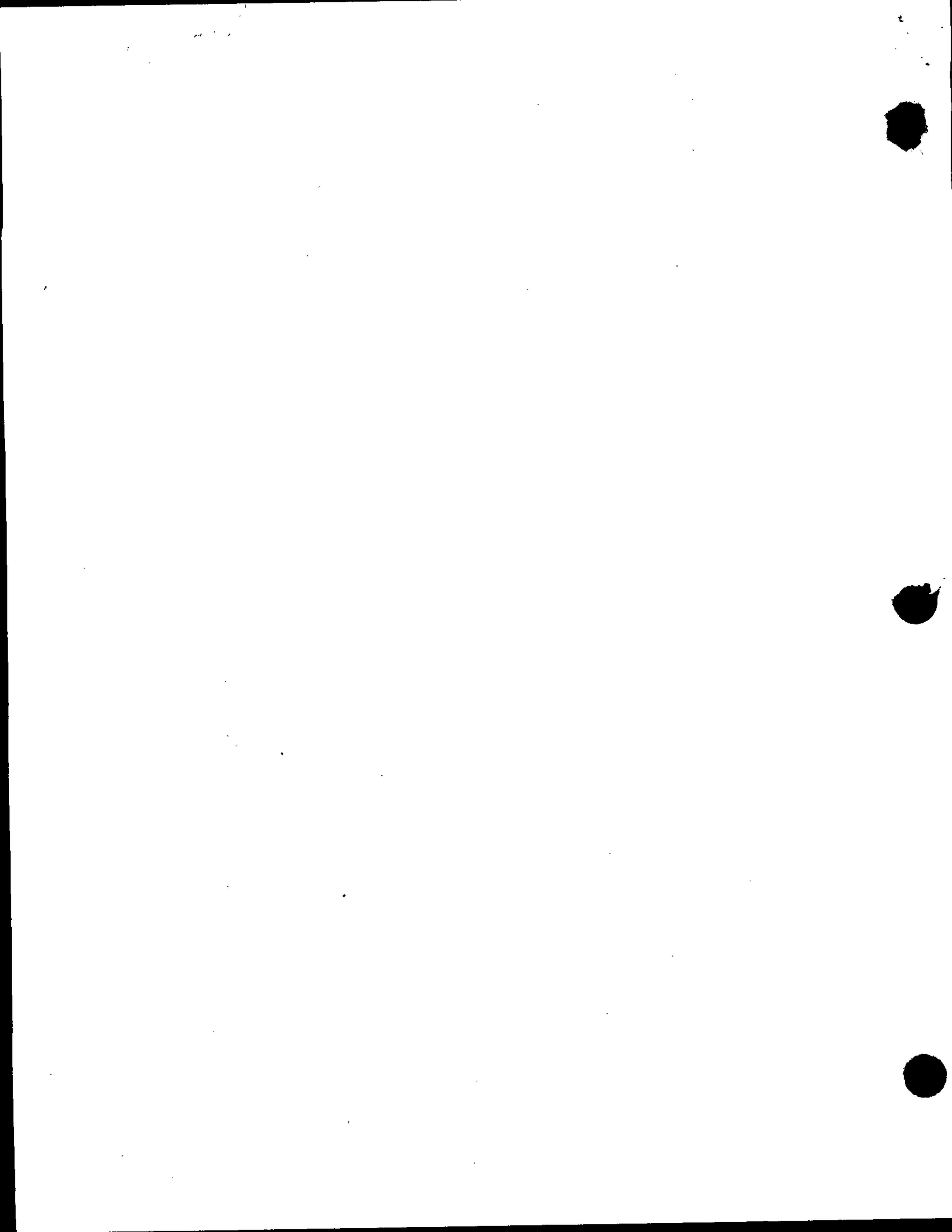
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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

By: Jill M. Peterson
Assistant Secretary



SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-65508; File No. S7-40-10]

Roundtable on Issues Relating to Conflict Minerals

AGENCY: Securities and Exchange Commission.

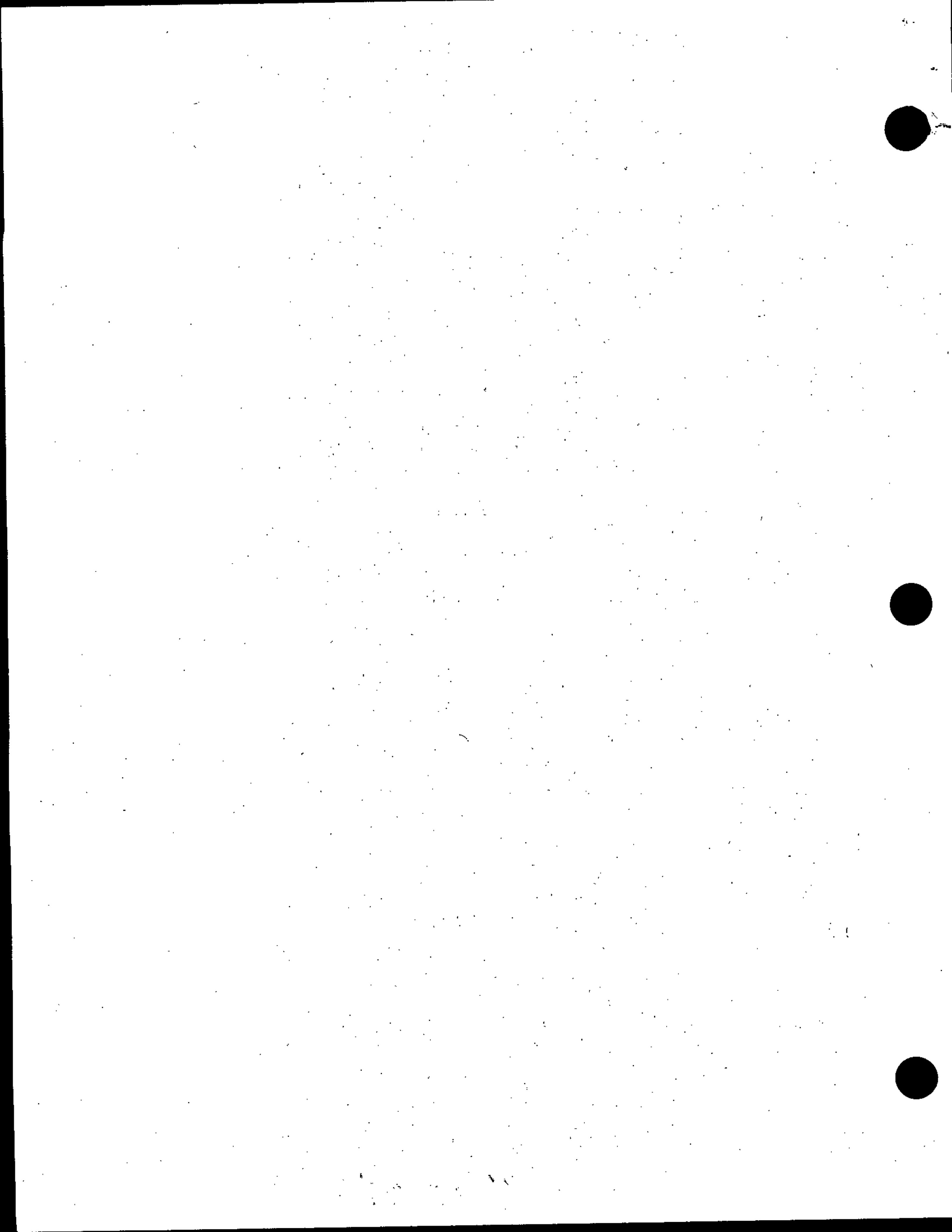
ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: On October 18, 2011, the Commission will hold a public roundtable at which invited participants will discuss various issues related to the Commission's required rulemaking under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act"), which relates to reporting requirements regarding conflict minerals originating in the Democratic Republic of the Congo and adjoining countries. Roundtable panelists are expected to reflect the views of different constituencies, including investors, affected issuers, human rights organizations, and other stakeholders.

The roundtable will consist of a series of panels that are designed to provide a forum for various stakeholders to exchange views and provide input on issues related to the Commission's required rulemaking.

DATES: The roundtable discussion will take place on October 18, 2011. The Commission will accept comments regarding the issues to be addressed in the roundtable and otherwise regarding the proposed rule amendments until November 1, 2011.

ADDRESSES: The roundtable discussion will be held in the auditorium of the SEC's headquarters at 100 F Street, NE, Washington, DC on October 18, 2011 from 12:30 p.m. to approximately 5:15 p.m. The roundtable will be open to the public with seating on a first-come, first-served basis, and the discussion will also be available via webcast on the Commission's website at www.sec.gov.



Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form at http://www.sec.gov/rules/other.shtml; or
- Send an e-mail to rule-comments@sec.gov.

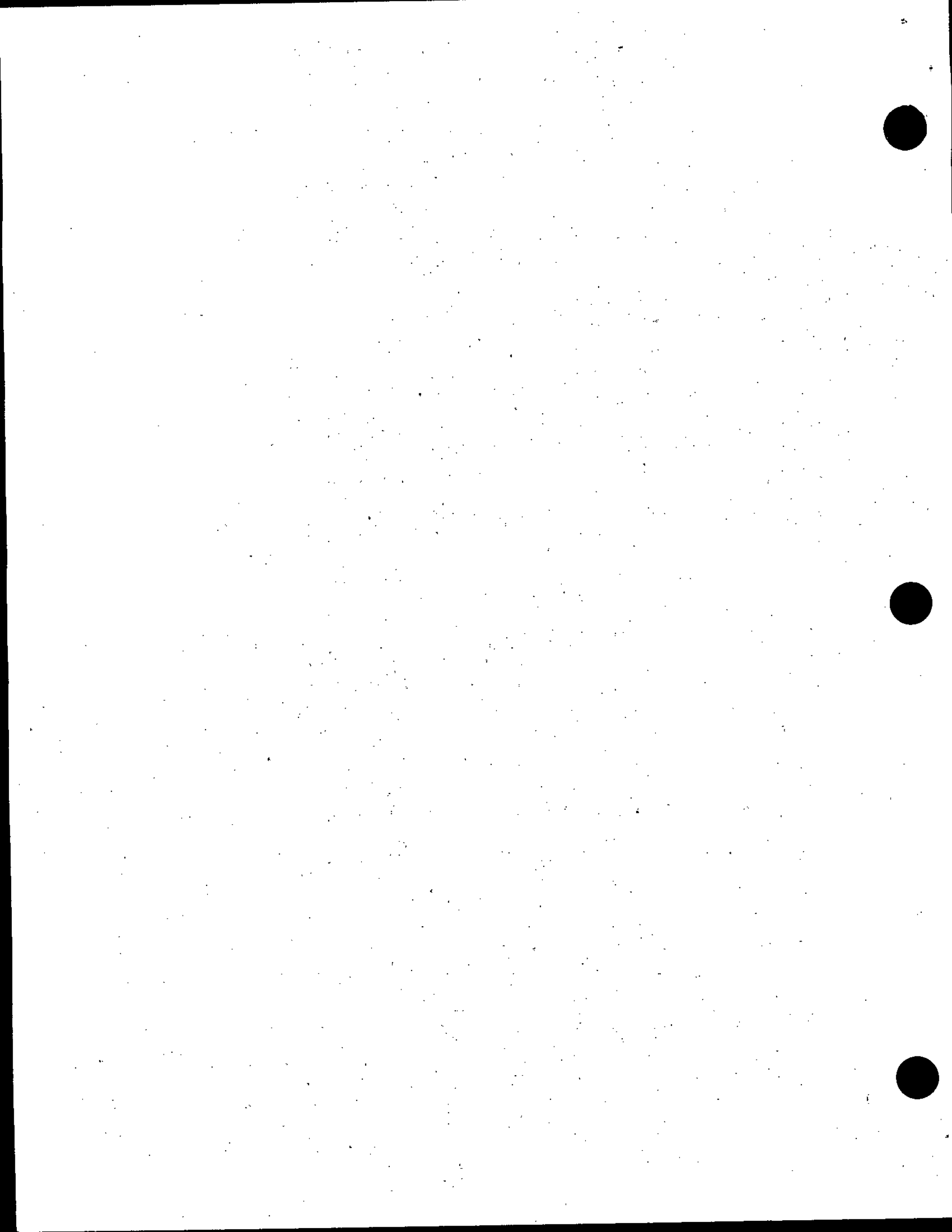
Paper Comments:

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

All submissions should refer to File Number S7-40-10. This file number should be included on the subject line if e-mail is used. To help process and review your submissions more efficiently, please use only one method. The Commission will post all comments on the Commission's website at www.sec.gov. Comments will also be available for website viewing and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Fieldsend, Special Counsel in the Office of Rulemaking, Division of Corporation Finance, at (202) 551-3430, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: Section 1502 of the Act amends the Securities Exchange Act by adding new Section 13(p). Section 13(p) requires the Commission to promulgate disclosure and reporting regulations regarding the use of conflict minerals from the Democratic Republic of the Congo and adjoining countries. On December 15, 2010, the



Commission proposed rule amendments to implement Exchange Act Section 13(p).[1]

The Commission has been asked to hold a roundtable discussion to facilitate its understanding of the issues surrounding conflict minerals. The Commission believes that additional public input on the proposed rulemaking would be beneficial in light of the particular subject matter.

By the Commission.

Elizabeth M. Murphy
Secretary

Dated: October 6, 2011

---

[1] Conflict Minerals, Release No. 34-63547; File No. S7-40-10 (Dec. 23, 2010) [75 FR 80948].

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-65511; File No. 4-639]

Public Roundtable on Execution, Clearance and Settlement of Microcap Securities

AGENCY: Securities and Exchange Commission.

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: On Monday, October 17, 2011, commencing at 1:00 p.m. and ending at 5:00 p.m., staff of the Securities and Exchange Commission ("SEC" or "Agency") will hold a public roundtable meeting at which invited participants will discuss various issues related to the Execution, Clearance and Settlement of Microcap Securities.

The roundtable discussion will be held in the multi-purpose room of the Securities and Exchange Commission headquarters at 100 F Street, NE, in Washington, DC on Monday, October 17, 2011, commencing at 1:00 p.m. and ending at 5:00 p.m. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-served basis. The roundtable discussion also will be available via webcast on the Commission's website at www.sec.gov.

The roundtable will consist of a series of three panels. Panelists will consider a range of microcap securities topics, such as the current issues facing small cap issuers in the clearance and settlement process, potential regulatory changes impacting the Over-The-Counter markets, and Anti-Money Laundering concerns specific to microcap issuers.

DATES: The roundtable discussion will be held on Monday, October 17, 2011. The Commission will accept comments regarding issues addressed at the roundtable until October 31, 2011

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

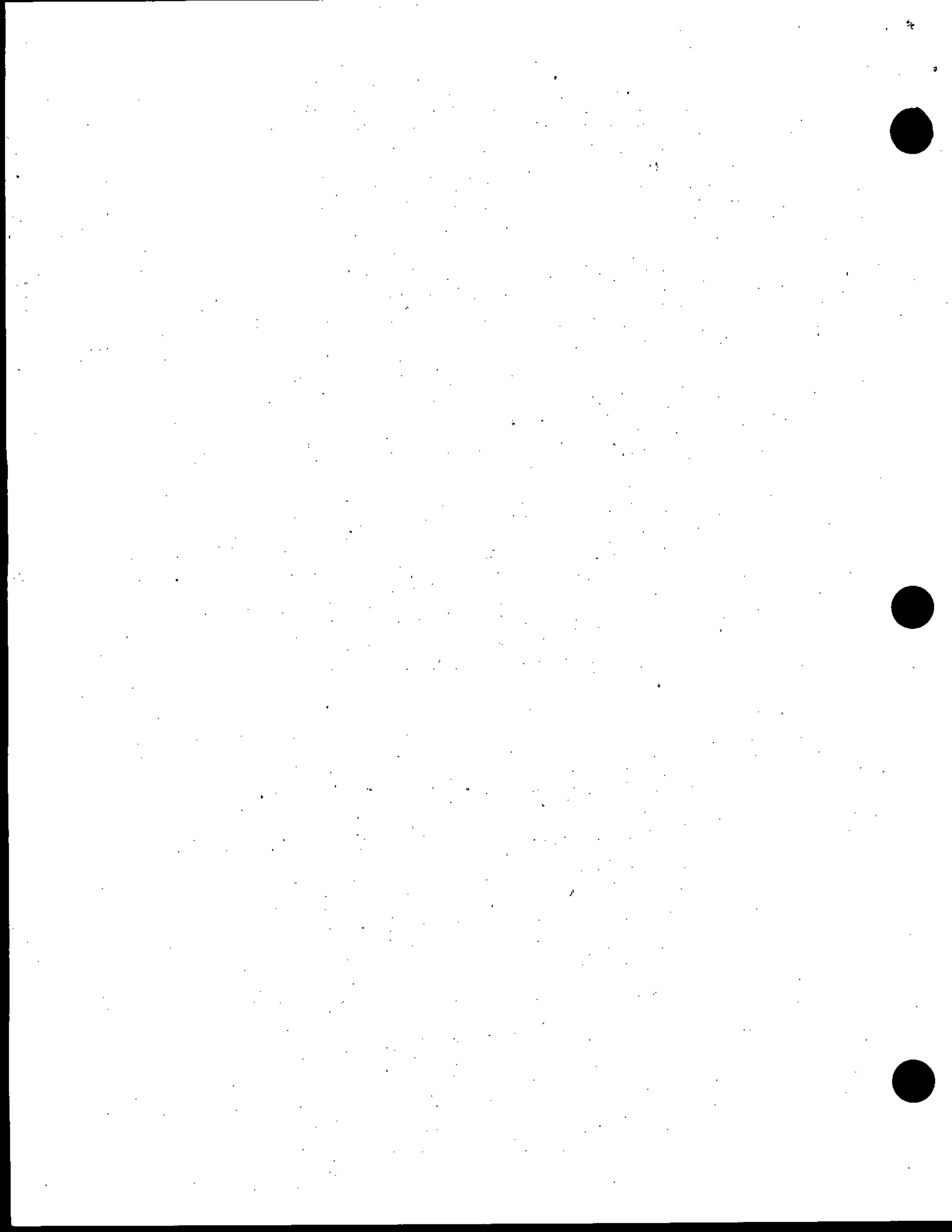
Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-639 on the subject line.

Paper Comments:

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

All submissions should refer to File Number 4-639. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.



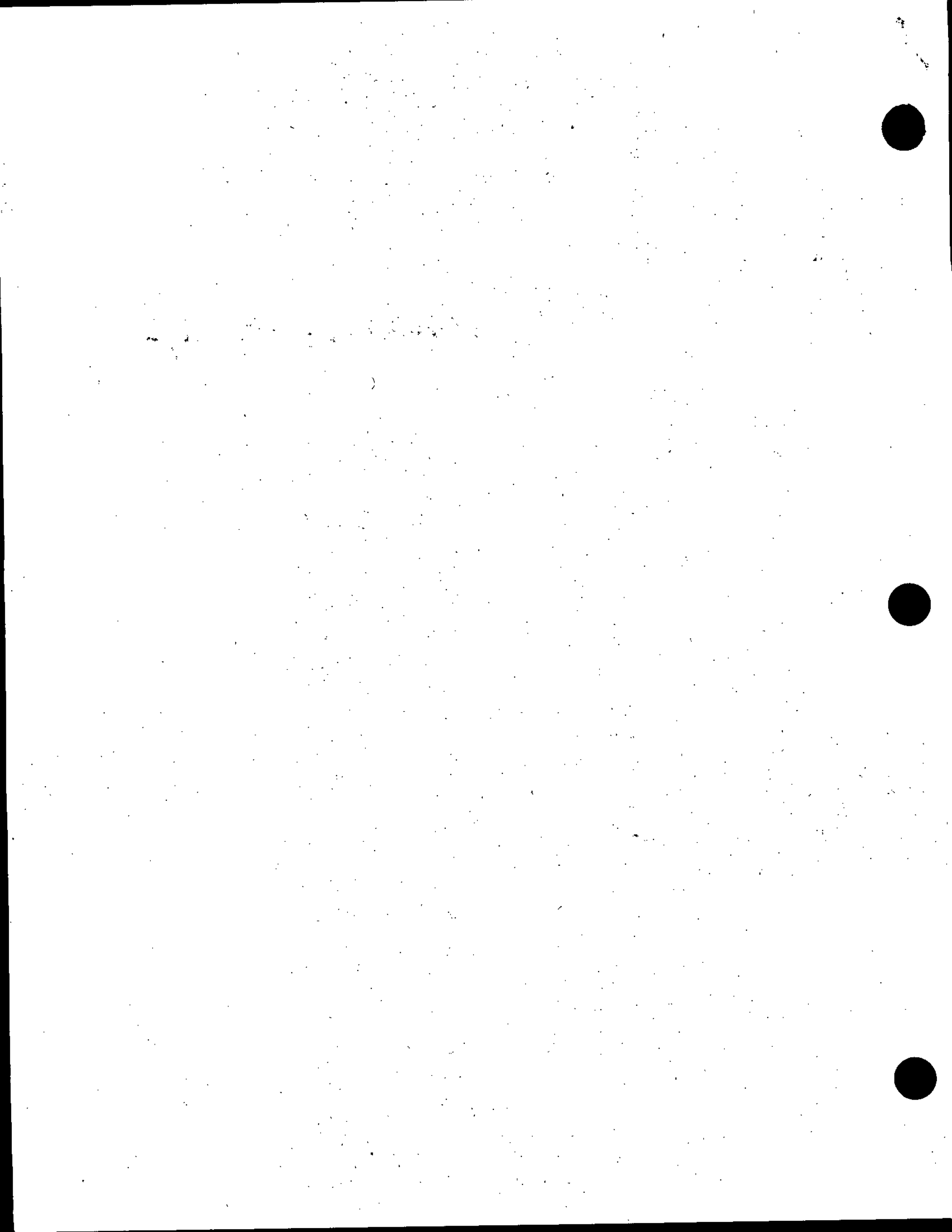
FOR FURTHER INFORMATION CONTACT: The Microcap Roundtable Hotline at (202) 551-6607 Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, in Washington, DC 20549-7010

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

October 7, 2011



Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 7, 2011

In the Matter of **China-Biotics, 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 China-Biotics, Inc. ("China-Biotics") because it has been delinquent in its required periodic reports since February 2011. China-Biotics is traded on the OTC Link under the ticker symbol CHBT.PK.

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, October 7, 2011 through 11:59 p.m. EDT, on October 20, 2011.

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. 65510 / October 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14581

In the Matter of **China-Biotics, 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 China-Biotics, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

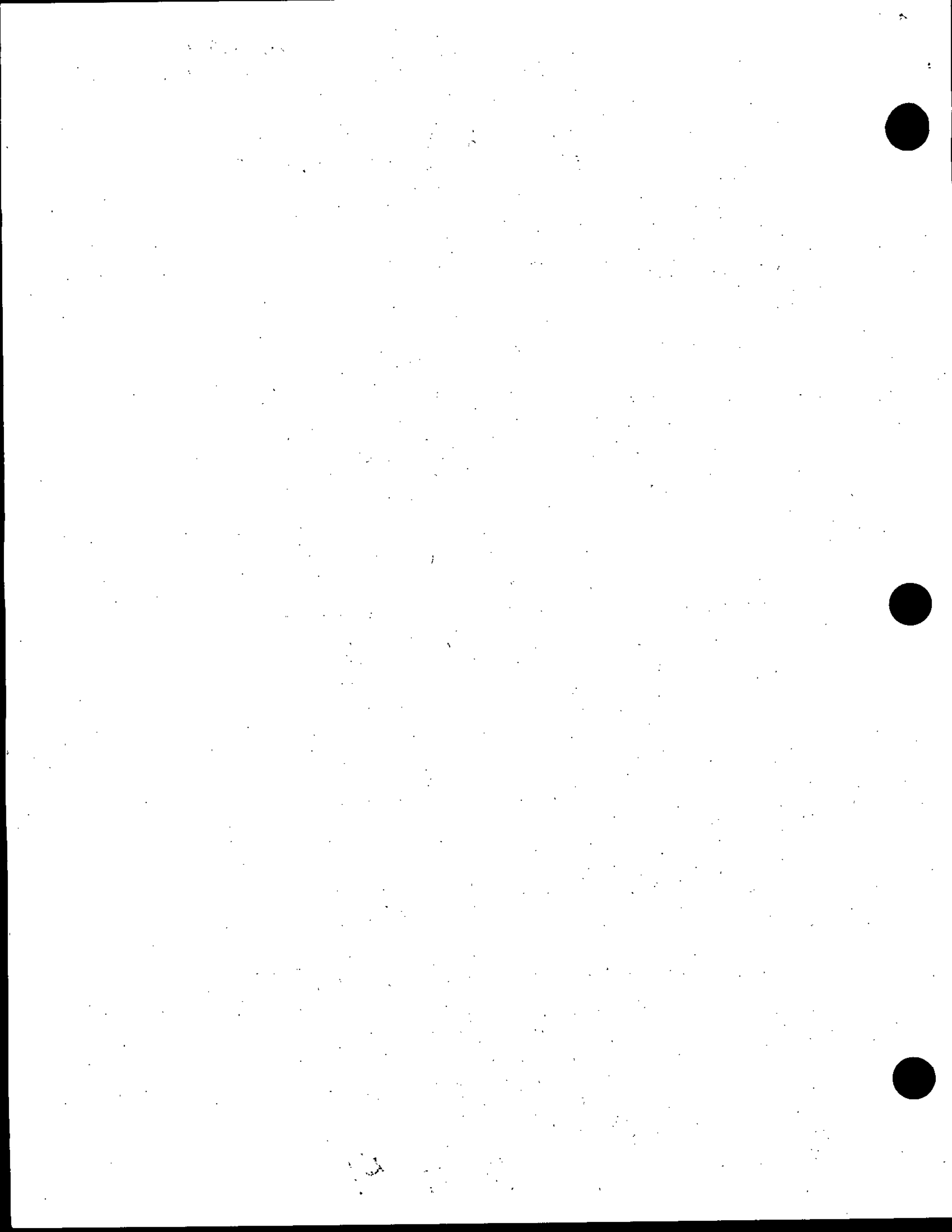
A. RESPONDENT

1. China-Biotics, Inc. ("China-Biotics") (CIK No. 1271057) is a Delaware corporation located in Shanghai, People's Republic of China, with a class of securities registered with the Commission pursuant to Exchange Act Section 12(b). China-Biotics 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, 2010. As of September 28, 2011, the common shares of China-Biotics were quoted on OTC Link under the ticker symbol CHBT or CHBT.PK.

B. DELINQUENT PERIODIC FILINGS

2. As described in more detail above, Respondent is delinquent in its periodic filings with the Commission, and has repeatedly failed to meet its obligations to file timely periodic reports.

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 to revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of 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)].

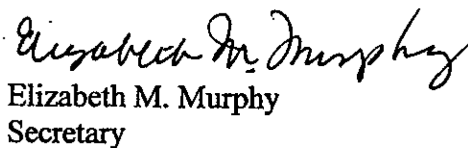
If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against 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's Rules of Practice.

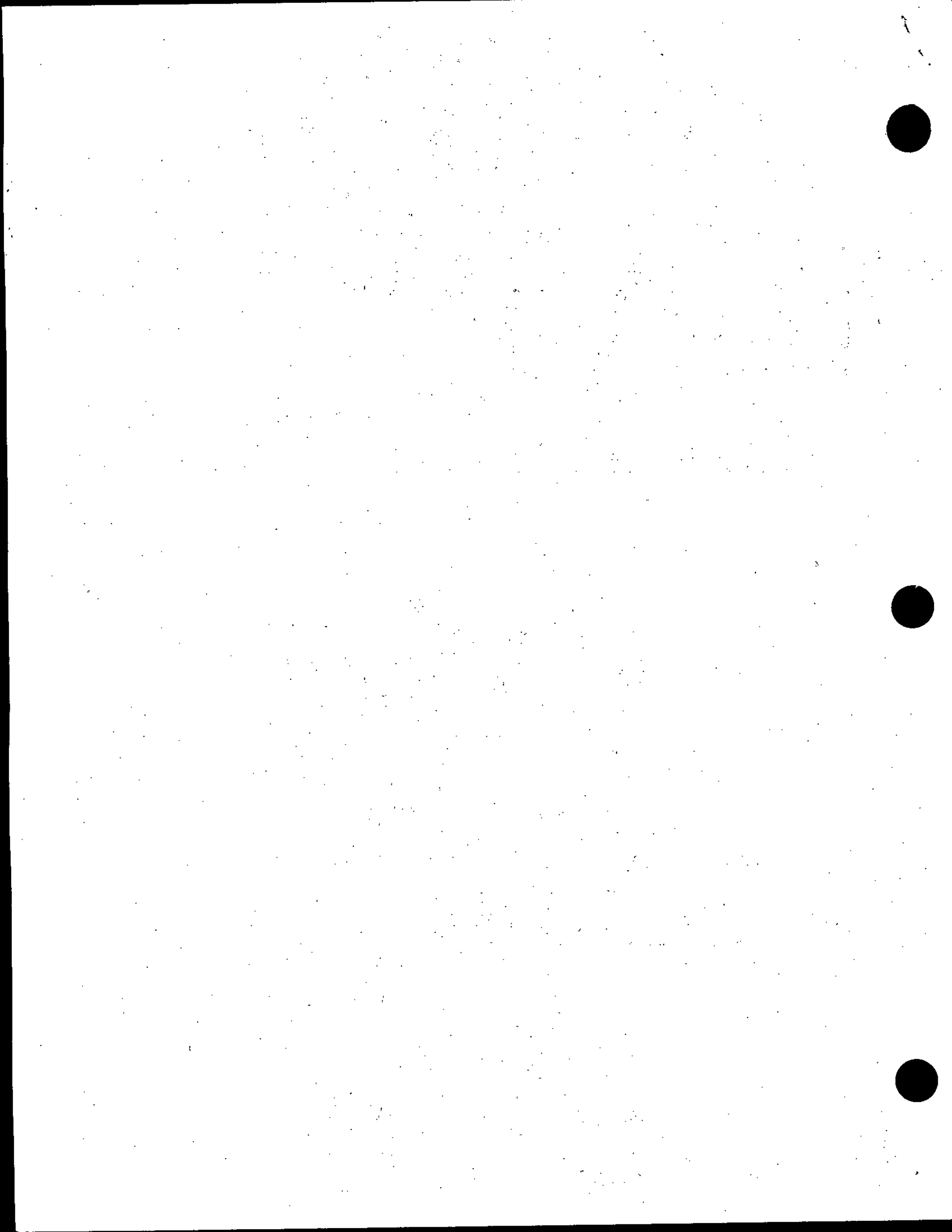
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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

By the Commission.



Elizabeth M. Murphy
Secretary



Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65513 / October 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14582

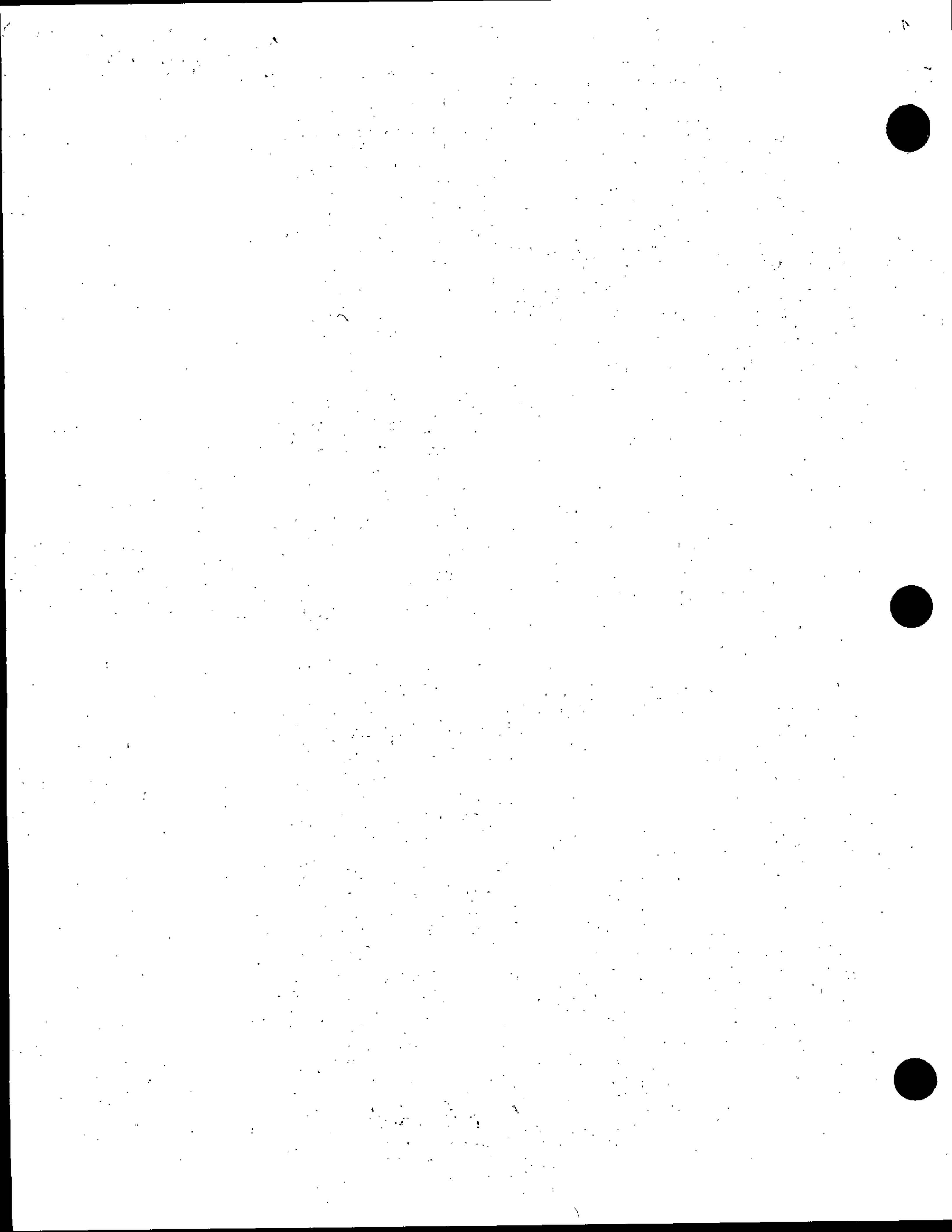
In the Matter of RICHARD A. HANSEN, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

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 Richard A. Hansen ("Hansen" 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.1 through III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.



III.

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

1. From April 2004 until November 2009, Hansen was associated with The Keystone Equities Group, L.P. ("Keystone"), a broker-dealer registered with the Commission pursuant to Section 15 of the Exchange Act.

2. On October 4, 2011, a final judgment was entered by consent against Hansen, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action styled, Securities and Exchange Commission v. Richard A. Hansen et al. ("SEC v. Hansen"), Civil Action No. 10-5050, in the United States District Court for the Eastern District of Pennsylvania.

3. On May 13, 2011, a judgment of criminal conviction was entered against Hansen, pursuant to Hansen's February 9, 2011 guilty plea, for conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371, and for securities fraud, in violation of 15 U.S.C. §§ 78j(b), 78ff and 18 U.S.C. § 2, in the United States District Court for the Southern District of New York in the action styled, United States v. Hansen, 10-Cr.-875 (S.D.N.Y.).

4. With respect to Hansen, the Commission's complaint in SEC v. Hansen alleged, among other things, that Hansen traded on tips of material, non-public information that he knew or was reckless in not knowing were dispensed in breach of duty to the information's source.

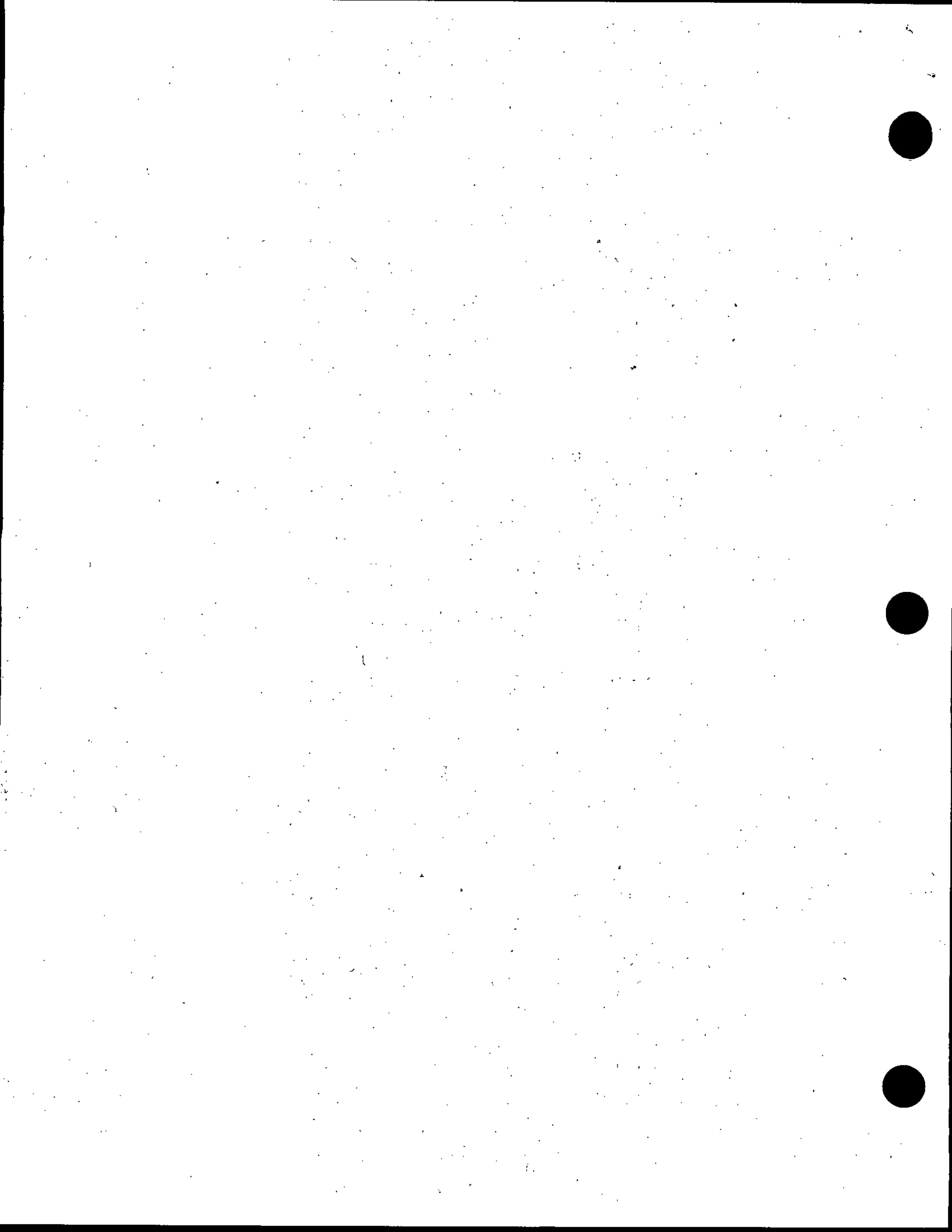
IV.

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

Accordingly, it is hereby ORDERED:

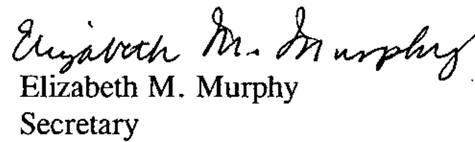
Pursuant to Section 15(b)(6) of the Exchange Act, as amended by section 925 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL 111-203, July 21, 2010, 124 Stat. 1376, Respondent Hansen be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, or 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

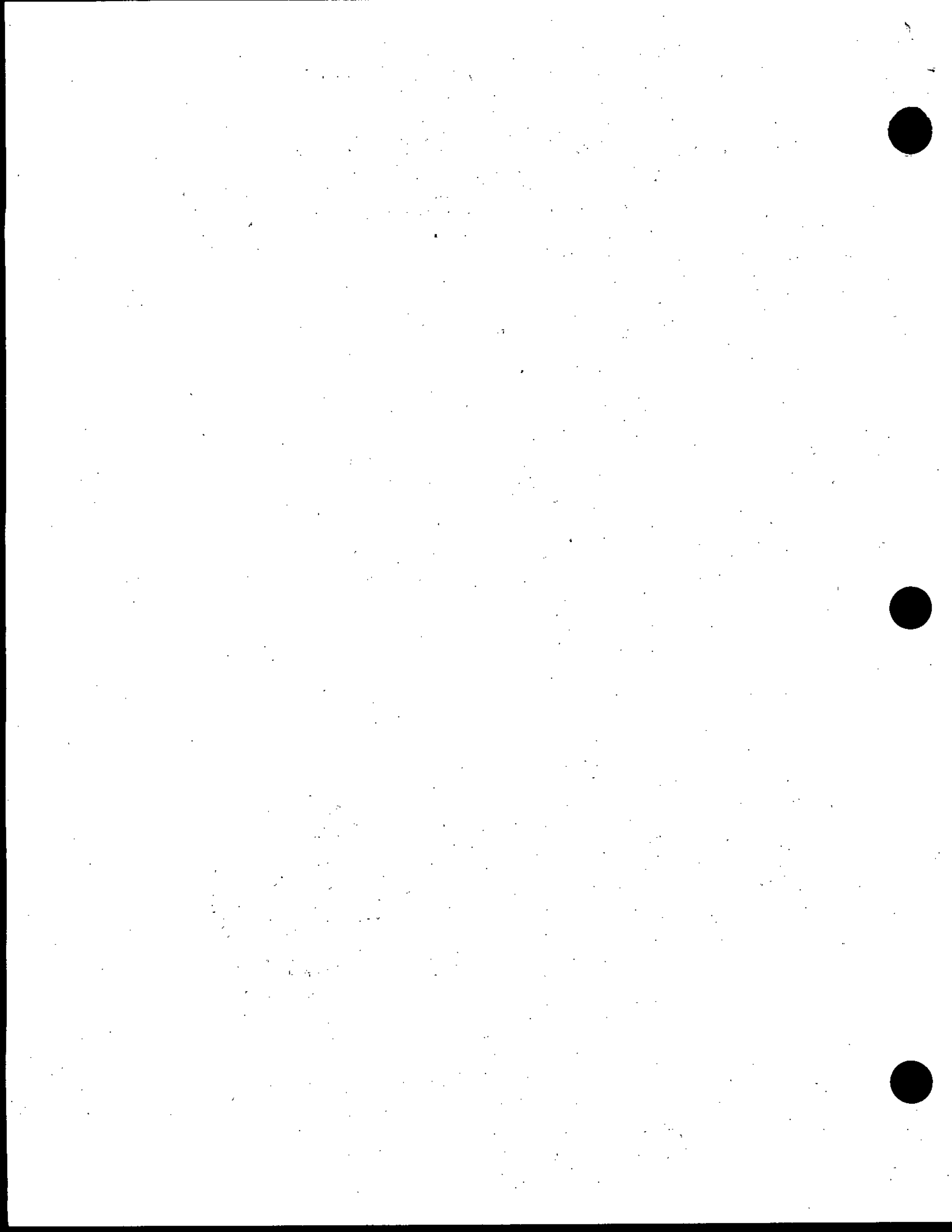


factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis 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



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65520 / October 7, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3299 / October 7, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14583

In the Matter of **Brian A. Bjork,** **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.

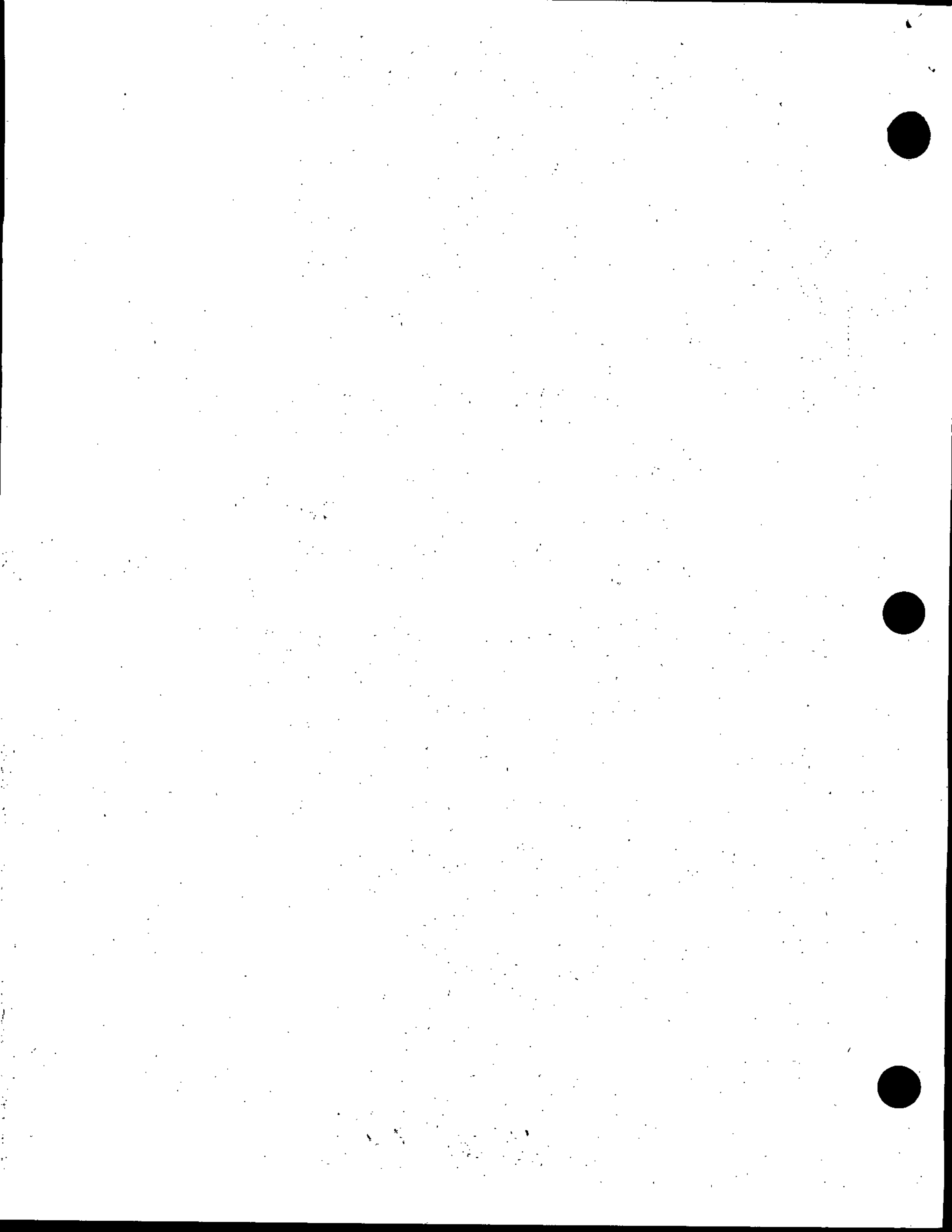
The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Brian A. Bjork ("Bjork" 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 over 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. From February 2006 through July 2011, Respondent served as the Managing Member, Chief Investment Officer, and Chief Compliance Officer of Select Asset Management, LLC ("Select Asset"), an investment adviser registered with the state of Texas since July 2008 and with the Commission since September 2010. From January 2004 through July 2011, Respondent was also a registered representative associated with broker-dealers registered with the Commission.

2. On August 25, 2011, a final judgment was entered by consent against Bjork, permanently enjoining him from violating or aiding and abetting violations of Section 17(a) of the Securities Act of 1933; from violating or aiding and abetting violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder or from controlling another person who violates these provisions; and from violating Sections 206(1) and 206(2) of the Advisers Act in the civil action entitled *Securities and Exchange Commission v. Brian A. Bjork et al.*, Civil Action Number 4:11-cv-2830, in the United States District Court for the Southern District of Texas.

3. The Commission's complaint alleged that, from 2004 through July 2011, Respondent offered securities in two fraudulent securities schemes, raising approximately $52 million combined. In the first scheme, Respondent offered investors corporate and other bonds, raising approximately $39 million from more than 100 investors. Respondent promised investors safe, fixed income from highly rated corporate and other bonds, but never acquired the bonds as promised. In the second scheme, Respondent offered securities issued by two private funds at Select Asset, raising approximately $13 million from at least 52 investors. The two funds, which Respondent controlled, commingled investor money, failed to provide promised financial statements, and transferred money to fund-affiliated entities in transactions undisclosed to investors. Moreover, in the affiliate loans, the funds disregarded due-diligence and loan-approval procedures promised in fund documents given to investors.

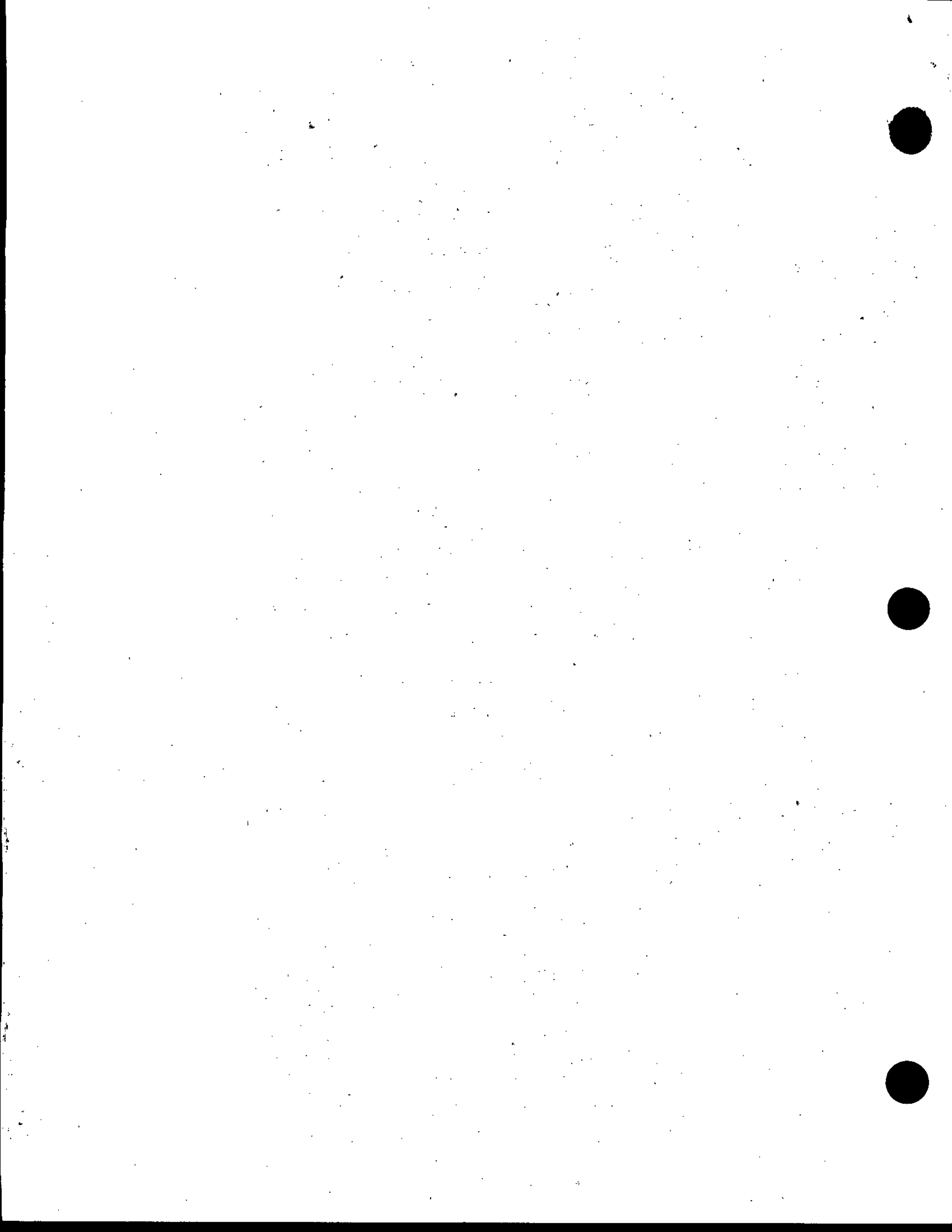
IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Bjork 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.

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

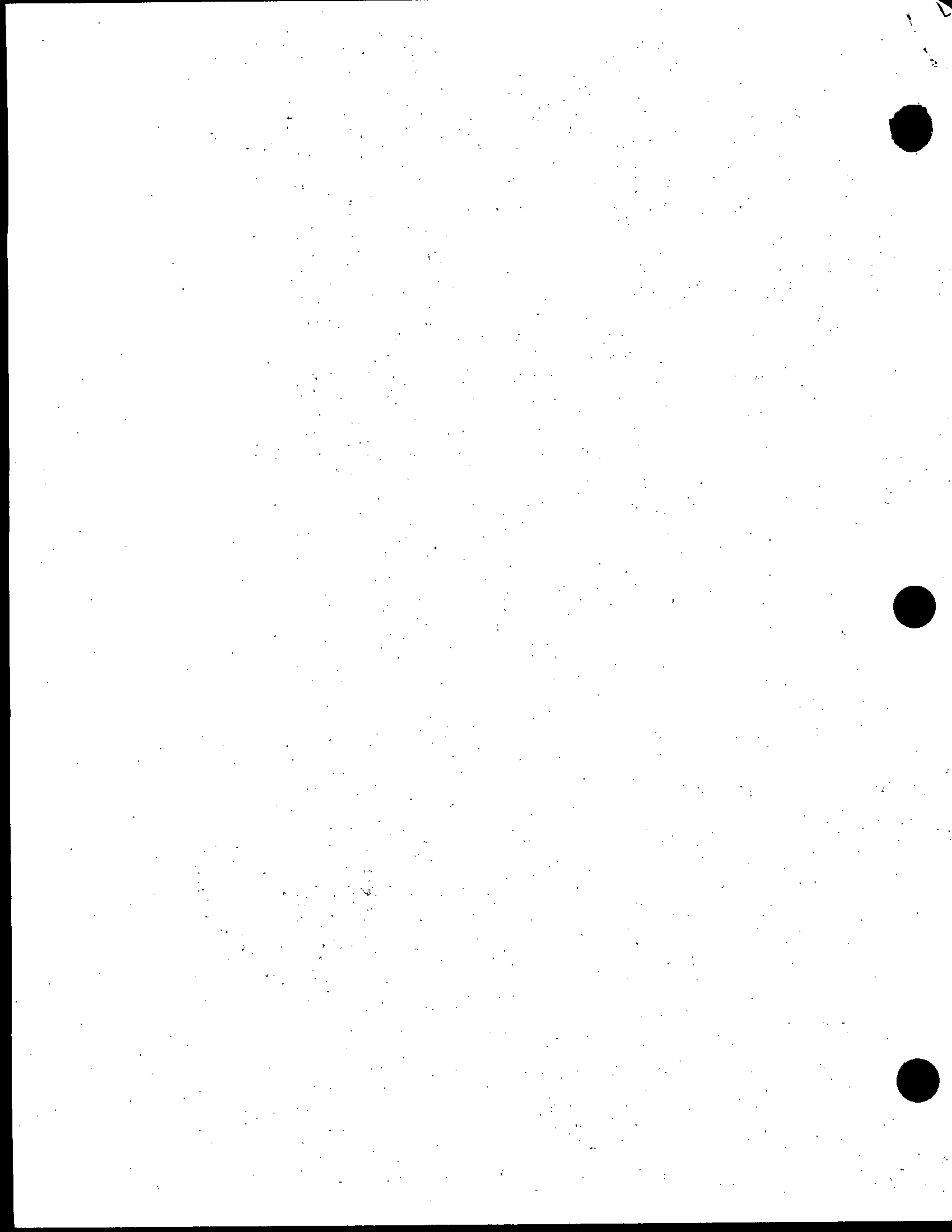


customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary



Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65531 / October 11, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14584

In the Matter of UCBH HOLDINGS, INC., Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

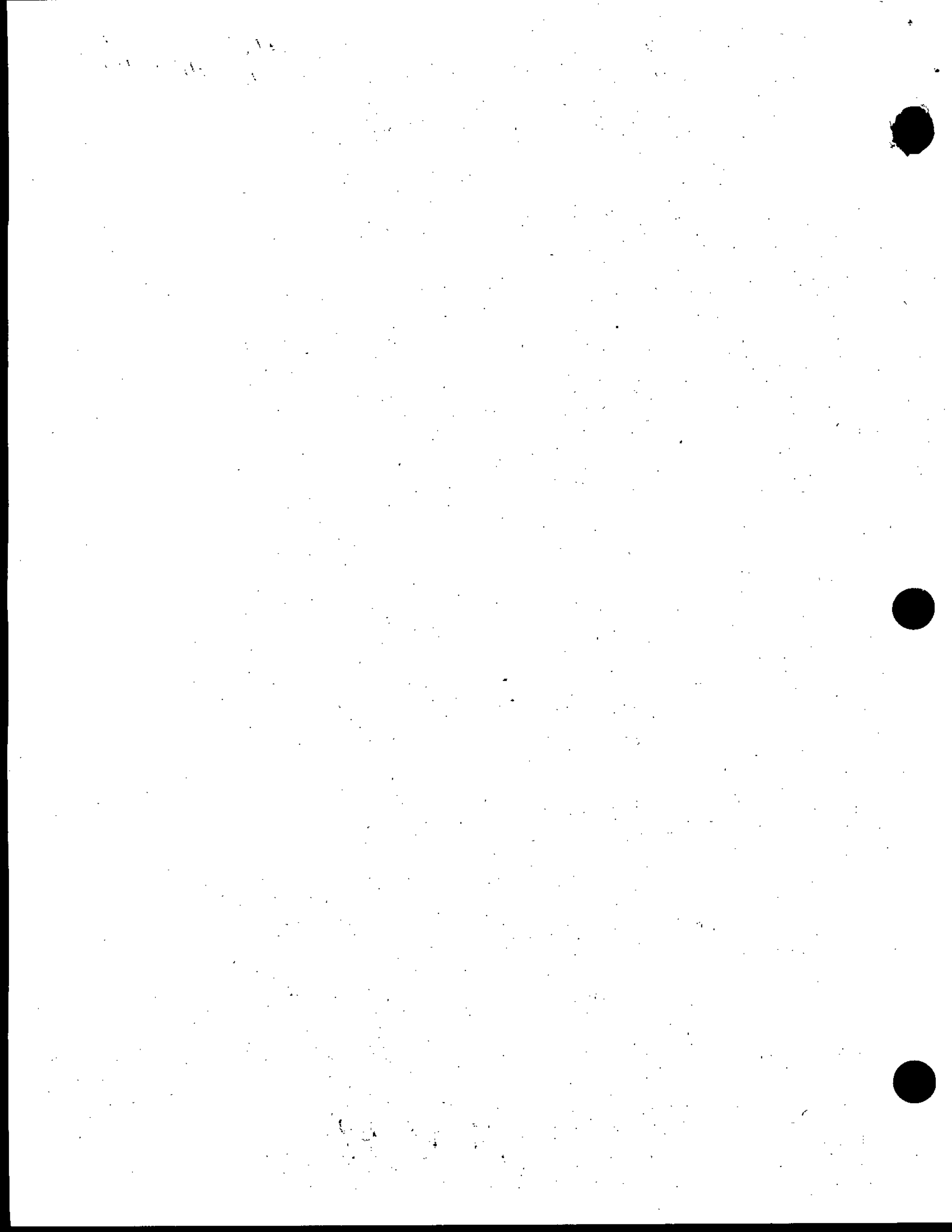
The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against UCBH Holdings, Inc. ("UCBH" or "Respondent").

II.

As a result of an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. UCBH (CIK No. 0001061580) is a Delaware corporation headquartered in San Francisco, California. UCBH's common stock was formerly registered pursuant to Section 12(b) of the Exchange Act and, until December 2009, was listed on the NASDAQ under the symbol "UCBH." On November 6, 2009, UCBH's subsidiary, United Commercial Bank, which accounted for substantially all of UCBH's assets and revenue, was seized by the Federal Deposit Insurance Corporation and placed into receivership. On December 15, 2009, the NASDAQ filed a Form 25 Notification of Removal from Listing and/or Registration of UCBH's common stock under Section 12(b) of the Exchange Act. Thereafter, UCBH's common stock reverted to its previous registration under Section 12(g) of the Exchange Act. UCBH has not filed any quarterly or annual reports since filing, in March 2009, a Form 10-K for year-end 2008.



B. DELINQUENT PERIODIC FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act 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 (Forms 10-K), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q).

3. UCBH is delinquent in its periodic filings with the Commission. Since March 16, 2009, when it filed a Form 10-K for the year ending December 31, 2008, and while its securities have been registered with the Commission, UCBH has failed to file any of its periodic reports required by Section 13(a) and Rules 13a-1 and 13a-13 under the Exchange Act.

4. As a result, UCBH has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

III.

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

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

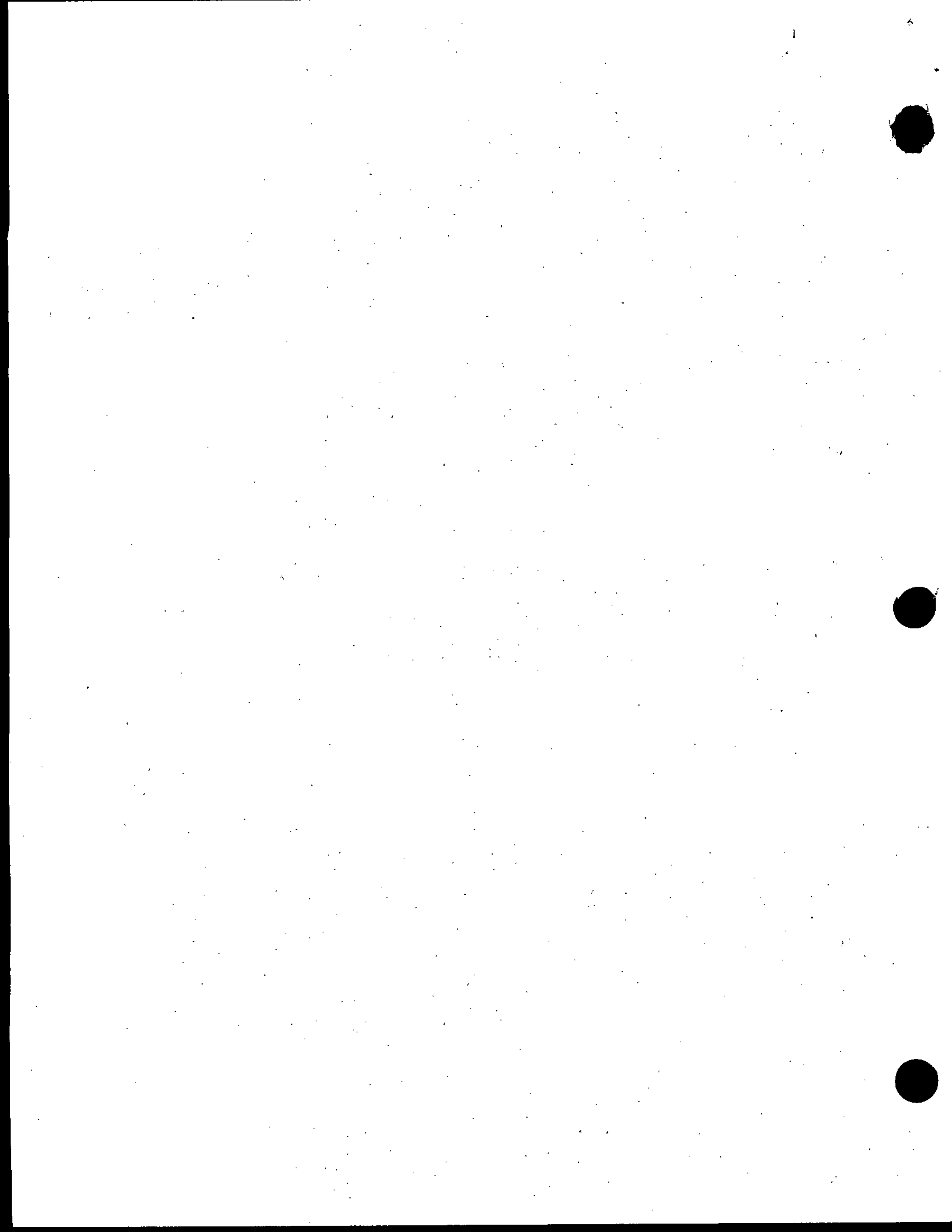
B. Whether it is necessary or appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registration of UCBH's securities identified in Section II hereof registered pursuant to Section 12 of the Exchange Act.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III 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 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].

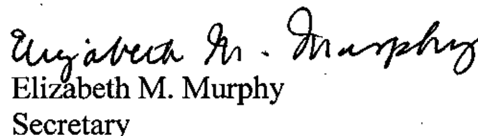


This Order shall be served forthwith upon Respondent in accordance with the provisions of Rule 141 of the Commission's Rules of Practice [17 C.F.R. § 201.141].

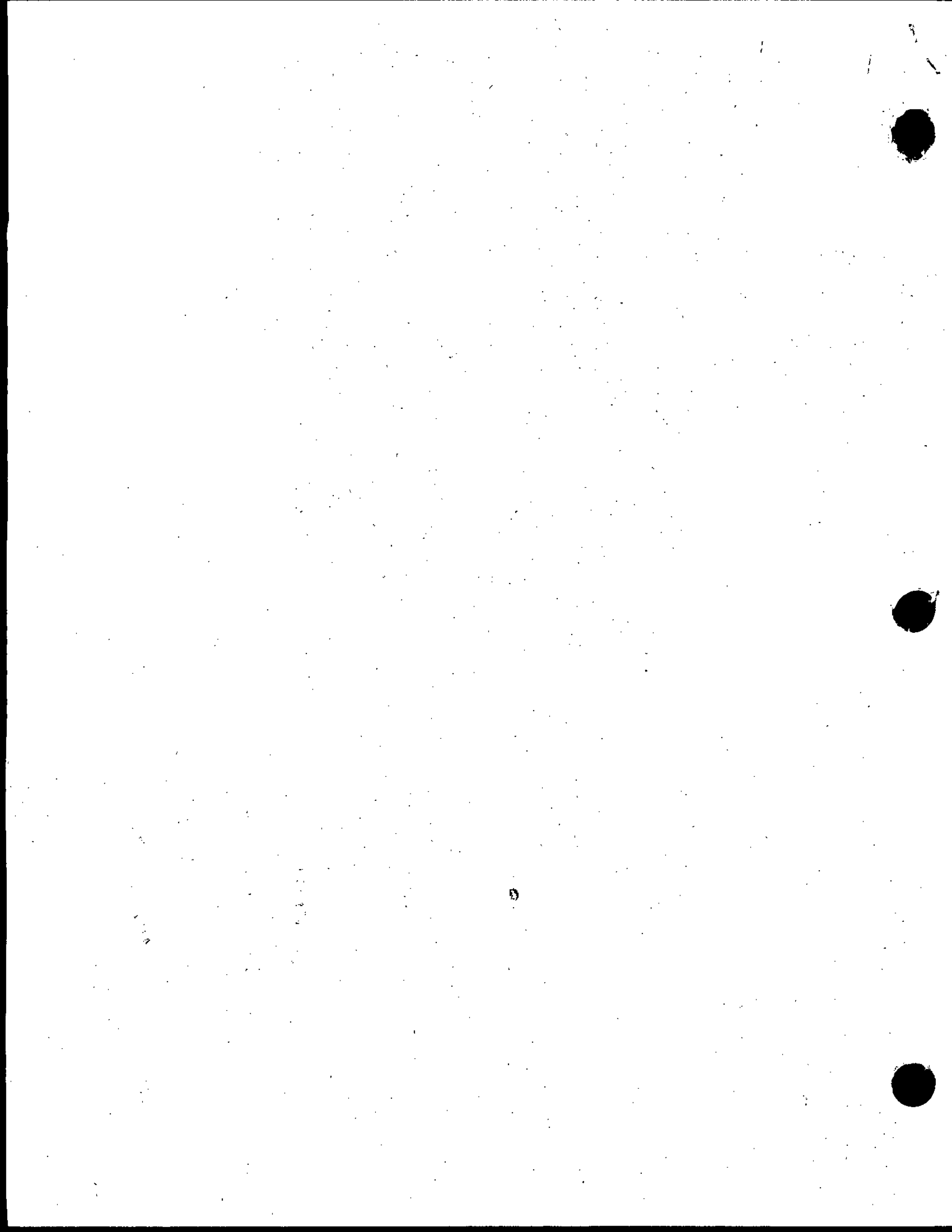
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. §201.360(a)(2)].

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



DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 44
Docket No. OCC-2011-0014
RIN: 1557-AD44

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
12 CFR Part 248
Docket No. R-1432
RIN: 7100 AD 82

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 351
RIN: 3064-AD85

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 255
Release No. 34-65545; File No. S7-41-11
RIN: 3235-AL07

PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS

AGENCIES: Office of the Comptroller of the Currency, Treasury ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); and Securities and Exchange Commission ("SEC").

ACTION: Notice of proposed rulemaking.

SUMMARY: The OCC, Board, FDIC, and SEC (individually, an "Agency," and collectively, "the Agencies") are requesting comment on a proposed rule that would implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") which contains certain prohibitions and restrictions on the ability of a banking entity and nonbank financial company supervised by the Board to engage in proprietary trading and have certain interests in, or relationships with, a hedge fund or private equity fund.

DATES: Comments should be received on or before January 13, 2012.

ADDRESSES: Interested parties are encouraged to submit written comments jointly to all of the Agencies. Commenters are encouraged to use the title "Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds" to facilitate the organization and distribution of comments among the Agencies. Commenters are also encouraged to identify the number of the specific question for comment to which they are responding.

Office of the Comptroller of the Currency: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by the Federal eRulemaking Portal or e-mail, if possible. Please use the title "Restrictions on Proprietary Trading and Certain Interests in and Relationships with Hedge Funds and Private Equity Funds" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

- **Federal eRulemaking Portal – "Regulations.gov":** Go to http://www.regulations.gov. Select "Document Type" of "Proposed Rules," and in the "Enter Keyword or ID Box," enter Docket ID "OCC-2011-14," and click "Search." On "View By Relevance" tab at the bottom of screen, in the "Agency" column, locate the Proposed Rule for the OCC, in the "Action" column, click on "Submit a Comment" or "Open Docket Folder" to submit or view public comments and to view supporting and related materials for this rulemaking action.

- Click on the "Help" tab on the Regulations.gov home page to get information on using Regulations.gov, including instructions for submitting or viewing public comments,

viewing other supporting and related materials, and viewing the docket after the close of the comment period.

- **E-mail:** regs.comments@occ.treas.gov.
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.
- **Fax:** (202) 874-5274.
- **Hand Delivery/Courier:** 250 E Street, SW., Mail Stop 2-3, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2011-14" in your comment. In general, OCC will enter all comments received into the docket and publish them on the Regulations.gov web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials that pertain to this proposed rulemaking by any of the following methods:

- **Viewing Comments Electronically:** Go to http://www.regulations.gov. Select "Document Type" of "Public Submissions," and in the "Enter Keyword or ID Box," enter Docket ID "OCC-2011-14," and click "Search." Comments will be listed under "View By Relevance" tab at the bottom of screen. If comments from more than one agency are listed, the "Agency" column will indicate which comments were received by the OCC.

- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC, 250 E Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 874-4700. Upon arrival, visitors will be required to present valid government-issued photo identification and submit to security screening in order to inspect and photocopy comments.

Docket: You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System:

You may submit comments, identified by **Docket No. R-1432 and RIN 7100 AD 82**, by any of the following methods:

- **Agency Web Site**: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.

- **Federal eRulemaking Portal**: http://www.regulations.gov. Follow the instructions for submitting comments.

- **E-mail**: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.

- **Fax**: (202) 452-3819 or (202) 452-3102.

- Mail: Address to Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

All public comments will be made available on the Board's web site at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9:00 a.m. and 5:00 p.m. on weekdays.

Federal Deposit Insurance Corporation: You may submit comments, identified by RIN number, by any of the following methods:

- **Agency Web Site**: http://www.fdic.gov/regulations/laws/federal/propose.html. Follow instructions for submitting comments on the Agency Web Site.

- **E-mail:** Comments@fdic.gov. Include the RIN 3064-AD85 on the subject line of the message.

- **Mail:** Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

- **Hand Delivery:** Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7:00 a.m. and 5:00 p.m.

Public Inspection: All comments received must include the agency name and RIN 3064-AD85 for this rulemaking. All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information

Center, 3501 North Fairfax Drive, Room E-I002, Arlington, VA 22226 by telephone at 1 (877) 275-3342 or 1 (703) 562-2200.

Securities and Exchange Commission: You may submit comments by the following method:

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 S7-41-11 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 S7-41-11. 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 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:

OCC: Deborah Katz, Assistant Director, or Ursula Pfeil, Counsel, Legislative and Regulatory Activities Division, (202) 874-5090; Roman Goldstein, Senior Attorney, Securities and Corporate Practices Division, (202) 874-5210; Kurt Wilhelm, Director for Financial Markets Group, (202) 874-4660; Stephanie Boccio, Technical Expert for Asset Management Group, or Joel Miller, Group Leader for Asset Management Group, (202) 874-4660, Office of the Comptroller of the Currency, 250 E Street SW., Washington, DC 20219.

Board: Jeremy R. Newell, Counsel, (202) 452-3239, or Christopher M. Paridon, Counsel, Legal Division, (202) 452-3274; Sean D. Campbell, Deputy Associate Director, Division of Research and Statistics, (202) 452-3760; David Lynch, Manager, Division of Bank Supervision and Regulation, (202) 452-2081, Board of Governors of the Federal Reserve System, 20th and C Streets, NW., Washington, DC 20551.

FDIC: Bobby R. Bean, Acting Associate Director, Capital Markets (202) 898-6705, or Karl R. Reitz, Senior Capital Markets Specialist, (202) 898-6775, Division of Risk Management Supervision; Michael B. Phillips, Counsel, (202) 898-3581, or Gregory S. Feder, Counsel, (202) 898-8724, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429-0002.

SEC: Josephine Tao, Assistant Director, Elizabeth Sandoe, Senior Special Counsel, David Bloom, Branch Chief, Anthony Kelly, Special Counsel, Angela Moudy, Attorney Advisor, or Daniel Staroselsky, Attorney Advisor, Office of Trading Practices, Division of Trading and

Markets, (202) 551-5720; David Blass, Chief Counsel, or Gregg Berman, Senior Advisor to the Director, Division of Trading and Markets; Daniel S. Kahl, Assistant Director, Tram N. Nguyen, Branch Chief, Michael J. Spratt, Senior Counsel, or Parisa Haghshenas, Law Clerk, Office of Investment Adviser Regulation, Division of Investment Management, (202) 551-6787; David Beaning, Special Counsel, Office of Structured Finance, Division of Corporation Finance, (202) 551-3850; John Harrington, Special Counsel, Office of Capital Market Trends, Division of Corporation Finance, (202) 551-3860; Richard Bookstaber, Senior Policy Advisor, or Jennifer Marietta-Westberg, Assistant Director, Office of the Sell Side; or Adam Yonce, Financial Economist, Division of Risk Strategy and Financial Innovation, (202) 551-6600, U.S. Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background.

The Dodd-Frank Act was enacted on July 21, 2010.[1] Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company Act of 1956 ("BHC Act") (to be codified at 12 U.S.C. § 1851) that generally prohibits any banking entity[2] from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund ("covered fund"), subject to certain exemptions.[3] New section 13 of the BHC Act also provides for nonbank financial companies

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] Application of the proposed rule to smaller, less-complex banking entities is discussed below in Part II.F of this Supplemental Information.

[3] The term "banking entity" is defined in section 13(h)(1) of the BHC Act, as amended by section 619 of the Dodd-Frank Act. See 12 U.S.C. 1851(h)(1). The statutory definition includes any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106), and any affiliate or subsidiary of any of the foregoing. Section 13 of the BHC Act defines the terms "hedge fund" and "private equity fund" as an issuer that would be an investment company, as defined under the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act,

supervised by the Board that engage in such activities or have such interests or relationships to be subject to additional capital requirements, quantitative limits, or other restrictions.[4]

A. Rulemaking framework.

Section 13 of the BHC Act requires that implementation of its provisions occur in several stages. First, the Council was required to conduct a study ("Council study") and make recommendations by January 21, 2011 on the implementation of section 13 of the BHC Act. The Council study was issued on January 18, 2011, and included a detailed discussion of key issues related to implementation of section 13 and recommended that the Agencies consider taking a number of specified actions in issuing rules under section 13 of the BHC Act.[5] The Council study also recommended that the Agencies adopt a four-part implementation and supervisory framework for identifying and preventing prohibited proprietary trading, which included a programmatic compliance regime requirement for banking entities, analysis and reporting of quantitative metrics by banking entities, supervisory review and oversight by the Agencies, and

---

or any such similar funds as the appropriate Federal banking agencies (i.e., the Board, OCC, and FDIC), the SEC, and the CFTC may, by rule, determine should be treated as a hedge fund or private equity fund. See 12 U.S.C. 1851(h)(2).

[4] See 12 U.S.C. 1851(a)(2) and (f)(4). A "nonbank financial company supervised by the Board" is a nonbank financial company or other company that the Financial Stability Oversight Council ("Council") has determined, under section 113 of the Dodd-Frank Act, shall be subject to supervision by the Board and prudential standards. The Board is not proposing at this time any additional capital requirements, quantitative limits, or other restrictions on nonbank financial companies pursuant to section 13 of the BHC Act, as it believes doing so would be premature in light of the fact that the Council has not yet finalized the criteria for designation of, nor yet designated, any nonbank financial company.

[5] See Financial Stability Oversight Council, Study and Recommendations on Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds (Jan. 18, 2011), available at http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20619%20study%20final%201%2018%2011%20rg.pdf. See 12 U.S.C. 1851(b)(1). Prior to publishing its study, the Council requested public comment on a number of issues to assist the Council in conducting its study. See 75 FR 61,758 (Oct. 6, 2010). Approximately 8,000 comments were received from the public, including from members of Congress, trade associations, individual banking entities, consumer groups, and individuals. As noted in the issuing release for the Council Study, these comments were carefully considered by the Council when drafting the Council study.

enforcement procedures for violations.[6] The Agencies have carefully considered the Council study and its recommendations, and have consulted with staff of the Commodity Futures Trading Commission ("CFTC"), in formulating this proposal.[7]

Authority for developing and adopting regulations to implement the prohibitions and restrictions of section 13 of the BHC Act is divided between the Agencies in the manner provided in section 13(b)(2) of the BHC Act.[8] The statute also requires the Agencies, in developing and issuing implementing rules, to consult and coordinate with each other, as appropriate, for the purposes of assuring, to the extent possible, that such rules are comparable and provide for consistent application and implementation of the applicable provisions of section 13 of the BHC Act.[9] Such coordination will assist in ensuring that advantages are not unduly provided to, and that disadvantages are not unduly imposed upon, companies affected by section 13 of the BHC Act and that the safety and soundness of banking entities and nonbank financial companies supervised by the Board are protected. The statute requires the Agencies to implement rules under section 13 not later than 9 months after the Council completes its study

[6] See Council study at 5-6. The Agencies have implemented this recommendation through the proposed compliance program requirements contained in Subpart D of this proposal with respect to both proprietary trading and covered fund activities and investments.

[7] The Agencies also received a number of comment letters concerning implementation of section 13 of the BHC Act in advance of this proposal. The Agencies have carefully considered these comments in formulating this proposal.

[8] See 12 U.S.C. 1851(b)(2). Under section 13(b)(2)(B) of the BHC Act, rules implementing section 13's prohibitions and restrictions must be issued by: (i) the appropriate Federal banking agencies (i.e., the Board, the OCC, and the FDIC), jointly, with respect to insured depository institutions; (ii) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act, any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an appropriate Federal banking agency, the SEC, or the CFTC is the primary financial regulatory agency); (iii) the CFTC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act; and (iv) the SEC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act. See id.

[9] See 12 U.S.C. 1851(b)(2)(B)(ii). The Secretary of the Treasury, as Chairperson of the Council, is responsible for coordinating the Agencies' rulemakings under section 13 of the BHC Act. See id.

(i.e., not later than October 18, 2011).[10] The restrictions and prohibitions of section 13 of the BHC Act become effective 12 months after issuance of final rules by the Agencies, or July 21, 2012, whichever is earlier.[11]

In addition, the statute required the Board, acting alone, to adopt rules to implement the provisions of section 13 of the BHC Act that provide a banking entity or a nonbank financial company supervised by the Board a period of time after the effective date of section 13 of the BHC Act to bring the activities, investments, and relationships of the banking entity into compliance with that section and the Agencies' implementing regulations.[12] The Board issued its final conformance rule as required under section 13(c)(6) of the BHC Act on February 8, 2011 ("Board's Conformance Rule").[13] As noted in the issuing release for the Board's Conformance Rule, this period is intended to give markets and firms an opportunity to adjust to section 13 of the BHC Act.[14]

B. Section 13 of the BHC Act.

Section 13 of the BHC Act generally prohibits banking entities from engaging in proprietary trading or from acquiring or retaining any ownership interest in, or sponsoring, a covered fund.[15] However, section 13(d)(1) of that Act expressly includes exemptions from these prohibitions for certain permitted activities, including:

- Trading in certain government obligations;
- Underwriting and market making-related activities;
- Risk-mitigating hedging activity;

---

[10] See id. at 1851(b)(2)(A).

[11] See id. at 1851(c)(1).

[12] See id. at 1851(c)(6).

[13] See Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 FR 8265 (Feb. 14, 2011).

[14] See id. (citing 156 Cong. Rec. S5898 (daily ed. July 15, 2010) (statement of Sen. Merkley)).

[15] 12 U.S.C. 1851(a)(1)(A) and (B).

- Trading on behalf of customers;
- Investments in Small Business Investment Companies ("SBICs") and public interest investments;
- Trading for the general account of insurance companies;
- Organizing and offering a covered fund (including limited investments in such funds);
- Foreign trading by non-U.S. banking entities; and
- Foreign covered fund activities by non-U.S. banking entities.[16]

For purposes of this Supplementary Information, trading activities subject to section 13 of the BHC Act, including those permitted under a relevant exemption, are sometimes referred to as "covered trading activities." Similarly, activities and investments with respect to a covered fund that are subject to section 13 of the BHC Act, including those permitted under a relevant exemption, are sometimes referred to as "covered fund activities or investments."

Additionally, section 13 of the BHC Act permits the Agencies to grant, by rule, other exemptions from the prohibitions on proprietary trading and acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund if the Agencies determine that the exemption would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.[17] Furthermore, under the statute, no banking entity may engage in a permitted activity if that activity would (i) involve or result in a material conflict of interest or material exposure of the banking entity to high-risk assets or high-risk trading strategies, or (ii)

[16] See id. at 1851(d)(1). As described in greater detail in Part III.B.4 of this Supplementary Information, the proposed rule applies some of these statutory exemptions only to the proprietary trading prohibition or the covered fund prohibitions and restrictions, but not both, where it appears either by plain language or by implication that the exemption was intended only to apply to one or the other.

[17] Id. at 1851(d)(1)(J).

pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.[18]

Section 13(f) of the BHC Act separately prohibits a banking entity that serves, directly or indirectly, as the investment manager, investment adviser, or sponsor to a covered fund, and any affiliate of such a banking entity, from entering into any transaction with the fund, or any other covered fund controlled by such fund, that would be a "covered transaction" as defined in section 23A of the Federal Reserve Act ("FR Act"),[19] as if such banking entity or affiliate were a member bank and the covered fund were an affiliate thereof, subject to certain exceptions.[20] Section 13(f) also provides that a banking entity may enter into certain prime brokerage transactions with any covered fund in which a covered fund managed, sponsored, or advised by the banking entity has taken an equity, partnership, or other ownership interest, but any such transaction (and any other permitted transaction with such funds) must be on market terms in accordance with the provisions of section 23B of the FR Act.[21]

Section 13 of the BHC Act does not prohibit a nonbank financial company supervised by the Board from engaging in proprietary trading, or from having the types of ownership interests in or relationships with a covered fund that a banking entity is prohibited or restricted from having under section 13 of the BHC Act. However, section 13 of the BHC Act provides for the Board or other appropriate Agency to impose additional capital charges, quantitative limits, or

---

[18] See id. at 1851(d)(2).

[19] See 12 U.S.C. 371c.

[20] 12 U.S.C. 1851(f).

[21] 12 U.S.C. 371c-1.

other restrictions on a nonbank financial company supervised by the Board or their subsidiaries and affiliates that are engaged in such activities or maintain such relationships.[22]

II. Overview of Proposed Rule.

A. General Approach.

In formulating the proposed rule, the Agencies have attempted to reflect the structure of section 13 of the BHC Act, which is to prohibit a banking entity from engaging in proprietary trading or acquiring or retaining an ownership interest in, or having certain relationships with, a covered fund, while permitting such entities to continue to provide client-oriented financial services. However, the delineation of what constitutes a prohibited or permitted activity under section 13 of the BHC Act often involves subtle distinctions that are difficult both to describe comprehensively within regulation and to evaluate in practice. The Agencies appreciate that while it is crucial that rules under section 13 of the BHC Act clearly define and implement its requirements, any rule must also preserve the ability of a banking entity to continue to structure its businesses and manage its risks in a safe and sound manner, as well as to effectively deliver to its clients the types of financial services that section 13 expressly protects and permits. These client-oriented financial services, which include underwriting, market making, and traditional asset management services, are important to the U.S. financial markets and the participants in those markets, and the Agencies have endeavored to develop a proposed rule that does not unduly constrain banking entities in their efforts to safely provide such services. At the same time, providing appropriate latitude to banking entities to provide such client-oriented services need not and should not conflict with clear, robust, and effective implementation of the statute's

---

[22] See 12 U.S.C. 1851(a)(2), (d)(4).

prohibitions and restrictions. Given these complexities, the Agencies request comment on the potential impacts the proposed approach may have on banking entities and the businesses in which they engage. In particular, and as discussed further in Part VII of this Supplemental Information, the Agencies recognize that there are economic impacts that may arise from the proposed rule and its implementation of section 13 of the BHC Act, and the Agencies request comment on such impacts, including quantitative data, where possible.

In light of these larger challenges and goals, the Agencies' proposal takes a multi-faceted approach to implementing section 13 of the BHC Act. In particular, the proposed rule includes a framework that: (i) clearly describes the key characteristics of both prohibited and permitted activities; (ii) requires banking entities to establish a comprehensive programmatic compliance regime designed to ensure compliance with the requirements of the statute and rule in a way that takes into account and reflects the unique nature of a banking entity's businesses; and (iii) with respect to proprietary trading, requires certain banking entities to calculate and report meaningful quantitative data that will assist both banking entities and the Agencies in identifying particular activity that warrants additional scrutiny to distinguish prohibited proprietary trading from otherwise permissible activities. This multi-faceted approach, which is consistent with the implementation and supervisory framework recommended in the Council study, is intended to strike an appropriate balance between accommodating prudent risk management and the continued provision of client-oriented financial services by banking entities while ensuring that

such entities do not engage in prohibited proprietary trading or restricted covered fund activities or investments.[23]

In addition, and consistent with the statutory requirement that the Agencies' rules under section 13 of the BHC Act be, to the extent possible, comparable and provide for consistent application and implementation, the Agencies have proposed a common rule and appendices. This uniform approach to implementation is intended to provide the maximum degree of clarity to banking entities and market participants and ensure that section 13's prohibitions and restrictions are applied consistently across different types of regulated entities.[24]

As a matter of structure, the proposed rule is generally divided into four subparts and contains three appendices, as follows:

- Subpart A of the proposed rule describes the authority, scope, purpose, and relationship to other authorities of the rule and defines terms used commonly throughout the rule;

- Subpart B of the proposed rule prohibits proprietary trading, defines terms relevant to covered trading activity, establishes exemptions from the prohibition on proprietary trading and limitations on those exemptions, and requires certain banking entities to report quantitative measurements with respect to their trading activities;

- Subpart C of the proposed rule prohibits or restricts acquiring or retaining an ownership interest in, and certain relationships with, a covered fund, defines terms relevant to

---

[23] In recognition of economic impacts that may arise from the proposed rule and its implementation of section 13 of the BHC Act, the Agencies are requesting comment on the relative costs and benefits of the proposal in Part VII of this Supplemental Information.

[24] Under this uniform approach, each Agency is proposing the same rule provisions under section 13 of the BHC Act. Each Agency's proposed rule would apply only to banking entities for which the Agency has regulatory authority under section 13(b)(2)(B) of the BHC Act.

covered fund activities and investments, as well as establishes exemptions from the restrictions on covered fund activities and investments and limitations on those exemptions;

- Subpart D of the proposed rule generally requires banking entities to establish an enhanced compliance program regarding compliance with section 13 of the BHC Act and the proposed rule, including written policies and procedures, internal controls, a management framework, independent testing of the compliance program, training, and recordkeeping;

- Appendix A of the proposed rule details the quantitative measurements that certain banking entities may be required to compute and report with respect to their trading activities;[25]

- Appendix B of the proposed rule provides commentary regarding the factors the Agencies propose to use to help distinguish permitted market making-related activities from prohibited proprietary trading; and

- Appendix C of the proposed rule details the minimum requirements and standards that certain banking entities must meet with respect to their compliance program, as required under subpart D.[26]

---

[25] A banking entity must comply with proposed Appendix A's reporting and recordkeeping requirements only if it has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

[26] In particular, a banking entity must comply with the minimum standards specified in Appendix C of the proposed rule (i) with respect to its covered trading activities, if it engages in any covered trading activities and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters, (X) is equal to or greater than $1 billion or (Y) equals 10 percent or more of its total assets; and (ii) with respect to its covered fund activities and investments, if it engages in any covered fund activities and investments and either (X) has, together with its affiliates and subsidiaries, aggregate investments in covered funds the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion or (Y)

In addition, the Board's proposed rule also contains a subpart E, to which the provisions of the Board's Conformance Rule under section 13 of the BHC Act will be recodified from their current location in the Board's Regulation Y.

B. Proprietary Trading Restrictions.

Subpart B of the proposed rule implements the statutory prohibition on proprietary trading and the various exemptions to this prohibition included in the statute. Section __.3 of the proposed rule contains the core prohibition on proprietary trading and defines a number of related terms, including "proprietary trading" and "trading account." The proposed rule's definition of proprietary trading generally parallels the statutory definition, and includes engaging as principal for the trading account of a banking entity in any transaction to purchase or sell certain types of financial positions.[27]

The proposed rule's definition of trading account generally parallels the statutory definition, and provides further guidance regarding the circumstances in which a position will be considered to have been taken principally for the purpose of short-term resale or benefiting from actual or expected short-term price movements, recognizing the importance of providing as much clarity as possible regarding this term, which ultimately defines the scope of accounts subject to the prohibition on proprietary trading.[28] In particular, the proposed definition of trading account identifies three classes of positions that would cause an account to be a trading account. First, the definition includes positions taken principally for the purpose of short-term

---

sponsors and advises, together with its affiliates and subsidiaries, covered funds the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

[27] See proposed rule § __.3(b)(1).

[28] See proposed rule § __.3(b)(2).

resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging another trading account position.[29] As described in this notice, this language is substantially similar to language for a "trading position" used in the Federal banking agencies' current market risk capital rules, as proposed to be revised ("Market Risk Capital Rules"),[30] and the Agencies propose to interpret this language in a similar manner. Second, with respect to a banking entity subject to the Federal banking agencies' Market Risk Capital Rules, the definition includes all positions in financial instruments subject to the prohibition on proprietary trading that are treated as "covered positions" under those capital rules, other than certain foreign exchange and commodities positions. Third, the definition includes all positions acquired or taken by certain registered securities and derivatives dealers (or, in the case of financial institutions[31] that are government securities dealers, that have filed notice with an appropriate regulatory agency) in connection with their activities that require such registration or notice.[32] The definition of trading account also contains clarifying exclusions for certain positions that do not appear to involve the requisite short-term trading intent, such as positions arising under certain repurchase and reverse repurchase arrangements or securities lending transactions, positions acquired or taken for bona fide liquidity management purposes, and certain positions of derivatives clearing organizations or clearing agencies.[33]

---

[29] See proposed rule § __.3(b)(2)(i)(A).

[30] See 76 FR 1890 (Jan. 11, 2011).

[31] In the context of regulation of government securities dealers under the Securities Exchange Act of 1934 ("Exchange Act"), the term "financial institution" as defined in section 3(a)(46) of the Exchange Act includes a bank (as defined in section 3(a)(36) of the Exchange Act) and a foreign bank (as defined in the International Banking Act of 1978). See 15 U.S.C. 78c(a)(46).

[32] See proposed rule § __.3(b)(2)(i)(B).

[33] See proposed rule § __.3(b)(2)(iii).

Section __.3 of the proposed rule also defines a number of other relevant terms, including the term "covered financial position." This term is used to define the scope of financial instruments subject to the prohibition on proprietary trading. Consistent with the statutory language, such covered financial positions include positions (including long, short, synthetic and other positions) in securities, derivatives, commodity futures, and options on such instruments, but do not include positions in loans, spot foreign exchange or spot commodities.[34]

Section __.4 of the proposed rule implements the statutory exemptions for underwriting and market making-related activities. For each of these permitted activities, the proposed rule provides a number of requirements that must be met in order for a banking entity to rely on the applicable exemption. These requirements are generally designed to ensure that the activities, revenues and other characteristics of the banking entity's trading activity are consistent with underwriting and market making-related activities, respectively, and not prohibited proprietary trading.[35] These requirements are intended to support and augment other parts of the proposed rule's approach to implementing the prohibition on proprietary trading, including the compliance program requirement and the reporting of quantitative measurements, in order to assist banking entities and the Agencies in identifying prohibited trading activities that may be conducted in the context of, or mischaracterized as, permitted underwriting or market making-related activities.

Section __.5 of the proposed rule implements the statutory exemption for risk-mitigating hedging. As with the underwriting and market-making exemptions, proposed § __.5 contains a number of requirements that must be met in order for a banking entity to rely on the exemption. These requirements are generally designed to ensure that the banking entity's trading activity is

---

[34] See proposed rule § __.3(b)(3).

[35] See proposed rule § __.4(a), (b).

truly risk-mitigating hedging in purpose and effect.[36] Proposed § __.5 also requires banking entities to document, at the time the transaction is executed, the hedging rationale for certain transactions that present heightened compliance risks.[37] As with the exemptions for underwriting and market making-related activity, these requirements form part of a broader implementation approach that also includes the compliance program requirement and the reporting of quantitative measurements.

Section __.6 of the proposed rule implements statutory exemptions for trading in certain government obligations, trading on behalf of customers, trading by a regulated insurance company, and trading by certain foreign banking entities outside the United States. Section __.6(a) of the proposed rule describes the government obligations in which a banking entity may trade notwithstanding the prohibition on proprietary trading, which include U.S. government and agency obligations, obligations and other instruments of certain government sponsored entities, and State and municipal obligations.[38] Section __.6(b) of the proposed rule describes permitted trading on behalf of customers and identifies three categories of transactions that would qualify for the exemption.[39] These categories include: (i) transactions conducted by a banking entity as investment adviser, commodity trading advisor, trustee, or in a similar fiduciary capacity for the account of a customer where the customer, and not the banking entity, has beneficial ownership of the related positions; (ii) riskless principal transactions; and (iii) transactions conducted by a banking entity that is a regulated insurance company for the separate account of insurance policyholders, subject to certain conditions. Section __.6(c) of the proposed rule describes

---

[36] See proposed rule §§ __.5(b)(1), (2).

[37] See proposed rule § __.5(b)(3).

[38] See proposed rule § __.6(a).

[39] See proposed rule § __.6(b).

permitted trading by a regulated insurance company for its general account, and generally parallels the statutory language governing this exemption.[40] Finally, § __.6(d) of the proposed rule describes permitted trading outside of the United States by a foreign banking entity.[41] The proposed exemption clarifies when a foreign banking entity will be considered to engage in such trading pursuant to sections 4(c)(9) or 4(c)(13) of the BHC Act, as required by the statute, including with respect to a foreign banking entity not currently subject to section 4 of the BHC Act. The exemption also clarifies when trading will be considered to have occurred solely outside of the United States, as required by the statute, and provides a number of specific criteria for determining whether that standard is met.

Section __.7 of the proposed rule requires certain banking entities with significant covered trading activities to comply with the reporting and recordkeeping requirements specified in Appendix A of the proposed rule. In addition, § __.7 requires that a banking entity comply with the recordkeeping requirements in § __.20 of the proposed rule, including, where applicable, the recordkeeping requirements in Appendix C of the proposed rule. Section __.7 of the proposed rule also requires a banking entity to comply with any other reporting or recordkeeping requirements that an Agency may impose to evaluate the banking entity's compliance with the proposed rule.[42] Proposed Appendix A requires those banking entities with significant covered trading activities to furnish periodic reports to the relevant Agency regarding a variety of quantitative measurements of its covered trading activities and maintain records documenting the preparation and content of these reports. These proposed reporting and recordkeeping requirements vary depending on the scope and size of covered trading activities,

[40] See proposed rule § __.6(c).

[41] See proposed rule § __.6(d).

[42] See proposed rule § __.7.

and a banking entity must comply with proposed Appendix A's reporting and recordkeeping requirements only if it has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion. These thresholds are designed to reduce the burden on smaller, less complex banking entities, which generally engage in limited market-making and other trading activities. Other provisions of the proposal, and in particular the compliance program requirement in § __.20 of the proposed rule, are likely to be less burdensome and equally effective methods for ensuring compliance with section 13 of the BHC Act by smaller, less complex banking entities.

The quantitative measurements that must be furnished under the proposed rule are generally designed to reflect, and provide meaningful information regarding, certain characteristics of trading activities that appear to be particularly useful to help differentiate permitted market making-related activities from prohibited proprietary trading and to identify whether certain trading activities result in a material exposure to high-risk assets or high-risk trading strategies. In addition, proposed Appendix B contains a detailed commentary regarding identification of permitted market making-related activities and distinguishing such activities from trading activities that constitute prohibited proprietary trading.

As described in Part II.B.5 of the Supplementary Information below, the Agencies expect to utilize the conformance period provided in section 13(c)(2) of the BHC Act to further refine and finalize the reporting requirements, reflecting the substantial public comment, practical experience, and revision that will likely be required to ensure appropriate, effective use of reported quantitative data in practice.

Section __.8 of the proposed rule prohibits a banking entity from relying on any exemption to the prohibition on proprietary trading if the permitted activity would involve or result in a material conflict of interest, result in a material exposure to high-risk assets or high-risk trading strategies, or pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.[43] This section also defines material conflict of interest, high-risk asset, and high-risk trading strategy for these purposes.

C. Covered Fund Activities and Investments.

Subpart C of the proposed rule implements the statutory prohibition on, as principal, directly or indirectly, acquiring and retaining an ownership interest in, or having certain relationships with, a covered fund, as well as the various exemptions to this prohibition included in the statute. Section __.10 of the proposed rule contains the core prohibition on covered fund activities and investments and defines a number of related terms, including "covered fund" and "ownership interest." The proposed rule's definition of covered fund generally parallels the statutory definition of "hedge fund" and "private equity fund," and explains the universe of entities that would be considered a "covered fund" (including those entities determined by the Agencies to be "such similar funds") and, thus, subject to the general prohibition.[44]

The definition of "ownership interest" provides further guidance regarding the types of interests that would be considered to be an ownership interest in a covered fund.[45] As described in this Supplementary Information, these interests may take various forms. The definition of ownership interest also explicitly excludes from the definition "carried interest" whereby a

---

[43] See proposed rule § __.8.

[44] See proposed rule § __.10(b)(1).

[45] See proposed rule § __.10(b)(3).

banking entity may share in the profits of the covered fund solely as performance compensation for services provided to the covered fund by the banking entity (or an affiliate, subsidiary, or employee thereof).[46]

Section __.10 of the proposed rule also defines a number of other relevant terms, including the terms "prime brokerage transaction," "sponsor," and "trustee."

Section __.11 of the proposed rule implements the exemption for organizing and offering a covered fund provided for under section 13(d)(1)(G) of the BHC Act. Section __.11(a) of the proposed rule outlines the conditions that must be met in order for a banking entity to organize and offer a covered fund under this authority. These requirements are contained in the statute and are intended to allow a banking entity to engage in certain traditional asset management and advisory businesses in compliance with section 13 of the BHC Act.[47] The requirements are discussed in detail in Part III.C.2 of this Supplementary Information.

Section __.12 of the proposed rule permits a banking entity to acquire and retain, as an investment in a covered fund, an ownership interest in a covered fund that the banking entity organizes and offers under § __.11.[48] This section implements section 13(d)(4) of the BHC Act and related provisions. Section 13(d)(4) of the BHC Act permits a banking entity to make an investment in a covered fund that the banking entity organizes and offers pursuant to section 13(d)(1)(G), or for which it acts as sponsor, for the purposes of (i) establishing the covered fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, or (ii) making a de minimis investment in the covered fund in compliance

---

[46] See proposed rule § __.10(b)(3)(ii).

[47] See 156 Cong. Rec. S5889 (daily ed. July 15, 2010) (statement of Sen. Hagan).

[48] See proposed rule § __.12.

with applicable requirements. Section __.12 of the proposed rule implements this authority and related limitations, including limitations regarding the amount and value of any individual per-fund investment and the aggregate value of all such permitted investments.[49] Proposed § __.12 also clarifies how a banking entity must calculate its compliance with these investment limitations (including by deducting such investments from applicable capital, as relevant), as well as sets forth how a banking entity may request an extension of the period of time within which it must conform an investment in a single covered fund.[50]

Section __.13 of the proposed rule implements the statutory exemptions described in sections 13(d)(1)(C), (E), and (I) of the BHC Act that permit a banking entity: (i) to acquire and retain an ownership interest in, or act as sponsor to, one or more SBICs, a public welfare investment, or certain qualified rehabilitation expenditures; (ii) to acquire and retain an ownership interest in a covered fund as a risk-mitigating hedging activity; and (iii) in the case of a non-U.S. banking entity, to acquire and retain an ownership interest in, or act as sponsor to, a foreign covered fund.[51] Section __.13(a) of the proposed rule permits a banking entity to acquire and retain an ownership interest in, or act as sponsor to, an SBIC or certain public interest investments, without limitation as to the amount of ownership interests it may own, hold, or control with the power to vote.[52]

Section __.13(b) of the proposed rule permits a banking entity to use an ownership interest in a covered fund to hedge, but only with respect to individual or aggregated obligations or liabilities of a banking entity that arise from: (i) the banking entity acting as intermediary on

---

[49] See proposed rule § __.12(a)(2).

[50] See proposed rule §§ __.12(b), (c), and (d).

[51] See proposed rule § __.13(a) – (c).

[52] See proposed rule § __.13(a).

behalf of a customer that is not itself a banking entity to facilitate the customer's exposure to the profits and losses of the covered fund (similar to acting as a "riskless principal"); or (ii) a compensation arrangement with an employee of the banking entity that directly provides investment advisory or other services to that fund.[53] Additionally, § __.13(b) of the proposed rule requires that the hedge represent a substantially similar offsetting exposure to the same covered fund and in the same amount of ownership interest in the covered fund arising out of the transaction that the acquisition or retention of an ownership interest in the covered fund is intended to hedge or otherwise mitigate.[54] Proposed § __.13(b) also requires a banking entity to document, at the time the transaction is executed, the hedging rationale for all hedging transactions involving an ownership interest in a covered fund.[55]

Section __.13(c) of the proposed rule implements section 13(d)(1)(I) of the BHC Act and permits certain foreign banking entities to acquire or retain an ownership interest in, or to act as sponsor to, a covered fund so long as such activity occurs solely outside of the United States and the entity meets the requirements of sections 4(c)(9) or 4(c)(13) of the BHC Act. This statutory exemption limits the extraterritorial application of the statutory restrictions on covered fund activities and investments to foreign firms that, in the course of operating outside of the United States, engage in activities permitted under relevant foreign law outside of the United States, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States.[56] The proposed rule defines both the type of foreign banking entities that are eligible for the exemption and the circumstances in which covered fund activities or

---

[53] See proposed rule § __.13(b)(1).

[54] See proposed rule §§ __.13(b)(2)(ii)(C) and (D).

[55] See proposed rule § __.13(b)(3).

[56] See 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

investments by such an entity will be considered to have occurred solely outside of the United States (including clarifying when an ownership interest will be considered to have been offered for sale or sold to a resident of the United States). Section __.13(d) of the proposed rule also implements in part the rule of construction contained in section 13(g)(2) of the BHC Act, which permits the sale and securitization of loans.[57] Proposed § __.13(d) clarifies that a banking entity may acquire and retain an ownership interest in, or act as sponsor to, a covered fund that is an issuer of asset-backed securities, the assets or holdings of which are solely comprised of: (i) loans; (ii) contractual rights or assets directly arising from those loans supporting the asset-backed securities; and (iii) a limited amount of interest rate or foreign exchange derivatives that materially relate to such loans and that are used for hedging purposes with respect to the securitization structure.[58] The authority contained in this section of the proposed rule would therefore allow a banking entity to acquire and retain an ownership interest in a loan securitization vehicle (which would be a covered fund for purposes of section 13(h)(2) of the BHC Act and the proposed rule) that the banking entity organizes and offers, or acts as sponsor to, in excess of the three percent limits specified in section 13(d)(4) of the BHC Act and § __.12 of the proposed rule.

Section __.14 of the proposed rule implements section 13(d)(1)(J) of the BHC Act[59] and permits a banking entity to engage in any covered fund activity or investment that the Agencies determine promotes and protects the safety and soundness of banking entities and the financial

---

[57] See 12 U.S.C. 1851(g)(2).

[58] See proposed rule § __.13(d).

[59] Section 13(d)(1)(J) of the BHC Act provides the Agencies discretion to determine that activities not specifically identified by sections 13(d)(1)(A) – (I) of the BHC Act are also exempted from the general prohibitions contained in section 13(a) of that Act, and are thus permitted activities. In order to make such a determination, the Agencies must find that such activity or activities promote and protect the safety and soundness of banking entities, as well as promote and protect the financial stability of the United States. See 12 U.S.C. 1851(d)(1)(J).

stability of the United States.[60] The Agencies have proposed to permit three activities at this time under this authority. These activities involve acquiring and retaining an ownership interest in, or acting as sponsor to, certain bank owned life insurance ("BOLI") separate accounts, investments in and sponsoring of certain asset-backed securitizations, and investments in and sponsoring of certain entities that rely on the exclusion from the definition of investment company in section 3(c)(1) and/or 3(c)(7) of the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) ("Investment Company Act") but that are, in fact, common corporate organizational vehicles.[61] Additionally, the Agencies have proposed to permit a banking entity to acquire and retain an ownership interest in, or act as sponsor to, a covered fund, if such acquisition or retention is done (i) in the ordinary course of collecting a debt previously contracted, or (ii) pursuant to and in compliance with the conformance or extended transition periods implemented under section 13(c)(6) of the BHC Act.[62]

Section __.15 of the proposed rule, which implements section 13(e)(1) of the BHC Act,[63] requires a banking entity engaged in covered fund activities and investments to comply with (i) the internal controls, reporting, and recordkeeping requirements required under § __.20 and Appendix C of the proposed rule, as applicable and (ii) such other reporting and recordkeeping requirements as the relevant supervisory Agency may deem necessary to appropriately evaluate the banking entity's compliance with subpart C.[64]

---

[60] See 12 U.S.C. 1851(d)(1)(J).

[61] See proposed rule § __.13(a)(1) – (2).

[62] See proposed rule at § __.14(b).

[63] Section 13(e)(1) of the BHC Act requires the Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with section 13. See 12 U.S.C. 1851(e)(1).

[64] See proposed rule § __.15.

Section __.16 of the proposed rule implements section 13(f) of the BHC Act and generally prohibits a banking entity from entering into certain transactions with a covered fund that would be a covered transaction as defined in section 23A of the FR Act.[65] Section __.16(a)(2) of the proposed rule clarifies that, for reasons explained in part III.C.7 of this Supplementary Information, certain transactions between a banking entity and a covered fund remain permissible. Section __.16(b) of the proposed rule implements the statute's requirement that any transaction permitted under section 13(f) of the BHC Act (including a prime brokerage transaction) between the banking entity and a covered fund is subject to section 23B of the FR Act,[66] which, in general, requires that the transaction be on market terms or on terms at least as favorable to the banking entity as a comparable transaction by the banking entity with an unaffiliated third party.

Section __.17 of the proposed rule prohibits a banking entity from relying on any exemption to the prohibition on acquiring and retaining an ownership interest in, acting as sponsor to, or having certain relationships with, a covered fund, if the permitted activity or investment would involve or result in a material conflict of interest, result in a material exposure to high-risk assets or high-risk trading strategies, or pose a threat to the safety and soundness of the banking entity or to the financial stability of the United States.[67] This section also defines material conflict of interest, high-risk asset, and high-risk trading strategy for these purposes.

---

[65] See proposed rule § __.16.

[66] 12 U.S.C. 371c-1.

[67] See proposed rule § __.17.

D. Compliance Program Requirement.

Subpart D of the proposed rule requires a banking entity engaged in covered trading activities or covered fund activities to develop and implement a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on covered trading activities and covered fund activities and investments set forth in section 13 of the BHC Act and the proposed rule.[68] Section __.20(b) of the proposed rule specifies six elements that each compliance program established under subpart D must, at a minimum, include:

- Internal written policies and procedures reasonably designed to document, describe, and monitor the covered trading activities and covered fund activities and investments of the banking entity to ensure that such activities comply with section 13 of the BHC Act and the proposed rule;

- A system of internal controls reasonably designed to monitor and identify potential areas of noncompliance with section 13 of the BHC Act and the proposed rule in the banking entity's covered trading and covered fund activities and to prevent the occurrence of activities that are prohibited by section 13 of the BHC Act and the proposed rule;

- A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and the proposed rule;

[68] See proposed rule § __.20. If a banking entity does not engage in covered trading activities and/or covered fund activities and investments, it need only ensure that its existing compliance policies and procedures include measures that are designed to prevent the banking entity from becoming engaged in such activities and making such investments, and which require the banking entity to develop and provide for the required compliance program prior to engaging in such activities or making such investments.

- Independent testing for the effectiveness of the compliance program, conducted by qualified banking entity personnel or a qualified outside party;

- Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

- Making and keeping records sufficient to demonstrate compliance with section 13 of the BHC Act and the proposed rule, which a banking entity must promptly provide to the relevant Agency upon request and retain for a period of no less than 5 years.

For a banking entity with significant covered trading activities or covered fund activities and investments, the compliance program must also meet a number of minimum standards that are specified in Appendix C of the proposed rule.[69] The application of detailed minimum standards for these types of banking entities is intended to reflect the heightened compliance risks of large covered trading activities and covered fund activities and investments and to provide clear, specific guidance to such banking entities regarding the compliance measures that would be required for purposes of the proposed rule. For banking entities with smaller, less complex covered trading activities and covered fund activities and investments, these detailed minimum standards are not applicable, though the Agencies expect that such smaller entities will consider these minimum standards as guidance in designing an appropriate compliance program.

---

[69] A banking entity must comply with the minimum standards specified in Appendix C of the proposed rule (i) with respect to its covered trading activities, if it engages in any covered trading activities and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters, (X) is equal to or greater than $1 billion or (Y) equals 10 percent or more of its total assets; and (ii) with respect to its covered fund activities and investment, if it engages in any covered fund activities and investments and either (X) has, together with its affiliates and subsidiaries, aggregate investments in covered funds the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion or (Y) sponsors and advises, together with its affiliates and subsidiaries, covered funds the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

E. Conformance Provisions.

Subpart E of the Board's proposed rule incorporates, with minor technical and conforming edits, the final rule which the Board, after soliciting and considering public comment, issued regarding the conformance periods for entities engaged in prohibited proprietary trading or covered fund activities and investments.[70] That rule implements the conformance period and extended transition period, as applicable, during which a banking entity and nonbank financial company supervised by the Board must bring its activities, investments and relationships into compliance with the prohibitions and restrictions on proprietary trading and acquiring an ownership interest in, or having certain relationships with, a covered fund.

F. Treatment of Smaller, Less-Complex Banking Entities.

In formulating the proposed rule, the Agencies have carefully considered and taken into account the potential impact of the proposed rule on small banking entities and banking entities that engage in little or no covered trading activities or covered fund activities and investments, including the burden and cost that might be associated with such banking entities' compliance with the proposed rule. In particular, the Agencies have proposed to reduce the effect of the proposed rule on such banking entities by limiting the application of certain requirements, such as the reporting and recordkeeping requirements of § __.7 and Appendix A of the proposed rule and the compliance program requirements contained in subpart D and Appendix C of the proposed rule, to those banking entities that engage in little or no covered trading activities or covered fund activities and investments. The Agencies have also requested comment (i) throughout this Supplementary Information on a number of questions related to the costs and

[70] See 76 FR 8265 (Feb. 14, 2011).

burdens associated with particular aspects of the proposal, as well as (ii) in Part VII.B of this Supplementary Information on any significant alternatives that would minimize the impact of the proposal on small banking entities.

G. Application of Section 13 of the BHC Act to Securitization Vehicles or Issuers of Asset-Backed Securities.

Many issuers of asset-backed securities may be included within the definition of covered fund since they would be an investment company but for the exclusions contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act.[71] If an issuer of asset-backed securities is considered to be a covered fund, then a banking entity would not be permitted to acquire or retain any ownership interest issued by such issuer except as otherwise permitted under section 13 of the BHC Act and the proposed rule.[72] Separately, issuers of asset-backed securities may be included within the definition of banking entity, as noted in Part III.A.2 of this Supplementary information. Although the proposed definition of banking entity would not include any entity that is a covered fund, an issuer of asset-backed securities that is both (i) an affiliate or subsidiary

[71] For purposes of the proposed rule, any securitization entity that meets the requirements for an exclusion under Rule 3a-7 or section 3(c)(5) of the Investment Company Act, or any other exclusion or exemption from the definition of "investment company" under the Investment Company Act (other than sections 3(c)(1) or 3(c)(7) of the Investment Company Act), would not be a covered fund under the proposed definition. Additionally, an issuer of asset-backed securities that is subject to legal documents mandating compliance with the conditions of section 3(c)(1) of 3(c)(7) of the Investment Company Act would not be a covered fund if such issuer also can satisfy all the conditions of an alternative exclusion or exemption for which it is eligible.

[72] For example, under the proposed rule, a banking entity would be able to acquire or retain an interest or security of an issuer of asset-backed securities that is a covered fund if: (i) the interest or security of the issuer does not qualify as an "ownership interest" under § __.10(b)(3) of the proposed rule; (ii) the issuer of asset-backed securities is comprised solely of loans, contractual rights or assets directly arising from those loans, and certain specified interest rate or foreign exchange derivatives used for hedging purposes, as permitted under § __.13(d) or __.14(a)(2)(v) of the proposed rule; (iii) the banking entity is a "securitizer" or "originator" and acquires and retains such interest in compliance with the minimum requirements of section 15G of the Exchange Act and any implementing regulations issued thereunder, as provided under § __.14(a)(2)(iii) of the proposed rule; or (v) the banking entity organizes and offers the issuer and the ownership interest is a permitted investment under § __.12 of the proposed rule. The circumstances where a banking entity may acquire or retain an ownership interest in a covered fund are discussed in detail in Part III.C of this Supplemental Information.

of a banking entity,[73] and (ii) does not rely on an exclusion contained in section 3(c)(1) of 3(c)(7) of the Investment Company Act, would be a banking entity and thus subject to the requirements of section 13 of the BHC Act and the proposed rule, including: (i) the prohibition on proprietary trading; (ii) limitations on investments in and relationships with a covered fund; (iii) the establishment and implementation of a compliance program as required under the proposed rule; and (iv) recordkeeping and reporting requirements. Given the breadth of the definition of "affiliate," these requirements may apply to a significant portion of the outstanding securitization market, including issuers of asset-backed securities that rely on rule 3a-7 or section 3(c)(5) of the Investment Company Act.

In recognition of these concerns, the Agencies have requested comment throughout this Supplementary Information on the potential effects of section 13 of the BHC Act and the proposed rule on the securitization industry and issuers of asset-backed securities.

III. Section by Section Summary of Proposed Rule.

A. Subpart A – Authority and Definitions.

1. Section __.1: Authority, purpose, scope, and relationship to other authorities.

a. Authority and scope.

Section __.1 of the proposed rule describes the authority under which each Agency is issuing the proposed rule, the purpose of the proposed rule, and the banking entities to which each Agency's rule applies. In addition, § __.1(d) of the proposed rule implements section 13(g)(1) of the BHC Act, which provides that the prohibitions and restrictions of section 13

[73] The definitions of "affiliate" and "subsidiary" are discussed in detail in Part III.A.2 of this Supplemental Information.

apply to the activities of a banking entity regardless of whether such activities are authorized for a banking entity under other applicable provisions of law.[74]

b. Effective date.

Section 13(c)(1) of the BHC Act provides that section 13 shall take effect on the earlier of (i) 12 months after the date of issuance of final rules implementing that section, or (ii) 2 years after the date of enactment of section 13, which is July 21, 2012.[75] Because the Agencies did not issue final rules implementing section 13 of the BHC Act by July 21, 2011, § __.1 of the proposed rule specifies that the effective date for its provisions will be July 21, 2012.

The Agencies note that the proposed effective date will impact not only the date on which the proposed rule's prohibitions and restrictions on proprietary trading and covered fund activities and investments go into effect (subject to the conformance period or extended transition period provided by section 13(c) of the BHC Act),[76] but also the date on which a banking entity must comply with (i) the reporting and recordkeeping requirements of § __.7 and Appendix A of the proposed rule and (ii) the compliance program mandate of § __.20 and Appendix C of the proposed rule. As proposed, § __.1 would require a banking entity subject to either the reporting and recordkeeping or compliance program requirements to begin complying with these requirements as of July 21, 2012.[77] With respect to the compliance program requirement of the proposed rule, § __.1 would require a banking entity to have developed and implemented the required program by the proposed effective date, though the Agencies note that prohibited activities and investments may not be fully conformed by that date. The Agencies

---

[74] See proposed rule § __.1(d).

[75] See 12 U.S.C. 1851(c)(1).

[76] See id. at 1851(c)(2) – (6).

[77] See proposed rule § __.1.

expect a banking entity to fully conform all investments and activities to the requirements of the proposed rule as soon as practicable within the conformance periods provided in section 13 of the BHC Act and the Board's rules thereunder, which define the conformance periods. With respect to the reporting and recordkeeping requirements of the proposed rule, § __.1 of the proposed rule would require a banking entity to begin furnishing these reports for all trading units or asset management units as of the effective date, though the quantitative measurements furnished for proprietary trading activities that are conducted in reliance on the authority provided by the conformance period would not be used to identify prohibited proprietary trading until such time as the relevant trading activities must be conformed.

The Agencies expect that a banking entity may need a period of time to prepare for effectiveness of the proposed rule and, in particular, to implement both the compliance program and the reporting and recordkeeping requirements provided under the proposed rule. Accordingly, in order to help assess the effects and impact of the proposed effective date and any alternative compliance dates, the Agencies request comment on the following questions:

Question 1. Does the proposed effective date provide banking entities with sufficient time to prepare to comply with the prohibitions and restrictions on proprietary trading and covered fund activities and investments? If not, what other period of time is needed and why?

Question 2. Does the proposed effective date provide banking entities with sufficient time to implement the proposal's compliance program requirement? If not, what are the impediments to implementing specific elements of the compliance program and what would be a more effective time period for implementing each element and why?

Question 3. Does the proposed effective date provide banking entities sufficient time to implement the proposal's reporting and recordkeeping requirements? If not, what are the impediments to implementing specific elements of the proposed reporting and recordkeeping requirements and what would be a more effective time period for implementing each element and why?

Question 4. Should the Agencies use a gradual, phased in approach to implement the statute rather than having the implementing rules become effective at one time? If so, what prohibitions and restrictions should be implemented first? Please explain.

2. Section __.2: Definitions.

Section __.2 of the proposed rule defines a variety of terms used throughout the proposed rule, including "banking entity," which defines the scope of entities to which the proposed rule applies. Consistent with the statutory definition of that term, § __.2(e) of the proposed rule provides that a "banking entity" includes: (i) any insured depository institution; (ii) any company that controls an insured depository institution; (iii) any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and (iv) any affiliate or subsidiary of any of the foregoing.[78] In addition, in order to avoid application of section 13 of the BHC Act in a way that appears unintended by the statute and would create internal inconsistencies in the statutory scheme, the proposed rule also clarifies that the term "banking entity" does not include any affiliate or subsidiary of a banking entity, if that

[78] See proposed rule § __.2(e). Sections __.2(a) and (bb) of the proposed rule clarify that the terms "affiliate" and "subsidiary" have the same meaning as in sections 2(d) and (k) of the BHC Act (12 U.S.C. 1841(d) and (k)).

affiliate or subsidiary is (i) a covered fund, or (ii) any entity controlled by such a covered fund.[79] This clarification is proposed because the definition of "affiliate" and "subsidiary" under the BHC Act is broad, and could include a covered fund that a banking entity has permissibly sponsored or made an investment in because, for example, the banking entity acts as general partner or managing member of the covered fund as part of its permitted sponsorship activities.[80] If such a covered fund were considered a "banking entity" for purposes of the proposed rule, the fund itself would become subject to all of the restrictions and limitations of section 13 of the BHC Act and the proposed rule, which would be inconsistent with the purpose and intent of the statute. For example, such a covered fund would then generally be prohibited from investing in other covered funds, notwithstanding the fact that section 13(f)(3) of the BHC Act specifically contemplates such investments. Accordingly, the proposed rule would exclude from the definition of banking entity any fund that a banking entity may invest in or sponsor as permitted by the proposed rule.

An entity such as a mutual fund would generally not be a subsidiary or affiliate of a banking entity under this definition if the banking entity only provides advisory or administrative services to, has certain limited investments in, or organizes, sponsors, and manages a mutual fund (which includes a registered investment company) in accordance with BHC Act rules.[81]

---

[79] The Agencies note that since the proposed rule implements section 13 of the BHC Act, it incorporates that Act's definition of "affiliate" and "subsidiary." See proposed rule §§ __.2(a) and (bb). The terms affiliate and subsidiary are generally defined in section 2 of the BHC Act according to whether such entity controls or is controlled by another relevant entity. See 12 U.S.C. 1841(d), (k). The concept of control under the proposed rule, in turn, is as defined in section 2 of the BHC Act and as implemented by the Board. See 12 U.S.C. 1841(a)(2); 12 CFR 225.2(e).

[80] Under section 2 of the BHC Act and the Board's Regulation Y (12 CFR part 225), a banking entity acting as general partner or managing member of another company would be deemed to control that company and, as such, the company would be both an "affiliate" and "subsidiary" of the banking entity for purposes of the BHC Act. See 12 U.S.C. 1841(d), (k).

[81] See, e.g., 12 U.S.C. 1483(c)(6), (c)(8), and (k); 12 CFR 225.28(b)(6), 225.86(b)(3).

Section __.2(j) of the proposed rule defines the term "covered banking entity," which is used in each Agency's proposed rule to describe the specific types of banking entities to which that Agency's rule applies. In addition, a number of other definitions contained in § __.2 are discussed in further detail below in connection with the separate sections of the proposed rule in which they are used.

The proposed rule also defines the terms "buy and purchase" and "sell and sale," which are used throughout the proposed rule to describe the scope of transactions that are subject to subparts B and C of the proposed rule. These definitions are substantially similar to the definitions of the same terms under the Exchange Act, except that the proposed definitions provide additional clarity regarding the types of transactions that would be considered the purchase or sale of a commodity future or derivative or ownership interest in a covered fund.[82] These definitions are purposefully broad in scope, and are intended to include a wide range of transaction types that would permit a banking entity to gain or eliminate, or increase or reduce, exposure to a covered financial position or ownership interest in a covered fund.

Request for comment.

The Agencies request comment on the proposed rule's definition of "banking entity." In particular, the Agencies request comment on the following questions:

Question 5. Is the proposed rule's definition of banking entity effective? What alternative definitions might be more effective in light of the language and purpose of the statute?

---

[82] See proposed rule §§ __.2(g), (v); 15 U.S.C. 78c(a)(13), (14).

Question 6. Are there any entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results? Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not?

Question 7. Is the proposed rule's exclusion of a covered fund that is organized, offered and held by a banking entity from the definition of banking entity effective? Should the definition of banking entity be modified to exclude any covered fund? Why or why not?

Question 8. Banking entities commonly structure their registered investment company relationships and investments such that the registered investment company is not considered an affiliate or subsidiary of the banking entity. Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not? Are there circumstances in which such companies should be treated as banking entities subject to section 13 of the BHC Act? How many such companies would be covered by the proposed definition?

Question 9. Under the proposed rule, would issuers of asset-backed securities be captured by the proposed definition of "banking entity"? If so, are issuers of asset-backed securities within certain asset classes particularly impacted? Are particular types of securitization vehicles (trusts, LLCs, etc.) more likely than others to be included in the definition of banking entity? Should issuers of asset-backed securities be excluded from the proposed definition of "banking entity," and if so, why? How would such an exclusion be consistent with the language and purpose of the statute?

Question 10. What would be the potential impact of including existing issuers of asset-backed securities[83] in the proposed definition of "banking entity" on existing issuers of asset-backed securities and the securitization market generally? How many existing issuers of asset-backed securities might be included in the proposed definition of "banking entity"? Are there ways in which the proposed rule could be amended to mitigate or eliminate potential impact, if any, on existing asset-backed securities[84] without compromising the intent of the statute?

Question 11. What would be the legal and economic impact to an issuer of asset-backed securities of being considered a "banking entity"? What additional costs would be incurred in the establishment and implementation of a compliance program related to the provisions of the proposed rule as required by § __.20 of the proposed rule (including Appendix C, where applicable)? Who would pay those additional costs?

Question 12. If the ownership requirement under the proposed rule for credit risk retention (section 15G of the Exchange Act) combined with the control inherent in the position of servicer or investment manager means that more securitization vehicles would be considered affiliates of banking entities, would fewer banking entities be willing to (i) serve as the servicer or investment manager of securitization transactions and/or (ii) serve as the originator or securitizer (as defined in section 15G of the Exchange Act) of securitization transactions? What other impact might the potential interplay between these rules have on future securitization transactions? Could there be other potential unintended consequences?

---

[83] For purposes of this Supplemental Information, "existing issuers of asset-backed securities" means issuers that issued asset-backed securities prior to the effective date of the proposed rule.

[84] For purposes of this Supplemental Information, "existing asset-backed securities" means asset-backed securities that were issued prior to the effective date of the proposed rule.

Question 13. Are the proposed rule's definitions of buy and purchase and sale and sell appropriate? If not, what alternative definitions would be more appropriate? Should any other terms be defined? If so, are there existing definitions in other rules or regulations that could be used in this context? Why would the use of such other definitions be appropriate?

B. Subpart B – Proprietary Trading Restrictions.

1. Section __.3: Prohibition on proprietary trading.

Section __.3 of the proposed rule describes the scope of the prohibition on proprietary trading and defines a number of terms related to proprietary trading. The Agencies note that the definition of "proprietary trading" in the statute and under the proposed rule is broad. This definition must be viewed in light of the exemptions described later in the proposed rule, which reflect statutory provisions permitting a number of activities.

a. Prohibition on proprietary trading.

Section __.3(a) of the proposed rule implements section 13(a)(1)(A) of the BHC Act and prohibits a banking entity from engaging in proprietary trading unless otherwise permitted under §§ __.4 through __.6 of the proposed rule. Section __.3(b)(1) of the proposed rule defines proprietary trading in accordance with section 13(h)(4) of the BHC Act.[85] This definition is a key element of the proposal because, unless an activity covered by the definition is specifically permitted under one of the exemptions contained in §§ __.4 through __.6 of the proposed rule, a banking entity is prohibited from engaging in that activity. Specifically, the proposal largely restates the statutory definition of proprietary trading, defining that term to mean engaging in the purchase or sale of one or more covered financial positions as principal for the trading account of

[85] See proposed rule § __.3(b)(1).

the banking entity.[86] The terms "trading account" and "covered financial position" are defined in §§ __.3(b)(2) and __.3(b)(3) of the proposed rule, respectively. The proposed definition of proprietary trading also clarifies that proprietary trading does not include acting as agent, broker, or custodian for an unaffiliated third party, because acting in these types of capacities does not involve trading as principal, which is one of the requisite aspects of the statutory definition.

b. "Trading account".

i. Definition of "trading account".

Section 13(h)(6) of the BHC Act defines the term "trading account" as "any account used for acquiring or taking positions in securities [or other enumerated instruments] principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements)," as well as any such other accounts that the Agencies by rule determine.[87] As an initial matter, the Agencies note that it is often difficult to clearly identify the purpose for which a position is acquired or taken and whether that purpose is short-term in nature, particularly since identification of that purpose generally depends on the intent with which the position is acquired or taken. Moreover, the statute does not define the terms "near-term" or "short-term" for these purposes.

In implementing the statutory definition of trading account, the proposed rule generally restates the statutory definition, with the addition of certain details intended to provide banking entities with greater clarity regarding the scope of positions that fall within the definition of

---

[86] See 12 U.S.C. 1851(h)(4); see also proposed rule § __.3(b)(1). Although the statutory definition refers to the "purchase, sale, acquisition, or disposition of" covered financial positions, the proposed rule uses the simpler terms "purchase" and "sale," which are defined broadly in §§ __.2(g) and (v) of the proposed rule.

[87] See 12 U.S.C. 1851(h)(6).

trading account.[88] The proposed definition of trading account has three prongs. First, under the proposed rule, a trading account includes any account that is used by a banking entity to acquire or take one or more covered financial positions for the purpose of: (i) short-term resale; (ii) benefitting from actual or expected short-term price movements; (iii) realizing short-term arbitrage profits; or (iv) hedging one or more such positions.[89] Second, the proposed definition of trading account also includes any account used by a banking entity that is subject to the Market Risk Capital Rules to acquire or take one or more covered financial positions that are subject to those rules, other than certain foreign exchange and commodity positions.[90] Third, the proposed definition of trading account also includes any account used by a banking entity that is a securities dealer, swap dealer, or security-based swap dealer to acquire or take positions in connection with its dealing activities.[91] To provide additional clarity and guidance regarding the trading account definition, the proposed rule also includes a rebuttable presumption that any account used to acquire or take a covered financial position that is held for sixty days or less is a trading account under the first prong, unless the banking entity can demonstrate that the position was not acquired principally for short-term trading purposes. The proposed definition also clarifies that no account will be a trading account to the extent that it is used to acquire or take certain positions under repurchase or reverse repurchase arrangements or securities lending transactions, positions for bona fide liquidity management purposes, or certain positions held by derivatives clearing organizations or clearing agencies. Each of the three definitional prongs is

---

[88] The Agencies note that the structure of the proposed definition, which defines a trading account by reference to the positions that the account is used to acquire or take, is consistent with the structure of the statutory language used in section 13(h)(6) of the BHC Act.

[89] See proposed rule § __.3(b)(2)(i)(A).

[90] See proposed rule § __.3(b)(2)(i)(B).

[91] See proposed rule § __.3(b)(2)(i)(C).

independent of the others – any one prong would, if met, cause the relevant account to fall within the definition of "trading account."

The Agencies have drawn on existing rules, in particular the Market Risk Capital Rules and various securities and commodities laws, in identifying trading accounts and defining related terms in the proposal.

ii. Positions acquired or taken for short-term trading purposes.

The first prong of the proposed trading account definition refers to positions that a banking entity acquires or takes principally for short-term purposes – that is, for one of the following enumerated purposes described in §§ __.3(b)(2)(i)(A)(1) through (4) of the proposed rule:

- Short-term resale;
- Benefitting from actual or expected short-term price movements;
- Realizing short-term arbitrage profits; or
- Hedging one or more such positions.

This prong reflects the statutory definition's reference to positions acquired or taken "principally for the purpose of selling in the near-term (or otherwise with the intent to resell in order to profit from short-term price movements)."[92]

[92] See 12 U.S.C. 1851(h)(6); see also proposed rule § __.3(b)(2)(i).

Section __.3(b)(2)(i)(A)(1) of the proposed rule's definition of trading account includes covered financial positions acquired or taken principally for the purpose of short-term resale.[93] This part of the trading account definition restates language contained in the statutory definition of trading account and describes one class of positions that are acquired or taken for short-term trading purposes.

Section __.3(b)(2)(i)(A)(2) of the proposed rule includes covered financial positions acquired or taken principally for the purpose of benefitting from actual or expected short-term price movements.[94] This part of the trading account definition does not require the resale of the position; rather, it requires only an intent to engage in any form of transaction on a short-term basis (including a transaction separate from, but related to, the initial acquisition of the position) for the purpose of benefitting from a short-term movement in the price of the underlying position. This part of the proposed definition would, for example, include a derivative or other position where the banking entity enters into (or intends to enter into) a subsequent transaction in the near-term to simply offset or "close out," rather than sell, all or a portion of the risks of the initial position, in order to benefit from a price movement occurring between the acquisition of the underlying position and the subsequent offsetting transaction. Similarly, it would also include a derivative, commodity future, or other position that, regardless of the term of that position, is subject to the exchange of short-term variation margin through which the banking entity intends to benefit from short-term price movements. The proposed definition would also capture the acquisition of a debt instrument where the banking entity intends to enter into a short-term transaction to simply offset, rather than sell, the credit, interest rate and/or other material

---

[93] See proposed rule § __.3(b)(2)(i)(A)(1).

[94] See proposed rule § __.3(b)(2)(i)(A)(2).

risk elements of the initial position so as to benefit from a price movement occurring between acquisition of the underlying position and the subsequent offsetting transaction.

Section __.3(b)(2)(i)(A)(3) of the proposed rule's definition of trading account includes covered financial positions acquired or taken principally to lock in short-term arbitrage profits.[95] Although similar to the positions described in § __.3(b)(2)(i)(A)(2) of the proposed definition (i.e., those acquired for the purpose of benefitting from actual or expected short-term price movements), this part of the definition focuses on short-term arbitrage profits more generally, without regard to whether the transaction is predicated on expected or actual movements in price. Rather, a position acquired to lock in arbitrage profits would include positions acquired or taken with the intent to benefit from differences in multiple market prices, even in cases in which no movement in those prices is necessary to realize the intended profit. Such arbitrage-based transactions might involve profiting from the difference in the market price of multiple related positions or assets, or might instead involve the difference in market price for particular price or risk elements associated with positions or assets. This would include, for example, arbitrage profits resulting from the convergence or divergence in prices between different positions held by a banking entity engaged in relative value convergence arbitrage, which involves marrying a long and short position to benefit from a convergence or divergence in price between the two, or any similar strategy, because such convergence or divergence could happen at any time (i.e., in one day, in sixty-one days, or some other time period).

Section __.3(b)(2)(i)(A)(4) of the proposed rule's definition of trading account includes covered financial positions acquired or taken for the purpose of hedging another position that is

[95] See proposed rule § __.3(b)(2)(i)(A)(3).

itself held in a trading account.[96] In particular, the Agencies assume that, with respect to any position the purpose of which is to hedge another covered financial position in the trading account, the banking entity generally intends to hold the hedging position, whatever its nominal duration, for only so long as the underlying position is held. Accordingly, the proposed rule makes clear that such hedging positions fall within the definition of trading account.

iii. Overview of current Market Risk Capital Rules approach to short-term trading positions.

The first prong of the proposed trading account definition, which references positions acquired principally for short-term trading purposes, is, like the statutory definition it implements, substantially similar to a key portion of the definition of a "covered position" under the Market Risk Capital Rules.[97] For the reasons discussed below, the Agencies have taken this similarity into account and propose to construe the first prong of the definition of trading account under the proposed rule – and in particular its reference to "short-term" – in a manner that is consistent with the Market Risk Capital Rules' approach to identifying positions taken with short-term trading intent.

[96] See proposed rule § __.3(b)(2)(i)(A)(4).

[97] The Federal banking agencies' current Market Risk Capital Rules are located at 12 CFR Part 3, Appendix B (OCC), 12 CFR Part 208, Appendix E and 12 CFR Part 225, Appendix E (Board), and 12 CFR Part 325, Appendix C (FDIC), and apply on a consolidated basis to banks and bank holding companies with trading activity (on a worldwide consolidated basis) that equals 10 percent or more of the institution's total assets, or $1 billion or more. On January 11, 2011, the Federal banking agencies proposed revisions to the Market Risk Capital Rules that include, inter alia, changes to the definition of covered position. Proposed revisions to the Market Risk Capital Rules include (i) changes to portions of the covered position definition not relevant to the statutory definition of trading account in section 13 of the BHC Act and (ii) the addition of a requirement that any position in a trading account also be a "trading position" in order to be considered a covered position. See 76 FR 1890 (Jan. 11, 2011). The revised definition of "trading position" that has been proposed for those purposes is generally identical to this proposed rule's definition of trading account (i.e., a position acquired or taken: (i) for the purpose of short-term resale; (ii) with the intent of benefitting from actual or expected short-term price movements; (iii) to lock in short-term arbitrage profits; or (iv) to hedge another trading position). The Agencies also note that the first prong of the proposed rule's trading account definition is also substantially similar to the Basel Committee's definition of "trading book." See Basel Committee on Banking Supervision, Amendment to the Capital Accord to Incorporate Market Risks, available at http://bis.org/publ/bcbs119.pdf.

The Market Risk Capital Rules define a covered position to include all positions in a bank's "trading account," as that term is defined, in part, in the Report of Condition and Income that banks are required to file periodically with respect to their financial condition ("Call Report"). Under the Market Risk Capital Rules, a covered position is one that is subject to a risk-based capital charge that is based, at least in part, on the banking organization's internal risk management models for purposes of calculating the banking organization's risk-based capital requirement.[98] In defining the term "trading account," the Call Report notes that trading activities typically include, among other activities, "acquiring or taking positions in such items principally for the purpose of selling in the near-term or otherwise with the intent to resell in order to profit from short-term price movements."[99] This language is substantially identical to the statutory definition of trading account in section 13 of the BHC Act in that it refers to acquiring or taking positions (i) principally for the purpose of selling in the near-term or (ii) otherwise with the intent to resell in order to profit from short-term price movements.

In providing guidance regarding the application of "trading account," the Call Report also states that trading account positions include any position that is classified as "trading securities" under relevant U.S. Generally Accepted Accounting Principles ("GAAP") standards for

---

[98] The Agencies note that the Market Risk Capital Rules, both in their current and proposed form, also (i) include within the definition of covered position other positions not captured by the reference to positions acquired for the purpose of short-term resale or with the intent of benefitting from actual or expected short-term price movements (e.g., all commodity and foreign exchange positions, regardless of the intended holding period) and (ii) exclude from that definition certain positions otherwise acquired with short-term trading intent for a variety of policy reasons. The Agencies have not proposed to incorporate such inclusions or exclusions for purposes of the proposed rule's definition of trading account; rather, the Market Risk Capital Rules and related concepts have been referred to only to the extent that they pertain to positions acquired for the purpose of short-term resale or with the intent of benefitting from actual or expected short-term price movements.

[99] Report of Condition and Income at A78a (also including, in the definition of "trading account," "regularly underwriting or dealing in securities; interest rate, foreign exchange rate, commodity, equity, and credit derivative contracts; other financial instruments; and other assets for resale ... and ... acquiring or taking positions in such items as an accommodation to customers or for other trading purposes."). Accordingly, given its broader scope, the Call Report "trading account" includes trading positions that fall outside the statutory "trading account" for purposes of determining what is prohibited and permitted covered trading activity under section 13 of the BHC Act.

accounting.[100] Under the referenced accounting standards, trading securities are defined as those "that are bought and held principally for the purpose of selling them in the near-term" and "generally used with the objective of generating profits on short-term differences in price."[101] The Agencies note that the definition of a trading security under the relevant U.S. GAAP accounting standards is similar to both (i) the financial positions described in the second prong of the Call Report's definition of trading account and (ii) the financial positions described in the statutory definition of trading account under section 13 of the BHC Act.

Although neither the Market Risk Capital Rules, the Call Report, nor relevant accounting standards provide a precise definition of what constitutes "near-term" or "short-term" for purposes of evaluating whether a position is of the type held in a trading account or is a trading security, guidance provided under relevant accounting standards notes that "near-term" for purposes of classifying trading activities is "generally measured in hours and days rather than months or years."[102] The Agencies expect that the precise period of time that may be considered near-term or short-term for purposes of evaluating any particular covered financial position would depend on a variety of factors, including the facts and circumstances of the covered financial position's acquisition, the banking entity's trading and business strategies, and the

---

[100] See Report of Condition and Income at A78a, referring to ASC Topic 320, Investments-Debt and Equity Securities (formerly FASB Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities").

[101] See id. In formulating the proposed rule, the Agencies carefully considered whether to define trading account for purposes of the proposed rule in a manner that formally incorporated the accounting standards governing trading securities. The Agencies have not proposed this approach because: (i) the statutory proprietary trading prohibition under section 13 of the BHC Act applies to financial instruments, such as derivatives, to which the trading security accounting standards may not apply; (ii) these accounting standards permit companies to classify, at their discretion, assets as trading securities even where the assets would not otherwise meet the definition of trading security; and (iii) these accounting standards could change in the future without consideration of the potential impact on section 13 of the BHC Act.

[102] See FASB ASC Master Glossary definition of "trading." Although § __.3(b)(2)(ii) of the proposed rule includes a rebuttable presumption that an account used to acquire or take certain covered financial positions that are held for 60 days or less is a trading account, the Agencies note that U.S. GAAP does not include a presumption that securities sold within 60 days of acquisition were held for the purpose of selling them in the near term.

nature of the relevant markets. In considering the purpose for which a covered financial position is acquired or taken and evaluating whether such position is acquired or taken for short-term purposes, the Agencies intend to rely on a variety of information, including quantitative measurements of banking entities' covered trading activities (as described below in Part II.B.5 of this Supplementary Information), supervisory review of banking entities' compliance practices and internal controls, and supervisory review of individual transactions.

In order to better reinforce the general consistency between the proposal's approach to defining a trading account and the "trading account" concept embedded in the Market Risk Capital Rules, the second prong of the proposed definition of trading account, contained in § __.3(b)(2)(i)(B) of the proposed rule, provides that a trading account includes any account used to acquire or take one or more covered financial positions, other than positions that are foreign exchange derivatives, commodity derivatives, or contracts of sale of a commodity for future delivery (unless the position is otherwise held with short-term intent), that are also market risk capital rule covered positions, if the banking entity, or any affiliate of the banking entity that is a bank holding company, calculates risk-based capital ratios under the Market Risk Capital Rules.[103] For these purposes, a "market risk capital rule covered position" is defined as any covered position as that term is defined for purposes of (i) in the case of a banking entity that is a bank holding company or insured depository institution, the market risk capital rule that is applicable to the banking entity, and (ii) in the case of a banking entity that is affiliated with a bank holding company, other than a banking entity to which a market risk capital rule is

[103] The Agencies have excluded positions that are foreign exchange derivatives, commodity derivatives, or contracts of sale of a commodity for future delivery from this prong of the proposed trading account definition because all foreign exchange and commodity positions are considered "covered positions" under the Market Risk Capital Rules regardless of whether they involve the short-term trading intent required under the statutory definition of trading account in section 13(h)(6) of the BHC Act.

applicable, the market risk capital rule that is applicable to the affiliated bank holding company.[104] In particular, for banking entities already subject to the Market Risk Capital Rules, it appears that positions subject to trading account treatment under those rules because they involve short-term trading intent are generally the type of positions to which the proprietary trading restrictions of section 13 of the BHC Act were intended to apply. In addition, including all covered financial positions that receive trading account treatment under the Market Risk Capital Rules because they meet a nearly identical standard regarding short-term trading intent would also eliminate the potential for inconsistency or regulatory arbitrage in which a banking entity might characterize a position as "trading" for capital purposes but not for purposes of the proposed rule.

The Agencies emphasize that this second prong of the trading account definition is being proposed in contemplation of the proposed revisions to the Market Risk Capital Rules and, in particular, the proposed definition of "covered position" under those proposed revisions. To the extent that those proposed revisions with respect to the definition of "covered position" are not adopted, or adopted in a form other than as proposed, the Agencies would expect to take that into account in determining whether or how to include the proposed second prong of the trading account definition for purposes of the final rule to implement section 13 of the BHC Act.[105]

---

[104] See proposed rule § __.3(c)(8). Accordingly, in the context of a subsidiary of a bank holding company (other than a subsidiary, such as a bank, to which a market risk capital rule is already directly applicable), if that bank holding company is subject to a market risk capital rule, any position of that subsidiary that meets the definition of a "covered position" under the market risk capital rule applicable to the bank holding company would be subject to § __.3(b)(2)(i)(B) of the proposed rule.

[105] In particular, the Agencies note that under the proposed revisions to the Market Risk Capital Rules, but not the existing Market Risk Capital Rule, the term "covered position" expressly includes, other than with respect to commodity and foreign exchange positions, only positions taken with short-term trading intent. See 76 FR 1890 (Jan. 11, 2011). The Agencies do not intend to incorporate "covered positions" under the Market Risk Capital Rules in a way that includes positions lacking short-term trading intent.

iv. Positions acquired or taken by securities dealers, swap dealers, and security-based swap dealers.

The third prong of the proposed definition of trading account is contained in § __.3(b)(2)(i)(C) of the proposed rule and provides that a trading account includes any account used to acquire or take one or more covered financial positions by a banking entity that is: (i) a SEC-registered securities or municipal securities dealer; (ii) a government securities dealer that registered, or that has filed notice, with an appropriate regulatory agency;[106] (iii) a CFTC-registered swap dealer; or (iv) a SEC-registered security-based swap dealer, in each case to the extent that the covered financial position is acquired or taken in connection with the activities that require the banking entity to be registered, or to file notice, as such.[107] Similarly included is any covered financial position acquired or taken by a banking entity that is engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, if such position is acquired or taken in connection with the activities of such business.[108] As a result of this third prong, all covered financial positions acquired or taken by a registered dealer, swap dealer or security-based swap dealer, a government securities dealer that has filed notice

[106] See 15 U.S.C. 78c(a)(42)(E); 15 U.S.C. 78o-5(a)(1)(B); 17 CFR 400.5(b); 17 CFR 449.1. Section 15C(a)(1)(A) of the Exchange Act requires any government securities dealer, other than a registered broker-dealer or a financial institution, to register with the SEC pursuant to section 15C(a)(2). Registered broker-dealers and financial institutions are required to file written notice with their appropriate regulatory agency, as defined in section 3(a)(34) of the Exchange Act, prior to acting as a government securities dealer. See 15 U.S.C. 78o-5(a)(1)(B). The proposed definition of trading account would cover positions of all three forms of government securities dealers: (i) those registered with the SEC; (ii) registered broker-dealers; and (iii) financial institutions that have filed notice with an appropriate regulatory agency.

[107] See proposed rule § __.3(b)(2)(i)(C)(1)-(4). The Agencies emphasize that this provision applies only to positions taken in connection with the activities that require the banking entity to be registered as one of the listed categories of dealer, not to all of the activities of that banking entity. For example, an insured depository institution may be registered as a swap dealer, but only the swap dealing activities that require it to be so registered would be covered by the second prong of the trading account definition. A position taken in connection with other activities of the insured depository institution that do not trigger registration as a swap dealer, such as lending, deposit-taking, the hedging of business risks, or other end-user activity, would only be included within the trading account if the position met one of the other prongs of the trading account definition (i.e., §§ __.3(b)(2)(i)(A) or (B) of the proposed rule).

[108] See proposed rule § __.3(b)(2)(i)(C)(5).

with an appropriate regulatory agency, or a banking entity engaged in the same type of dealing activities outside the United States, are automatically included within the scope of positions described in the trading account definition, if they are acquired or taken in connection with the activities that require the banking entity to be registered, or file notice, as such (or, in the case of a banking entity engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States, in connection with the activities of such business). As discussed below, the proposed rule contains exemptions that permit a variety of covered trading activity in which these types of entities typically engage, notwithstanding the inclusion of all covered financial positions of such entities within the definition of trading account.

The Agencies have proposed this third prong of the trading account definition because all assets or other positions held by firms that register or file notice as securities or derivatives dealers as part of their dealing activity are generally held for sale to customers upon request or otherwise support the firm's trading activities (e.g., by hedging its dealing positions), and so would appear to involve the requisite short-term intent and be captured within the statutory definition of trading account. To the extent that a covered financial position is acquired or taken by such a banking entity outside the scope of the dealing activities that require the banking entity to be registered, or to file notice, as a dealer, swap dealer, or security-based swap dealer, that position may still cause the relevant account to be a trading account under the proposed rule if the account holding such a position otherwise meets the terms of the first or second prong of the trading account definition (i.e., positions acquired or taken for short-term trading purposes or certain Market Risk Capital Rules positions).

v. Rebuttable presumption for certain positions.

In order to provide greater clarity and guidance on the application of the trading account definition, and in particular for those banking entities with no experience in evaluating short-term trading intent or that are not subject to the Market Risk Capital Rules, the proposed rule also includes a rebuttable presumption regarding certain positions that, by reason of their holding period, are presumed to be trading account positions. In particular, § __.3(b)(2)(ii) of the proposed rule provides that an account would be presumed to be a trading account if it is used to acquire or take a covered financial position, other than dealing positions or certain Market Risk Capital Rules covered positions that are automatically considered part of the trading account, that the banking entity holds for a period of sixty days or less. However, the presumption does not apply if the banking entity can demonstrate, based on all the facts and circumstances, that the covered financial position, either individually or as a category, was not acquired or taken principally for the purpose of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging another trading account position.[109] Because it appears likely that most positions held for sixty days or less would have been acquired with short-term trading intent, the proposal presumes such positions are trading account positions unless the banking entity can demonstrate otherwise. The purpose of the proposed rebuttable presumption is to simplify the process of evaluating whether individual positions are included in the definition of trading account. The proposal does not apply this rebuttable presumption to positions described in § __.3(b)(2)(i)(B) or (C) of the proposed rule (i.e., certain Market Risk Capital Rules positions and dealing positions), because these positions are automatically part of the trading account, and cannot be rebutted.

[109] See proposed rule § __.3(b)(2)(ii).

However, the Agencies recognize that, for a variety of reasons, a banking entity may acquire a covered financial position for purposes other than short-term trading but nonetheless dispose of that position within the sixty-day period covered by the presumption. Accordingly, § __.3(b)(2)(ii) is only a presumption, and may be rebutted by reference to all the facts and circumstances surrounding the acquisition of a particular position. For example, if a banking entity acquired a covered financial position with the demonstrable intent of holding it for investment or other non-trading purposes but, because of developments not expected or anticipated at the time of acquisition (e.g., increased customer demand, an unexpected increase in its volatility or a need to liquidate the position to meet unexpected liquidity demands), held it for less than sixty days, those facts and circumstances would generally suggest that the position was not acquired with short-term trading intent, notwithstanding the presumption.[110] The proposed rule also makes clear that this rebuttal may be made not only with respect to a particular transaction, but also with respect to a particular category of transactions, recognizing that it may be possible to identify a category of similar transactions that clearly do not involve short-term trading, notwithstanding the typical holding period of the related positions.

It is important to note that these presumptions are designed to help determine whether a transaction is within the definition of "proprietary trading," not whether a transaction is permissible under section 13 of the BHC Act. A transaction may fall within the definition of "proprietary trading" and yet be permissible if it meets one of the exemptions provided in the proposed rule, such as the exemption for market making-related activities.

---

[110] In such cases, the documented intention for acquiring or taking the position should be consistent with the intention articulated for financial reporting and other purposes.

vi. Request for comment.

The Agencies request comment on the proposed rule's approach to defining trading account. In particular, the Agencies request comment on the following questions:

Question 14. Is the proposed rule's definition of trading account effective? Is it over- or under-inclusive in this context? What alternative definition might be more effective in light of the language and purpose of the statute? How would such definition better identify the accounts that are intended to be covered by section 13 of the BHC Act?

Question 15. Is the proposed rule's approach for determining when a position falls within the definition of "trading account" for purposes of the proposed rule from when it must be reported in the "trading account" for purpose of filing the Call Report effective? What additional guidance could the Agencies provide on this distinction? Are there alternative approaches that would be more effective in light of the language and purpose of the statute? Is this approach workable for affiliates of bank holding companies that are not subject to the Federal banking agencies' market Risk Capital Rules (e.g., affiliated investment advisers)? If not, why not? Are affiliates of bank holding companies familiar with the concepts from the Market Risk Capital Rules that are being incorporated into the proposed rule? If not, what steps would an affiliate of a bank holding company have to take to become familiar with these concepts and what would be the costs and/or benefits of such actions? Is application of the trading account concept from the Federal banking agencies' Market Risk Capital Rules to affiliates of bank holding companies necessary to promote consistency and prevent regulatory arbitrage? Please explain.

Question 16. Is the manner in which the Agencies intend to take into account, and substantially adopt, the approach used in the Market Risk Capital Rules and related concepts for determining whether a position is acquired with short-term trading intent effective?

Question 17. Should the proposed rule's definition of trading account, or its use of the term "short-term," be clarified? Are there particular transactions or positions to which its application would be unclear? Should the proposed rule define "short-term" for these purposes? What alternative approaches to construing the term "short-term" should the Agencies consider and/or adopt?

Question 18. Are there particular transactions or positions to which the application of the proposed definition of trading account is unclear? Is additional regulatory language, guidance, or clarity necessary?

Question 19. Is the exchange of variation margin as a potential indicator of short-term trading in derivative or commodity future transactions appropriate for the definition of trading account? How would this impact such transactions or the manner by which banking entities conduct such transactions? For instance, would banking entities seek to avoid the use of variation margin to avoid this rule? What are the costs and benefits of referring to the exchange of variation margin to determine if positions should be included in a banking entity's trading account? Please explain.

Question 20. Are there particular transactions or positions that are included in the definition of trading account that should not be? If so, what transactions or positions and why?

Question 21. Are there particular transactions or positions that are not included in the definition of trading account that should be? If so, what transactions or positions and why?

Question 22. Is the proposed rule of construction for positions acquired or taken by dealers, swap dealers and security-based swap dealers appropriate and consistent with the purpose and language of section 13 of the BHC Act? Is its application to any particular type of entity, such as an insured depository institution engaged in derivatives dealing activities, sufficiently clear and effective? If not, what alternative would be clearer and/or more effective?

Question 23. Is the rebuttable presumption included in the proposed rule appropriate and effective? Are there more effective ways in which to provide clarity regarding the determination of whether or not a position is included within the definition of trading account? If so, what are they?

Question 24. Are records currently created and retained that could be used to demonstrate investment or other non-trading purposes in connection with rebutting the presumption in the proposed rule? If yes, please identify such records and explain when they are created and whether they would be useful in connection with a single transaction or a category of similar transactions. If no, we seek commenter input regarding the manner in which banking entities might demonstrate investment or other non-trading intent. Should the Agencies require banking entities to make and keep records to demonstrate investment or non-trading intent with respect to their covered financial positions?

Question 25. How should the proposed trading account definition address arbitrage positions? Should all arbitrage positions be included in the definition of trading account, unless the timing of such profits is long-term and established at the time the arbitrage position is

acquired or taken? Please explain in detail, including a discussion of different arbitrage trading strategies and whether subjecting such strategies to the proposed rule would be consistent with the language and purpose of section 13 of the BHC Act.

Question 26. Is the holding period referenced in the rebuttable presumption appropriate? If not, what holding period would be more appropriate, and why?

Question 27. Should the proposed rule include a rebuttable presumption regarding positions that are presumed not to be within the definition of trading account? If so, why, and what would the presumption be?

Question 28. Should any additional accounts be included in the proposed rule pursuant to the authority granted under section 13(h)(6) of the BHC Act? If so, what accounts and why? For example, should accounts used to acquire or take certain long-term positions be included in the definition? If so, how would subjecting such accounts to the proposed rule's prohibitions and restrictions be consistent with the language and purpose of section 13 of the BHC Act?

Question 29. Do any of the activities currently engaged in by issuers of asset-backed securities that would be considered a banking entity constitute proprietary trading as defined by §__.3(b) of this rule proposal? Would any activities relating to investment of funds in accounts held by issuers of asset-backed securities (e.g., reserve accounts, prefunding accounts, reinvestment accounts, etc.) or the purchase and sale of securities as part of the management of a collateralized debt obligation portfolio be considered proprietary trading under the proposed rule? What would be the potential impact of the prohibition on proprietary trading on the use of such accounts in (i) existing securitization transactions and (ii) future securitization transactions? Would any of the securities typically acquired and retained using these accounts be considered

an ownership interest in a covered fund under the proposed rule? Does the exclusion of trading in certain government obligations in § __.6(a) of the proposed rule mitigate the impact of the proposed rule on such issuers of asset-backed securities and their activities? Why or why not?

c. Excluded positions.

i. Excluded positions under certain repurchase and reverse repurchase arrangements.

Section __.3(b)(2)(iii)(A) of the proposed rule's definition of trading account provides that an account will not be a trading account to the extent that such account is used to acquire or take one or more covered financial positions that arise under a repurchase or reverse repurchase agreement pursuant to which the banking entity has simultaneously agreed, in writing at the start of the transaction, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty.[111] This clarifying exclusion is proposed because positions held under a repurchase or reverse repurchase agreement operate in economic substance as a secured loan, and are not based on expected or anticipated movements in asset prices. Accordingly, these types of asset purchases and sales do not appear to be the type of transaction intended to be covered by the statutory definition of trading account.

ii. Excluded positions under securities lending transactions.

Section __.3(b)(2)(iii)(B) of the proposed rule's definition of trading account provides that an account will not be a trading account to the extent that such account is used to acquire or take one or more covered financial positions that arise under a transaction in which the banking entity lends or borrows a security temporarily to or from another party pursuant to a written

[111] See proposed rule § __.3(b)(2)(iii)(A).

securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed to by the parties.[112] This clarifying exclusion is proposed because a position held under a securities lending arrangement can be used, for example, to operate in economic substance and function, as a means to facilitate settlement of securities transactions, and is not based on expected or anticipated movements in asset prices. Accordingly, securities lending transactions do not appear to be the type of transaction intended to be covered by the statutory definition of trading account.

iii. Excluded positions acquired or taken for liquidity management purposes.

Section __.3(b)(2)(iii)(C) of the proposed definition of trading account provides that an account will not be a trading account to the extent that such account is used to acquire or take a position for the purpose of bona fide liquidity management, so long as important criteria are met.[113]

This proposed clarifying exclusion is intended to make clear that, where the purpose for which a banking acquires or takes a position is to ensure that it has sufficient liquid assets to meet its short-term cash demands, and the related position is held as part of the banking entity's liquidity management process, that transaction falls outside of the types of transactions described in the proposed rule's definition of trading account. Maintaining liquidity management positions is a critical aspect of the safe and sound operation of certain banking entities, and does not involve the requisite short-term trading intent that forms the basis of the statutory definition of

---

[112] See proposed rule § __.3(b)(2)(iii)(B). The language describing securities lending transactions in the proposed rule generally mirrors that contained in Rule 3a5-3 under the Exchange Act. See 17 CFR 240.3a5-3.

[113] See proposed rule § __.3(b)(2)(iii)(C).

"trading account." In the context of bona fide liquidity management activity that would qualify for the clarifying exclusion, a banking entity's purpose for acquiring or taking these types of positions is not to benefit from short-term profit or short-term price movements, but rather to ensure that it has sufficient, readily-marketable assets available to meet its expected short-term liquidity needs.

However, the Agencies are concerned with the potential for abuse of this clarifying exclusion – specifically, that a banking entity might attempt to improperly mischaracterize positions acquired or taken for prohibited proprietary trading purposes as positions acquired or taken for liquidity management purposes. To address this, the proposed rule requires that the transaction be conducted in accordance with a documented liquidity management plan that meets five criteria. First, the plan would be required to specifically contemplate and authorize any particular instrument used for liquidity management purposes, its profile with respect to market, credit and other risks, and the liquidity circumstances in which the position may or must be used. Second, the plan would have to require that any transaction contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position acquired or taken for such short-term purposes. Third, the plan would have to require that any positions acquired or taken for liquidity management purposes be highly liquid and limited to financial instruments the market, credit and other risks of which are not expected to give rise to appreciable profits or losses as a result of short-term price movements.[114] Fourth, the plan would be required to limit

[114] Any instance in which positions characterized as taken for liquidity purposes do give rise to appreciable profits or losses as a result of short-term price movements will be subject to significant Agency scrutiny and, absent

any position acquired or taken for liquidity management purposes, together with any other positions acquired or taken for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations, as estimated and documented pursuant to methods specified in the plan. Fifth, the plan would be required to be consistent with the relevant Agency's supervisory requirements, guidance and expectations regarding liquidity management. The Agencies would review these liquidity plans and transactions effected in accordance with these plans through supervisory and examination processes to ensure that the applicable criteria are met and that any position acquired or taken in reliance on the clarifying exclusion for liquidity management transactions is fully consistent with such plans.

iv. Excluded positions of derivatives clearing organizations and clearing agencies.

Section __.3(b)(2)(iii)(D) of the proposed rule's definition of trading account provides that an account will not be a trading account to the extent that such account is used to acquire or take one or more covered financial positions that are acquired or taken by a banking entity that is a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) or a clearing agency registered with the SEC under section 17A of the Exchange Act (15 U.S.C. 78q-1) in connection with clearing derivatives or securities transactions.[115] This clarifying exclusion is proposed because, in the case of a banking entity that acts as a registered, central counterparty in the securities or derivatives markets, these types of transactions do not appear to be the type of transaction intended to be covered by the statutory definition of trading

---

compelling explanatory facts and circumstances, would be viewed as prohibited proprietary trading under the proposal.

[115] See proposed rule § __.3(b)(2)(iii)(D).

account, as the purpose of such transactions is to provide a clearing service to third parties and not to profit from short-term resale or short-term price movements.

v. Request for comment.

The Agencies request comment regarding the proposed clarifying exclusions and whether any other types of activity or transactions should be excluded from the proposed definition of trading account for clarity. In particular, the Agencies request comment on the following questions:

Question 30. Are the proposed clarifying exclusions for positions under certain repurchase and reverse repurchase arrangements and securities lending transactions over- or under-inclusive and could they have unintended consequences? Is there an alternative approach to these clarifying exclusions that would be more effective? Are the proposed clarifying exclusions broad enough to include bona fide arrangements that operate in economic substance as secured loans and are not based on expected or anticipated movements in asset prices? Are there other types of arrangements, such as open dated repurchase arrangements, that should be excluded for clarity and, if so, how should the proposed rule be revised? Alternatively, are the proposed clarifying exclusions narrow enough to not inadvertently exclude from coverage any similar arrangements or transactions that do not have these characteristics?

Question 31. Are repurchase and reverse repurchase arrangements and securities lending transactions sufficiently similar that they should be treated in the same way for purposes of the proposed rule? Are there aspects of repurchase and reverse repurchase arrangements or securities lending transactions that should be highlighted in considering the application of the proposed rule? Do repurchase and reverse repurchase arrangements or securities lending

transactions raise any additional or heightened concerns regarding risk? Please identify and explain how these concerns should be reflected in the proposed rule.

Question 32. Are the proposed exclusions for repurchase and reverse repurchase arrangements and securities lending transactions appropriate or are there conditions that commenters believe would be appropriate as a pre-requisite to relying on these exclusions? Please identify such conditions and explain. Alternatively, we seek commenter input regarding why repurchase and reverse repurchase arrangements and securities lending transactions do not present the potential for abuse, namely, that a banking entity might attempt to improperly mischaracterize prohibited proprietary trading as activity that qualifies for the proposed exclusions.

Question 33. Is the proposed clarifying exclusion for liquidity management transactions effective and appropriate? If not, what alternative would be more effective and appropriate, and why? Is the proposed exclusion under- or over-inclusive? Does the proposed clarifying exclusion place sufficient limitations on liquidity management transactions to prevent abuse of the clarifying exclusion? If not, what additional limitations should be specified? Are any of the limitations contained in the proposed rule inappropriate or unnecessary? If so, how could such limitations be eliminated or altered in way that does not permit abuse of the clarifying exclusion?

Question 34: Is the proposed exclusion for liquidity management positions necessary? If not excluded, would such activity otherwise qualify for an exemption contained in the proposed rule (e.g., the exemptions contains in §§ __.5 and __.6(a) of the proposed rule)? What types of banking entities are likely to engage in the liquidity management activities described in the proposed exclusion?

Question 35: What types of instruments do particular types of banking entities currently use in connection with liquidity management activities (e.g., Treasuries)? Why are such instruments chosen for liquidity management purposes? Would such instruments meet the proposed requirement that the position be highly liquid and limited to financial instruments the market, credit and other risk of which are not expected to give rise to appreciable profits or losses as a result of short-term price movements? Why or why not?

Question 36: What methodologies do banking entities currently use for estimating deviations from normal operations in connection with liquidity management programs?

Question 37: Which unit or units within a banking entity are typically responsible for liquidity management? What is the typical reporting line structure used to control and supervise that unit or units? Are the responsibilities of personnel in the unit limited to liquidity management or do they perform other functions in addition to liquidity management? How is compensation determined for personnel in the unit of the banking entity responsible for liquidity management?

Question 38: Would current liquidity management programs meet the five proposed criteria for liquidity management programs? If not which criteria would not be met, and why? What effect would the proposed liquidity management exclusions have on current liquidity management programs and banking entities in general?

Question 39: Are liquidity management programs used for purposes other than ensuring the banking entity has sufficient assets available to it that are readily marketable to meet expected short-term liquidity needs? If so, for what purposes, and why?

Question 40: What costs or other burdens would arise if the proposal did not contain an exclusion for positions acquired or taken for liquidity management purpose? Please explain and quantify these costs or other burdens in detail.

Question 41: Is the proposed liquidity management exclusion sufficiently clear? If not, why is the exclusion unclear and how should the Agencies clarify the terms of this exclusion?

Question 42. Is the proposed clarifying exclusion for certain positions taken by derivatives clearing organizations and clearing agencies effective and appropriate? If not, what alternative would be more effective and appropriate, and why?

Question 43. Are any additional clarifying exclusions warranted? If so, what clarifying exclusion, and why?

Question 44. Should the proposed definition exclude any position the market risk of which cannot be hedged by the banking entity in a two-way market?[116] If so, what would be the basis for concluding that such positions are clearly not within the statutory definition of trading account?

Question 45. Should the proposed definition include a clarifying exclusion for any position in illiquid assets? If so, what would be the basis for concluding that such positions are clearly not within the statutory definition of trading account? How should "illiquid assets" be defined for these purposes? Should the definition be consistent with the definition given that

[116] The Agencies also note that such an exclusion would be similar to the express exclusion of similar positions under the Federal banking agencies' most recent proposed revisions to the Market Risk Capital Rules. See 76 FR 1890, 1912 (Jan. 11, 2011) (excluding from the definition of a covered position any position the material risk elements of which the holder is unable to hedge in a two-way market).

term in the Board's Conformance Rule under section 13 of the BHC Act (12 CFR 225.180 et seq.)?[117]

d. Covered financial position.

i. Definition of "covered financial position".

Section __.3(b)(3)(i) of the proposed rule defines a covered financial position as any long, short, synthetic or other position[118] in: (i) a security, including an option on a security; (ii) a derivative, including an option on a derivative; or (iii) a contract of sale of a commodity for future delivery, or an option on such a contract. The types of financial instruments described in the proposed definition are consistent with those referenced in section 13(h)(4) of the BHC Act as part of the statutory definition of proprietary trading.[119]

To provide additional clarity, § __.3(b)(3)(ii) of the proposed rule provides that, consistent with the statute, the term covered financial position does not include any position that is itself a loan, a commodity, or foreign exchange or currency.[120] The exclusion of these types of positions is intended to eliminate potential confusion by making clear that the purchase and sale

---

[117] See 76 FR 8265 (Feb. 14, 2011). The Board's conformance rule defines "illiquid asset" as "any real property, security obligation, or other asset that (i) is not a liquid asset; (ii) because of statutory or regulatory restrictions applicable to the hedge fund, private equity fund or asset, cannot be offered, sold, or otherwise transferred by the hedge fund or private equity fund to a person that is unaffiliated with the relevant banking entity; or (iii) because of contractual restrictions applicable to the hedge fund, private equity fund or asset, cannot be offered, sold, or otherwise transferred by the hedge fund or private equity fund for a period of 3 years or more to a person that is unaffiliated with the relevant banking entity." 12 CFR 225.180(g). A "liquid asset" is defined in paragraph (h) of the conformance rule. See 12 CFR 225.180(h).

[118] The proposed definition's reference to any "long, short, synthetic or other position" is intended to make clear that a position in an identified category of financial instrument qualifies as a covered financial position regardless of whether the position is (i) an asset or liability or (ii) is acquired through acquisition or sale of the financial instrument or synthetically through a derivative or other transaction.

[119] Section 13(h)(4) of the BHC Act also permits the Agencies to extend the scope of the proprietary trading restrictions to other financial instruments. The Agencies have not proposed to do so at this time.

[120] See proposed rule § __.3(b)(ii).

of loans, commodities and foreign exchange – none of which are referred to in section 13(h)(4) of the BHC Act – are outside the scope of transactions to which the proprietary trading restrictions apply. The reference in § __.3(b)(3)(ii) to a position that is, rather than a position that is in, a loan, a commodity, or foreign exchange or currency is intended to capture only the purchase and sale of these instruments themselves. This reflects the fact that, consistent with section 13(h)(4) of the BHC Act and the proposed rule, although a position that is a foreign exchange derivative or commodity derivative is included in the definition of covered financial position and therefore subject to the prohibition on proprietary trading, a position that is a commodity or foreign currency is not.[121] For example, the spot purchase of a commodity would meet the terms of the exclusion, but the acquisition of a futures position in the same commodity would not. The Agencies request comment on the proposed rule's definition of covered financial position. In particular, the Agencies request comment on the following questions:

Question 46. Is the proposed rule's definition of covered financial position effective? Is the definition over- or under-inclusive? What alternative approaches might be more effective in light of the language and purpose of section 13 of the BHC Act, and why?

Question 47. Are there definitions in other rules or regulations that might inform the proposed definition of covered financial position? If so, what rule or regulation? How should that approach be incorporated into the proposed definition? Why would that approach be more appropriate?

[121] The types of commodity- and foreign exchange-related derivatives that are included within the definition of "derivative" under the proposed rule are discussed in detail below in Part III.B.2.d.ii of this Supplementary Information.

Question 48. Are there particular transactions or positions to which the application of the proposed definition of covered financial position is unclear? Is additional regulatory language, guidance, or clarity necessary?

Question 49. The proposal would apply to long, short, synthetic, or other positions in one of the listed categories of financial instruments. Does this language adequately describe the type of positions that are intended to fall within the proposed definition of covered financial position? If not, why not? Are there different or additional concepts that should be specified in this context? Please explain.

Question 50. Should the Agencies expand the scope of covered financial positions to include other transactions, such as spot commodities or foreign exchange or currency, or certain subsets of transaction (e.g., spot commodities or foreign exchange or currency traded on a high-frequency basis)? If so, which instruments and why?

Question 51. What factors should the Agencies consider in deciding whether to extend the scope of the proprietary trading restriction to other financial instruments under the authority granted in section 13(h)(4) of the BHC Act? Please explain.

Question 52. Is the proposed exclusion of any position that is a loan, a commodity, or foreign exchange or currency effective? If not, what alternative approaches might be more effective in light of the language and purpose of section 13 of the BHC Act? Should additional positions be excluded? If so, why and under what authority?

ii. Other terms used in the definition of covered financial position.

The proposal also defines a number of terms used in the proposed definition of covered financial position. The term "security" is defined by reference to that same term under the Exchange Act.[122] The terms "commodity" and "contract of sale of a commodity for future delivery" are defined by reference to those same terms under the Commodity Exchange Act.[123] The Agencies have proposed to reference these existing definitions from the securities and commodities laws because these existing definitions are generally well-understood by market participants and have been subject to extensive interpretation in the context of securities and commodities trading activities.

The proposed rule also defines the term "derivative."[124] In particular, the definition of "derivative" under the proposed rule includes any "swap" (as that term is defined in the Commodity Exchange Act) and any "security-based swap" (as that term is defined in the Exchange Act), in each case as further defined by the CFTC and SEC by joint regulation, interpretation, guidance, or other action, in consultation with the Board pursuant to section 712(d) of the Dodd-Frank Act. The Agencies have proposed to incorporate these definitions of "swap" and "security-based swap" under the Federal securities and commodities laws because those definitions: (i) govern the primary Federal regulatory scheme applicable to exchange-traded and over-the-counter derivatives; (ii) will be frequently evaluated and applied by banking entities in the course of their trading activities; and (iii) capture agreements and contracts that are or function as derivatives.[125] The proposed rule also includes within the definition of derivative

---

[122] See proposed rule § __.2(w).

[123] See proposed rule §§ __.3(c)(1), (2).

[124] See proposed rule § __.2(l).

[125] The Agencies note that they have not included a variety of security-related derivatives within the proposed definition of derivative, as such transactions are "securities" for purposes of both the Exchange Act and the

certain other transactions that, although not included within the definition of "swap" or "security-based swap," also appear to be, or operate in economic substance as, derivatives, and which if not included could permit banking entities to engage in proprietary trading that is inconsistent with the spirit of section 13 of the BHC Act. Specifically, the proposed definition of derivative also includes: (i) any purchase or sale of a nonfinancial commodity for deferred shipment or delivery that is intended to be physically settled; (ii) any foreign exchange forward or foreign exchange swap (as those terms are defined in the Commodity Exchange Act);[126] (iii) any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));[127] (iv) any agreement, contract, or transactions in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the

---

proposed rule and, as a result, already included in the broader definition of "covered financial position" to which the prohibition on proprietary trading applies.

[126] The Agencies note that foreign exchange swaps and foreign exchange forwards are considered swaps for purposes of the Commodity Exchange Act definition of that term unless the Secretary of the Treasury determines, pursuant to section 1a(47)(E) of that Act (7 U.S.C. 1a(47)(E)), that foreign exchange swaps and forwards should not be regulated as swaps under the Commodity Exchange Act and are not structured to evade certain provisions of the Dodd-Frank Act. On May 5, 2011, the Treasury Secretary proposed to exercise that authority to exclude foreign exchange forwards and foreign exchange swaps from the definition of "swap." See Determination of Foreign Exchange Swaps and Foreign Exchange Forwards Under the Commodity Exchange Act, 76 FR 25774 (May 5, 2011). If the Secretary of the Treasury issues a final determination, as proposed, a "foreign exchange swap" and "foreign exchange forward" would be excluded from the definition of "swap" under the Commodity Exchange Act and, therefore, would fall outside of the proposed rule's definition of "derivative." Accordingly, the Agencies have proposed to expressly include such transactions in the proposed definition of derivative, but have requested comment on a variety of questions related to whether foreign exchange swaps and forwards should be included or excluded from the definition of derivative. The Agencies note that, aside from foreign exchange swaps and forwards, the Commodity Exchange Act's definition of "swap" (and therefore the proposed definition of "derivative") also includes other types of foreign exchange derivatives, including non-deliverable foreign exchange forwards (NDFs), foreign exchange options, and currency options, which fall outside of the Secretary of the Treasury's authority to issue a determination to exclude certain transactions from the "swap" definition.

[127] Section 2(c)(2)(C)(i) was added to the Commodity Exchange Act in 2008 to address retail foreign exchange transactions that were documented as automatically renewing spot contracts (so-called rolling spot transactions) and therefore not futures contracts subject to the Commodity Exchange Act, but which were functionally and economically similar to futures. See Retail Foreign Exchange Transactions, 76 FR 41375, 47376–77 (July 15, 2011). However, section 2(c)(2)(C)(i) of the Commodity Exchange Act does not apply to transactions entered into by U.S. financial institutions, including insured depository institutions, brokers, dealers, and certain retail foreign exchange dealers. See 7 U.S.C. 2(c)(2)(C)(i)(I)(aa). To apply this definitional prong to such banking entities, the definition of derivative includes a transaction "described in" section 2(c)(2)(C)(i) of the Commodity Exchange Act. In other words, the use of this phrase is intended to capture any transaction described in section 2(c)(2)(C)(i) without regard to the identity of the counterparty.

Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and (v) any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b)). The Agencies are requesting comment on whether including these five types of transactions within the proposed definition of derivative is appropriate.

To provide additional clarity, the proposed definition of derivative also clarifies two types of transactions that are outside the scope of the definition. First, the proposed definition of derivative would not include any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in the Commodity Exchange Act, or security-based swap, as that term is defined in the Exchange Act. The SEC and CFTC have, in proposing rules further defining the terms "swap" and "security-based swap," proposed to not include a variety of agreements, contracts, and transactions within those definitions by joint regulation or interpretation, and the Agencies have proposed to expressly reflect such exclusions in the proposed rule's definition in order to avoid the potential application of its restrictions to transactions that are not commonly thought to be derivatives.[128] Second, the proposed definition of derivative also does not include any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)). This provision is

---

[128] See 76 FR 29818 (May 23, 2011). For example, the SEC and CFTC have proposed to not include (i) certain insurance products within the definitions of "swap" and "security-based swap" by regulation and (ii) certain consumer agreements (e.g., agreements to acquire or lease real property or purchase products at a capped price) and commercial agreements (e.g., employment contracts or the purchase of real property, intellectual property, equipment or inventory) by joint interpretation. See id. at 29832-34. The Agencies have proposed to define "derivative" in the proposed rule by reference to the definition of "swap" and "security-based swap" under the Federal securities and commodities laws in contemplation of the SEC and CFTC's proposed regulatory and interpretative exclusions; to the extent that such exclusions are not included in any final action taken by the SEC and CFTC, the Agencies will consider whether to state such exclusions expressly within the proposed rule's definition of derivative.

proposed to clearly exclude identified banking products that are expressly excluded (i) from the definition of "security-based swap" and (ii) from Commodity Exchange Act and CFTC jurisdiction pursuant to section 403(a) of the Legal Certainty for Bank Products Act of 2000.[129]

The proposed rule defines a "loan" as any loan, lease, extension of credit, or secured or unsecured receivable.[130] The Agencies note that the proposed definition of loan is expansive, and includes a broad array of loans and similar credit transactions, but does not include any asset-backed security that is issued in connection with a loan securitization or otherwise backed by loans.

The Agencies request comment on the proposed rule's definition of terms used in the definition of covered financial position. In particular, the Agencies request comment on the following questions:

Question 53: Are the proposed rule's definitions of commodity and contract of sale of a commodity for future delivery appropriate? If not, what alternative definitions would be more appropriate?

Question 54. Is the proposed definition of derivative effective? If not, what alternative definition would be more effective? Should the proposed rule expressly incorporate the definition of "swap" and security-based swap" under the Federal commodities and securities laws? If not, what alternative approach should be taken? Are there transactions included in those incorporated definitions that should not be included in the proposed rule's definition? If so, what transactions and why? Are there transactions excluded from those incorporated

[129] Examples of excluded identified banking products are deposit accounts, savings accounts, certificates of deposit, or other deposit instruments issued by a bank.

[130] See proposed rule § __.2(q).

definitions that should be included within the proposed rule's definition? If so, what transactions and why?

Question 55. Is the proposed inclusion of foreign exchange forwards and swaps in the definition of derivative effective? If not, why not? On what basis would the Agencies conclude that such transactions are not derivatives? Are these transactions economically or functionally more similar to secured loans or repurchase arrangements than to commodity forwards and swaps? Would there be any unintended consequences to banking entities if such transactions are included in the proposal's definition of derivative? What effect is including foreign exchange swaps and forwards in the definition of derivative likely to have on banking entities, participants in the foreign exchange markets, and the liquidity and efficiency of foreign exchange markets generally? If included within the definition of derivative, should transactions in foreign exchange swaps and forwards be permitted under section 13(d)(1)(J) of the BHC Act? If so, why and on what basis? Please quantify your responses, to the extent feasible.

Question 56. Is the proposed inclusion of any purchase or sale of a nonfinancial commodity for deferred shipment or delivery that is intended to be physically settled in the definition of derivative effective? If not, why not? Would there be any unintended consequences to banking entities if such transactions are included in the proposal's definition of derivative?

Question 57. Is the proposed inclusion of foreign currency transactions described in section 2(c)(2)(C)(i) of the Commodity Exchange Act in the definition of derivative effective? If

not, why not? Would there be any unintended consequences to banking entities if such transactions are included in the proposal's definition of derivative?

Question 58. Is the proposed inclusion of commodity transactions described in section 2(c)(2)(D)(i) of the Commodity Exchange Act in the definition of derivative effective? If not, why not? Would there be any unintended consequences to banking entities if such transactions are included in the proposal's definition of derivative?

Question 59. Is the proposed inclusion of any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b)) in the definition of derivative effective? If not, why not? Would there be any unintended consequences to banking entities if such transactions are included in the proposal's definition of derivative?

Question 60. Is the manner in which the proposed definition of derivative excludes any transaction that the CFTC or SEC exclude by joint regulation, interpretation, guidance, or other action from the definition of "swap" or "security-based swap" effective? If not, what alternative approach would be more appropriate? Should such exclusions be restated in the proposed rule's definition? If so, why?

Question 61. Is the proposed rule's definition of loan appropriate? If not, what alternative definition would be more appropriate? Should the definition of "loan" exclude a security? Should other types of traditional banking products be included in the definition of "loan"? If so, why?

iii. Definition of other terms related to proprietary trading.

Section __.3(d) of the proposed rule defines a variety of other terms used throughout subpart B of the proposed rule. These definitions are discussed in further detail below in the relevant summary of the separate sections of the proposed rule in which they are used.

The Agencies request comment on the proposed rule's definition of other terms used in subpart B of the proposed rule. In particular, the Agencies request comment on the following questions:

Question 62. Are the proposed rule's definitions of other terms in § __.3(d) appropriate? If not, what alternative definitions would be more appropriate?

Question 63. Is the definition of additional terms for purposes of subpart B of the proposed rule necessary? If so, what terms should be defined? How should those terms be defined?

2. Section __.4: Permitted underwriting and market making-related activities.

Section __.4 of the proposed rule implements section 13(d)(1)(B) of the BHC Act, which permits banking entities to engage in certain underwriting and market making-related activities, notwithstanding the prohibition on proprietary trading.[131] Section __.4(a) addresses permitted underwriting activities, and § __.4(b) addresses permitted market making-related activities.

a. Permitted underwriting activities.

---

[131] See 12 U.S.C. 1851(d)(1)(B).

Section __.4(a) of the proposed rule permits a banking entity to purchase or sell a covered financial position in connection with the banking entity's underwriting activities to the extent that such activities are designed not to exceed the reasonably expected near-term demands of clients, customers, or counterparties (the "underwriting exemption"). In order to rely on this exemption, a banking entity's underwriting activities must meet all seven of the criteria listed in § __.4(a)(2). These seven criteria are intended to ensure that any banking entity relying on the underwriting exemption is engaged in bona fide underwriting activities, and conducts those activities in a way that is not susceptible to abuse through the taking of speculative, proprietary positions as a part of, or mischaracterized as, underwriting activity.

First, the banking entity must have established the internal compliance program required by subpart D of the proposed rule, as further described below in Part III.D of this Supplementary Information. This requirement is intended to ensure that any banking entity relying on the underwriting exemption has reasonably designed written policies and procedures, internal controls, and independent testing in place to support its compliance with the terms of the exemption.

Second, the covered financial position that is being purchased or sold must be a security. This requirement reflects the common usage and understanding of the term "underwriting."[132]

Third, the transaction must be effected solely in connection with a distribution of securities for which the banking entity is acting as an underwriter. This prong is intended to give effect to the essential element of the underwriting exemption – i.e., that the transaction be in connection with underwriting activity. For these purposes, the proposed rule defines both (i) a

[132] The Agencies note, however, that a derivative or commodity future transaction may be otherwise permitted under another exemption (e.g., the exemptions for market making-related or risk-mitigating hedging activities).

distribution of securities and (ii) an underwriter. The definitions of these terms are generally identical to the definitions provided for the same terms in the SEC's Regulation M,[133] which governs the activities of underwriters, issuers, selling security holders, and others in connection with offerings of securities under the Exchange Act.[134] The Agencies have proposed to use similar definitions because the meanings of these terms under Regulation M are generally well-understood by market participants and define the scope of underwriting activities in which banking entities typically engage, including underwriting of SEC-registered offerings, underwriting of unregistered distributions, and acting as a placement agent in private placements.

With respect to the definition of distribution, the Agencies note that Regulation M defines a distribution of securities as "an offering of securities, whether or not subject to registration under the Securities Act that are distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts."[135] The manner in which this Regulation M definition distinguishes a distribution of securities from other transactions appears to be relevant in the context of the underwriting exemption and useful to address potential evasion of the general prohibition on proprietary trading, while permitting bona fide underwriting activities. Accordingly, in order to qualify as a distribution for purposes of the proposal, as with Regulation M, the offering must meet the two elements – "magnitude" and "special selling efforts and selling methods." The Agencies have not defined the terms "magnitude" and "special selling efforts and selling methods" in the proposed rule, but would expect to rely on the same factors considered under Regulation M in assessing these elements. For example, the number of shares to be sold, the percentage of the outstanding shares, public

---

[133] 17 CFR 242.100 et seq.

[134] See proposed rule §§ __.4(a)(3), (4); 17 CFR 242.100(b).

[135] 17 CFR 242.100.

float, and trading volume that those shares represent are all relevant to an assessment of magnitude.[136] In addition, delivering a sales document, such as a prospectus, and conducting road shows are generally indicative of special selling efforts and selling methods.[137] Another indicator of special selling efforts and selling methods is compensation that is greater than that for secondary trades but consistent with underwriting compensation for an offering. Similar to the approach taken under Regulation M, the Agencies note that "magnitude" does not imply that a distribution must be large; instead, this factor is a means to distinguish a distribution from ordinary trading, and therefore does not preclude small offerings or private placements from qualifying for the underwriting exemption.

The definition of "underwriter" in the proposed rule is generally similar to that under the SEC's Regulation M, except that the proposed rule's definition would also include, within that definition, a person who has an agreement with another underwriter to engage in a distribution of securities for or on behalf of an issuer or selling security holder.[138] Consistent with current practices and the Council study, the Agencies propose to take into consideration the extent to which the banking entity is engaged in the following activities when determining whether a banking entity is acting as an underwriter as part of a distribution of securities:

- Assisting an issuer in capital raising;
- Performing due diligence;

[136] See Review of Antimanipulation Regulation of Securities Offering, Exchange Act Release No. 33924 (Apr. 19, 1994), 59 FR 21681, 21684 (Apr. 26, 1994) ("Regulation M Concept Release").

[137] See Regulation M Concept Release, 59 FR at 21684-85.

[138] See proposed rule § __.4(a)(4)(ii).

- Advising the issuer on market conditions and assisting in the preparation of a registration statement or other offering documents;

- Purchasing securities from an issuer, a selling security holder, or an underwriter for resale to the public;

- Participating in or organizing a syndicate of investment banks;

- Marketing securities; and

- Transacting to provide a post-issuance secondary market and to facilitate price discovery.

The Agencies note that the precise activities performed by an underwriter may vary depending on the liquidity of the securities being underwritten and the type of distribution being conducted. For example, each factor need not be present in a private placement.

There may be circumstances in which an underwriter would hold securities that it could not sell in the distribution for investment purposes. If the acquisition of such unsold securities were in connection with the underwriting pursuant to the permitted underwriting activities exemption, the underwriter would also be able to dispose of such securities at a later time.[139]

Fourth, to the extent that the transaction involves a security for which a person must generally be a registered securities dealer, municipal securities dealer or government securities dealer in order to underwrite the security, the banking entity must have the appropriate dealer registration (or in the case of a financial institution that is a government securities dealer, has

[139] The Agencies note, however, that such sale would have to be made in compliance with other applicable provisions of the Federal securities laws and regulations.

filed notice of that status as required by section 15C(a)(1)(B) of the Exchange Act) or otherwise be exempt from registration or excluded from regulation as a dealer.[140] Similarly, if the banking entity is engaged in the business of a dealer outside the United States in a manner for which no U.S. registration is required, the banking entity must be subject to substantive regulation of its dealing business in the jurisdiction in which the business is located. This requirement is intended to ensure that (i) any underwriting activity conducted in reliance on the exemption is subject to appropriate regulation and (ii) banking entities are not simultaneously characterizing the transaction as underwriting for purposes of the exemption while characterizing it in a different manner for purposes of applicable securities laws.

Fifth, the underwriting activities of the banking entity with respect to the covered financial position must be designed not to exceed the reasonably expected near-term demands of clients, customers and counterparties.[141] This requirement restates the statutory limitation on the underwriting exemption.

Sixth, the underwriting activities of the banking entity must be designed to generate revenues primarily from fees, commissions, underwriting spreads or other income, and not from appreciation in the value of covered financial positions it holds related to such activities or the hedging of such covered financial position.[142] This requirement is intended to ensure that

---

[140] See proposed rule § __.4(a)(2)(iv). For example, if a banking entity is a bank engaged in underwriting asset-backed securities for which it would be required to register as a securities dealer but for the exclusion contained in section 3(a)(5)(C)(iii) of the Exchange Act, the proposed rule would not require that banking entity be a registered securities dealer in order to rely on the underwriting exemption for that transaction. The proposed rule does not apply the dealer registration/notice requirement to the underwriting of exempted securities, security-based swaps, commercial paper, bankers acceptances or commercial bills because the underwriting of such instruments does not require registration as a securities dealer under the Exchange Act.

[141] See proposed rule § __.4(a)(2)(v).

[142] For these purposes, underwriting spreads would include any "gross spread" (i.e., the difference between the price an underwriter sells securities to the public and the price it purchases them from the issuer) designed to compensate the underwriter for its services.

activities conducted in reliance on the underwriting exemption demonstrate patterns of revenue generation and profitability consistent with, and related to, the services an underwriter provides to its customers in bringing securities to market, rather than changes in the market value of the securities underwritten.

Seventh, the compensation arrangements of persons performing underwriting activities at the banking entity must be designed not to encourage proprietary risk-taking. Activities for which a banking entity has established a compensation incentive structure that rewards speculation in, and appreciation of, the market value of securities underwritten, rather than success in bringing securities to market for a client, are inconsistent with permitted underwriting activities under the proposed rule. Although a banking entity relying on the underwriting exemption may appropriately take into account revenues resulting from movements in the price of securities that the banking entity underwrites to the extent that such revenues reflect the effectiveness with which personnel have managed underwriting risk, the banking entity should provide compensation incentives that primarily reward client revenues and effective client service, not proprietary risk-taking.

The Agencies request comment on the proposed rule's implementation of the underwriting exemption. In particular, the Agencies request comment on the following questions:

Question 64. Is the proposed rule's implementation of the underwriting exemption effective? If not, what alternative approach would be more effective? For example, should the exemption include other transactions that do not involve a distribution of securities for which the banking entity is acting as underwriter?

Question 65. Are the seven requirements included in the underwriting exemption effective? Is the application of each requirement to potential transactions sufficiently clear? Should any of the requirements be changed or eliminated? Should other requirements be added in order to better provide an exemption that is not susceptible to abuse through the taking of speculative, proprietary positions in the context of, or mischaracterized as, underwriting? Alternatively, are any of the proposed requirements inappropriately restrictive in that they would be inconsistent with the statutory exemption for certain underwriting activities? If so, how?

Question 66. Do underwriters currently have processes in place that would prevent or reduce the likelihood of taking speculative, proprietary positions in the context of, or mischaracterized as, underwriting? If so, what are those processes?

Question 67. Would any of the proposed requirements cause unintended consequences? Would the proposed requirements alter current underwriting practices in any way? Would any of the proposed requirements trigger an unwillingness to engage in underwriting? What impact, if any, would the proposed exemption have on capital raising? Please explain.

Question 68. What increased costs, if any, would underwriters incur to satisfy the seven proposed requirements of the underwriting exemption? Would underwriters pass the increased costs onto issuers, selling security holders, or their customers in connection with qualifying for the proposed exemption?

Question 69. In addition to the specific activities highlighted above for purposes of evaluating whether a banking entity is acting as an underwriter as part of distribution of securities (e.g., assisting an issuer in capital raising, performing due diligence, etc), are there other or alternative activities that should be considered? Please explain.

Question 70. Should the requirement that a covered financial position be a security be expanded to include other financial instruments? If so, why? How are such other instruments underwritten within the meaning of section 13(d)(1)(B) of the BHC Act?

Question 71. Is the proposed definition of a "distribution" of securities appropriate, or over- or under-inclusive in this context? Is there any category of underwriting activity that would not be captured by the proposed definition? If so, what are the mechanics of that underwriting activity? Should it be permitted under the proposed rule, and, if so, why? Would an alternative definition better identify offerings intended to be covered by the proposed definition? If so, what alternative definition, and why?

Question 72. Is the proposed definition of "underwriter" appropriate, or over- or under-inclusive in this context? Would an alternative definition, such as the statutory definition of "underwriter" under the Securities Act, better identify persons intended to be covered by the proposed definition? If so, why?

Question 73. How accurately can a banking entity engaging in underwriting predict the near-term demands of clients, customers, and counterparties with respect to an offering? How can principal risk that is retained in connection with underwriting activities to support near-term client demand be distinguished from positions taken for speculative purposes?

Question 74. Is the requirement that the underwriting activities of a banking entity relying on the underwriting exemption be designed to generate revenues primarily from fees, commissions, underwriting spreads or similar income effective? If not, how should the requirement be changed? Does the requirement appropriately capture the type and nature of

revenues typically generated by underwriting activities? Is any further clarification or additional guidance necessary?

Question 75. Is the requirement that the compensation arrangements of persons performing underwriting activities at a banking entity be designed not to reward proprietary risk-taking effective? If not, how should the requirement be changed? Are there other types of compensation incentives that should be clearly referenced as consistent, or inconsistent, with permitted underwriting activity? Are there specific and identifiable characteristics of compensation arrangements that clearly incentivize prohibited proprietary trading?

Question 76. Are there other types of underwriting activities that should also be included within the scope of the underwriting exemption? If so, what additional activities and why? How would an exemption for such additional activities be consistent with the language and purpose of section 13 of the BHC Act? What criteria, requirements, or restrictions would be appropriate to include with respect to such additional activities to prevent misuse or evasion of the prohibition on proprietary trading?

Question 77. Does the proposed underwriting exemption appropriately accommodate private placements? If not, what changes are necessary to do so?

Question 78. The creation, offer and sale of certain structured securities such as trust preferred securities or tender option bonds, among others, may involve the purchase of another security and repackaging of that security through an intermediate entity. Should the sale of the security by a banking entity to an intermediate entity as part of the creation of the structured security be permitted under one of the exemptions to the prohibition on proprietary trading currently included in the proposed rule (e.g., underwriting or market making)? Why or why not?

For purposes of determining whether an exemption is available under these circumstances, should gain on sale resulting from the sale of the purchased security to the intermediate entity as part of the creation of the structured security be considered a relevant factor? Why or why not? What other factors should be considered in connection with the creation of the structured securities and why? Would the analysis be different if the banking entity acquired and retained the security to be sold to the intermediate entity as part of the creation of the structured securities as part of its underwriting of the underlying security? Why or why not?

Question 79. We seek comment on the application of the proposed exemption to a banking entity retaining a portion of an underwriting. Please discuss whether or not firms frequently retain securities in connection with a distribution in which the firm is acting as underwriter. Please identify the types of offerings in which this may be done (e.g., fixed income offerings, securitized products, etc.). Please identify and discuss any circumstances which can contribute to the decision regarding whether or not to retain a portion of an offering. Please describe the treatment of retained securities (e.g., the time period of retention, the type of account in which securities are retained, the potential disposition of the securities). Please discuss whether or not the retention is documented and, if so, how. Should the Agencies require disclosure of securities retained in connection with underwritings? Should the Agencies require specific documentation to demonstrate that the retained portion is connected to an underwriting pursuant to the proposed rule? If so, what kind of documentation should be required? Please discuss how you believe retention should be addressed under the proposal.

b. Permitted market making-related activities.

Section __.4(b) of the proposed rule permits a banking entity to purchase or sell a covered financial position in connection with the banking entity's market making-related activities (the "market-making exemption").

i. Approach to implementing the exemption for market making-related activities.

As the Council study noted, implementing the statutory exception for permitted market making-related activities requires a regulatory regime that differentiates permitted market making-related activity, and in particular the taking of principal positions in the course of making a market in particular financial instruments, from prohibited proprietary trading. Although the purpose and function of these two activities are markedly different – market making-related activities provide intermediation and liquidity services to customers, while proprietary trading involves the generation of profit through speculative risk-taking – clearly distinguishing these activities may be difficult in practice. Market making-related activities, like prohibited proprietary trading, sometimes require the taking of positions as principal, and the amount of principal risk that must be assumed by a market maker varies considerably by asset class and differing market conditions.[143] It may be difficult to distinguish principal positions that appropriately support market making-related activities from positions taken for short-term, speculative purposes. In particular, it may be difficult to determine whether principal risk has been retained because (i) the retention of such risk is necessary to provide intermediation and

[143] With respect to certain kinds of market making-related activities, such as market making in securities, these principal positions are often referred to as "inventory" or "inventory positions." However, since certain types of market making-related activities, such as market making in derivatives, involve the retention of principal positions arising out of multiple derivatives transactions in particular risks (e.g., retained principal interest rate risk), rather than retention of actual financial instruments, the broader term "principal positions" is used in this discussion.

liquidity services for a relevant financial instrument or (ii) the position is part of a speculative trading strategy designed to realize profits from price movements in retained principal risk.[144]

In order to address these complexities, the Agencies have proposed a multi-faceted approach that draws on several key elements. First, similar to the underwriting exemption, the proposed rule includes a number of criteria that a banking entity's activities must meet in order to rely on the exemption for market making-related activities. These criteria are intended to ensure that the banking entity is engaged in bona fide market making. As described in greater detail in Part III.D of the Supplementary Information, among these criteria is the requirement that the banking entity have in place a programmatic compliance regime to guide its compliance with section 13 of the BHC Act and the proposed rule. This compliance regime includes requirements that a banking entity have effective policies, procedures, and internal controls that are designed to ensure that prohibited proprietary trading positions are not taken under the guise of permitted market making-related activity. Second, as described in greater detail in Part III.B.5 of this Supplementary Information, Appendix B of the proposed rule contains a detailed commentary regarding how the Agencies propose to identify permitted market making-related activities. This commentary includes six principles the Agencies propose to use as a guide to help distinguish market-making related activities from prohibited proprietary trading. Third, also as described in greater detail in Part III.B.5 of this Supplementary Information, § __.7 and Appendix A of the proposed rule require a banking entity with significant covered trading activities to report certain quantitative measurements for each of its trading units.[145] These

[144] The Council study contains a detailed discussion of the challenges involved in delineating prohibited proprietary trading from permitted market making-related activities. See Council study at 15-18.

[145] The definition of "trading unit" for this purpose is discussed in detail in Part III.B.5 of this Supplementary Information.

quantitative measurements are intended to assist both banking entities and the Agencies in assessing whether the quantitative profile of a trading unit (e.g., the types of revenues it generates and the risks it retains) is consistent with permitted market making-related activities under the proposed rule.

The proposal's multi-faceted approach is intended, through the incorporation of multiple regulatory and supervisory tools, to strike an appropriate balance in implementing the market-making exemption in a way that articulates the scope of permitted activities and meaningfully addresses the potential for misuse of the exemption, while not unduly constraining the important liquidity and intermediation services that market makers provide to their customers and to the capital markets at large.

The Agencies request comment on the proposed rule's approach to implementing the exemption for permitted market making-related activities. In particular, the Agencies request comment on the following questions:

Question 80. Is the proposed rule's approach to implementing the exemption for permitted market making-related activities (i) appropriate and (ii) likely to be effective? If not, what alternative approach would be more appropriate or effective?

Question 81. Does the proposed multi-faceted approach appropriately take into account and address the challenges associated with differentiating prohibited proprietary trading from permitted market making-related activities? Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 82. Does the proposed multi-faceted approach provide banking entities and market participants with sufficient clarity regarding what constitutes permitted market making-related activities? If not, how could greater clarity be provided?

Question 83. What impact will the proposed multi-faceted approach have on the market making-related services that a banking entity provides to its customers? How will the proposed approach impact market participants who use the services of market makers? How will the approach impact the capital markets at large, and in particular the liquidity, efficiency and price transparency of capital markets? If any of these impacts are positive, how can they be amplified? If any of these impacts are negative, how can they be mitigated? Would the proposed rule's prohibition on proprietary trading and exemption for market making-related activity reduce incentives or opportunities for banking entities to trade against customers, as opposed to trading on behalf of customers? If so, please discuss the benefits arising from such reduced incentives or opportunities.

Question 84. What burden will the proposed multi-faceted approach have on banking entities, their customers, and other market participants? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?

Question 85. Are there particular asset classes that raise special concerns in the context of market making-related activity that should be considered in connection with the proposed market-making exemption? If so, what asset class(es) and concern(s), and how should the concerns be addressed in the proposed exemption?

Question 86. Are there other market making-related activities that the rule text should more clearly permit? Why or why not?

ii. Required criteria for permitted market making-related activities.

As part of the proposal's multi-faceted approach to implementing the exemption for permitted market making-related activities, § __.4(b)(2) of the proposed rule specifies seven criteria that a banking entity's market making-related activities must meet in order to rely on the exemption, each of which are described in detail below. These criteria are designed to ensure that any banking entity relying on the exemption is engaged in bona fide market making-related activities and conducts those activities in a way that is not susceptible to abuse through the taking of speculative, proprietary positions as a part of, or mischaracterized as, market making-related activity.

First criterion - establishment of internal compliance program.

Section __.4(b)(2)(i) of the proposed rule requires a banking entity to establish a comprehensive compliance program to monitor and control its market making-related activities. Subpart D of the proposed rule further describes the appropriate elements of an effective compliance program. This criterion is intended to ensure that any banking entity relying on the market-making exemption has reasonably designed written policies and procedures, internal controls, and independent testing in place to support its compliance with the terms of the exemption.

Second criterion - bona fide market making.

Section __.4(b)(2)(ii) of the proposed rule articulates the core element of the statutory exemption, which is that the activity must be market making-related. In order to give effect to this requirement, § __.4(b)(2)(ii) of the proposed rule requires the trading desk or other

organizational unit that purchases or sells a particular covered financial position to hold itself out as being willing to buy and sell, or otherwise enter into long and short positions in, the covered financial position for its own account on a regular or continuous basis. Notably, this criterion requires that a banking entity relying on the exemption with respect to a particular transaction must actually make a market in the covered financial position involved; simply because a banking entity makes a market in one type of covered financial position does not permit it to rely on the market-making exemption for another type of covered financial position.[146] Similarly, the particular trading desk or other organizational unit of the banking entity that is relying on the exemption for a particular type of covered financial position must also be the trading desk or other organizational unit that is actually making the market in that covered financial position; market making in a particular covered financial position by one trading desk of a banking entity does not permit another trading desk of the banking entity to rely on the market-making exemption for that type of covered financial position.

The language used in § __.4(b)(2)(ii) of the proposed rule to describe bona fide market making-related activity is similar to the definition of "market maker" under section 3(a)(38) of the Exchange Act.[147] The Agencies have proposed to use similar language because the Exchange Act definition is generally well-understood by market participants and is consistent with the scope of bona fide market making-related activities in which banking entities typically engage.

---

[146] The Agencies note that a market maker may often make a market in one type of covered financial positions and hedge its activities using different covered financial positions in which it does not make a market. Such hedging transactions would meet the terms of the market-making exemption if the hedging transaction met the requirements of § __.4(b)(3) of the proposed rule.

[147] Section 3(a)(38) of the Exchange Act defines "market maker" as "any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer quotation communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." 15 U.S.C. 78c(a)(38).

In assessing whether a particular trading desk or other organizational unit holds itself out as being willing to buy and sell, or otherwise enter into long and short positions in, a covered financial position for its own account on a regular or continuous basis in liquid markets, the Agencies expect to take an approach similar to that used by the SEC in the context of assessing whether a person is engaging in bona fide market making. The precise nature of a market maker's activities often varies depending on the liquidity, trade size, market infrastructure, trading volumes and frequency, and geographic location of the market for any particular covered financial position. In the context of relatively liquid positions, such as equity securities or other exchange-traded instruments, a trading desk or other organizational unit's market making-related activity should generally include:

- Making continuous, two sided quotes and holding oneself out as willing to buy and sell on a continuous basis;
- A pattern of trading that includes both purchases and sales in roughly comparable amounts to provide liquidity;
- Making continuous quotations that are at or near the market on both sides; and
- Providing widely accessible and broadly disseminated quotes.[148]

[148] The Agencies note that these indicia are generally consistent with the indicia of bona fide market making in equity markets articulated by the SEC for purposes of describing the exception to the locate requirement of the SEC's Regulation SHO for market makers engaged in bona fide market-making activities. See Exchange Act Release No. 58775 (October 14, 2008), 73 FR 61690, 61698-61699 (Oct. 17, 2008); see also 17 CFR 242.203(b)(2)(iii).

In less liquid markets, such as over-the-counter markets for debt and equity securities or derivatives, the appropriate indicia of market making-related activities will vary, but should generally include:

- Holding oneself out as willing and available to provide liquidity by providing quotes on a regular (but not necessarily continuous) basis;[149]

- With respect to securities, regularly purchasing covered financial positions from, or selling the positions to, clients, customers, or counterparties in the secondary market; and

- Transaction volumes and risk proportionate to historical customer liquidity and investments needs.[150]

The Agencies would apply these indicia when evaluating when a banking entity is eligible for the market making-related activities exemption, but also recognize that these indicia cannot be applied at all times and under all circumstances because some may be inapplicable to the specific asset class or market in which the market making activity is conducted.

The bona fide market making-related activity described in § __.4(b)(2)(ii) of the proposed rule would include block positioning if undertaken by a trading desk or other

[149] The frequency of such regular quotations will itself vary; less illiquid markets may involve quotations on a daily or more frequent basis, while highly illiquid markets may trade only by appointment.

[150] The Agencies also note that the CFTC and SEC have identified, in a proposed rule further defining the terms "swap dealer" and "security-based swap dealer" under the Commodity Exchange Act and Exchange Act, a variety of distinguishing characteristics of swap dealers and security-based swap dealers in the context of derivatives, including that: (i) dealers tend to accommodate demand for swaps and security-based swaps from other parties; (ii) dealers are generally available to enter into swaps or security-based swaps to facilitate other parties' interest in entering into those instruments; (iii) dealers tend not to request that other parties propose the terms of swaps or security-based swaps, but instead tend to enter into those instruments on their own standard terms or on terms they arrange in response to other parties' interest; and (iv) dealers tend to be able to arrange customized terms for swaps or security-based swaps upon request, or to create new types of swaps or security-based swaps at the dealer's own initiative. See 75 FR 80174, 80176 (Dec. 21, 2010).

organizational unit of a banking entity for the purpose of intermediating customer trading.[151] In addition, bona fide market making-related activity may include taking positions in securities in anticipation of customer demand, so long as any anticipatory buying or selling activity is reasonable and related to clear, demonstrable trading interest of clients, customers, or counterparties.

Third criterion - reasonably expected near-term demands of clients, customers, and counterparties.

Under § __.4(b)(2)(iii) of the proposed rule, the market making-related activities of the trading desk or other organization unit that conducts a transaction in reliance on the market-making exemption must be designed not to exceed the reasonably expected near-term demands of clients, customers, and counterparties. This criterion implements the language in section 13(d)(1)(B) of the BHC Act and is intended to prevent a trading desk relying on the market-making exemption from taking a speculative proprietary position unrelated to customer needs as part of its purported market making-related activities. As described in further detail in Parts III.B.5 and III.D of the Supplementary Information, the proposed rule also includes a programmatic compliance requirement and requires reporting of quantitative measurements for certain banking entities, both of which are designed, in part, to meaningfully circumscribe the

[151] The definition of "market maker" in the Exchange Act includes a dealer acting in the capacity of a block positioner. Although the term "block positioner" is not defined in the proposed rule, the Agencies note that the SEC has adopted a definition of "qualified block positioner" in the SEC's Rule 3b-8(c) (17 CFR 240.3b-8(c)), which may serve as guidance in determining whether a block positioner engaged in block positioning is engaged in bona fide market making-related activities for purposes of § __.4(b)(2)(ii) of the proposed rule. Under the SEC's Rule 3b-8(c), among other things, a qualified block positioner must meet all of the following conditions: (i) engages in the activity of purchasing long or selling short, from time to time, from or to a customer (other than a partner or a joint venture or other entity in which a partner, the dealer, or a person associated with such dealer participates) a block of stock with a current market value of $200,000 or more in a single transaction, or in several transactions at approximately the same time, from a single source to facilitate a sale or purchase by such customer; (ii) has determined in the exercise of reasonable diligence that the block could not be sold to or purchased from others on equivalent or better terms; and (iii) sells the shares comprising the block as rapidly as possible commensurate with the circumstances. The Agencies note that the rule establishes a minimum dollar value threshold for a block. The size of a block will vary among different asset classes.

principal positions taken as part of market making-related activities to those which are necessary to meet the reasonably expected near-term demands of clients, customers and counterparties. The Agencies expect that the programmatic compliance requirement and required reporting of quantitative measurements will play an important role in assessing a banking entity's compliance with § __.4(b)(2)(iii)'s requirement. In addition, as described in Part II.B.5 of the Supplementary Information, Appendix B of the proposed rule provides additional, detailed commentary regarding how the Agencies expect a firm relying on the market-making exemption to manage principal positions and how the Agencies propose to assess whether such positions are consistent with market making-related activities under the proposed rule.

In order for a banking entity's expectations regarding near-term customer demand to be considered reasonable, such expectations should be based on more than a simple expectation of future price appreciation and the generic increase in marketplace demand that such price appreciation reflects. Rather, a banking entity's expectation should generally be based on the unique customer base of the banking entity's specific market-making business lines and the near-term demands of those customers based on particular factors beyond a general expectation of price appreciation. To the extent that a trading desk or other organizational unit of a banking entity is engaged wholly or principally in trading that is not in response to, or driven by, customer demands, the Agencies would not expect those activities to qualify under § __.4(b) of the proposed rule, regardless of whether those activities promote price transparency or liquidity. For example, a trading desk or other organizational unit of a banking entity that is engaged wholly or principally in arbitrage trading with non-customers would not meet the terms of the proposed rule's market making exemption. In the case of a market maker engaging in market making in a security that is executed on an organized trading facility or exchange, that market

maker's activities are generally consistent with reasonably expected near-term customer demand when such activities involve passively providing liquidity by submitting resting orders that interact with the orders of others in a non-directional or market-neutral trading strategy and the market maker is registered, if the exchange or organized trading facility registers market makers.[152] However, activities by such a person that primarily takes liquidity on an organized trading facility or exchange, rather than provides liquidity, would not qualify for the market-making exemption under the proposed rule, even if those activities were conducted by a registered market maker.

Fourth criterion - registration under securities or commodities laws.

Under § __.4(b)(2)(iv) of the proposed rule, a banking entity relying on the market-making exemption with respect to trading in securities or certain derivatives must be appropriately registered as a dealer, or exempt from registration or excluded from regulation as a dealer, under applicable securities or commodities laws. With respect to a market-making transaction in one or more covered financial positions that are securities, other than exempted securities, security-based swaps, commercial paper, bankers acceptances or commercial bills, for which a person must be a registered securities dealer, municipal securities dealer or government securities dealer in order to deal in the security, the banking entity must have the appropriate dealer registration (or in the case of a financial institution that is a government securities dealer, has filed notice of that status as required by section 15C(a)(1)(B) of the Exchange Act) or

---

[152] The Agencies emphasize that the status of being a registered market maker is not, on its own, a sufficient basis for relying on the exemption for market making-related activity contained in § __.4(b). however, being a registered market maker is required under these circumstances if the applicable exchange or organized trading facility registers market makers. Registration as a market maker generally involves filing a prescribed form with an exchange or organized trading facility, in accordance with its rules and procedures, and complying with the applicable requirements for market makers set forth in the rules of that exchange or organized trading facility. See, e.g., Nasdaq Rule 4612, New York Stock Exchange Rule 104, CBOE Futures Exchange Rule 515, BATS Exchange Rule 11.5.

otherwise be exempt from registration or excluded from regulation as a dealer.[153] Similarly, with respect to a market-making transaction involving a swap or security-based swap for which a person must generally be a registered swap dealer or security-based swap dealer, respectively, the banking entity must be appropriately registered or otherwise be exempt from registration or excluded from regulation as a swap dealer or security-based swap dealer.[154] If the banking entity is engaged in the business of a securities dealer, swap dealer or security-based swap dealer outside the United States in a manner for which no U.S. registration is required, the banking entity must be subject to substantive regulation of its dealing business in the jurisdiction in which the business is located. This requirement is intended to ensure that (i) any market making-related activity conducted in reliance on the exemption is subject to appropriate regulation and (ii) a banking entity does not simultaneously characterize the transaction as market making-related for purposes of the exemption while characterizing it in a different manner for purposes of applicable securities or commodities laws.

[153] See proposed rule §§ __.4(b)(2)(iv)(A), (D), (E). For example, if a banking entity is a bank engaged in market-making in qualified Canadian government obligations for which it would be required to register as a securities dealer but for the exclusion contained in section 3(a)(5)(C)(i)(I) of the Exchange Act, the proposed rule would not require that banking entity to be a registered securities dealer in order to rely on the market-making exemption for that market-making transaction. Such a bank would, however, be required to file notice that it is a government securities dealer and comply with rules applicable to financial institutions that are government securities dealers. See 15 U.S.C. 78c(a)(42)(E); 15 U.S.C. 78o-5(a)(1)(B); 17 CFR 400.5(b); 17 CFR 449.1. Similar to the underwriting exemption, the proposed rule does not apply the dealer registration requirement to market making in securities that are exempted securities, commercial paper, bankers acceptances or commercial bills because dealing in such securities does not require registration as securities dealer under the Exchange Act; however, registering as a municipal securities dealer or government securities dealer is required, if applicable.

[154] See proposed rule §§ __.4(b)(2)(iv)(B), (C). A banking entity may be required to be a registered securities dealer if it engages in market-making transactions involving security-based swaps with persons that are not eligible contract participants. See 15 U.S.C. 78c(a)(5) (the definition of "dealer" in section 3(a)(5) of the Exchange Act, 15 U.S.C. 78c(a)(5), generally includes "any person engaged in the business of buying and selling securities (not including security-based swaps, other than security-based swaps with or for persons that are not eligible contract participants), for such person's own account.").

Fifth criterion - revenues from fees, commissions, bid/ask spreads or other similar income.

Under § __.4(b)(2)(v) of the proposed rule, the market making-related activities of the banking entity must be designed to generate revenues primarily from fees, commissions, bid/ask spreads or other income not attributable to appreciation in the value of covered financial positions it holds in trading accounts or the hedging of such positions. This criterion is intended to ensure that activities conducted in reliance on the market-making exemption demonstrate patterns of revenue generation and profitability consistent with, and related to, the intermediation and liquidity services a market maker provides to its customers, rather than changes in the market value of the positions or risks held in inventory. Similar to the requirement that a firm relying on the market-making exemption design its activities not to exceed reasonably expected near-term client, customer, or counterparty demands, the Agencies expect that the programmatic compliance requirement and required reporting of quantitative measurements will play an important role in assessing a banking entity's compliance with § __.4(b)(2)(v)'s requirement. In addition, as described in Part III.B.5 of this Supplementary Information, Appendix B of the proposed rule provides additional, detailed commentary regarding how the Agencies propose to assess whether the types of revenues generated by a banking entity relying on the market-making exemption are consistent with market making-related activities.

Sixth criterion - compensation incentives.

Under § __.4(b)(2)(vii) of the proposed rule, the compensation arrangements of persons performing market making-related activities at the banking entity must be designed not to encourage or reward proprietary risk-taking. Activities for which a banking entity has established a compensation incentive structure that rewards speculation in, and appreciation of,

the market value of a covered financial position held in inventory, rather than success in providing effective and timely intermediation and liquidity services to customers, are inconsistent with permitted market making-related activities. Although a banking entity relying on the market-making exemption may appropriately take into account revenues resulting from movements in the price of principal positions to the extent that such revenues reflect the effectiveness with which personnel have managed principal risk retained, a banking entity relying on the market-making exemption should provide compensation incentives that primarily reward customer revenues and effective customer service, not proprietary risk-taking. In addition, as described in Part III.B.5 of this Supplementary Information, Appendix B of the proposed rule provides further commentary regarding how the Agencies propose to assess whether the compensation incentives provided to trading personnel performing trading activities in reliance on the market-making exemption are consistent with market making-related activities.

<u>Seventh criterion – consistency with Appendix B commentary</u>.

Under § __.4(b)(2)(vi) of the proposed rule, the market making-related activities of the trading desk or other organizational unit that conducts the purchase or sale are required to be consistent with the commentary provided in Appendix B, which provides guidance that the Agencies propose to apply to help distinguish permitted market making-related activities from prohibited proprietary trading. Appendix B's proposed commentary, which is described in detail below in Part III.B.5 of this Supplementary Information, discusses various factors by which the Agencies propose to distinguish prohibited proprietary trading from permitted market making-related activities (e.g., how and to what extent a market maker hedges the risk of its market-making transactions, including (i) further detail related directly to other criteria in § __.4(b)(2)

(e.g., the types of revenues generated by market makers), and (ii) expectations regarding other factors not expressly included in § __.4(b)(2)).

B. Market making-related hedging.

Section __.4(b)(3) of the proposed rule provides that certain hedging transactions related to market-making positions and holdings will also be deemed to be made in connection with a banking entity's market making-related activities for purposes of the market-making exemption. In particular, § __.4(b)(3) provides that the purchase or sale of a covered financial position for hedging purposes will qualify for the market-making exemption if it meets two requirements. First, the purchase or sale must be conducted in order to reduce the specific risks to the banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings acquired pursuant to the market-making exemption. Where the purpose of a transaction is to hedge a market making-related position, it would appear to be market making-related activity of the type described in section 13(d)(1)(B) of the BHC Act. Second, the hedging transaction must also meet the criteria specified in the general exemption for risk-mitigating hedging activity for purposes of the proprietary trading prohibition, which is contained in §§ __.5(b) and (c) of the proposed rule and described in detail in Part III.B.3 of this Supplementary Information. Those criteria are intended to clearly define the scope of appropriate risk-mitigating hedging activities, to foreclose reliance on the exemption for prohibited proprietary trading that is conducted in the context of, or mischaracterized as, hedging activity, and to require documentation regarding the hedging purpose of certain transactions that are established at a level of organization that is different than the level of organization establishing or responsible for the underlying risk or risks that are being hedged, which in the context of the market making-related activity would generally be the trading desk.

iii. Request for comment.

The Agencies request comment on the proposed criteria that must be met in order to rely on the market-making exemption. In particular, the Agencies request comment on the following questions (as well as related questions in Part III.B.5 of this Supplementary Information):

Question 87. Are the seven criteria included in the market-making exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other criteria be added?

Question 88. Is incorporation of concepts from the definition of "market maker" under the Exchange Act useful for purposes of section 13 of the BHC Act and consistent with its purposes? If not, what alternative definition would be more useful or more consistent?

Question 89. Is the proposed exemption overly broad or narrow? For example, would it encompass activity that should be considered prohibited proprietary trading under the proposed rule? Alternatively, would it prohibit forms of market making or market making-related activities that are permitted under other rules or regulations?

Question 90. We seek commenter input on the types of banking entities and forms of activities that would not qualify for the proposed market-making exemption but that commenters consider to otherwise be market making. Please discuss the impact of not permitting such activities under the proposed exemption (e.g., the impact on liquidity).

Question 91. Is the requirement that a trading desk or other organizational unit relying on the market-making exemption hold itself out as being willing to buy and sell, or otherwise enter into long and short positions in, the relevant covered financial position for its own account on a

regular or continuous basis effective? If not, what alternative would be more effective? Does the proposed requirement appropriately differentiate between market making-related activities in different markets and asset classes? If not, how could such differences be better reflected? Should the requirement be modified to include certain arbitrage trading activities engaged in by market makers that promote liquidity or price transparency, but do not serve customer, client or counterparty demands, within the scope of market making-related activity? If so why? How could such liquidity- or price transparency-promoting activities be meaningfully identified and distinguished from prohibited proprietary trading practices that also may incidentally promote liquidity or price transparency? Do particular markets or instruments, such as the market for exchange-traded funds, raise particular issues that are not adequately or appropriately addressed in the proposal? If so, how could the proposal better address those instruments, markets or market features?

Question 92. Do the proposed indicia of market making in liquid markets accurately reflect the factors that should generally be used to analyze whether a banking entity is engaged in market making-related activities for purposes of section 13 of the BHC Act and the proposed rule? If not, why not? Should any of the proposed factors be eliminated or modified? Should any additional factors be included? Is reliance on the SEC's indicia of bona fide market making for purposes of Regulation SHO under the Exchange Act and the equity securities market appropriate in the context of section 13 of the BHC Act and the proposed rule with respect to liquid markets? If not, why not?

Question 93. Do the proposed indicia of market making in illiquid markets accurately reflect the factors that should generally be used to analyze whether a banking entity is engaged in market making-related activities for purposes of section 13 of the BHC Act and the proposed

rule? If not, why not? Should any of the proposed factors be eliminated or modified? Should any additional factors be included?

Question 94. How accurately can a banking entity predict the near-term demands of clients, customers, and counterparties? Are there measures that can distinguish the amount of principal risk that should be retained to support such near-term client, customer, or counterparty demand from positions taken for speculative purposes? How is client, customer, or counterparty demand anticipated in connection with market making-related activities, and how does such approach vary by asset class?

Question 95. Is the requirement that a banking entity relying on the market-making exemption be registered as a dealer (or in the case of a financial institution that is a government securities dealer, has filed notice of that status as required by section 15C(a)(1)(B) of the Exchange Act), or exempt from registration or excluded from regulation as a dealer under relevant securities or commodities laws effective? If not, how should the requirement be changed? Does the requirement appropriately take into account the particular registration requirements applicable to dealing in different types of financial instruments? If not, how could it better do so? Does the requirement appropriately take into account the various registration exemptions and exclusions available to certain entities, such as banks, under the securities and commodities laws? If not, how could it better do so?

Question 96. Is the requirement that a trading desk or other organizational unit of a banking entity relying on the market-making exemption be designed to generate revenues primarily from fees, commissions, bid/ask spreads or similar income effective? If not, how should the requirement be changed? Does the requirement appropriately capture the type and

nature of revenues typically generated by market making-related activities? Is any further clarification or additional guidance necessary? Can revenues primarily from fees, commissions, bid/ask spreads or similar income be meaningfully separated from other types of revenues?

Question 97. Is the requirement that the compensation arrangements of persons performing market making-related activities at a banking entity not be designed to encourage proprietary risk-taking effective? If not, how should the requirement be changed? Are there other types of compensation incentives that should be clearly referenced as consistent, or inconsistent, with permitted market making-related activity? Are their specific and identifiable characteristics of compensation arrangements that clearly incentivize prohibited proprietary trading?

Question 98. Is the inclusion of market making-related hedging transactions within the market-making exemption effective and appropriate? Are the proposed requirements that certain hedging transactions must meet in order to be considered to have been made in connection with market making-related activity effective and sufficiently clear? If not, what alternative requirements would be more effective and/or clearer? Should any of the proposed requirements be eliminated? If so, which ones, and why?

Question 99. Should the terms "client," "customer," or "counterparty" be defined for purposes of the market-making exemption? If so, how should these terms be defined? For example, would an appropriate definition of "customer" be: (i) a continuing relationship in which the banking entity provides one or more financial products or services prior to the time of the transaction; (ii) a direct and substantive relationship between the banking entity and a prospective customer prior to the transaction; (iii) a relationship initiated by the banking entity to

a prospective customer to induce transactions; or (iv) a relationship initiated by the prospective customer with a view to engaging in transactions?

Question 100. Are there other types of market making-related activities that should also be included within the scope of the market-making exemption? If so, what additional activities and why? How would an exemption for such additional activities be consistent with the language and intent of section 13 of the BHC Act? What criteria, requirements, or restrictions would be appropriate to include with respect to such additional activities? How would such criteria, requirements, or restrictions prevent circumvention or evasion of the prohibition on proprietary trading?

Question 101. Do banking entities currently have processes in place that would prevent or reduce the likelihood of taking speculative, proprietary positions in the context of, or mischaracterized as, market making-related activities? If so, what processes?

3. Section __.5: Permitted risk-mitigating hedging activities.

Section __.5 of the proposed rule permits a banking entity to purchase or sell a covered financial position if the transaction is made in connection with, and related to, individual or aggregated positions, contracts, or other holdings of a banking entity and is designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings (the "hedging exemption"). This section of the proposed rule implements, in relevant part, section 13(d)(1)(C) of the BHC Act, which provides an exemption from the prohibition on proprietary trading for certain risk-mitigating hedging activities.

a. Approach to implementing the hedging exemption.

Like market making-related activities, risk-mitigating hedging activities present certain implementation challenges because of the potential that prohibited proprietary trading could be conducted in the context of, or mischaracterized as, a hedging transaction. This is because it may often be difficult to identify in retrospect whether a banking entity engaged in a particular transaction to manage or eliminate risks arising from related positions, on the one hand, or to profit from price movements related to the hedge position itself, on the other. The intent with which a purported hedge position is acquired may often be difficult to discern in practice.

In light of these complexities, the Agencies have again proposed a multi-faceted approach to implementation. As with the underwriting and market-making exemptions, the Agencies have proposed a set of criteria that must be met in order for a banking entity to rely on the hedging exemption. The proposed criteria are intended to define the scope of permitted risk-mitigating hedging activities and to foreclose reliance on the exemption for prohibited proprietary trading that is conducted in the context of, or mischaracterized as, permitted hedging activity. This includes implementation of the programmatic compliance regime required under subpart D of the proposed rule and, in particular, requires that a banking entity with significant trading activities implement robust, detailed hedging policies and procedures and related internal controls that are designed to prevent prohibited proprietary trading in the context of permitted hedging activity.[155] In particular, a banking entity's compliance regime must include written hedging policies at the trading unit level and clearly articulated trader mandates for each trader to ensure that the decision of when and how to put on a hedge is consistent with such policies and mandates, and not fully left to a trader's discretion.[156] In addition, to address potential

[155] These aspects of the compliance program requirement are described in further detail in Part III.D of this Supplementary Information.

[156] See, e.g., proposed rule Appendix C.II.a.

supervisory concerns raised by certain types of hedging transactions, § __.5 of the proposed rule also requires a banking entity to document certain hedging transactions at the time the hedge is established. This multi-faceted approach is intended to articulate the Agencies' expectations regarding the scope of permitted risk-mitigating hedging activities in a manner that limits potential abuse of the hedging exemption while not unduly constraining the important risk management function that is served by a banking entity's hedging activities.

b. Required criteria for permitted risk-mitigating hedging activities.

Section __.5(b) of the proposed rule describes the seven criteria that a banking entity must meet in order to rely on the hedging exemption. First, § __.5(b)(1) of the proposed rule requires the banking entity to have established an internal compliance program, consistent with the requirements of subpart D, that is designed to ensure the banking entity's compliance with the requirements of this paragraph, including reasonably-designed written policies and procedures, internal controls, and independent testing. This criterion is intended to ensure that any banking entity relying on the exemption has appropriate internal control processes in place to support its compliance with the terms of the exemption.

Second, § __.5(b)(2)(i) of the proposed rule requires that a transaction for which a banking entity is relying on the hedging exemption have been made in accordance with written policies, procedures and internal controls established by the banking entity pursuant to subpart D. This criterion would preclude reliance on the hedging exemption if the transaction was inconsistent with a banking entity's own hedging policies and procedures, as such inconsistency would appear to be indicative of prohibited proprietary trading.

Third, § __.5(b)(2)(ii) of the proposed rule requires that the transaction hedge or otherwise mitigate one or more specific risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, basis risk, or similar risks, arising in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity. This criterion implements the essential element of the hedging exemption – i.e., that the transaction be risk-mitigating. Notably, and consistent with the statutory reference to mitigating risks of individual or aggregated positions, this criterion would include the hedging of risks on a portfolio basis. For example, it would include the hedging of one or more specific risks arising from a portfolio of diverse holdings, such as the hedging of the aggregate risk of one or more trading desks. However, in each case, the Agencies would expect that the transaction or series of transactions being used to hedge is, in the aggregate, demonstrably risk-reducing with respect to the positions, contracts, or other holdings that are being hedged. A banking entity relying on the exemption should be prepared to identify the specific position or portfolio of positions that is being hedged and demonstrate that the hedging transaction is risk-reducing in the aggregate, as measured by appropriate risk management tools.

In addition, this criterion would include a series of hedging transactions designed to hedge movements in the price of a portfolio of positions. For example, a banking entity may need to engage in dynamic hedging, which involves rebalancing its current hedge position(s) based on a change in the portfolio resulting from permissible activities or from a change in the price, or other characteristic, of the individual or aggregated positions, contracts, or other

holdings. The Agencies recognize that, in such dynamic hedging, material changes in risk may require a corresponding modification to the banking entity's current hedge positions.[157]

The Agencies also expect that a banking entity relying on the exemption would be able to demonstrate that the banking entity is already exposed to the specific risks being hedged; generally, the purported hedging of risks to which the banking entity is not actually exposed would not meet the terms of the exemption. However, the hedging exemption would be available in certain cases where the hedge is established slightly before the banking entity becomes exposed to the underlying risk if such anticipatory hedging activity: (i) is consistent with appropriate risk management practices; (ii) otherwise meets the terms of the hedging exemption; and (iii) does not involve the potential for speculative profit. For example, if a banking entity was contractually obligated, or otherwise highly likely, to become exposed to a particular risk and there was a sound risk management rationale for hedging that risk slightly in advance of actual exposure, the hedging transaction would generally be consistent with the requirement described in § __.5(b)(2)(ii) of the proposed rule.

Fourth, § __.5(b)(2)(iii) of the proposed rule requires that the transaction be reasonably correlated, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the transaction is intended to hedge or otherwise mitigate. A transaction that is only tangentially related to the risks that it purportedly mitigates would appear to be indicative of prohibited proprietary trading. Importantly, the Agencies have not proposed that a transaction relying on the hedging exemption

---

[157] This corresponding modification to the hedge should also be reasonably correlated to the material changes in risk that are intended to be hedged or otherwise mitigated, as required by proposed rule § __.5(b)(2)(iii).

be <u>fully</u> correlated; instead, only <u>reasonable</u> correlation is required.[158] The degree of correlation that may be reasonable will vary depending on the underlying risks and the availability of alternative hedging options – risks that can be easily and cost-effectively hedged with extremely high or near-perfect correlation would typically be expected to be so hedged, whereas other risks may be difficult or impossible to hedge with anything greater than partial correlation. Moreover, it is important to consider the fact that trading positions are often subject to a number of different risks, and some risks may be hedged easily and at low cost but may only account for a small proportion of the total risk in the position.[159] More generally, potential correlation levels between asset classes can differ significantly, and analysis of the reasonableness of correlation would depend on the facts and circumstances of the initial position(s), risk(s) created, liquidity of the instrument, and the legitimacy of the hedge. Regardless of the precise degree of correlation, if the predicted performance of a hedge position during the period that the hedge position and the related position are held would result in a banking entity earning appreciably more profits on the hedge position than it stood to lose on the related position, the hedge would appear likely to be a proprietary trade designed to result in profit rather than an exempt hedge position.

Fifth, § __.5(b)(2)(iv) of the proposed rule requires that the hedging transaction not give rise, at the inception of the hedge, to significant exposures that are not themselves hedged in a contemporaneous transaction. A transaction that creates significant new risk exposure that is not

---

158 Although certain accounting standards, such as FASB ASC Topic 815 hedge accounting, address circumstances in which a transaction may be considered a hedge of another transaction, the proposed rule does not refer to or rely on these accounting standards, because such standards (i) are designed for financial statement purposes, not to identify proprietary trading and (ii) change often and are likely to change in the future without consideration of the potential impact on section 13 of the BHC Act.

159 Interest rate risk in an equity derivative transaction is one example – the hedging of interest rate risk in an equity derivative position may only result in a small reduction in overall risk and interest rates may only exhibit a small correlation with the value of the equity derivative, but the lack of perfect or significant correlation would not impair reliance on the hedging exemption.

itself hedged at the same time would appear to be indicative of prohibited proprietary trading. For example, over-hedging, correlation trading, or pairs trading strategies that generate profits through speculative, proprietary risk-taking would fail to meet this criterion. Similarly, a transaction involving a pair of positions that hedge each other with respect to one type of risk exposure, but create or contain a residual risk exposure would, taken together, constitute prohibited proprietary trading and not risk-mitigating hedging if those positions were taken collectively for the purpose of profiting from short-term movements in the effective price of the residual risk exposure. However, the proposal also recognizes that any hedging transaction will inevitably give rise to certain types of new risk, such as counterparty credit risk or basis risk reflecting the differences between the hedge position and the related position; the proposed criterion only prohibits the introduction of additional significant exposures through the hedging transaction. In addition, proposed § __.5(b)(2)(iv) only requires that no new and significant exposures be introduced at the inception of the hedge, and not during the entire period that the hedge is maintained, reflecting the fact that new, unanticipated risks can and sometimes do arise out of hedging positions after the hedge is established. The Agencies have proposed to address the appropriate management of risks that arise out of a hedge position after inception through § __.5(b)(2)(v) of the proposed rule.

Sixth, § __.5(b)(2)(v) of the proposed rule requires that any transaction conducted in reliance on the hedging exemption be subject to continuing review, monitoring and management after the hedge position is established. Such review, monitoring, and management must: (i) be consistent with the banking entity's written hedging policies and procedures; (ii) maintain a reasonable level of correlation, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the purchase

or sale is intended to hedge or otherwise mitigate; and (iii) mitigate any significant exposure arising out of the hedge after inception. In accordance with a banking entity's written internal hedging policies, procedures, and internal controls, a banking entity should actively review and manage its hedging positions and the risks that may arise out of those positions over time. A banking entity's internal hedging policies should be designed to ensure that hedges remain effective as correlations or other factors change. In particular, a risk-mitigating hedge position typically should be unwound as exposure to the underlying risk is reduced or increased as underlying risk increases, as selective hedging activity would appear to be indicative of prohibited proprietary trading.[160] A banking entity's written internal hedging policies, procedures, and internal controls for monitoring and managing its hedges also should be reasonably designed to prevent the occurrence of such prohibited proprietary trading activity and be reasonably specific about the level of hedging that is expected to be maintained regardless of opportunities for profit associated with over- or under-hedging.

Seventh, § __.5(b)(2)(vi) of the proposed rule requires that the compensation arrangements of persons performing the risk-mitigating hedging activities are designed not to reward proprietary risk-taking. Hedging activities for which a banking entity has established a compensation incentive structure that rewards speculation in, and appreciation of, the market value of a covered financial position, rather than success in reducing risk, are inconsistent with permitted risk-mitigating hedging activities.

[160] The Agencies note that in some cases, it may be appropriate for a banking entity to unwind a hedge, even if the underlying risk remains, if the cost of that hedge become uneconomic, better hedging options become available, or the overall risk profile of the banking entity has changed such that no longer hedging the risk is consistent with appropriate risk management practices.

c. Documentation requirement.

Section __.5(c) of the proposed rule imposes a documentation requirement on certain types of hedging transactions. Specifically, for any transaction that a banking entity conducts in reliance on the hedging exemption that involves a hedge established at a level of organization that is different than the level of organization establishing the positions, contracts, or other holdings the risks of which the hedging transaction is designed to reduce, the banking entity must, at a minimum, document the risk-mitigating purpose of the transaction and identify the risks of the individual or aggregated positions, contracts, or other holdings of a banking entity that the transaction is designed to reduce.[161] Such documentation must be established at the time the hedging transaction is effected, not after the fact. The Agencies are concerned that hedging transactions established at a different level of organization than the positions being hedged may present or reflect heightened potential for prohibited proprietary trading, as a banking entity may be able, after the fact, to point to a particular, offsetting exposure within its organization after a position is established and characterize that position as a hedge even when, at the time the position was established, it was intended to generate speculative proprietary gains, not mitigate risk. To address this concern, the Agencies have proposed to require a banking entity, when establishing a hedge at a different level of organization than that establishing or responsible for the underlying positions or risks being hedged, to document the hedging purpose of the transaction and risks being hedged so as to establish a contemporaneous, documentary record that will assist the Agencies in assessing the actual reasons for which the position was established.

[161] For example, a hedge would be established at a different level of organization of the banking entity if multiple market making desks were exposed to similar risks and, to hedge such risks, a portfolio hedge was established at the direction of a supervisor or risk manager responsible for more than one desk rather than at each of the market making desks that established the initial positions, contracts, or other holdings.

d. Request for comment.

The Agencies request comment on the proposed implementation of the risk-mitigating hedging exemption with respect to proprietary trading. In particular, the Agencies request comment on the following questions:

Question 102. Is the proposed rule's approach to implementing the hedging exemption effective? If not, what alternative approach would be more effective?

Question 103. Does the proposed multi-faceted approach appropriately take into account and address the challenges associated with differentiating prohibited proprietary trading from permitted hedging activities? Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 104. Does the proposed approach to implementing the hedging exemption provide banking entities and market participants with sufficient clarity regarding what constitutes permitted hedging activities? If not, how could greater clarity be provided?

Question 105. What impact will the proposed approach to implementing the hedging exemption have on the hedging and risk management activities of a banking entity and the services it provide to its clients? If any of these impacts are positive, how can they be amplified? If any of these impacts are negative, how can they be mitigated?

Question 106. What burden will the proposed approach to implementing the hedging exemption have on banking entities? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?

Question 107. Are the criteria included in the hedging exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other requirements be added?

Question 108. Is the requirement that a transaction hedge or otherwise mitigate one or more specific risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, basis risk, or similar risks, arising in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity effective? If not, what requirement would be more effective? Does the proposed approach sufficiently articulate the types of risks that a banking entity typically hedges? Does the proposal sufficiently address application of the hedging exemption to portfolio hedging strategies? If not, how should the proposal be changed?

Question 109. Does the manner in which section __.5 of the proposal would implement the risk-mitigating hedging exemption effectively address transactions that hedge or otherwise mitigate specific risks arising in connection with and related to aggregated positions, contracts, or other holdings of a banking entity? Do certain hedging strategies or techniques that involve hedging the risks of aggregated positions (e.g., portfolio hedging) (i) create the potential for abuse of the hedging exemption or (ii) give rise to challenges in determining whether a banking entity is engaged in exempt, risk-mitigating hedging activity or prohibited proprietary trading? If so, what hedging strategies and techniques, and how? Should additional restrictions, conditions, or requirements be placed on the use of the hedging exemption with respect to aggregated positions so as to limit potential abuse of the exemption, assist banking entities and the Agencies in determining compliance with the exemption, or otherwise improve the effectiveness of the rule? If so, what additional restrictions, conditions, or requirements, and why?

Question 110. Is the requirement that the transaction be reasonably correlated to the risk or risks the transaction is intended to hedge or otherwise mitigate effective? If not, how should the requirement be changed? Should some specific level of correlation and/or hedge effectiveness be required? Should the proposal specify in greater detail how correlation should be measured? Should the proposal require hedges to be effective in periods of financial stress? Does the proposal sufficiently reflect differences in levels of correlation among asset classes? If not, how could it better do so?

Question 111. Is the requirement that the transaction not give rise, at the inception of the hedge, to significant exposures that are not themselves hedged in a contemporaneous transaction effective? Does the requirement establish an appropriate range for legitimate hedging while constraining impermissible proprietary trading? Is this requirement sufficiently clear? If not, what alternative would be more effective and/or clearer? Are there types of risk-mitigating hedging activities that may give rise to new and significant exposures that should be permitted under the hedging exemption? If so, what activities? Should the requirement that no significant exposure be introduced be extended for the duration of the hedging position? If so, why?

Question 112. Is the requirement that any transaction conducted in reliance on the hedging exemption be subject to continuing review, monitoring and management after the transaction is established effective? If not, what alternative would be more effective?

Question 113. Is the requirement that the compensation arrangements of persons performing risk-mitigating hedging activities at a banking entity be designed not to reward proprietary risk-taking effective? If not, how should the requirement be changed? Are there other types of compensation incentives that should be clearly referenced as consistent, or

inconsistent, with permitted risk-mitigating hedging activity? Are there specific and identifiable characteristics of compensation arrangements that clearly incentivize prohibited proprietary trading?

Question 114. Is the proposed documentation requirement effective? If not, what alternative would be more effective? Are there certain additional types of hedging transactions that should be subject to the documentation requirement? If so, what transactions and why? Should all types of hedging transactions be subject to the documentation requirement? If so, why? Should banking entities be required to document more aspects of a particular transactions (e.g., all of the criteria applicable to § __.5(b) of the proposed rule)? If so, what aspects and why? What burden would the proposed documentation requirement place on banking entities? How might such burden be reduced or eliminated in a manner consistent with the language and purpose of the statute?

Question 115. Aside from the required documentation, do the substantive requirements of the proposed risk-mitigating hedging exemption suggest that additional documentation would be required to achieve compliance with the proposed rule? If so, what burden would this additional documentation requirement place on banking entities? How might such burden be reduced or eliminated in a manner consistent with the language and purpose of the statute?

4. Section _.6: Other permitted trading activities.

Section __.6 of the proposed rule permits a banking entity to engage in certain other trading activities described in section 13(d)(1) of the BHC Act. These permitted activities include trading in certain government obligations, trading on behalf of customers, trading by insurance companies, and trading outside of the United States by certain foreign banking entities.

Section __.6 of the proposed rule does not contain all of the statutory exemptions contained in section 13(d)(1) of the BHC Act. Several of these exemptions appear, either by plain language or by implication, to be intended to apply only to covered fund activities and investments, and so the Agencies have not proposed to include them in the proposed rule's proprietary trading provisions.[162] Those exemptions are referenced in other portions of the proposed rule pertaining to covered funds.

The Agencies request comment on the proposed rule's approach to implementing the exemptions contained in section 13(d)(1) of the BHC Act to the proposed rule's proprietary trading provisions. In particular, the Agencies request comment on the following questions:

Question 116. Is the proposed rule's approach of identifying which of the statutory exemptions contained in section 13(d)(1) of the BHC Act apply to the proposed rule's proprietary trading provisions effective and/or consistent the language and purpose of the statute? If not, what alternative would be more effective and/or consistent with the language and purpose of the statute?

Question 117. Are there statutory exemptions that should apply to the proposed rule's proprietary trading provisions that were not included? If so, what exemptions and why?

Question 118. Are there statutory exemptions that were included in the proposed rule's proprietary trading provisions that should not have been included? If so, what exemptions and why?

---

[162] In particular, the proposed rule does not apply (i) the exemption in section 13(d)(1)(E) of the BHC Act for SBICs and certain public welfare or qualified rehabilitation investments, or (ii) the exemptions in sections 13(d)(1)(G) and 13(d)(1)(I) of the BHC Act for certain covered funds activities and investments, to the proprietary trading provisions of subpart B.

a. Permitted trading in government obligations.

Section __.6(a) of the proposed rule, which implements section 13(d)(1)(A) of the BHC Act,[163] permits the purchase or sale of a covered financial position that is: (i) an obligation of the United States or any agency thereof;[164] (ii) an obligation, participation, or other instrument of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.); or (iii) an obligation issued by any State or any political subdivision thereof.[165] The proposed rule also clarifies that these obligations include limited as well as general obligations of the relevant government entity. The Agencies note that, consistent with the statutory language, the types of instruments described with respect to the enumerated government-sponsored entities include not only obligations of such entities, but also participations and other instruments of or issued by such entity. This would include, for example, pass-through or participation certificates that are issued and guaranteed by one of these government-sponsored entities (e.g., the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation) in connection with their securitization activities.

---

[163] Section 13(d)(1)(A) of the BHC Act permits a banking entity to purchase, sell, acquire or dispose securities and other instruments described in section 13(h)(4) of the BHC Act if those securities or other instruments are specified types of government obligations, notwithstanding the prohibition on proprietary trading. See 12 U.S.C. 1851(d)(1)(A).

[164] The Agencies propose that United States "agencies" for this purpose will include those agencies described in section 201.108(b) of the Board's Regulation A. See 12 CFR 201.108(b). The Agencies also note that the terms of the exemption would encompass the purchase or sale of enumerated government obligations on a forward basis (e.g., in a to-be-announced market).

[165] Consistent with the statutory language, the proposed rule does not extend the government obligations exemption to transactions in obligations of an agency of any State or political subdivision thereof.

The Agencies request comment on the proposed rule's approach to implementing the government obligation exemption. In particular, the Agencies request comment on the following questions:

Question 119. Is the proposed rule's application to trading in government obligations sufficiently clear? Should such obligations expressly include, for example, instruments issued by third parties but insured or guaranteed by an enumerated government entity or otherwise backed by its full faith and credit?

Question 120. Should the Agencies adopt an additional exemption for proprietary trading in State or municipal agency obligations under section 13(d)(1)(J) of the BHC Act? If so, how would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 121. Should the Agencies adopt an additional exemption for proprietary trading in options or other derivatives referencing an enumerated government obligation under section 13(d)(1)(J) of the BHC Act? For example, should the Agencies provide an exemption for options or other derivatives with respect to U.S. government debt obligations? If so, how would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 122. Should the Agencies adopt an additional exemption for proprietary trading in the obligations of foreign governments and/or international and multinational development banks under section 13(d)(1)(J) of the BHC Act? If so, what types of obligations should be exempt? How would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 123. Should the Agencies adopt an additional exemption for proprietary trading in any other type of government obligations under section 13(d)(1)(J) of the BHC Act? If so, how would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 124. Are the definitions of "government security" and "municipal security" in sections 3(a)(42) and 3(a)(29) of the Exchange Act helpful in determining the proper scope of this exemption? If so, please explain their utility and how incorporating such definitions into the exemption would be consistent with the language and purpose of section 13 of the BHC Act.

b. Permitted trading on behalf of customers.

Section 13(d)(1)(D) of the BHC Act permits a banking entity to purchase or sell a covered financial position on behalf of customers, notwithstanding the prohibition on proprietary trading. Section __.6(b) of the proposed rule implements this section. Because the statute does not specifically define when a transaction would be conducted "on behalf of customers," the proposed rule identifies three categories of transactions that, while they may involve a banking entity acting as principal for certain purposes, appear to be on behalf of customers within the purpose and meaning of the statute. As proposed, only transactions meeting the terms of these three categories would be considered on behalf of customers for purposes of the exemption.

Section __.6(b)(i) of the proposed rule provides that a purchase or sale of a covered financial position is on behalf of customers if the transaction (i) is conducted by a banking entity acting as investment adviser, commodity trading advisor, trustee, or in a similar fiduciary capacity for a customer and for the account of that customer, and (ii) involves solely covered financial positions of which the banking entity's customer, and not the banking entity or any

subsidiary or affiliate of the banking entity, is beneficial owner (including as a result of having long or short exposure under the relevant covered financial position). This category is intended to capture a wide range of trading activity conducted in the context of customer-driven investment or commodity advisory, trust, or fiduciary services, so long as that activity is structured in a way that the customer, and not the banking entity providing those services, benefits from any gains and suffers from any losses on such covered financial positions.[166] A transaction that is structured so as to involve a listed form of relationship but nonetheless allows gains or losses from trading activity to inure to the benefit or detriment of the banking entity would fall outside the scope of this category.

Section __.6(b)(ii) of the proposed rule provides that a transaction is on behalf of customers if the banking entity is acting as riskless principal. These type of transactions are similarly customer-driven and do not expose the banking entity to gains or losses on the value of the traded positions, notwithstanding the fact that the banking entity technically acts as principal. The Agencies note that the proposed language describing riskless principal transactions generally mirrors that used in the Board's Regulation Y, OCC interpretive letters, and the SEC's Rule 3a5-1 under the Exchange Act.[167]

Section __.6(b)(iii) of the proposed rule addresses trading for the separate account of insurance policyholders by a banking entity that is an insurance company. In particular, this part of the proposed rule provides that a purchase or sale of a covered financial position is on behalf of customers if:

---

[166] For example, in the case of a banking entity acting as investment adviser to a registered mutual fund, any trading by the banking entity in its capacity of investment adviser and on behalf of that fund would be permitted pursuant to § __.6(b)(i) of the proposed rule, so long as the relevant criteria were met.

[167] See 12 CFR 225.28(b)(7)(ii); 17 CFR 240.3a5-1(b); OCC Interpretive Letter 626 (July 7, 1993).

- The banking entity is an insurance company engaging in the transaction for a separate account;

- The banking entity is directly engaged in the business of insurance and subject to regulation by a State insurance regulator or foreign insurance regulator;[168]

- The banking entity purchases or sells the covered financial position solely for a separate account established by the insurance company in connection with one or more insurance policies issued by that insurance company;

- All profits and losses arising from the purchase or sale of the covered financial position are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, and not the banking entity; and

- The purchase or sale is conducted in compliance with, and subject to, the insurance company investment and other laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled.

This category is included within the exemption for transactions on behalf of customers because such insurance-related transactions are generally customer-driven and do not expose the banking entity to gains or losses on the value of separate account assets, even though the banking entity may be treated as the owner of those assets for certain purposes. However, to limit the potential for abuse of the exemption, the proposed rule also includes related requirements designed to ensure that the separate account trading activity is subject to appropriate regulation

[168] The proposed rule provides definitions of the terms "State insurance regulator" and "foreign insurance regulator." See proposed rule §§ __.3(c)(4), (13).

and supervision under insurance laws and not structured so as to allow gains or losses from trading activity to inure to the benefit or detriment of the banking entity.[169] The proposed rule defines a "separate account" as an account established or maintained by a regulated insurance company subject to regulation by a State insurance regulator or foreign insurance regulator under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.[170]

The Agencies request comment on the proposed rule's approach to implementing the exemption for trading on behalf of customers. In particular, the Agencies request comment on the following questions:

Question 125. Is the proposed rule's articulation of three categories of transactions on behalf of customers effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should any of the categories be eliminated? Should any additional categories be added? Please explain.

Question 126. Is the proposed rule's exemption of certain investment adviser, commodity trading advisor, trustee or similar fiduciary transactions effective? What other types of relationships are or should be captured by the proposed rule's reference to "similar fiduciary relationships," and why? Is application of this part of the exemption to particular transactions sufficiently clear? Should any other specific types of fiduciary or other relationships be specified in the rule? If so, what types and why? What impact will the proposed rule's implementation of

---

[169] The Agencies would not consider profits to inure to the benefit of the banking entity if the banking entity were solely to receive payment, out of separate account profits, of fees unrelated to the investment performance of the separate account.

[170] See proposed rule § __.2(z).

the exemption have on the investment adviser, commodity trading advisor, trustee or similar fiduciary activities of banking entities? If such impacts are negative, how could they be mitigated or eliminated in a manner consistent with the purpose and language of the statute?

Question 127. Is the proposed rule's exemption of riskless principal transactions effective? If not, what alternative would be more appropriate? Is the description of qualifying riskless principal activity sufficiently clear? If not, how should it be clarified? Should the riskless principal transaction exemption include a requirement that the banking entity must purchase (or sell) the covered financial position as principal at the same price to satisfy the customer buy (or sell) order, exclusive of any explicitly disclosed markup or markdown, commission equivalent, or other fee? Why or why not? Should the riskless principal exemption include a requirement with respect to the timeframe in which the principal transaction must be allocated to a riskless principal or customer account? Why or why not?

Question 128. Is the proposed rule's exemption of trading for separate accounts by insurance companies effective? If not, what alternative would be more appropriate? Does the proposed exemption sufficiently address the variety of customer-driven separate account structures typically used? If not, how should it address such structures? Does the proposed exemption sufficiently address the variety of regulatory or supervisory regimes to which insurance companies may be subject?

Question 129. What impact will the proposed rule's implementation of the exemption have on the insurance activities of insurance companies affiliated with banking entities? If such impacts are negative, how could they be mitigated or eliminated in a manner consistent with the purpose and language of the statute?

Question 130. Should the term "customer" be defined for purposes of the exemption for transactions on behalf of customers? If so, how should it be defined? For example, would an appropriate definition be (i) a continuing relationship in which the banking entity provides one or more financial products or services prior to the time of the transaction, (ii) a direct and substantive relationship between the banking entity and a prospective customer prior to the transaction, or (iii) a relationship initiated by the banking entity to a prospective customer for purposes of the transaction?

Question 131. Is the exemption for trading on behalf of customers in the proposed rule over- or under-inclusive? If it is under-inclusive, please discuss any additional activities that should qualify as trading on behalf of customers under the rule. What are the mechanics of the particular trading activity and how does it qualify as being on behalf of customers? Are there certain requirements or restrictions that should be placed on the activity, if permitted by the rule, to prevent evasion of the prohibition on proprietary trading? How would permitting the activity be consistent with the purpose and language of section 13 of the BHC Act? If the proposed exemption is over-inclusive, please explain what aspect of the proposed exemption does not involve trading on behalf of customers within the language and purpose of the statute.

c. Permitted trading by a regulated insurance company.

Section __.6(c) of the proposed rule implements section 13(d)(1)(F) of the BHC Act,[171] which permits a banking entity to purchase or sell a covered financial position if the banking entity is a regulated insurance company acting for its general account or an affiliate of an insurance company acting for the insurance company's general account, subject to certain

---

[171] See 12 U.S.C. 1851(d)(1)(F).

conditions. Section __.6(d) of the proposed rule generally restates the statutory requirements of the exemption, which provide that:

- The insurance company must directly engage in the business of insurance and be subject to regulation by a State insurance regulator or foreign insurance regulator;

- The insurance company or its affiliate must purchase or sell the covered financial position solely for the general account of the insurance company;

- The purchase or sale must be conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

- The appropriate Federal banking agencies, after consultation with the Council and the relevant insurance commissioners of the States, must not have jointly determined, after notice and comment, that a particular law, regulation, or written guidance described above is insufficient to protect the safety and soundness of the banking entity or of the financial stability of the United States.[172]

The proposed rule defines a "general account" as all of the assets of the insurance company that are not legally segregated and allocated to separate accounts under applicable State law.[173]

---

[172] The Federal banking agencies have not proposed at this time to determine, as part of the proposed rule, that the insurance company investment laws, regulations, and written guidance of any particular State or jurisdiction are insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States. The Federal banking agencies expect to monitor, in conjunction with the Federal Insurance Office established under section 502 of the Dodd-Frank Act, the insurance company investment laws, regulations, and written guidance of States or jurisdictions to which exempt transactions are subject and make such determinations in the future, where appropriate.

[173] See proposed rule § __.3(c)(6).

The Agencies request comment on the proposed rule's approach to implementing the exemption for general account trading by insurance companies. In particular, the Agencies request comment on the following questions:

Question 132. Should any of the statutory requirements for the exemption be further clarified in the proposed rule? If so, how? Should any additional requirements be added? If so, what requirements and why?

Question 133. Does the proposed rule appropriately and clearly define a general account for these purposes? If not, what alternative definition would be more appropriate?

Question 134. For purposes of the exemption, are the insurance company investment laws, regulations, and written guidance of any particular State or jurisdiction insufficient to protect the safety and soundness of the banking entity, or of the financial stability of the United States? If so, why?

Question 135. What impact will the proposed rule's implementation of the exemption have on the insurance activities of insurance companies affiliated with banking entities? If such impacts are negative, how could they be mitigated or eliminated in a manner consistent with the purpose and language of the statute?

d. Permitted trading outside of the United States.

Section __.6(d) of the proposed rule implements section 13(d)(1)(H) of the BHC Act,[174] which permits certain foreign banking entities to engage in proprietary trading that occurs solely

[174] Section 13(d)(1)(H) of the BHC Act permits a banking entity to engage in proprietary trading, notwithstanding the prohibition on proprietary trading, if it is conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act and the trading occurs solely outside of the United States and the banking entity is not

outside of the United States.[175] This statutory exemption limits the extraterritorial application of the prohibition on proprietary trading to the foreign activities of foreign firms, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States. Consistent with the statute, the proposed rule defines both the type of foreign banking entities that are eligible for the exemption and the circumstances in which proprietary trading by such an entity will be considered to have occurred solely outside of the United States.

i. Foreign banking entities eligible for the exemption.

Section __.6(d)(1)(i) of the proposed rule provides that, in order to be eligible for the foreign trading exemption, the banking entity must not be directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States. This requirement limits the scope of the exemption to banking entities that are organized under foreign law and controlled only by entities organized under foreign law. Consistent with the statutory language, a banking entity organized under the laws of the United States or any State and the subsidiaries and branches of such banking entity (wherever organized or licensed) may not rely on the exemption.[176] Similarly, a U.S. subsidiary or branch of a foreign banking entity would not qualify for the exemption.

Section __.6(d)(1)(ii) of the proposed rule incorporates the statutory requirement that the banking entity must also conduct the transaction pursuant to sections 4(c)(9) or 4(c)(13) of the

---

directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States. See 12 U.S.C. 1851(d)(1)(H).

[175] This section's discussion of the concept "solely outside of the United States" is provided solely for purposes of the proposed rule's implementation of section 13(d)(1)(H) of the BHC Act., and does not affect a banking entity's obligation to comply with additional or different requirements under applicable securities, banking, or other laws.

[176] Under the proposal, a "State" means any State, territory or possession of the United States, and the District of Columbia. See proposed rule § __.2(aa).

BHC Act. Section __.6(d)(2) clarifies when a banking entity would meet that requirement, the criteria for which vary depending on whether or not the banking entity is a foreign banking organization.[177]

Section 4(c)(9) of the BHC Act provides that the restrictions on interests in nonbanking organizations contained in that statute do not apply to the ownership of shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at variance with the purposes of the BHC Act and would be in the public interest.[178] The Board has implemented section 4(c)(9) as part of subpart B of the Board's Regulation K,[179] which specifies a number of conditions and requirements that a foreign banking organization must meet in order to use such authority. Such conditions and requirements include, for example, a qualifying foreign banking organization test that requires the foreign banking organization to demonstrate that more than half of its worldwide business is banking and that more than half of its banking business is outside the United States. The proposed rule makes clear that if a banking entity is a foreign banking organization, it will qualify for the foreign trading exemption if the entity is a qualifying foreign banking organization that conducts the transaction in compliance with subpart B of the Board's Regulation K, and the transaction occurs solely outside of the United States.

[177] Section __.6(d)(2) only addresses when a transaction will be considered to have been conducted pursuant to section 4(c)(9) of the BHC Act. Although the statute also references section 4(c)(13) of the BHC Act, the Board has applied the authority contained in that section solely to the foreign activities of U.S. banking organizations which, by the express terms of section 13(d)(1)(H) of the BHC Act, are unable to rely on the foreign trading exemption.

[178] See 12 U.S.C. 1843(c)(9).

[179] See 12 CFR 211.20 et seq.

Section 13 of the BHC Act also applies to foreign companies that control a U.S. insured depository institution but are not currently subject to the BHC Act generally or to the Board's Regulation K – for example, because the foreign company controls a savings association or an FDIC-insured industrial loan company. Accordingly, the proposed rule also clarifies when this type of foreign banking entity would be considered to have conducted a transaction "pursuant to section 4(c)(9)" for purposes of the foreign trading exemption.[180] In particular, the draft rule proposes that to qualify for the foreign trading exemption, such firms must meet at least two of three requirements that evaluate the extent to which the foreign entity's business is conducted outside the United States, as measured by assets, revenues, and income. This test largely mirrors the qualifying foreign banking organization test that is made applicable under section 4(c)(9) of the BHC Act and § 211.23(a) of the Board's Regulation K, except that the test does not also require such a foreign entity to demonstrate that more than half of its banking business is outside the United States.[181]

ii. Trading solely outside of the United States.

The proposed rule also clarifies when a transaction will be considered to have occurred solely outside of the United States for purposes of the exemption. In interpreting this aspect of the statutory language, the proposal focuses on the extent to which material elements of the transaction occur within, or are conducted by personnel within, the United States. This focus

[180] The Board emphasizes that this clarification would be applicable solely in the context of section 13(d)(1) of the BHC Act. The application of section 4(c)(9) to foreign companies in other contexts is likely to involve different legal and policy issues and may therefore merit different approaches.

[181] See 12 U.S.C. 1843(c)(9); 12 CFR 211.23(a); proposed rule § __.6(d)(2). This difference reflects the fact that foreign entities subject to section 13 of the BHC Act, but not the BHC Act generally, are likely to be, in many cases, predominantly commercial firms. A requirement that such firms also demonstrate that more than half of their banking business is outside the United States would likely make the exemption unavailable to such firms and subject their global activities to the prohibition on proprietary trading, a result that the statute does not appear to have intended.

seeks to avoid extraterritorial application of the prohibition of proprietary trading outside the United States while preserving competitive parity within U.S. markets. The proposed rule does not evaluate solely whether the risk of the transaction or management or decision-making with respect to the transaction rests outside the United States, as such an approach would appear to permit foreign banking entities to structure transactions so as to be "outside of the United States" for risk and booking purposes while engaging in transactions within U.S. markets that are prohibited for U.S. banking entities.

In particular, § __.6(d)(3) of the proposed rule provides that a transaction will be considered to have occurred solely outside of the United States only if four conditions are met:

- The transaction is conducted by a banking entity that is not organized under the laws of the United States or of one or more States;
- No party to the transaction is a resident of the United States;
- No personnel of the banking entity that is directly involved in the transaction is physically located in the United States;[182] and
- The transaction is executed wholly outside the United States.

These four criteria are intended to ensure that a transaction executed in reliance on the exemption does not involve U.S. counterparties, U.S. trading personnel, U.S. execution facilities, or risks retained in the United States. The presence of any of these factors would appear to constitute a

[182] Personnel directly involved in the transaction would generally not include persons performing purely administrative, clerical, or ministerial functions.

sufficient locus of activity in the U.S. marketplace so as to preclude availability of the exemption.

A resident of the United States is defined in § __.2(t) of the proposed rule, and includes: (i) any natural person resident in the United States; (ii) any partnership, corporation or other business entity organized or incorporated under the laws of the United States or any State; (iii) any estate of which any executor or administrator is a resident of the United States; (iv) any trust of which any trustee, beneficiary or, if the trust is revocable, settlor is a resident of the United States; (v) any agency or branch of a foreign entity located in the United States; (vi) any discretionary or non-discretionary account or similar account (other than an estate or trust) held by a dealer or fiduciary for the benefit or account of a resident of the United States; (vii) any discretionary account or similar account (other than an estate or trust) held by a dealer or fiduciary organized or incorporated in the United States, or (if an individual) a resident of the United States; or (viii) any partnership or corporation organized or incorporated under the laws of any foreign jurisdiction formed by or for a resident of the United States principally for the purpose of engaging in one or more transactions described in § __.6(d)(1) or § __.13(c)(1) of the proposed rule.[183] The proposed definition is designed to capture the scope of U.S. counterparties, decision-makers and personnel that, if involved in the transaction, would preclude that transaction from being considered to have occurred solely outside the United States. The Agencies note that the proposed definition is similar but not identical to the definition of "U.S. person" for purposes of the SEC's Regulation S, which governs securities offerings and sales outside of the United States that are not registered under the Securities Act.[184]

[183] See proposed rule § __.2(t).

[184] See 17 CFR 230.902(k).

iii. Request for comment.

The Agencies request comment on the proposed rule's approach to implementing the foreign trading exemption. In particular, the Agencies request comment on the following questions:

Question 136. Is the proposed rule's implementation of the foreign trading exemption effectively delineated? If not, what alternative would be more effective and/or clearer?

Question 137. Are the proposed rule's provisions regarding when an activity will be considered to have been conducted pursuant to section 4(c)(9) of the BHC Act effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Do those provisions effectively address the application of the foreign trading exemption to foreign banking entities not subject to the BHC Act generally? If not, how should the proposed rule apply the exemption?

Question 138. Are the proposed rule's provisions regarding when an activity will be considered to have occurred solely outside the United States effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should any requirements be modified or removed? If so, which requirements and why? Should additional requirements be added? If so, what requirements and why?

Question 139. Is the proposed rule's definition of "resident of the United States" effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Is the definition over- or under-inclusive? If so, why? Should the definition more closely track,

or incorporate by reference, the definition of "U.S. person" under the SEC's Regulation S under the Securities Act? If so, why?

Question 140. Does the proposed rule effectively define a resident of the United States for these purposes? If not, how should the definition be altered?

Question 141. Should the Agencies use the authority provided in section 13(d)(1)(J) of the BHC Act to allow U.S.-controlled banking entities to engage in proprietary trading pursuant to section 4(c)(13) of the BHC Act outside of the United States under certain circumstances? If so, under what circumstances should this be permitted and how would such activity promote and protect the safety and soundness of banking entities and the financial stability of the United States?

e. Discretionary Exemptions for Proprietary Trading under Section 13(d)(1)(J) of the BHC Act.

Section 13(d)(1)(J) of the BHC Act permits the Agencies to grant, by rule, other exemptions from the prohibition on proprietary trading if the Agencies determine that the exemption would promote and protect the safety and soundness of the banking entity and the financial stability of the United States.[185] The Agencies have not, at this time, proposed any such discretionary exemptions with respect to the prohibition on proprietary trading. The Agencies request comment as follows:

[185] See 12 U.S.C. 1851(d)(1)(J). In addition to permitting the Agencies to provide additional exemptions from the prohibition on proprietary trading, section 13(d)(1)(J) also states that the Agencies may provide additional exemptions from the prohibition on investing in or sponsoring a covered fund, as discussed in Part III.C.5 of this Supplementary Information.

Question 142. Should the Agencies adopt any exemption from the prohibition on proprietary trading under section 13(d)(1)(J) of the BHC Act? If so, what exemption and why? How would such an exemption promote and protect the safety and soundness of banking entities and the financial stability of the United States?

5. Section __.7: Reporting and recordkeeping requirements applicable to trading activities.

Section __.7 of the proposed rule, which implements in part section 13(e)(1) of the BHC Act,[186] requires certain banking entities to comply with the reporting and recordkeeping requirements specified in Appendix A of the proposed rule. In addition, §__.7 requires banking entities to comply with the recordkeeping requirements in §__.20 of the proposed rule, related to the banking entity's compliance program,[187] as well as any other reporting or recordkeeping requirements that the relevant Agency may impose to evaluate the banking entity's compliance with the proposed rule.[188] Proposed Appendix A requires a banking entity with significant trading activities to furnish periodic reports to the relevant Agency regarding various quantitative measurements of its trading activities and create and retain records documenting the preparation and content of these reports. The measurements vary depending on the scope, type, and size of trading activities. In addition, proposed Appendix B contains a detailed commentary regarding the characteristics of permitted market making-related activities and how such activities may be distinguished from trading activities that, even if conducted in the context of a banking entity's market-making operations, would constitute prohibited proprietary trading.

---

[186] Section 13(e)(1) of the BHC Act requires the Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with section 13. See 12 U.S.C. 1851(e)(1). Section __.20 and Appendix C of the proposed rule also implement section 13(e)(1) of the BHC Act.

[187] See Supplementary Information, Part III.D.

[188] See proposed rule § __.7.

A banking entity must comply with proposed Appendix A's reporting and recordkeeping requirements only if it has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.[189] The Agencies have not proposed to extend the reporting and recordkeeping requirements to banking entities with smaller amounts of trading activity, as it appears that the more limited benefits of applying these requirements to such banking entities, whose trading activities are typically small, less complex, and easier to supervise, would not justify the burden associated with complying with the reporting and recordkeeping requirements.

a. General approach to reporting and recordkeeping requirements.

The reporting and recordkeeping requirements of § __.7 and Appendix A of the proposed rule are an important part of the proposed rule's multi-faceted approach to implementing the prohibition on proprietary trading. These requirements are intended, in particular, to address some of the difficulties associated with (i) identifying permitted market making-related activities and distinguishing such activities from prohibited proprietary trading and (ii) identifying certain trading activities resulting in material exposure to high-risk assets or high-risk trading strategies. To do so, the proposed rule requires certain banking entities to calculate and report detailed quantitative measurements of their trading activity, by trading unit. These measurements will help banking entities and the Agencies in assessing whether such trading activity is consistent

[189] See proposed rule § __.7(a). The Agencies note that this $1 billion trading asset and liability threshold is the same standard that is used in the Market Risk Capital Rules for determining which bank holding companies and insured depository institutions must calculate their risk-based capital requirements for trading positions under those rules. These banking entities maintain large and complex portfolios of trading assets and are therefore the most likely to be engaged in the types of trading activities that will require significant oversight of compliance with the restrictions on proprietary trading.

with permitted trading activities in scope, type and profile. The quantitative measurements that must be reported under the proposed rule are generally designed to reflect, and to provide meaningful information regarding, certain characteristics of trading activities that appear to be particularly useful in differentiating permitted market making-related activities from prohibited proprietary trading. For example, the proposed quantitative measurements measure the size and type of revenues generated, and the types of risks taken, by a trading unit. Each of these measurements appears to be useful in assessing whether a trading unit is (i) engaged in permitted market making-related activity or (ii) materially exposed to high-risk assets or high-risk trading strategies. Similarly, the proposed quantitative measurements also measure how much revenue is generated per such unit of risk, the volatility of a trading unit's profitability, and the extent to which a trading unit trades with customers. Each of those characteristics appears to be useful in assessing whether a trading unit is engaged in permitted market making-related activity.

However, the Agencies recognize that no single quantitative measurement or combination of measurements can accurately identify prohibited proprietary trading without further analysis of the context, facts, and circumstances of the trading activity. In addition, certain quantitative measurements may be useful for assessing one type of trading activity, but not helpful in assessing another type of trading activity. As a result, the Agencies propose to use a variety of quantitative measurements to help identify transactions or activities that warrant more in-depth analysis or review.

To be effective, this approach requires identification of useful quantitative measurements as well as judgment regarding the type of measurement results that suggest a further review of the trading unit's activity is warranted. The Agencies intend to take a heuristic approach to implementation in this area that recognizes that quantitative measurements can only be usefully

identified and employed after a process of substantial public comment, practical experience, and revision. In particular, the Agencies note that, although a variety of quantitative measurements have traditionally been used by market participants and others to manage the risks associated with trading activities, these quantitative tools have not been developed, nor have they previously been utilized, for the explicit purpose of identifying trading activity that warrants additional scrutiny in differentiating prohibited proprietary trading from permitted market making-related activities. Additional study and analysis will be required before quantitative measurements may be effectively designed and employed for that purpose.

Consistent with this heuristic approach, the proposed rule includes a large number of potential quantitative measurements on which public comment is sought, many of which overlap to some degree in terms of their informational value. Not all of these quantitative measurements may ultimately be adopted, depending on their relative strengths, weaknesses, costs, and benefits. The Agencies note that some of the proposed quantitative measurements may not be relevant to all types of trading activities or may provide only limited benefits, relative to cost, when applied to certain types of trading activities. In addition, certain quantitative measurements may be difficult or impracticable to calculate for a specific covered trading activity due to differences between asset classes, market structure, or other factors. The Agencies have therefore requested comment on a large number of issues related to the relevance, practicability, costs, and benefits of the quantitative measurements proposed. The Agencies also seek comment on whether the quantitative measurements described in the proposal may be appropriate to use in assessing compliance with section 13 of the BHC Act.

In addition to the proposed quantitative measurements, a banking entity may itself develop and implement other quantitative measurements in order to effectively monitor its

covered trading activities for compliance with section 13 of the BHC Act and the proposed rule and to establish, maintain, and enforce an effective compliance program, as required by § __.20 of the proposed rule and Appendix C. The Agencies note that the proposed quantitative measurements in Appendix A are intended to assist banking entities and Agencies in monitoring compliance with the proprietary trading restrictions and, thus, are related to the compliance program requirements in § __.20 of the proposed rule and proposed Appendix C. Nevertheless, implementation of the proposed quantitative measurements under Appendix A would not necessarily provide all the data necessary for the banking entity to establish an effective compliance program, and a banking entity may need to develop and implement additional quantitative measurements. The Agencies recognize that appropriate and effective quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading unit, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure the activities are within risk tolerances established by the banking entity, and to monitor for compliance with the proprietary trading restrictions in the proposed rule.

To the extent that data regarding measurements, as set forth in the proposed rule, are collected, the Agencies propose to utilize the automatic two-year conformance period provided in section 13 of the BHC Act to carefully review that data, further study the design and utility of these measurements, and if necessary, propose changes to the reporting requirements as the

Agencies believe are needed to ensure that these measurements are as effective as possible.[190] This heuristic, gradual approach to implementing reporting requirements for quantitative measurements would be intended to ensure that the requirements are formulated in a manner that maximizes their utility for identifying trading activity that warrants additional scrutiny in assessing compliance with the prohibition on proprietary trading, while limiting the risk that the use of quantitative measurements could inadvertently curtail permissible market making-related activities that provide an important service to market participants and the capital markets at large.

In addition, the Agencies request comment on the use of numerical thresholds for certain quantitative measurements that, if reported by a banking entity, would require the banking entity to review its trading activities for compliance and summarize that review to the relevant Agency. The Agencies have not proposed specific numerical thresholds in the proposal because substantial public comment and analysis would be beneficial prior to formulating and proposing specific numerical thresholds. Instead, the Agencies intend to carefully consider public comments that are provided on this issue and to separately determine whether it would be appropriate to propose, subsequent to finalizing the current proposal, such numerical thresholds.

The Agencies request comment on the proposed approach to implementing reporting requirements for proprietary trading. In particular, the Agencies request comment on the following questions:

---

[190] Section 13(c)(2) of the BHC Act provides banking entities two years from the date that the proposed rule becomes effective (with the possibility of up to three, one-year extensions) to bring their activities, investments, and relationships into compliance with section 13, including the prohibition on proprietary trading. See 12 U.S.C. 1851(c)(2).

Question 143. Is the use of the proposed reporting requirements as part of the multi-faceted approach to implementing the prohibition on proprietary trading appropriate? Why or why not?

Question 144. Is the proposed gradual approach to implementing reporting requirements effective? If not, what approach would be more effective? For example, should the Agencies defer reporting of quantitative measurements until banking entities have developed and refined their compliance programs through the supervision and examination process? What would be the costs and benefits of such an approach?

Question 145. What role, if any, could or should the Office of Financial Research ("OFR") play in receiving and analyzing banking entities' reported quantitative measurements? Should reporting to the OFR be required instead of reporting to the relevant Agency, and would such reporting be consistent with the composition and purpose of OFR? In the alternative, should reporting to either (i) only the relevant Agency (or Agencies) or (ii) both the relevant Agency (or Agencies) and OFR be required? If so, why? What are the potential costs and benefits of reporting quantitative measurements to the OFR? Please explain.

Question 146. Is there an alternative manner in which the Agencies should develop and propose the reporting requirements for quantitative measurements? If so, how should they do so?

Question 147. Does the proposed approach provide sufficient time for the development and implementation of effective reporting requirements? If not, what alternative approach would be preferable?

Question 148. Should a trading unit be permitted not to furnish a quantitative measurement otherwise required under Appendix A if it can demonstrate that the measurement is not, as applied to that unit, calculable or useful in achieving the purposes of the Appendix with respect to the trading unit's covered trading activities? How might a banking entity make such a demonstration?

Question 149. Is the manner in which the Agencies propose to utilize the conformance period for review of collected data and refinement of the reporting requirements effective? If not, what process would be more effective?

Question 150. Is the proposed $1 billion trading asset and liability threshold, which is also currently used in the Market Risk Capital Rules for purposes of identifying which banks and bank holdings companies must comply with those rules, an appropriate standard for triggering the reporting and recordkeeping requirements of the proposed rule? Why or why not? If not, what alternative standard would be a better benchmark for triggering the reporting and recordkeeping requirements?

Question 151. What are the typical trading activities (e.g., market making-related activities) of a banking entity with less than $1 billion in gross trading assets and liabilities? How complex are those trading activities?

Question 152. Should the proposed $1 billion trading and asset liability threshold used for triggering the reporting and recordkeeping requirements adjust each time the thresholds for complying with the Market Risk Capital Rules adjust, or otherwise be adjusted over time? If not, how and when should the numerical threshold be adjusted?

Question 153. Should all banking entities be required to comply with the reporting and recordkeeping requirements set forth in Appendix A in order to better protect against prohibited proprietary trading, rather than only those banking entities that meet the proposed $1 billion trading asset and liability threshold? Why or why not?

Question 154. Should banking entities that fall under the proposed $1 billion trading asset and liability threshold be required to comply with the reporting and recordkeeping provisions for a pilot period in order to help inform judgment regarding the levels of quantitative measurements at such entities and the appropriate frequency and scope of examination by the relevant Agency for such banking entities? Why or why not?

b. Proposed Appendix A - purpose and definitions.

Section I of proposed Appendix A describes the purpose of the appendix, which is to specify reporting requirements that are intended to assist banking entities that are engaged in significant trading activities and the Agencies in identifying trading activities that warrant further review or examination to verify compliance with the proprietary trading restrictions, including whether an otherwise-permitted activity under §§ __.4 through __.6(a) of the proposed rule is consistent with the requirement that such activity not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies. In particular, section I provides that the purpose of the appendix is to assist the relevant Agency and banking entities in:

- Better understanding and evaluating the scope, type, and profile of the banking entity's covered trading activities;

- Monitoring the banking entity's covered trading activities;

- Identifying covered trading activities that warrant further review or examination by the banking entity to verify compliance with the proprietary trading restrictions;

- Evaluating whether the trading activities of trading units engaged in market making-related activities under § __.4(b) of the proposed rule are consistent with the requirements governing permitted market making-related activities;

- Evaluating whether the trading activities of trading units that are engaged in permitted trading activity under §§ __.4, __.5, or __.6(a) of the proposed rule (e.g., permitted underwriting, market making-related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies;

- Identifying the profile of particular trading activities of the banking entity, and the individual trading units of the banking entity, to help establish the appropriate frequency and scope of examination by the relevant Agency of such activities; and

- Assessing and addressing the risks associated with the banking entity's trading activities.

The types of trading and market making-related activities in which banking entities engage is often highly complex, and any quantitative measurement is capable of producing both "false negatives" and "false positives" that suggest that prohibited proprietary trading is occurring when it is not, or vice versa. Recognizing this, section I of proposed Appendix A

makes clear that the quantitative measurements that may be required to be reported would not be intended to serve as a dispositive tool for identifying permissible or impermissible activities.

Section II of proposed Appendix A defines relevant terms used in the appendix. These include certain definitions that clarify how and when certain calculations must be made, as well as a definition of "trading unit" that governs the level of organization at which a banking entity must calculate quantitative measurements. The proposed definition of "trading unit" covers multiple organizational levels of a banking entity, including:

- Each discrete unit engaged in the coordinated implementation of a revenue generation strategy that participates in the execution of any covered trading activity;[191]

- Each organizational unit used to structure and control the aggregate risk-taking activities and employees of one or more trading units described above;

- All trading operations, collectively; and

- Any other unit of organization specified by the relevant Agency with respect to a particular banking entity.[192]

[191] As noted in Appendix A, the Agencies expect that this would generally be the smallest unit of organization used by the banking entity to structure and control its risk-taking activities and employees, and would include each unit generally understood to be a single "trading desk." For example, if a banking entity has one set of employees engaged in market making-related activities in the equities of U.S. non-financial corporations, and another set of employees engaged in market making-related activities in the equities of U.S. financial corporations, the two sets of employees would appear to be part of a single trading unit if both sets of employees structure and control their trading activities together, making and executing highly coordinated decisions about required risk levels, inventory levels, sources of revenue growth and similar features. On the other hand, if the risk decisions and revenue strategies are considered and executed separately by the two sets of employees, with only loose coordination, they would appear to be two distinct trading units. In determining whether a set of employees constitute a single trading unit, important factors would likely include whether compensation is strongly linked to the group's performance, whether risk levels and trading limits are managed and set jointly or separately, and whether trades are booked together or separately.

The definition of "trading unit" is intended to capture multiple layers of a banking entity's organization structure, including individual trading desks, intermediate divisions that oversee a variety of trading desks, and all trading operations in the aggregate. As described below, under the proposal, the quantitative measurements specified in section IV of proposed Appendix A must be calculated and reported for each such "trading unit." Accordingly, the definition of trading unit is purposefully broad and captures multiple levels of organization so as to ensure that quantitative measurements provide meaningful information, at both a granular and aggregate level, to help banking entities and the Agencies evaluate the quantitative profile of trading operations in a variety of contexts.

The Agencies expect that the scope and nature of trading units to which the quantitative measurements are applied would have an important impact on the informational content and utility of the resulting measurements. Applying a quantitative measurement to a trading unit at a level that aggregates a variety of distinct trading activities may obscure or "smooth" differences between distinct lines of business, asset categories and risk management processes in a way that renders the measurement relatively uninformative, because it does not adequately reflect the specific characteristics of the trading activities being conducted. Similarly, applying a quantitative measurement to a trading unit at a highly granular level could, if it captured only a narrow portion of activity that is conducted as part of a broader business strategy, introduce meaningless "noise" into the measure or result in a measurement that is idiosyncratic in nature. This highly granular application could render the measurement relatively uninformative because it would not accurately reflect the entirety of the trading activities being conducted. In order to

[192] This latter prong of the definition has been included to ensure that the Agencies have the ability to require banking entities to report quantitative measurements in other ways to prevent a banking entity from organizing its trading operations so as to undermine the effectiveness of the reporting requirement.

address the potential weaknesses of applying the quantitative measurements at an aggregate and a granular level, respectively, the proposal requires reporting at both levels. The informational inputs required to calculate any particular quantitative measurement at either level are the same. Consequently, it is expected that, depending on the nature of the systems of a particular institution, there may be little, if any, incremental burden associated with calculating and reporting quantitative measurements at multiple levels.

The Agencies request comment on the proposed reporting requirements in Appendix A. In particular, the Agencies request comment on the following questions:

Question 155. Are the ways in which the proposed rule would make use of reported quantitative measurements effective? If not, what uses would be more effective? Should the proposed rule instead use quantitative measurements as a dispositive tool for identifying prohibited proprietary trading? If so, what types of quantitative measurements should be employed, what numerical amount would indicate impermissible proprietary trading activity, and why? Should the quantitative measurements play a less prominent role than proposed in identifying prohibited proprietary trading and why?

Question 156. Are the proposed definitions of terms provided in Appendix A effective? If not, how should the definitions be amended?

Question 157. Is the proposed definition of "trading unit" effective? Is it sufficiently clear? If not, what alternative definition would be more effective and/or clearer? Should the definition include more or less granular levels of activity? If so, what specific criteria should be used to determine the appropriate level of granularity?

Question 158. If you are a banking entity, how would your trading activity be categorized, in terms of quantity and type, under the proposed definition of trading unit in Appendix A? For each trading unit type, what categories of quantitative measurements (e.g., risk-management measurements) or specific quantitative measurements (e.g., Stressed Value-at-Risk ("Stress VaR")) are best suited to assist in distinguishing prohibited proprietary trading from permitted trading activity?

Question 159. Is the proposed rule's requirement that quantitative measurements be reported at multiple levels of organization, including for quantitative measurements historically reported on an aggregate basis (e.g., Value-at-Risk ("VaR") or Stress VaR) appropriate? If not, what alternative would be more effective? What burdens are associated with such a requirement? How might those burdens be reduced or limited? Please quantify your answers, to the extent feasible.

c. Proposed Appendix A - scope of required reporting.

Part III of proposed Appendix A defines the scope of the reporting requirements. The proposed rule adopts a tiered approach that requires banking entities with the most extensive trading activities to report the largest number of quantitative measurements, while banking entities with smaller trading activities have fewer or no reporting requirements. This tiered approach is intended to reflect the heightened compliance risks of banking entities with extensive trading activities and limit the regulatory burden imposed on banking entities with relatively small or no trading activities, which appear to pose significantly less compliance risk.

Banking entities with gross trading assets and liabilities of $5 billion or more.

For any banking entity that has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters, equals or exceeds $5 billion, the proposal would require the banking entity to furnish quantitative measurements for all trading units of the banking entity engaged in trading activity subject to §§ __.4, __.5, or __.6(a) of the proposed rule (i.e., permitted underwriting and market making-related activity, risk-mitigated hedging, and trading in certain government obligations). The scope of data to be furnished depends on the activity in which the trading unit is engaged. First, for the trading units of such a banking entity that are engaged in market making-related activity pursuant to § __.4(b) of the proposed rule, proposed Appendix A requires that a banking entity furnish seventeen quantitative measurements.[193] Second, all trading units of such a banking entity engaged in trading activity subject to §§ __.4(a), __.5, or __.6(a) of the proposed rule would be required to report five quantitative measurements designed to measure the general risk and profitability of the trading unit.[194] The Agencies expect that each of these general types of measurements will be useful in assessing the extent to which any permitted trading activity involves exposure to high-risk assets or high-risk trading strategies. These requirements would apply to all type of trading units engaged in underwriting and market making-related activity, risk-mitigated hedging, and trading in certain government obligations. These additional measurements are designed to help evaluate the extent to which the quantitative profile of a trading unit's activities is consistent with permissible market making-related activities.

---

[193] See proposed rule Appendix A.III.A. These seventeen quantitative measurements are discussed further below.

[194] See proposed rule Appendix A.III.A. These five quantitative measurements are: (i) Comprehensive Profit and Loss; (ii) Comprehensive Profit and Loss Attribution; (iii) VaR and Stress VaR; (iv) Risk Factor Sensitivities; and (v) Risk and Position Limits. Each of these and other quantitative measurements discussed in proposed Appendix A are discussed in detail below.

Banking entities with gross trading assets and liabilities between $1 billion and $5 billion.

For any banking entity that has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters, equals or exceeds $1 billion but is less than $5 billion, the proposal would require quantitative measurements to be furnished for trading units that are engaged in market making-related activity subject to § __.4(b) of the proposed rule. Trading units of such banking entities that are engaged in market making-related activities must report eight quantitative measurements that are designed to help evaluate the extent to which the quantitative profile of a trading unit's activities is consistent with permissible market making-related activities.[195] The proposal applies a smaller number of measurements to a smaller universe of trading units for this class of banking entities because they are likely to pose lesser compliance risk and fewer supervisory and examination challenges. A less burdensome reporting regime, coupled with other elements of the proposal (e.g., the compliance program requirement), is likely to be equally as effective in ensuring compliance with section 13 of the BHC Act and the proposed rule for banking entities with smaller trading operations.

Frequency of calculation and reporting.

Section III.B of proposed Appendix A specifies the frequency of required calculation and reporting of quantitative measurements. Under the proposed rule, each required quantitative measurement must be calculated for each trading day. Required quantitative measurements must

---

[195] See proposed rule Appendix A.III.A. These eight quantitative measurements are (i) Comprehensive Profit and Loss; (ii) Comprehensive Profit and Loss Attribution; (iii) Portfolio Profit and Loss; (iv) Fee Income and Expense; (v) Spread Profit and Loss; (vi) VaR; (vii) Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss; and (viii) Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio.

be reported to the relevant Agency on a monthly basis, within 30 days of the end of the relevant calendar month, or on such other reporting schedule as the relevant Agency may require. Section III.C of proposed Appendix A requires a banking entity to create and retain records documenting the preparation and content of any quantitative measurement furnished by the banking entity, as well as such information as is necessary to permit the relevant Agency to verify the accuracy of such measurements, for a period of 5 years. This would include records for each trade and position.

Question 160. Is the proposed tiered approach to identifying which banking entities and trading units must comply with the reporting requirements effective? If not, what alternative would be more effective? Does the proposal strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved? Should the relevant gross trading assets and liabilities threshold for any category be increased or reduced? If so, why?

Question 161. Should the $1 billion and $5 billion gross trading assets and liabilities thresholds used to identify the extent to which a banking entity is required to furnish quantitative measurements be increased or reduced? If so, why? Should the thresholds be indexed in some way to account for fluctuations in capital markets activity over time? If so, what would be an appropriate method of indexation?

Question 162. Is the proposed $5 billion trading asset and liability threshold an appropriate standard for triggering enhanced reporting requirements under the proposed rule?

Why or why not? If not, what alternative standard would be a better benchmark for triggering enhanced reporting requirements?

Question 163. Should the proposed $5 billion trading and asset liability threshold used for triggering enhanced reporting requirements under the proposed rule be subject to adjustment over time? If so, how and when should the numerical threshold be adjusted?

Question 164. Is there a different criterion other than gross trading assets and liabilities that would be more appropriate for identifying banking entities that must furnish quantitative measurements? If so, what is the alternative criterion, and why would it be more appropriate? Are worldwide gross trading assets and liabilities the appropriate criterion for foreign-based banking entities? If not, what alternative criterion would be more appropriate, and why?

Question 165. Are the quantitative measurements specified for the various types of banking entities and trading units effective? If not, what alternative set of measurements would be more effective? For each type of trading unit, does the proposal strike the appropriate balance between the potential benefits of the reporting requirements for monitoring and assuring compliance and the potential costs of those reporting requirements? If not, how could that balance be improved?

Question 166. Should banking entities with gross trading assets and liabilities between $1 billion and $5 billion also be required to calculate and report some of the quantitative measurements proposed for banking entities meeting the $5 billion threshold for purposes of assessing whether the banking entity's underwriting, market making, risk-mitigating hedging, and trading in certain government obligations activities involve a material exposure to high-risk

assets or high-risk trading strategies? If so, which quantitative measurements and why? If not, why not?

Question 167. Is the proposed frequency of reporting effective? If not, what frequency would be more effective? Should the quantitative measurements be required to be reported quarterly, annually, or upon the request of the applicable Agency and why?

d. Proposed Appendix A - quantitative measurements.

Section IV of proposed Appendix A describes, in detail, the individual quantitative measurements that must be furnished. These measurements are grouped into the following five broad categories, each of which is described in more detail below:

- Risk-management measurements – VaR, Stress VaR, VaR Exceedance, Risk Factor Sensitivities, and Risk and Position Limits;

- Source-of-revenue measurements – Comprehensive Profit and Loss, Portfolio Profit and Loss, Fee Income and Expense, Spread Profit and Loss, and Comprehensive Profit and Loss Attribution;

- Revenues-relative-to-risk measurements – Volatility of Comprehensive Profit and Loss, Volatility of Portfolio Profit and Loss, Comprehensive Profit and Loss to Volatility Ratio, Portfolio Profit and Loss to Volatility Ratio, Unprofitable Trading Days based on Comprehensive Profit and Loss, Unprofitable Trading Days based on Portfolio Profit and Loss, Skewness of Portfolio Profit and Loss, and Kurtosis of Portfolio Profit and Loss;

- Customer-facing activity measurements – Inventory Turnover, Inventory Aging, and Customer-facing Trade Ratio; and

- Payment of fees, commissions, and spreads measurements – Pay-to-Receive Spread Ratio.

The Agencies have proposed these quantitative measurements because, taken together, these measurements appear useful for understanding the context in which trading activities occur and identifying activities that may warrant additional scrutiny to determine whether these activities involve prohibited proprietary trading because the trading activity either is inconsistent with permitted market making-related activities or presents a material exposure to high-risk assets or high-risk trading strategies. As described below, different quantitative measurements are proposed to identify different aspects and characteristics of trading activity for the purpose of helping to identify prohibited proprietary trading, and the Agencies expect that the quantitative measurements will be most useful for this purpose when implemented and reviewed collectively, rather than in isolation. The Agencies believe that, in the aggregate, many banking entities already collect and review many of these measurements as part of their risk management activities, and expect that many of the quantitative measurements proposed would be readily computed and monitored at the multiple levels of organization that are included in proposed Appendix A's definition of "trading unit," to which they would apply.

The first set of quantitative measurements relates to risk management, and includes VaR, Stress VaR, VaR Exceedance, Risk Factor Sensitivities, and Risk and Position Limits. These measurements are widely used by banking entities to measure and manage trading risks and activities. In the case of VaR, Stress VaR, VaR Exceedance, and Risk Factor Sensitivities, these

measures provide internal, model-based assessments of overall risk, stated in terms of large but plausible losses that may occur or changes in revenue that would be expected to result from movements in underlying risk factors. In the case of Risk and Position Limits, the measure provides an explicit assessment of management's expectation of how much risk is required to perform permitted market-making and hedging activities. With the exception of Stress VaR, each of these measurements are routinely used to manage and control risk taking activities, and are also used by some banking entities for purposes of calculating regulatory capital and allocating capital internally. In the context of permitted market making-related activities, these risk management measures are useful in assessing whether the actual risk taken is consistent with the level of principal risk that a banking entity must retain in order to service the near-term demands of customers. Significant, abrupt or inconsistent changes to key risk management measures, such as VaR, that are inconsistent with prior experience, the experience of similarly situated trading units and management's stated expectations for such measures may indicate impermissible proprietary trading. In addition, indicators of unanticipated or unusual levels of risk taken, such as a significant number of VaR Exceedance or breaches of internal Risk and Position Limits, may suggest behavior that is inconsistent with appropriate levels of risk and may warrant further scrutiny.

The second set of quantitative measurements relates to the source of revenues, and includes Comprehensive Profit and Loss, Portfolio Profit and Loss, Fee Income, Spread Profit and Loss, and Comprehensive Profit and Loss Attribution. These measurements are intended to capture the extent, scope, and type of profits and losses generated by trading activities and provide important context for understanding how revenue is generated by trading activities. Because permitted market making-related activities seek to generate profits by providing

customers with intermediation and related services while maintaining, and to the extent practicable minimizing, the risks associated with any asset or risk inventory required to meet customer demands, these revenue measurements would appear to provide helpful information to banking entities and the Agencies regarding whether actual revenues are consistent with these expectations. The Agencies note that although banking entities already routinely calculate and analyze the extent and source of revenues derived from their trading activities, calculating the proposed source of revenue measurements according to the specifications described in proposed Appendix A may require banking entities to implement new processes to calculate and furnish the required data.

The third set of measurements relates to realized risks and revenue relative to realized risks, and includes Volatility of Profit and Loss, Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio, Unprofitable Trading Days based on Comprehensive Profit and Loss and Unprofitable Trading Days based on Portfolio Profit and Loss, and Skewness of Portfolio Profit and Loss and Kurtosis of Portfolio Profit and Loss. These measurements are intended to provide banking entities and the Agencies with ex post, data-based assessments of risk, as a supplement to internal, model-based assessments of risk, and give further context around the riskiness of underlying trading activities and the profitability of these activities relative to the risks taken. Some of these measurements, such as the skewness and kurtosis measurements, are proposed in order to capture asymmetric, "fat tail" risks that (i) are not well captured by simple volatility measures, (ii) may not be well captured by internal risk measurement metrics, such as VaR, and (iii) can be associated with proprietary trading strategies that seek to earn short-term profits by taking exposures to these types of risks. The Agencies expect that these realized-risk and revenue-relative-to-realized-risk measurements would provide

information useful in assessing whether trading activities are producing revenues that are consistent, in terms of the degree of risk that is being assumed, with typical market making-related activities. Market making and related activities seek to generate profitability primarily by generating fees, commissions, spreads and other forms of customer revenue that are relatively, though not completely, insensitive to market fluctuations and generally result in a high level of revenue relative to risk over an appropriate time frame. In contrast, proprietary trading strategies seek to generate revenue primarily through favorable changes in asset valuations. The Agencies note that each of the proposed measurements relating to realized risks and revenues relative to realized risks are generally consistent with existing revenue, risk, and volatility data routinely collected by banking entities with large trading operations or are simple, standardized functions of such data.

The fourth set of quantitative measurements relates to customer-facing activity measurements, and includes Inventory Risk Turnover, Inventory Aging, and Customer-facing Trade Ratio. These measurements are intended to provide banking entities and Agencies with meaningful information regarding the extent to which trading activities are directed at servicing the demands of customers. Quantitative measurements such as Inventory Risk Turnover and Inventory Aging assess the extent to which size and volume of trading activity is aimed at servicing customer needs, while the Customer-facing Trade Ratio provides directionally useful information regarding the extent to which trading transactions are conducted with customers. The Agencies expect that these measurements will be useful in assessing whether permitted market making-related activities are focused on servicing customer demands. Although the Agencies understand that banking entities typically measure inventory aging and turnover in the context of cash instruments (e.g., equity and debt securities), they note that applying these

measurements, as well as the Customer-facing Trade Ratio generally, would require banking entities to implement new processes to calculate and furnish the related data.

The fifth set of quantitative measurements relates to the payment of fees, commissions, and spreads, and includes the Pay-to-Receive Spread Ratio. This measurement is intended to measure the extent to which trading activities generate revenues for providing intermediation services, rather than generate expenses paid to other intermediaries for such services. Because market making-related activities ultimately focus on servicing customer demands, they typically generate substantially more fees, spreads and other sources of customer revenue than must be paid to other intermediaries to support customer transactions. Proprietary trading activities, however, that generate almost no customer facing revenue will typically pay a significant amount of fees, spreads and commissions in the execution of trading strategies that are expected to benefit from short-term price movements. Accordingly, the Agencies expect that the proposed Pay-to-Receive Spread Ratio measurement will be useful in assessing whether permitted market making-related activities are primarily generating, rather than paying, fees, spreads and other transactional revenues or expenses. A level of fees, commissions, and spreads paid that is inconsistent with prior experience, the experience of similarly situated trading units and management's stated expectations for such measures could indicate impermissible proprietary trading.

For each individual quantitative measurement, proposed Appendix A describes the measurement, provides general guidance regarding how the measurement should be calculated (where needed) and specifies the period over which each calculation should be made. The proposed quantitative measurements attempt to incorporate, wherever possible, measurements already used by banking entities to manage risks associated with their trading activities. Of the

measurements proposed, the Agencies expect that a large majority of measurements proposed are either (i) already routinely calculated by banking entities or (ii) based solely on underlying data that are already routinely calculated by banking entities. However, calculating these measurements according to the specifications described in proposed Appendix A and at the various levels of organization mandated may require banking entities to implement new processes to calculate and furnish the required data.

The extent of the burden associated with calculating and reporting quantitative measurements will likely vary depending on the particular measurements and differences in the sophistication of management information systems at different banking entities. As noted, the proposal tailors these data collections to the size and type of activity conducted by each banking entity in an effort to minimize the burden in particular on firms that engage in few or no trading activities subject to the proposed rule.

The Agencies have also attempted to provide, to the extent possible, a standardized description and general method of calculating each quantitative measurement that, while taking into account the potential variation among trading practices and asset classes, would facilitate reporting of sufficiently uniform information across different banking entities so as to permit horizontal reviews and comparisons of the quantitative profile of trading units across firms.

The Agencies request comment on the proposed quantitative measurements. In particular, the Agencies request comment on the following questions:

Question 168. Are the proposed quantitative measurements appropriate in general? If not, what alternative(s) would be more appropriate, and why? Should certain quantitative measurements be eliminated, and if so, why? Should additional quantitative measurements be

added? If so, which measurements and why? How would those additional measurements be described and calculated?

Question 169. How many of the proposed quantitative measurements do banking entities currently utilize? What are the current benefits and costs associated with calculating such quantitative measurements? Would the reporting and recordkeeping requirements proposed in Appendix A for such quantitative measurements impose any significant, additional benefits or costs?

Question 170. Which of the proposed quantitative measurements do banking entities currently not utilize? What are the potential benefits and costs to calculating these quantitative measurements and complying with the proposed reporting and recordkeeping requirements? Please quantify your answers, to the extent feasible.

Question 171. Is the scope and frequency of required reporting appropriate? If not, what alternatives would be more appropriate? What burdens would be associated with reporting quantitative measurements on that basis, and how could those burdens be reduced or eliminated in a manner consistent with the purpose and language of the statute? Please quantify your answers, to the extent feasible.

Question 172. For each of the categories of quantitative measurements (e.g., quantitative measurements relating to risk management), what factors should be considered in order to further refine the proposed category of quantitative measurements to better distinguish prohibited proprietary trading from permitted trading activity? For example, should the timing of a calculation be considered significant in certain contexts (e.g., should specific quantitative

measurements be calculated during the middle of a trading day instead of the end of the day)? Please quantify your answers, to the extent feasible.

Question 173. In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to calculate the required quantitative measurements (e.g., collect data and make computations)? Do commenters anticipate the need to develop additional infrastructure to obtain and retain data necessary to compute the proposed quantitative measurements? Please explain and quantify your answers, to the extent feasible.

Question 174. For each individual quantitative measurement that is proposed:

- Is the use of the quantitative measurement to help distinguish between permitted and prohibited trading activities effective? If not, what alternative would be more effective? Does the quantitative measurement provide any additional information of value relative to other quantitative measurements proposed?

- Is the use of the quantitative measurement to help determine whether an otherwise-permitted trading activity is consistent with the requirement that such activity must not result, directly or indirectly, in a material exposure by the banking entity to high-risk assets and high-risk trading strategies effective? If not, what alternative would be more effective?

- What factors should be considered in order to further refine the proposed quantitative measurement to better distinguish prohibited proprietary trading from permitted trading activity? For example, should the timing of a calculation be considered significant in

certain contexts (e.g., should specific quantitative measurements be calculated during the middle of a trading day instead of at the end of the day)?

- If the quantitative measurement is proposed to be applied to a trading unit that is engaged in activity pursuant to §§ __.4(a), __.5, or __.6(a) of the proposed rule, is the quantitative measurement calculable in relation to such activity? Is the quantitative measurement useful for determining whether underwriting, risk-mitigating hedging, or trading in certain government obligations is resulting, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies?

- Is the description of the quantitative measurement sufficiently clear? What alternative would be more appropriate or clearer? Is the description of the quantitative measurement appropriate, or is it overly broad or narrow? If it is overly broad, what additional clarification is needed? Should the Agencies provide this additional clarification in the appendix's description of the quantitative measurement? If the description is overly narrow, how should it be modified to appropriately describe the quantitative measurement, and why?

- Is the general calculation guidance effective and sufficiently clear? If not, what alternative would be more effective or clearer? Is more or less specific calculation guidance necessary? If so, what level of specificity is needed to calculate the quantitative measurement? What are the different calculation options and methodologies that could be used to reach the desired level of specificity? What are the costs and benefits of these different options? If the proposed calculation guidance is not sufficiently specific, how should the calculation guidance be modified to reach the appropriate level of specificity? For example, rather than provide this level of specificity in proposed Appendix A, should the Agencies instead make each banking

entity responsible for determining the best method of calculating the quantitative measurement at this level of specificity, based on the banking entity's business and profile, which would then be subject to supervision, review, or examination by the relevant Agency? If the proposed calculation guidance is overly specific, why is it too specific and how should the guidance be modified to reach the appropriate level of specificity?

- Is the general calculation guidance for the measurement consistent with how banking entities currently calculate the quantitative measurement, if they do so? If not, how does the proposed guidance differ from methodology currently used by banking entities? What is the purpose of the current calculation methodology used by banking entities?

- What operational or logistical challenges might be associated with performing the calculation of the quantitative measurement and obtaining any necessary informational inputs?

- Is the quantitative measurement not calculable for any specific type of trading unit? If so, what type of trading unit, and why is the quantitative measurement not calculable for that type of trading unit? Is there an alternative quantitative measurement that would reflect the same trading activity but not pose the same calculation difficulty? Are there particular challenges to documenting that a specific quantitative measurement is not calculable?

- Is the quantitative measurement substantially likely to frequently produce false negatives or false positives that suggest that prohibited proprietary trading is occurring when it is not, or vice versa? If so, why? If so, what alternative quantitative measurement would better help identify prohibited proprietary trading?

- Should the quantitative measurement better account for distinctions among trading activities, trading strategies, and asset classes? If so, how? For example, should the quantitative measurements better account for distinctions between trading activities in cash and derivatives markets? If so, how? Are there any other distinctions for which the quantitative measurements may need to account? If so, what distinctions, and why?

- Does the quantitative measurement provide useful information as applied to all types of trading activities, or only a certain subset of trading activities? If it only provides useful information for a subset of trading activities, how should this issue be addressed? How beneficial is the information that the quantitative measurement provides for this subset of trading activities? Do any of the other quantitative measurements provide the same level of beneficial information for this subset of trading activities? Should the quantitative measurement be required to be reported for all trading activities, only a relevant subset of trading activities, or not at all?

- Does the quantitative measurement provide useful information as applied to all asset classes, or only a certain subset of asset classes? If it only provides useful information for a subset of asset classes, how should this issue be addressed? How beneficial is the information the quantitative measurement provides for this subset of asset classes? Do any of the other quantitative measurements provide the same level of beneficial information for this subset of asset classes? Should the quantitative measurement be required to be reported for all asset classes, only a relevant subset of asset classes, or not at all?

- Is the calculation period effective and sufficiently clear? If not, what alternative would be more effective or clearer?

- How burdensome and costly would it be to calculate the measurement at the specified calculation frequency and calculation period? Are there any difficulties or costs associated with calculating the measurement for particular trading units? How significant are those potential costs relative to the potential benefits of the measurement in monitoring for impermissible proprietary trading? Are there potential modifications that could be made to the measurement that would reduce the burden or cost? If so, what are those modifications? Please quantify your answers, to the extent feasible.

Question 175. In light of the size, scope, complexity, and risk of covered trading activities, are there certain types of quantitative measurements that will not be appropriate for some types of banking entities, desks, or levels? If so, would it be appropriate to require only certain quantitative measurements for such banking entities, desks, or levels?

Question 176. How might the number of quantitative measurements impact behavior of banking entities? Is there a cost of requiring more quantitative measurements, such as the cost of increased uncertainty regarding the combined results of such quantitative measurements? To what extent and in what ways might uncertainty as to how the quantitative measurements are applied and evaluated impact behavior?

Proposed Appendix B - commentary regarding identification of permitted market making-related activities.

Proposed Appendix B provides commentary that is intended to assist a banking entity in distinguishing permitted market making-related activities from trading activities that, even if conducted in the context of a banking entity's market making operations, would constitute prohibited proprietary trading. As noted in Part I of proposed Appendix B, the commentary applies to all banking entities that are engaged in market making-related activities in reliance on

§ __.4(b) of the proposed rule. Part II of proposed Appendix B clarifies that all defined terms used in Appendix B have the meaning given those terms in §§ __.2 and __.3 of the proposed rule and Appendix A.

The commentary regarding identification of permitted market making-related activities, which is contained in Part III of proposed Appendix B, includes three principal components. The first component provides an overview of market making-related activities and describes, in detail, typical practices in which market makers engage and typical characteristics of market making-related activities, articulating the general framework within which the Agencies view market making-related activities.[196] For example, the commentary provides that market making-related activities, in the context of a banking entity acting as principal, generally involve either (i) in the case of market making in a security that is executed on an organized trading facility or exchange, passively providing liquidity by submitting resting orders that interact with the orders of others on an organized trading facility or exchange and acting as a registered market maker, where such exchange or organized trading facility provides the ability to register as a market maker, or (ii) in other cases, providing an intermediation service to its customers by assuming the role of a counterparty that stands ready to buy or sell a position that the customer wishes to sell or buy. The second component of the commentary provides an overview of prohibited proprietary trading activities, which describes the general framework within which the Agencies view prohibited proprietary trading and contrasts that activity to the practices and characteristics of market making-related activities.[197] The third component describes certain challenges that

[196] See proposed rule Appendix B, § III.A. The practices and characteristics that are described generally reinforce and augment the specific requirements that a banking entity must meet in order to rely on the market-making exemption under § __.4(b) of the proposed rule.

[197] See proposed rule Appendix B, § III.B.

arise in distinguishing permitted market making-related activities and prohibited proprietary trading, particularly in cases in which both of these activities occur within the context of a market making operation,[198] and proposes guidance that the Agencies would apply in distinguishing permitted market making-related activities from prohibited proprietary trading. This guidance includes six factors that would cause a banking entity to be considered, absent explanatory circumstances, to be engaged in prohibited proprietary trading, and not permitted market making-related activity. The six factors are:

- Trading activity in which a trading unit retains risk in excess of the size and type required to provide intermediation services to customers;[199]

- Trading activity in which a trading unit primarily generates revenues from price movements of retained principal positions and risks, rather than customer revenues;

- Trading activity in which a trading unit: (i) generates only very small or very large amounts of revenue per unit of risk taken; (ii) does not demonstrate consistent profitability; or (iii) demonstrates high earnings volatility;

---

[198] See proposed rule Appendix B, § III.C. Proposed Appendix B notes, for example, that it may be difficult to distinguish (i) inventory positions that appropriately support market making-related activities from (ii) positions taken for proprietary purposes. See id.

[199] For simplicity and ease of reading, the Agencies have used the term "customer" throughout the discussion of market making-related activity. However, as discussed in proposed Appendix B, a market maker's "customers" generally vary depending on the asset class and market in which the market maker is providing intermediation services. In the context of market making in a security that is executed on an organized trading facility or an exchange, a "customer" is any person on behalf of whom a buy or sell order has been submitted by a broker-dealer or any other market participant. In the context of market making in a covered financial position in an over-the-counter market, a "customer" generally would be a market participant that makes use of the market maker's intermediation services, either by requesting such services or entering into a continuing relationship with the market maker with respect to such services. In certain cases, depending on the conventions of the relevant market (e.g., the over-the-counter derivatives market), such a "customer" may consider itself or refer to itself more generally as a "counterparty."

- Trading activity in which a trading unit either (i) does not transact through a trading system that interacts with orders of others or primarily with customers of the banking entity's market making desk to provide liquidity services, or (ii) holds principal positions in excess of reasonably expected near term customer demands;

- Trading activity in which a trading unit routinely pays rather than earns fees, commissions, or spreads; and

- The use of compensation incentives for employees of a particular trading activity that primarily reward proprietary risk-taking.[200]

The proposed commentary makes clear that the enumerated factors are subject to certain facts and circumstances that may explain why a trading activity may meet one or more factors but does not involve prohibited proprietary trading, and provides a range of examples of such explanatory facts and circumstances.[201] The Agencies emphasize that these examples are not meant to be exhaustive, as a variety of other circumstances may exist to explain why a particular trading activity, even if meeting one of the factors, may nonetheless be a permitted market making-related activity.[202]

In addition, for each of these six factors, the proposed rule provides general guidance as to (i) the types of facts and circumstances on which the relevant Agency may base any determination that a banking entity's trading activity met the relevant factor and (ii) which

---

[200] See proposed rule Appendix B, § III.C.1 – 6. The Agencies note that each of these six criteria is directly related to the overview of market making-related activities provided in section III.A. of proposed Appendix B.

[201] The proposed commentary does not contemplate explanatory facts and circumstances for the compensation incentives factor, given that the choice of compensation incentives provided to trading personnel is under the full control of the banking entity.

[202] The Agencies also note that, although a particular trading activity may not meet the requirements applicable to permitted market making-related activities, it may still be exempt under another available exemption.

quantitative measurements, if furnished by a banking entity pursuant to Appendix A, the relevant Agency would use to help assess the extent to which a banking entity's activities met the relevant factor.

The Agencies request comment on the proposed commentary regarding identification of permitted market making-related activities. In particular, the Agencies request comment on the following questions:

Question 177. Is the overview of permitted market making-related activities and prohibited proprietary trading proposed in Appendix B accurate? If not, what alternative overview would be more accurate? Does the overview appropriately account for differences in market making-related activities across different asset classes? If not, which type of market making-related activity does the overview not sufficiently describe or account for?

Question 178. Is the requirement that a market maker engaged in market making that is executed on an exchange or an organized trading facility must be a registered market maker, provided the relevant exchange or organized trading facility provides the ability to register, appropriate, or is it over- or under-inclusive? Please discuss and provide detailed examples of any such markets where registering as a market maker is not feasible or should not be required for purposes of this rule, and unregistered market makers provide similar services or perform similar functions.

Question 179. With respect to market making that is executed on an exchange or an organized trading facility, what potential impact or unintended consequences might result from limiting the market making exemption to registered market makers when the relevant exchange or organized trading facility registers market makers? Would such a requirement result in any

potential decrease in the passive provision of liquidity by the submission of resting orders? Do you anticipate that any such decrease would be exacerbated in times of market stress? If yes, please describe the impact on liquidity and the marketplace in general. Please discuss whether and how any potential decrease in liquidity could be mitigated. In addition, would such a requirement result in additional costs that would be borne by market participants purchasing and selling on an exchange or organized trading facility? Please identify and discuss any other additional costs. Please discuss whether and how any such consequences can be mitigated.

Question 180. In addition to benefits discussed in the Supplementary Information, are there other benefits that would be achieved by requiring that a market maker be registered with respect to market making on an exchange or an organized trading facility? Is there a way to amplify these benefits? Could these benefits be realized through alternative means? If so, how?

Question 181. In addition to registered market makers on exchanges or organized trading facilities, what other classes of liquidity providers exist? Are their obligations and activities similar to, or different than those of registered market makers? If so, how? Are the compensated in a different manner?

Question 182. How much liquidity is provided by registered market makers versus other liquidity providers by asset class (e.g., equities, etc.) with respect to trading on an exchange or an organized trading facility? The Agencies encourage commenters to provide data in support of comments.

Question 183. Is there any specific element of market making-related activity that the overview does not take into account in its description of market making? If so, how should the overview account for this element? Are there any descriptions of market making-related activity in the overview that should not be considered to be market making-related activity? If so, why? Is there any specific element of prohibited proprietary trading activity that the overview does not take into account in its description of prohibited proprietary trading? If so, how should the overview account for this element? Are there any descriptions of prohibited proprietary trading activity in the overview that should not be considered to be prohibited proprietary trading? If so, why?

Question 184. Are each of the six factors specified for helping to distinguish permitted market making-related activity from prohibited proprietary trading appropriate? If not, how should they be changed, and why? Should any factors be eliminated or added? If so, which ones and why? Could any of the proposed factors occur as a result of the banking entity engaging in one of the other permitted activities (e.g., underwriting, trading on behalf of customers)? If so, would the facts and circumstances that the Agencies propose to consider be sufficient to determine and verify that the banking entity is not engaged in prohibited proprietary trading? If not, how should this issue be addressed?

Question 185. Are the facts and circumstances that would be used to determine whether a banking entity's activities satisfy a certain factor appropriate? If not, how should they be changed, and why? Should any be eliminated or added? If so, which ones, and why?

Question 186. Are the identified quantitative measurements that the Agencies would use to help assess a particular factor appropriate? If not, how should they be changed, and why? Should any be eliminated or added? If so, which ones, and why?

f. Incorporation of numerical thresholds in the commentary regarding identification of permitted market making-related activities.

As noted above, the Agencies are currently requesting comment on whether to incorporate, as part of the proposed rule, numerical thresholds for certain quantitative measurements, and if so, how to do so. For example, the proposed rule could include one or more numerical thresholds that, if met by a banking entity, would require the banking entity to review its trading activities for compliance and summarize that review to the relevant Agency.

The primary purpose of using some form of threshold would be to provide banking entities with a clear standard regarding trading activity that presented a quantitative profile sufficiently questionable to warrant further review and explanation to the relevant Agency. Such clarity would appear to provide significant benefits both to banking entities in conducting their trading activities in conformance with the proposed rule and to Agencies in monitoring trading activities and obtaining additional, more detailed information in circumstances warranting closer scrutiny. In addition to the benefits of transparency, thresholds would also encourage consistent review by banking entities and the Agencies of transactions, both within a banking entity and across all banking entities. The purpose of such thresholds would not be to serve as bounds of permitted conduct or as a comprehensive, dispositive tool for determining whether prohibited proprietary trading has occurred.

Numerical thresholds have not been included in the proposed rule because the Agencies believe that public comment and further review is warranted before numerical thresholds and

specific numerical amounts may be proposed. Instead, the Agencies request comment on whether such thresholds would be desirable and, if so, what particular form such thresholds should take and what specific numerical thresholds would be appropriate. To facilitate the comment process, this request for comment includes a number of illustrative examples of numerical thresholds on which specific comment is sought.

In particular, the Agencies request comment on the following questions:

Question 187. What are the potential benefits and costs of incorporating into the proposed rule one or more numerical thresholds for certain quantitative measurements that, if reported by a banking entity, would require the banking entity to review its trading activities for compliance and summarize that review to the relevant Agency? Would such thresholds provide useful clarity to banking entities and/or market participants regarding the types of trading activities that merit additional scrutiny? Should numerical thresholds be used for any purposes other than highlighting trading activities that should be reviewed, the results of which would be reported to the relevant Agency? If so, for what purpose, and how and why?

Question 188. For which of the relevant quantitative measurements might it be appropriate and effective to include a numerical threshold that would trigger banking entity review and explanation? How should a numerical threshold be formulated, and why? Should a numerical threshold for a single quantitative measurement be applied individually, or should the threshold instead be triggered by exceeding some combination of numerical thresholds for different measurements? For any particular threshold, what numerical amount should be used, and why? How would such numerical amount be consistent with a level at which further review

and explanation is warranted? Should the amount vary by asset class or other characteristic? If so, how?

Question 189. For each of the following illustrative examples of potential thresholds, is the threshold formulated effectively? If not, what alternative formulation would be more effective? Should the threshold formulation vary by asset class or other characteristic? If so, how and why? If the threshold was utilized, what actual numerical amount should be specified, and why? How would such numerical amount be consistent with a level at which further review and explanation is warranted? Should the numerical amount vary by asset class or other characteristic? If so, how and why?

- "If a trading unit reports an increase in VaR, Stress VaR, or Risk Factor Sensitivities greater than [__] over a period of [__] months, or such other threshold as [Agency] may require, the banking entity must (i) promptly review and investigate the trading unit's activities to verify whether the trading unit is operating in compliance with the proprietary trading restrictions and (ii) report to [Agency] a summary of such review, including any explanatory circumstances."

- "If a trading unit reports an average Comprehensive Profit and Loss that is less than [__] times greater than the Portfolio Profit and Loss, exclusive of Spread Profit and Loss, for [__] consecutive months, or such other threshold as [Agency] may require, the banking entity must (i) promptly review and investigate the trading unit's activities to verify whether the trading unit is operating in compliance with the proprietary trading restrictions and (ii) report to [Agency] a summary of such review, including any explanatory circumstances."

- "If a trading unit reports a Comprehensive Profit and Loss to Volatility Ratio that is less than [__] times greater than that trading desk's Portfolio Profit and Loss to Volatility Ratio over a period of [__] months, or such other threshold as [Agency] may require, the banking entity must (i) promptly review and investigate the trading unit's activities to verify whether the trading unit is operating in compliance with the proprietary trading restrictions and (ii) report to [Agency] a summary of such review, including any explanatory circumstances."

- "If a trading unit reports a number of Unprofitable Trading Days Based on Portfolio Profit and Loss that is less than [__] greater than the number of Unprofitable Trading Days Based on Comprehensive Profit and Loss for [__] consecutive months, or such other threshold as [Agency] may require, the banking entity must (i) promptly review and investigate the trading unit's activities to verify whether the trading unit is operating in compliance with the proprietary trading restrictions and (ii) report to [Agency] a summary of such review, including any explanatory circumstances."

- "If a trading unit reports a Pay-to-Receive Spread Ratio that is less than [__] over a period of [__] months, or such other threshold as [Agency] may require, the banking entity must (i) promptly review and investigate the trading unit's activities to verify whether the trading unit is operating in compliance with the proprietary trading restrictions and (ii) report to [Agency] a summary of such review, including any explanatory circumstances."

6. Section __.8: Limitations on permitted trading activities.

Section __.8 of the proposed rule implements section 13(d)(2) of the BHC Act, which places certain limitations on the permitted trading activities (e.g., permitted market making-

related activities, risk-mitigating hedging, etc.) in which a banking entity may engage.[203] Consistent with the statute, § __.8(a) of the proposed rule provides that no transaction, class of transactions, or activity is permissible under §§ __.4 through __.6 of the proposed rule if the transaction, class of transactions, or activity would:

- Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

- Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

- Pose a threat to the safety and soundness of the banking entity or U.S. financial stability.

The proposed rule further defines "material conflict of interest," "high-risk asset," and "high-risk trading strategy" for these purposes.

a. Scope of "material conflict of interest".

Section __.8(b) of the proposed rule defines the scope of material conflicts of interest which, if arising in connection with a permitted trading activity, are prohibited under the proposal.[204] Conflicts of interest may arise in a variety of circumstances related to permitted trading activities. For example, a banking entity may acquire substantial amounts of nonpublic information about the financial condition of a particular company or issuer through its lending, underwriting, investment advisory or other activities which, if improperly transmitted to and

[203] See 12 U.S.C. 1851(d)(2).

[204] Section __.17(b) of the proposed rule defines the scope of material conflicts of interest which, if arising in connection with permitted covered fund activities, are prohibited.

used in trading operations, would permit the banking entity to use such information to its customers', clients' or counterparties' disadvantage. Similarly, a banking entity may conduct a transaction that places the banking entity's own interests ahead of its obligations to its customers, clients or counterparties, or it may seek to gain by treating one customer involved in a transaction more favorably than another customer involved in that transaction. Concerns regarding conflicts of interest are likely to be elevated when a transaction is complex, highly structured or opaque, involves illiquid or hard-to-value instruments or assets, requires the coordination of multiple internal groups (such as multiple trading desks or affiliated entities), or involves a significant asymmetry of information or transactional data among participants.[205] In all cases, the existence of a material conflict of interest depends on the specific facts and circumstances.

To address these types of material conflicts of interest, § __.8(b) of the proposed rule specifies that a material conflict of interest between a banking entity and its clients, customers, or counterparties exists if the banking entity engages in any transaction, class of transactions, or activity that would involve or result in the banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, unless the banking entity has appropriately addressed and mitigated the conflict of interest, where possible, and subject to specific requirements provided in the proposal, through either (i) timely and effective disclosure, or (ii) informational barriers.[206] Unless the conflict of interest is addressed and mitigated in one of the two ways specified in the proposal,

---

[205] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Apr. 13, 2011), available at http://hsgac.senate.gov/public/_files/Financial_Crisis/FinancialCrisisReport.pdf.

[206] See proposed rule § __.8(b)(1).

the related transaction, class of transactions or activity would be prohibited under the proposed rule, notwithstanding the fact that it may be otherwise permitted under §§ __.4 through __.6 of the proposed rule.[207]

However, while these conflicts may be material for purposes of the proposed rule, the mere fact that the buyer and seller are on opposite sides of a transaction and have differing economic interests would not be deemed a "material" conflict of interest with respect to transactions related to bona fide underwriting, market making, risk-mitigating hedging or other permitted activities, assuming the activities are conducted in a manner that is consistent with the proposed rule and securities and banking laws and regulations.

Section __.8(b)(1) of the proposed rule describes the two requirements that must be met in cases where a banking entity addresses and mitigates a material conflict of interest through timely and effective disclosure. First, § __.8(b)(1)(i) of the proposed rule requires that the banking entity, prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, for which a conflict may arise, make clear, timely, and effective disclosure of the conflict or potential conflict of interest, together with any other necessary information.[208] This would also require such disclosure to be provided in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully

---

[207] The Agencies note that a banking entity subject to Appendix C must implement a compliance program that includes, among other things, policies and procedures that explain how the banking entity monitors and prohibits conflicts of interest with clients, customers, and counterparties. Further, as noted in the discussion of the definition of "material conflict of interest" in Part III.B.6 of this Supplemental Information, the discussion of that definition is provided solely for purposes of the proposed rule's definition of material conflict of interest, and does not affect the scope of that term in other contexts or a banking entity's obligation to comply with additional or different requirements with respect to a conflict under applicable securities, banking, or other laws (e.g., section 27B of the Securities Act, which governs conflicts of interest relating to certain securitizations; section 206 of the Investment Advisers Act of 1940, which applies to conflicts of interest between investment advisers and their clients; or 12 CFR 9.12, which applies to conflicts of interest in the context of a national bank's fiduciary activities).

[208] See proposed rule § __.8(b)(1)(A).

understand the conflict of interest.[209] Disclosure that is only general or generic, rather than specific to the individual, class, or type of transaction or activity, or that omits details or other information that would be necessary to a reasonable client's, customer's, or counterparty's understanding of the conflict of interest, would not meet this standard. Second, § __.8(b)(1)(ii) of the proposed rule requires that the disclosure be made explicitly and effectively, and in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty that was created or would be created by the conflict or potential conflict.[210]

The Agencies note that, in order to provide the requisite opportunity for the client, customer or counterparty to negate or substantially mitigate the disadvantage created by the conflict, the disclosure would need to be provided sufficiently close in time to the client's, customer's, or counterparty's decision to engage in the transaction or activity to give the client, customer, or counterparty an opportunity to meaningfully evaluate and, if necessary, take steps that would negate or substantially mitigate the conflict. Disclosure provided far in advance of the individual, class, or type of transaction, such that the client, customer, or counterparty is unlikely to take that disclosure into account when evaluating a transaction, would not suffice. Conversely, disclosure provided without a sufficient period of time for the client, customer, or counterparty to evaluate and act on the information it receives, or disclosure provided after the fact, would also not suffice under the proposal. The Agencies note that the proposed definition would not prevent or require disclosure with respect to transactions or activities that align the

[209] See id.

[210] See proposed rule § __.8(b)(1)(B).

interests of the banking entity with its clients, customers, or counterparties or that otherwise do not involve "material" conflicts of interest as discussed above.

The proposed disclosure standard reflects the fact that some types of conflicts may be appropriately resolved through the disclosure of clear and meaningful information to the client, customer, or counterparty that provides such party with an informed opportunity to consider and negate or substantially mitigate the conflict. However, in the case of a conflict in which a client, customer, or counterparty does not have sufficient information and opportunity to negate or mitigate the materially adverse effect on the client, customer, or counterparty created by the conflict, the existence of that conflict of interest would prevent the banking entity from availing itself of any exemption (e.g., the underwriting or market-making exemptions) with respect to the relevant transaction, class of transactions, or activity. The Agencies note that the proposed disclosure provisions are provided solely for purposes of the proposed rule's definition of material conflict of interest, and do not affect a banking entity's obligation to comply with additional or different disclosure or other requirements with respect to a conflict under applicable securities, banking, or other laws (e.g., section 27B of the Securities Act, which governs conflicts of interest relating to certain securitizations; section 206 of the Investment Advisers Act of 1940, which governs conflicts of interest between investment advisers and their clients; or 12 CFR 9.12, which applies to conflicts of interest in the context of a national bank's fiduciary activities).

Section __.8(b)(2) of the proposed rule describes the requirements that must be met in cases where a banking entity uses information barriers that are reasonably designed to prevent a material conflict of interest from having a materially adverse effect on a client, customer or counterparty. Information barriers can be used to restrict the dissemination of information within a complex organization and to prevent material conflicts by limiting knowledge and coordination

of specific business activities among units of the entity. Examples of information barriers include, but are not limited to, restrictions on information sharing, limits on types of trading, and greater separation between various functions of the firm. Information barriers may also require that banking entity units or affiliates have no common officers or employees. Such information barriers have been recognized in Federal securities laws and rules as a means to address or mitigate potential conflicts of interest or other inappropriate activities.[211]

In order to address and mitigate a conflict of interest through the use of the information barriers pursuant to § __.8(b)(2) of the proposed rule, a banking entity would be required to establish, maintain, and enforce information barriers that are memorialized in written policies and procedures, including physical separation of personnel, functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer or counterparty.[212] Importantly, the proposed rule also provides that, notwithstanding a banking entity's establishment of such information barriers, if the banking entity knows or should reasonably know that a material conflict of interest arising out of a specific transaction, class or type of transactions, or activity may involve or result in a materially

---

[211] For example, information barriers have been used in complying with the requirement in section 15(g) of the Exchange Act that registered brokers and dealers establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer.

[212] See proposed rule § __.8(b)(2). As part of maintaining and enforcing information barriers, a banking entity should have processes to review, test, and modify information barriers on a continuing basis. In addition, banking entities should have ongoing monitoring to maintain and to enforce information barriers, for example by identifying whether such barriers have not prevented unauthorized information sharing and addressing instances in which the barriers were not effective. This may require both remediating any identified breach as well as updating the information barriers to prevent further breaches, as necessary. Periodic assessment of the effectiveness of information barriers and periodic review of the written policies and procedures are also important to the maintenance and enforcement of effective information barriers and reasonably designed policies and procedures. Such assessments can be done either (i) internally by a qualified employee or (ii) externally by a qualified independent party.

adverse effect on a client, customer, or counterparty, the banking entity may not rely on those information barriers to address and mitigate any conflict of interest. In such cases, the transaction or activity would be prohibited, unless the banking entity otherwise complies with the requirements of § __.8(b)(1).[213] This aspect of the proposal is intended to make clear that, in specific cases in which a banking entity has established an information barrier but knows or should reasonably know that it has failed or will fail to prevent a conflict of interest arising from a specific transactions or activity that disadvantages a client, customer, or counterparty, the information barrier is insufficient to address that conflict and the transaction would be prohibited, unless the banking entity is otherwise able to address and mitigate the conflict through timely and effective disclosure under the proposal.[214]

The Agencies note that the proposed definition of material conflict of interest does not address instances in which a banking entity has made a material misrepresentation to its client, customer, or counterparty in connection with a transaction, class of transactions, or activity, as such transactions or activity appears to involve fraud rather than a conflict of interest. However, the Agencies note that such misrepresentations are generally illegal under a variety of Federal and State regulatory schemes (e.g., the Federal securities laws). In addition, the Agencies note that any activity involving a material misrepresentation to, or other fraudulent conduct with respect to, a client, customer, or counterparty would not be permitted under the proposed rule in the first instance. For example, a trading activity involving a material misrepresentation to a

---

[213] See proposed rule § __.8(b)(2).

[214] In addition, if a conflict occurs to the detriment of a client, customer, or counterparty despite an information barrier, the Agencies would also expect the banking entity to review the effectiveness of its information barrier and make adjustments, as necessary, to avoid future occurrences, or review whether such information barrier is appropriate for that type of conflict.

client, customer, or counterparty would fail, on its face, to satisfy the proposed terms of the underwriting or market-making exemption.

b. Definition of "high-risk asset" and "high-risk trading strategy".

Section __.8(c) of the proposed rule defines "high-risk asset" and "high-risk trading strategy" for proposes of § __.8's proposed limitations on permitted trading activities. Section __.8(c)(1) defines a "high-risk asset" as an asset or group of assets that would, if held by the banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would fail. Section __.8(c)(2) defines a "high-risk trading strategy" as a trading strategy that would, if engaged in by the banking entity, significantly increase the likelihood that the banking entity would incur a substantial financial loss or would fail.[215]

c. Request for comment.

The Agencies request comment on the proposed limitations on permitted trading activities. In particular, the Agencies request comment on the following questions:

Question 190. Is the manner in which the proposed rule implements the limitations of section 13(d)(2) of the BHC Act effective and sufficiently clear? If not, what alternative would be more effective and/or clearer?

Question 191. Is the proposed rule's definition of material conflict of interest effective and sufficiently clear? If not, what alternative would be more effective and/or clearer?

---

[215] The Agencies note that a banking entity subject to proposed Appendix C must implement a compliance program that includes, among other things, policies and procedures that explain how the banking entity monitors and prohibits exposure to high-risk assets and high-risk trading strategies, and identifies a variety of assets and strategies (e.g., assets or strategies with significant embedded leverage).

Question 192. Is the proposed definition of material conflict of interest over-or under-inclusive? If so, how should the definition be broader or narrower? Is there an alternative definition that would be appropriate? If so, what definition? Why would that alternative definition better define material conflict of interest for purposes of implementing section 13 of the BHC Act?

Question 193. Would the proposed definition of material conflict of interest have any unintended chilling effect on underwriting, market making, risk-mitigating hedging or other permitted activities? If so, what alternatives might limit such an effect?

Question 194. Would the proposed definition of material conflict of interest lead to unintended consequences? If so, what unintended consequences and why? Please suggest modifications to the proposed definition that would mitigate those consequences.

Question 195. Is it likely that the proposed definition of material conflict of interest would anticipate all future material conflicts of interest, particularly as the financial markets evolve and change? If not, what alternative definition would better anticipate future material conflicts of interest?

Question 196. Does the proposed rule provide sufficient guidance for determining when a material conflict of interest exists? If not, what additional detail should be provided? Should the Agencies adopt an approach similar to that under the securities laws, in which a material conflict of interest is not specifically defined?

Question 197. Are there transactions, classes or types of transactions, or activities inherent in underwriting, market-making, risk-mitigating hedging or other permitted activities

that should not be prohibited but may be captured by the proposed definition of material conflict of interest? If so, what transactions and activities? Should they be permitted under the proposed rule? If so, why and under what conditions, if any? Conversely, are there transactions or activities that would be permitted under the proposed rule that should be prohibited? If so, what transactions and activities? Why should they be prohibited under the proposed rule?

Question 198. Please discuss the inherent conflicts of interest that arise from bona fide underwriting, market making-related activity, risk-mitigating hedging, or any other permitted activity, and provide specific examples of such inherent conflicts. Do you believe that such conflicts ever result in a materially adverse interest between a banking entity and a client, customer, or counterparty? How should the proposal address inherent conflicts that result from otherwise-permitted activities?

Question 199. Is the manner in which the proposed rule permits the use of disclosure in certain cases to address and mitigate conflicts of interest appropriate? Why or why not? Should additional or alternative requirements be placed on the use of disclosure to address and mitigate conflicts? If so, what additional and alternative requirements, and why? Is the level of detail and specificity required by the proposed rule with respect to disclosure appropriate? If not, what alternative level of detail and specificity would be more appropriate?

Question 200. Should the proposed rule require written disclosure to a client, customer, or counterparty regarding a material conflict of interest? If so, please explain why written disclosure should be required. Are there certain circumstances where written disclosure should be required, but others where oral disclosure should be sufficient? For example, should oral disclosure be permitted for transactions in certain fast-moving markets or transactions with

sophisticated clients, customers, or counterparties? If oral disclosure is permitted under certain circumstances, should subsequent written disclosure be required? Please explain.

Question 201. Should the proposed rule provide further detail regarding the types of conflicts of interest that cannot be addressed and mitigated through disclosure? If so, what type of additional detail would be helpful, and why? Should the proposed rule enumerate an exhaustive or non-exhaustive list of conflicts that cannot be addressed and mitigated through disclosure? If so, what conflicts should that list include, and why?

Question 202. Should the proposed rule provide further detail regarding the frequency at which disclosure must be made? Should general disclosure be permitted for certain types of transactions, classes of transactions, or activities? For example, should a banking entity be permitted to make a one-time, written disclosure to a client, customer, or counterparty prior to engaging in a certain type of transaction or activity? Should general disclosure be permitted for certain types of clients, customers, or counterparties (e.g., highly sophisticated parties)? Please explain why specific disclosure (i.e., prior to each transaction, class of transaction, or activity) would not be necessary under the identified circumstances. Are there any clients, customers, or counterparties that should be able to waive a material conflict of interest under certain circumstances? If so, under what circumstances would a waiver approach be appropriate and consistent with the statute? Please explain.

Question 203. Should the proposed definition of material conflict of interest deem certain potential conflicts of interest to not be material conflicts of interest if a banking entity establishes, maintains, and enforces policies and procedures (other than information barriers) reasonably designed to prevent transactions, classes of transactions, or activities that would

involve or result in a material conflict of interest? If so, for what types of potential conflicts? What policies and procedures would be appropriate? How would this approach be consistent with the purpose and language of the statute? Should such policies and procedures only be considered effective if they prevent the banking entity from receiving an advantage to the disadvantage of the client, customer, or counterparty?

Question 204. Are there any particular types of clients, customers, or counterparties for whom disclosure of a material conflict of interest should not be required under the proposal, consistent with the statute? Please identify the types of clients, customers, or counterparties for whom disclosure might not be necessary and explain. Why might disclosures be useful for some clients, customers, or counterparties, but not others? Please explain. What characteristics should a firm use in determining whether or not a client, customer, or counterparty needs a particular disclosure?

Question 205. Are there additional steps that a banking entity that seeks to manage conflicts of interest through the use of disclosure should be required to take with regard to disclosure? If so, what steps?

Question 206. Are there circumstances in which disclosure might be impracticable or ineffective? If so, what circumstances, and why?

Question 207. Is the manner in which the proposed rule permits the use of information barriers to address and mitigate conflicts of interest appropriate? Why or why not? Should additional or alternative requirements be placed on the use of information barriers to address and mitigate conflicts? If so, what additional and alternative requirements, and why?

Question 208. Should the proposed rule mandate the use of other means of managing potential conflicts of interest? If so, what specific means should be considered? How effective are any such methods as currently used? Can such methods be circumvented? If so, in what ways?

Question 209. What burdens or costs might be associated with the disclosure-related or information barrier-related requirements contained in the proposed definition of material conflict of interest? How might these burdens or costs be eliminated or reduced in a manner consistent with the purpose and language of section 13 of the BHC Act?

Question 210. Are there specific transactions, classes of transactions or activities that should be managed through consent? If so, what transactions or activities, and why? What form of consent should be required? What level of detail should any such consent include? Should consent only apply to certain conflicts and not others? If so, which conflicts? Are there circumstances in which obtaining consent might be impracticable or ineffective? Should consent be limited to certain types of clients, customers, or counterparties? If so, which clients, customers, or counterparties? Are there certain types of clients, customers, or counterparties for whom consent would never be sufficient? Are there additional steps that a banking entity that seeks to manage conflicts of interest through the use of consent should be required to take? Please specify such steps.

Question 211. What is the potential relationship between, and interplay of, the proposed rule and Section 621 of the Dodd-Frank Act regarding conflicts of interest relating to certain securitizations which contains a prohibition on material conflicts of interest?

Question 212. Should the proposed rule provide for specific types of procedures that would be more effective in managing and mitigating conflicts of interest than others? Do banking entities currently use certain procedures that effectively manage and mitigate material conflicts of interest? If so, please describe such procedures and explain why such procedures are effective. Is the proposed rule consistent with such procedures? Why or why not? What are the costs and benefits of modifying your current procedures in response to the proposed rule?

Question 213. Is the proposed rule's definition of a high-risk asset effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should the proposed rule specify particular assets that are deemed high-risk per se? If so, what assets and why?

Question 214. Is the proposed rule's definition of a high-risk trading strategy effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Should the proposed rule specify particular trading strategies that are deemed high-risk per se? If so, what trading strategies and why?

C. Subpart C - Covered Fund Activities and Investments

As noted above, except as otherwise permitted, section 13(a)(1)(B) of the BHC Act prohibits a banking entity from acquiring or retaining any ownership in, or acting as sponsor to, a covered fund.[216] Subpart C of the proposed rule applies those portions of section 13 of the BHC Act that operate as a prohibition or restriction on a banking entity's ability, as principal, directly or indirectly, to acquire or retain an ownership interest in, act as sponsor to, or have certain relationships with, a covered fund. Subpart C also implements the permitted activity and

[216] See 12 U.S.C. 1851(a)(1)(B).

investment authorities provided for under section 13(d)(1) of the BHC Act related to covered fund activities and investments, as well as the rule of construction related to the sale and securitization of loans under section 13(g)(2) of that Act. Additionally, subpart C contains a discussion of the internal controls, reporting and recordkeeping requirements applicable to covered fund activities and investments, and incorporates by reference the minimum compliance standards for banking entities contained in subpart D of the proposed rule, as well as Appendix C, to the extent applicable.

1. Section __.10: Prohibition of acquisition or retention of ownership interests in, and certain relationships with, a covered fund.

Section __.10 of the proposed rule defines the scope of the prohibition on acquisition or retention of ownership interests in, and certain relationships with, a covered fund, as well as defines a number of key terms related to such prohibition.

a. Prohibition regarding covered fund activities and investments.

Section __.10(a) of the proposed rule implements section 13(a)(1)(B) of the BHC Act and prohibits a banking entity from, as principal, directly or indirectly, acquiring or retaining an equity, partnership, or other ownership interest in, or acting as sponsor to, a covered fund, unless otherwise permitted under subpart C of the proposed rule.[217] This prohibition reflects the statute's purpose and effect of limiting a banking entity's ability to invest in or have exposure to a covered fund.

The Agencies note that the general prohibition in § __.10(a) of the proposed rule applies solely to a banking entity's acquisition or retention of an ownership interest in or acting as

[217] See proposed rule § __.10(a).

sponsor to a covered fund "as principal, directly or indirectly."[218] As such, the proposed rule would not prohibit the acquisition or retention of an ownership interest (including a general partner or membership interest) in a covered fund: (i) by a banking entity in good faith in a fiduciary capacity, except where such ownership interest is held under a trust that constitutes a company as defined in section (2)(b) of the BHC Act; (ii) by a banking entity in good faith in its capacity as a custodian, broker, or agent for an unaffiliated third party; (iii) by a "qualified plan," as that term is defined in section 401 of the Internal Revenue Code of 1956 (26 U.S.C. 401), if the ownership interest would be attributed to a banking entity solely by operation of section 2(g)(2) of the BHC Act; or (iv) by a director or employee of a banking entity who acquires the interest in his or her personal capacity and who is directly engaged in providing advisory or other services to the covered fund, unless the banking entity, directly or indirectly, extended credit for the purpose of enabling the director or employee to acquire the ownership interest in the fund and the credit was used to acquire such ownership interest in the fund.

Among other things, § __.10(b) of the proposed rule defines the term "covered fund."[219] This definition explains the universe of entities to which the prohibition contained in § __.10(a) applies unless the activity is specifically permitted under an available exemption contained in subpart C of the proposed rule. Other related terms, including "ownership interest," "prime brokerage transaction," "sponsor," and "trustee," are in turn defined in §§ __.10(b)(2) through __.10(b)(6) of the proposed rule.

[218] The Agencies note that this language is intended to prevent a banking entity from evading the restrictions contained in section 13(a)(1)(B) of the BHC Act on acquiring or retaining an ownership interest in a covered fund.

[219] See proposed rule § __.10(b)(1). The term banking entity, which is discussed above in Part III.A.2 of this Supplementary Information, is defined in § __.2(e).

b. "Covered fund" and related definitions.

i. Definition of "covered fund".

Section 13(h)(2) of the BHC Act defines the terms "hedge fund" and "private equity fund" to mean "any issuer that would be an investment company, as defined in the [Investment Company Act], but for section 3(c)(1) or 3(c)(7) of that Act," or such similar funds as the Agencies may by rule determine.[220] Given that the statute defines a "hedge fund" and "private equity fund" synonymously, the proposed rule implements this statutory definition by combining the terms into the definition of a "covered fund."[221]

Sections 3(c)(1) and 3(c)(7) of the Investment Company Act are exclusions from the definition of "investment company" in that Act and are commonly relied on by a wide variety of entities that would otherwise be covered by the broad definition of "investment company" contained in that Act. As a result, the statutory definition in section 13(h)(2) of the BHC Act could potentially include within its scope many entities and corporate structures that would not usually be thought of as a "hedge fund" or "private equity fund." For instance, joint ventures, acquisition vehicles, certain wholly-owned subsidiaries, and other widely-utilized corporate structures typically rely on the exclusion contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act. These types of entities are generally not used to engage in investment or trading

---

[220] 12 U.S.C. 1851(h)(2). Sections 3(c)(1) and 3(c)(7) of the Investment Company Act, in relevant part, provide two exclusions from the definition of "investment company" for, as appropriate, (1) any issuer whose outstanding securities 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 (other than short-term paper), or (2) 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 proposes to make a public offering of such securities. See 15 U.S.C. 80a-3(c)(1) and (c)(7).

[221] See proposed rule § __.10(b)(1).

activities. Additionally, as noted in Part II.G of this Supplementary Information, certain securitization vehicles may be included in this definition.

The proposed rule follows the scope of the statutory definition by covering an issuer only if it would be an investment company, as defined in the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act.[222] Additionally, the proposed rule incorporates the statutory application of the rule to "such similar funds as the Agencies may determine by rule as provided in section 13(b)(2) of the BHC Act."[223] The Agencies have proposed to include as "similar funds" a commodity pool,[224] as well as the foreign equivalent of any entity identified as a "covered fund."[225] These entities have been included in the proposed rule as "similar funds" given that they are generally managed and structured similar to a covered fund, except that they are not generally subject to the Federal securities laws due to the instruments in which they invest or the fact that they are not organized in the United States or one or more States.

---

[222] See proposed rule § __.10(b)(1)(i). Under the proposed rule, if an issuer (including an issuer of asset-backed securities) may rely on another exclusion or exemption from the definition of "investment company" under the Investment Company Act other than the exclusions contained in section 3(c)(1) or 3(c)(7) of that Act, it would not be considered a covered fund, as long as it can satisfy all of the conditions of an alternative exclusion or exemption for which it is eligible.

[223] 12 U.S.C. 1851(b)(2).

[224] "Commodity pool" is defined in the Commodity Exchange Act to mean any investment trust, syndicate, or similar form of enterprise operated for the purpose of trading in commodity interests, including any: (i) commodity for future delivery, security futures product, or swap; (ii) agreement, contract, or transaction described in section 2(c)(2)(C)(i) or 2(c)(2)(D)(i) of the Commodity Exchange Act; (iii) commodity option authorized under section 4c of the Commodity Exchange Act; or (iv) leverage transaction authorized under section 23 of the Commodity Exchange Act. See 7 U.S.C. 1a(10).

[225] See proposed rule § __.10(b)(1)(iii). The proposed rule makes clear that any issuer, as defined in section 2(a)(22) of the Investment Company Act, (15 U.S.C. 80a-2(a)(22)), that is organized or offered outside of the United States, would qualify as a covered fund if, were it organized or offered under the laws, or offered for sale or sold to a resident, of the United States or of one or more States, it would be either: (i) an investment company, as defined in the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act; (ii) a commodity pool; or (iii) any such similar fund as the appropriate Federal banking agencies, the SEC, and the CFTC may determine, by rule, as provided in section 13(b)(2) of the BHC Act.

ii. Definition of "ownership interest".

The proposed rule defines "ownership interest" in order to make clear the scope of section 13(a)(1)(B) of the BHC Act and § __.10(a)'s prohibition on a banking entity acquiring or retaining any equity, partnership, or other ownership interest in a covered fund. The definition of ownership interest includes a description of what interests constitute an ownership interest, as well as an exclusion from the definition of ownership interest for carried interest.[226] The proposed rule defines ownership interest to mean, with respect to a covered fund, any equity, partnership, or other similar interest (including, without limitation, a share, equity security, warrant, option, general partnership interest, limited partnership interest, membership interest, trust certificate, or other similar interest) in a covered fund, whether voting or nonvoting, as well as any derivative of such interest. This definition focuses on the attributes of the interest and whether it provides a banking entity with economic exposure to the profits and losses of the covered fund, rather than its form. To the extent that a debt security or other interest of a covered fund exhibits substantially the same characteristics as an equity or other ownership interest (e.g., provides the holder with voting rights, the right or ability to share in the covered fund's profits or losses, or the ability, directly or pursuant to a contract or synthetic interest, to earn a return based on the performance of the fund's underlying holdings or investments), the Agencies could consider such instrument an ownership interest as an "other similar instrument."

Many banking entities that serve as investment adviser or commodity trading advisor to a covered fund are compensated for services they provide to the fund through receipt of so-called "carried interest." In recognition of the manner in which such compensation is traditionally provided, the proposed rule also clarifies that an ownership interest with respect to a covered

[226] See proposed rule § __.10(b)(3).

fund does not include an interest held by a banking entity (or an affiliate, subsidiary or employee thereof) in a covered fund for which the banking entity (or an affiliate, subsidiary or employee thereof) serves as investment manager, investment adviser or commodity trading advisor, so long as: (i) the sole purpose and effect of the interest is to allow the banking entity (or the affiliate, subsidiary or employee thereof) to share in the profits of the covered fund as performance compensation for services provided to the covered fund by the banking entity (or the affiliate, subsidiary or employee thereof), provided that the banking entity (or the affiliate, subsidiary or employee thereof) may be obligated under the terms of such interest to return profits previously received; (ii) all such profit, once allocated, is distributed to the banking entity (or the affiliate, subsidiary or employee thereof) promptly after being earned or, if not so distributed, the reinvested profit of the banking entity (or the affiliate, subsidiary or employee thereof) does not share in the subsequent profits and losses of the covered fund; (iii) the banking entity (or the affiliate, subsidiary or employee thereof) does not provide funds to the covered fund in connection with acquiring or retaining this carried interest; and (iv) the interest is not transferable by the banking entity (or the affiliate, subsidiary or employee thereof) except to an affiliate or subsidiary.[227] The proposed rule therefore permits a banking entity to receive an interest as performance compensation for services provided by it or one of its affiliates, subsidiaries, or employees to a covered fund, but only if the enumerated conditions are met.

iii. Definition of "prime brokerage transaction".

Section 13(f)(3) of the BHC Act permits a banking entity to enter into a prime brokerage transaction with a covered fund in which a covered fund managed, organized, or sponsored by

[227] See proposed rule § __.10(b)(3)(ii).

such banking entity (or an affiliate or subsidiary thereof) has taken an ownership interest.[228] However, section 13 of the BHC Act does not define what qualifies as a prime brokerage transaction. In order to provide clarity regarding the types of services and relationships that are permitted as a prime brokerage transaction, the proposed rule defines a "prime brokerage transaction" to mean one or more products or services provided by a banking entity to a covered fund, such as custody, clearance, securities borrowing or lending services, trade execution, or financing, data, operational, and portfolio management support.[229]

iv. Definition of "sponsor" and "trustee".

The proposed rule defines "sponsor" in the same manner as section 13(h)(5) of the BHC Act.[230] Section __.10(b)(5) of the proposed rule defines the term "sponsor" as an entity that: (i) serves as a general partner, managing member, trustee, or commodity pool operator of a covered fund; (ii) in any manner selects or controls (or has employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or (iii) shares with a covered fund, for the corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.[231]

The definition of "sponsor" contained in section 13(h)(5) of the BHC Act focuses on the ability to control the decision-making and operational functions of the fund. In keeping with this focus, the proposed rule defines the term "trustee" (which is a part of the definition of "sponsor") to exclude trustee that does not exercise investment discretion with respect to a covered fund, including a directed trustee, as that term is used in section 403(a)(1) of the Employee's

---

[228] See 12 U.S.C. 1851(f)(3).

[229] See proposed rule § __.10(b)(4).

[230] See 12 U.S.C. 1851(h)(5).

[231] See proposed rule § __.10(b)(5).

Retirement Income Security Act (29 U.S.C. 1103(a)(1)). The proposed rule provides that a "trustee" includes any banking entity that directs a directed trustee, or any person who possesses authority and discretion to manage and control the assets of the covered fund.[232]

v. Request for comment

The Agencies request comment on the proposed rule's approach to defining the terms covered fund, ownership interest, and other related terms. In particular, the Agencies request comment on the following questions:

Question 215. Is the proposed rule's approach to applying section 13 of the BHC Act's restrictions related to covered fund activities and investments to those instances where a banking entity acts "as principal or beneficial owner" effective? If not, why? What alternative approach might be more effective in light of the language and purpose of the statute?

Question 216. Does the proposed rule effectively address the circumstances under which an investment by a director or employee of a banking entity in a covered fund would be attributed to a banking entity? If not, why? What alternative might be more effective?

Question 217. Does the proposed rule's definition of "covered fund" effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute?

Question 218. Is specific inclusion of commodity pools within the definition of "covered fund" effective and consistent with the language and purpose of the statute? Why or why not?

[232] See proposed rule § __.10(b)(6)(ii).

Question 219. The proposed definition of "sponsor" focuses on "the ability to control the decision-making and operational functions of the fund." In the securitization context, is this an appropriate manner to determine the identity of the sponsor? If not, what factors should be used to determine the identity of the sponsor in the securitization context for purposes of the proposed rule and why? Is the definition of "sponsor" set forth in the SEC's Regulation AB[233] an appropriate party to treat as sponsor for purposes of the proposed rule? Is additional guidance necessary with respect to how the proposed definition of "sponsor" should be applied to a securitization transaction?

Question 220. Should the application of the proposed definition of "sponsor" mean that the servicer or investment manager in a securitization transaction would be considered the sponsor for purposes of the proposed rule? What impact would this interpretation of the proposed definition have on existing securitizations?

Question 221. Should the definition of "covered fund" focus on the characteristics of an entity rather than whether it would be an investment company but for section 3(c)(1) or 3(c)(7) of the Investment Company Act? If so, what characteristics should be considered and why? Would a definition focusing on an entity's characteristics rather than its form be consistent with the language and purpose of the statute?

Question 222. Instead of adopting a unified definition of "covered fund" for those entities included under section 13(h)(2) of the BHC Act, should the Agencies consider having separate definitions for "hedge fund" and "private equity fund"? If so, which definitions and why?

[233] See 17 CFR 229.1101(l).

Question 223. Should the Agencies consider using the authority provided under section 13(d)(1)(J) of the BHC Act to exempt the acquisition or retention of an ownership interest in a covered fund with certain attributes or characteristics, including, for example: (i) a performance fee or allocation to an investment manager's equity account calculated by taking into account income and realized and unrealized gains; (ii) borrowing an amount in excess of one-half of its total capital commitments or has gross notional exposure in excess of twice its total capital commitments; (iii) sells securities or other assets short; (iv) has restricted or limited investor redemption rights; (v) invests in public and non-public companies through privately negotiated transactions resulting in private ownership of the business; (vi) acquires the unregistered equity or equity-like securities of such companies that are illiquid as there is no public market and third party valuations are not readily available; (vii) requires holding those investments long-term; (viii) has a limited duration of ten years or less; or (ix) returns on such investments are realized and the proceeds of the investments are distributed to investors before the anticipated expiration of the fund's duration? Which, if any, of these characteristics are appropriate to describe a hedge fund or private equity fund that should be considered a covered fund for purposes of this rule? Are there any other characteristics that would be more appropriate to describe a covered fund? If so, which characteristics and why?

Question 224. Is specific inclusion of certain non-U.S. entities as a "covered fund" under § __.10(b)(1)(iii) of the proposed rule necessary, or would such entities already be considered to be a "covered fund" under § __.10(b)(1)(i) of the proposed rule? If so, why? Does the proposed rule's language on non-U.S. entities correctly describe those non-U.S. entities, if any, that should be included in the definition of "covered fund"? Why or why not? What alternative language would be more effective? Should we define non-U.S. funds by reference to the following

structural characteristics: whether they are limited in the number or type of investors; whether they operate without regard to statutory or regulatory requirements relating to the types of instruments in which they may invest or the degree of leverage they may incur? Why or why not?

Question 225. Are there any entities that are captured by the proposed rule's definition of "covered fund," the inclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?

Question 226. Are there any entities that are not captured by the proposed rule's definition of "covered fund," the exclusion of which does not appear to be consistent with the language and purpose of the statute? If so, which entities and why?

Question 227. Do the proposed rule's definitions of "covered fund" and/or "ownership interest" pose unique concerns or challenges to issuers of asset-backed securities and/or securitization vehicles? If so, why? Do certain types of securitization vehicles (trusts, LLCs, etc.) typically issue asset-backed securities which would be included in the proposed definition of ownership interest? What would be the impact of the application of the proposed rules to these securitization vehicles? Are certain asset classes (collateralized debt obligations, future flows, corporate debt repackages, etc.) more likely to be impacted by the proposed definition of "covered fund" because the issuer cannot rely on an exemption other than 3(c)(1) or 3(c)(7) of the Investment Company Act?

Question 228. How many existing issuers of asset-backed securities would be included in the proposed definition of "covered fund?" What would be the legal and economic impact of

the proposed rule on holders of asset-backed securities issued by existing securitization vehicles that would be included in the proposed definition of covered fund?

Question 229. Are there entities that issue asset-backed securities (as defined in Section 3(a) of the Exchange Act) that should be exempted from the requirements of the proposed rule? How would such an exemption promote and protect the safety and soundness of the banking entity and the financial stability of the United States as required by section 13(d)(1)(J) of the BHC Act?

Question 230. Since certain existing asset-backed securities may have a term that exceeds the conformance or extended transition periods provided for under section 13(c) of the BHC Act, should the Agencies consider using the authority contained in section 13(d)(1)(J) of that Act to exclude those existing asset-backed securities from the proposed definition of "ownership interest" and/or should the rule permit a banking entity to acquire or retain an ownership interest in existing asset-backed issuers? If so, how would either approach be consistent with the language and purpose of the statute?

Question 231. Many issuers of asset-backed securities have features and structures that resemble some of the features of hedge funds and private equity funds (e.g., CDOs are managed by an investment adviser that has the discretion to choose investments, including investments in securities). If the proposed definition of "covered fund" were to exempt any entity issuing asset-backed securities, would this allow for interests in hedge funds or private equity funds to be structured as asset-backed securities and circumvent the proposed rule? If this approach is taken, how should the proposal address this concern?

Question 232. Are the structural similarities between an entity that issues asset-backed securities and hedge funds and private equity funds of sufficient concern that the Agencies should not exclude any entity that issues asset-backed securities from the definition of covered fund?

Question 233. Should entities that rely on a separate exclusion from the definition of investment company other than sections 3(c)(1) or 3(c)(7) of the Investment Company Act be included in the definition of "covered fund"? Why or why not?

Question 234. Do the proposed rule's definitions of "ownership interest" and "carried interest" effectively implement the statute? What alternative definitions might be more appropriate in light of the language and purpose of the statute? Are there other types of instruments that should be included or excluded from the definition of "ownership interest"? Does the proposed definition of ownership interest capture most interests that are typically viewed as ownership interests? Is the proposed rule's exemption of carried interest from the definition of ownership interest with respect to a covered fund appropriate? Does the exemption adequately address existing compensation arrangements and the way in which a banking entity becomes entitled to carried interest? Is it consistent with the current tax treatment of these arrangements?

Question 235. In the context of asset-backed securities, the distinction between debt and equity may be complicated (e.g., trust certificates issued in a residential mortgage backed security transaction) and the legal, accounting and tax treatment may differ for the same

instrument. Is guidance necessary with respect to the application of the definition of ownership interest for asset-backed securitization transactions?

Question 236. In many securitization transactions, the residual interest represents the "equity" in the transaction. As this often constitutes the portion of the securitization transaction with the most risk, because it may absorb any losses experienced by the underlying assets before any other interests issued by the securitization vehicle, should the Agencies instead use their authority under section 13(d)(1)(J) of the BHC Act to exempt the buying and selling of any ownership interest in a securitization vehicle that is a covered fund other than the residual interest?

Question 237. For purposes of limiting either an exclusion for issuers of asset-backed securities from the proposed definition of "covered fund" and/or an exclusion of asset-backed securities from the proposed definition of "ownership interest," what definition of asset-backed security most effectively implements the language of section 13 of the BHC Act? Section 3(a)(77) of the Exchange Act and the SEC's Regulation AB[234] provide two possible definitions. Is either of these definitions sufficient, and if so why? If one of the definitions is too narrow, what additional entities/securities should be included and why? If one of the definitions is too broad, what entities/securities should be excluded and why? Would some other definition of asset-backed security be more consistent with the language and purpose of section 13 of the BHC Act?

[234] See 17 CFR 229.1101(c).

Question 238. Are there special concerns raised by not including as an ownership interest the residual interests in a securitization vehicle? Should the Agencies instead exempt the buying and selling of any ownership interest in a securitization vehicle that is a covered fund other than the residual interest?

Question 239. Should the legal form of a beneficial interest be a determining factor for deciding whether a beneficial interest is an "ownership interest"? For example, should pass-through trust certificates issued as part of a securitization transaction be excluded from the definition of "ownership interest"? Should the definition of ownership interest explicitly include debt instruments with equity features (e.g., voting rights, profit participations, etc.)?

Question 240. How should the proposed rule address those instances in which both debt and equity interests are issued, and the debt interests receive all of the economic benefits and all of the control rights? Should the debt interests (other than the residual interest) be counted as ownership interests even though they are not legally ownership and do not receive any profit participation? Should the equity interests be counted as ownership interests even though the holder does not receive economic benefits or have any control rights? Should the residual interest be considered the only "ownership interest" for purposes of the proposed rule? Should mezzanine interests that lack both control rights and profit participation be considered an ownership interest? If the mezzanine interests obtain control rights (because more senior classes have been repaid), should they become "ownership interests" at that time for purposes of the proposed rule? If both debt and equity interests are counted as ownership interests, how should percentages of ownership interests be calculated when the units of measurement do not match (e.g., a single trust certificate, a single residual certificate with no face value and multiple classes of currency-denominated notes)?

Question 241. Does the proposed rule's definition of "prime brokerage transaction" effectively implement the statute? What other types of transactions or services, if any, should be included in the definition? Should any types of transactions or services be excluded from the definition? Would an alternative definition be more effective, and if so, why?

Question 242. Do the proposed rule's definitions of "sponsor" and "trustee" effectively implement the statute? Is the exclusion of "directed trustee" from the definition of "trustee" appropriate?

Question 243. Do the proposed rule's other definitions in § __.10(b) effectively implement the statute? What alternative definitions might be more effective in light of the language and purpose of the statute? Are additional definitions needed, and if so, what definition(s)?

2. Section __.11: Permitted organizing and offering of a covered fund.

Section __.11 of the proposed rule implements section 13(d)(1)(G) of the BHC Act and permits a banking entity to organize and offer a covered fund, including acting as sponsor of the fund, if certain criteria are met.[235] This exemption is designed to permit a banking entity to be able to engage in certain traditional asset management and advisory businesses in compliance with section 13 of the BHC Act.[236]

a. Required criteria for permitted organizing and offering of covered funds.

[235] See proposed rule § __.11.

[236] 156 Cong. Rec. S5889 (daily ed. July 15, 2010) (statement of Sen. Hagan).

Section __.11 of the proposed rule provides for and describes the conditions that must be met in order to enable a banking entity to qualify for the exemption to organize and offer a covered fund.[237] These conditions include: (i) the banking entity must provide bona fide trust, fiduciary, investment advisory, or commodity trading advisory services;[238] (ii) the covered fund must be organized and offered only in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and only to persons that are customers of such services of the banking entity; (iii) the banking entity may not acquire or retain an ownership interest in the covered fund except as permitted under subpart C of the proposed rule; (iv) the banking entity must comply with the restrictions governing relationships with covered funds under § __.16 of the proposed rule; (v) the banking entity may not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; (vi) the covered fund, for corporate, marketing, promotional, or other purposes, (A) may not share the same name or a variation of the same name with the banking entity(or an affiliate or subsidiary thereof), and (B) may not use the word "bank" in its name; (vii) no director or employee of the banking entity may take or retain an ownership interest in the covered fund, except for any director or employee of the banking entity who is directly engaged in providing investment advisory or other services to the covered fund; and (viii) the banking entity must (A) clearly and conspicuously disclose, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents) the enumerated disclosures contained in § __.11(h) of

---

[237] See proposed rule §§ __.11(a) – (h).

[238] While section 13(d)(1)(G) of the BHC Act does not explicitly mention "commodity trading advisory services," the Agencies have proposed to include commodity pools within the definition of "covered fund" and commodity trading advisory services in the same way as investment advisory services because commodity trading advisory services are the functional equivalent of investment advisory services to commodity pools.

the proposed rule, and (B) comply with any additional rules of the appropriate Agency or Agencies, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the banking entity.[239] These requirements are explained in detail below.

i. Bona fide services.

Section __.11(a) of the proposed rule requires that, in order to qualify for the exemption related to organizing and offering a covered fund, a banking entity provide bona fide trust, fiduciary, investment advisory, or commodity trading advisory services.[240] Banking entities provide a wide range of customer-oriented services which may qualify as bona fide trust, fiduciary, investment advisory, or commodity trading advisory services.[241] Additionally, depending on the type of banking entity that conducts the activity or provides the service, variations in the precise services involved may occur. For example, a national bank and an SEC-registered investment adviser may provide substantially similar investment advisory services to clients, but be subject to different statutory and regulatory requirements. In recognition of potential variations in services and functional regulation, the proposed rule does not specify what services would qualify as "bona fide trust, fiduciary, investment advisory, or commodity trading advisory services" under § __.11(a) of the proposed rule. Instead, the proposed rule largely mirrors the statutory language of section 13(d)(1)(G)(i) of the BHC Act and reflects the intention that so long as a banking entity provides trust, fiduciary, investment advisory, or commodity trading advisory services in compliance with relevant statutory and regulatory requirements, the

[239] See id. at § __.11(a) – (h). The Agencies are not proposing any such additional rules at this time, although they may do so in the future

[240] See 12 U.S.C. 1851(d)(1)(G)(i); proposed rule § __.11(a).

[241] See, e.g., 12 U.S.C. 1843(c)(4), (c)(8), (k),12 CFR 225.28(b)(5) and (6), 12 CFR 225.86, 12 CFR 225.125 (with respect to a bank holding company); 12 U.S.C. 24 (Seventh), 92a, 12 CFR Part 9 (with respect to a national bank); 12 U.S.C. 1831a, 12 CFR Part 362 (with respect to a state nonmember bank).

requirement contained in § __.11(a) of the proposed rule would generally be deemed to be satisfied.

ii. "Customers of such services" requirement.

Section 13(d)(1)(G)(ii) of the BHC Act requires that a banking entity organize and offer a covered fund "only in connection with" the provision of qualified services to persons that are customers of such services of the banking entity.[242] Section __.11(b) of the proposed rule implements the statute and reflects the statutory requirement that there are two independent conditions contained in section 13(d)(1)(G)(ii) of the BHC Act: (i) a covered fund must be organized and offered in connection with bona fide trust, fiduciary, investment advisory, or commodity trading advisory services, and (ii) the banking entity providing those services may offer the covered fund only to persons that are customers of those services of the banking entity.[243] Requiring a customer relationship in connection with organizing and offering a covered fund helps to ensure that a banking entity is engaging in the covered fund activity for others and not on the banking entity's own behalf.[244]

Section 13(d)(1)(G)(ii) of the BHC Act does not explicitly require that the customer relationship be pre-existing. Accordingly, the proposed rule provides that it may be established through or in connection with the banking entity's organization and offering of a covered fund, so long as that fund is a manifestation of the provision by the banking entity of bona fide trust, fiduciary, investment advisory or commodity trading advisory services to the customer. This application of the customer requirements is consistent with the manner in which trust, fiduciary,

[242] See 12 U.S.C. 1851(d)(1)(G)(ii).

[243] See proposed rule § __.11(b).

[244] See 156 Cong. Rec. at S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

investment advisory, and commodity trading advisory services are provided by banking entities. Historically, banking entities have raised capital commitments for covered funds from existing customers as well as individuals or entities that have no pre-existing relationship with the banking entity.

Banking entities commonly organize and offer funds to customers of the banking entity's trust, fiduciary, and investment advisory or commodity trading advisory services as a way of ensuring the efficient and consistent provision of these services. For example, a person often obtains the investment advisory services of the banking entity by acquiring an interest in a fund organized and offered by the banking entity. This is distinguished from a fund organized and offered by a banking entity for the purpose of itself investing as principal, indirectly through its investment in the fund, in assets held by the fund. Under the proposed rule, a banking entity could, consistent with past practice, provide a covered fund to persons that are customers of such services for purposes of the exemption so long as the fund is organized and offered as a means of providing bona fide trust, fiduciary, investment advisory, or commodity trading advisory services to customers. The banking entity may not organize and offer a covered fund as a means of itself investing in the fund or assets held in the fund.[245]

The Agencies note that a banking entity could, through organizing and offering a covered fund pursuant to the authority contained in § __.11 of the proposed rule that itself makes investments or engages in trading activity, seek to evade the restrictions contained in section 13 of the BHC Act and the proposed rule. In order to address these concerns, the proposed rule

[245] The proposed rule does not change any requirement imposed by separate statute, regulation, or other law, if applicable. For instance, a banking entity that conducts a private placement of a covered fund pursuant to the SEC's Regulation D pertaining to private offerings would still be expected to comply with the relevant requirements related to such offering, including the limitations related to the manner in which and types of persons to whom it may offer or sell interests in such fund. See 12 CFR 230.501 et seq.

provides that a banking entity relying on the authority contained in § __.11 must organize and offer a covered fund pursuant to a credible plan or similar documentation outlining how the banking entity intends to provide advisory or similar services to its customers through organizing and offering such fund.

iii. Compliance with investment limitations.

Section 13(d)(1)(G)(iii) of the BHC Act limits the ability of a banking entity that organizes and offers a covered fund to acquire or retain an ownership interest in that covered fund.[246] Separately, other provisions of section 13 of the BHC Act provide independent exemptions which permit a banking entity to acquire or retain an ownership interest in a covered fund.[247] Section __.11(c) of the proposed rule incorporates these statutory provisions by prohibiting a banking entity from acquiring or retaining an ownership interest in a covered fund that it organizes and offers except as permitted under subpart C of the proposed rule.[248] The limits on a banking entity's ability to invest in a covered fund that it organizes and offers are described in § __.12 of the proposal.

iv. Compliance with section 13(f) of the BHC Act.

Section __.11(d) of the proposed rule requires that the banking entity comply with the limitations on certain relationships with covered funds.[249] These limitations apply in several contexts, and are contained in § __.16 of the proposed rule, discussed in detail below. In general, § __.16 of the proposed rule prohibits certain transactions or relationships that would be covered

---

[246] See 12 U.S.C. 1851(d)(1)(G)(iii).

[247] See, e.g., id. at 1851(d)(1)(C).

[248] See proposed rule § __.11(c).

[249] 12 U.S.C. 1851(d)(1)(G)(iv); proposed rule § __.11(d).

by section 23A of the FR Act, and provides that any permitted transaction is subject to section 23B of the FR Act, in each instance as if such banking entity were a member bank and such covered fund were an affiliate thereof.[250]

v. No guarantees or insurance of fund performance.

Section __.11(e) of the proposed rule prohibits the banking entity from, directly or indirectly, guaranteeing, assuming or otherwise insuring the obligations or performance of the covered fund or any covered fund in which such covered fund invests.[251] This prong implements section 13(d)(1)(G)(iv) of the BHC Act and is intended to prevent a banking entity from engaging in bailouts of a covered fund in which it has an interest.[252]

vi. Limitation on name sharing with a covered fund.

Section __.11(f) of the proposed rule prohibits the covered fund from sharing the same name or a variation of the same name with the banking entity, for corporate, marketing, promotional, or other purposes.[253] This section implements section 13(d)(1)(G)(v) of the BHC Act and addresses the concern that name-sharing could undermine market discipline and encourage a banking entity to bail out a covered fund it organizes and offers in order to preserve the entity's reputation.[254] Thus, under § __.11(f) of the proposed rule, a covered fund would be prohibited from sharing the same name or variation of the same name with a banking entity that organizes and offers or serves as sponsor to that fund (or an affiliate or subsidiary of such

[250] See Supplementary Information, Part III.C.7.

[251] 12 U.S.C. 1851(d)(1)(G)(v); proposed rule § __.11(e).

[252] See 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

[253] 12 U.S.C. 1851(d)(1)(G)(vi); proposed rule § __.11(f).

[254] 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

banking entity). A covered fund would also be prohibited under the proposed rule from using the word "bank" in its name.[255]

vii. Limitation on ownership by directors and employees.

Section __.11(g) of the proposed rule implements section 13(d)(1)(G)(vii) of the BHC Act. The provision prohibits any director or employee of the banking entity from acquiring or retaining an ownership interest in the covered fund, except for any director or employee of the banking entity who is directly engaged in providing investment advisory or other services to the covered fund.[256] This allows an individual acting as fund manager or adviser and employed by a banking entity to acquire or retain an ownership interest in a covered fund that aligns the manager or adviser's incentives with those of its customers by allowing the individual to have "skin in the game" with respect to a covered fund for which that individual provides management or advisory services (which customers or clients often request).[257]

The Agencies recognize that director or employee investments in a covered fund may provide an opportunity for a banking entity to evade the limitations regarding the amount or value of ownership interests a banking entity may acquire or retain in a covered fund or funds contained in section 13(d)(4) of the BHC Act and § __.12 of the proposed rule. In order to address this concern, the proposed rule would generally attribute an ownership interest in a covered fund acquired or retained by a director or employee to such person's employing banking entity, if the banking entity either extends credit for the purpose of allowing the director or

---

[255] Similar restrictions on a fund sharing the same name, or variation of the same name, with an insured depository institution or company that controls an insured depository institution or having the word "bank" in its name, have been used previously in order to prevent customer confusion regarding the relationship between such companies and a fund. See, e.g., Bank of Ireland, 82 FED. RES. BULL. 1129 (1996).

[256] See 12 U.S.C. 1851(d)(1)(G)(vii); proposed rule § __.11(g).

[257] See 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

employee to acquire such ownership interest, guarantees the director or employee's purchase, or guarantees the director or employee against loss on the investment.

viii. Disclosure requirements.

Section __.11(h) of the proposed rule requires that, in connection with organizing and offering a covered fund, the banking entity (i) clearly and conspicuously disclose, in writing, to prospective and actual investors in the covered fund (such as through disclosure in the covered fund's offering documents) that "any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the banking entity and its affiliates or subsidiaries]; therefore, [the banking entity's and its affiliates' or subsidiaries'] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by [the banking entity and its affiliates or subsidiaries] in their capacity as investors in [the covered fund]," and (ii) comply with any additional rules of the appropriate Agency as provided in section 13(b)(2) of the BHC Act designed to ensure that losses in any such covered fund are borne solely by the investors in the covered fund and not by the banking entity.[258] The proposed rule also provides, as an additional disclosure requirement related to organizing and offering a covered fund, that a banking entity clearly and conspicuously disclose, in writing, to any prospective and actual investor (such as through disclosure in the covered fund's offering documents): (i) that such investor should read the fund offering documents before investing in the covered fund; (ii) that the "ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity" (unless that happens to be the case); and (iii) the role of the banking entity and its

[258] 12 U.S.C. 1851(d)(1)(G)(viii); proposed rule § __.11(h).

affiliates, subsidiaries, and employees in sponsoring or providing any services to the covered fund. As noted above, the proposed rule clarifies that a banking entity may satisfy the requirements of this prong with respect to a covered fund by making the required disclosures, in writing, in the covered fund's offering documents.[259]

ix. Request for comment.

The Agencies request comment on the proposed rule's approach with respect to implementing the exemption permitting banking entities to organize and offer a covered fund. In particular, the Agencies request comment on the following questions:

Question 244. Is the proposed rule's approach to implementing the exemption for organizing and offering a covered fund effective? If not, what alternative approach would be more effective and why?

Question 245. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 246. Is the proposed rule's approach to implementing the scope of bona fide trust, fiduciary, investment advisory and commodity trading advisory services consistent with the statute? If not, what alternative approach would be more effective? Should the scope of such services be broader or, in the alternative, more limited? Are there specific services which should be included but which are not currently under the proposed rule?

[259] As contemplated in § __.11(a)(8)(ii) of the proposed rule, to the extent that any additional rules are issued to ensure that losses in a covered fund are borne solely by the investors in the covered fund and not by the banking entity, a banking entity would be required to comply with those as well in order to satisfy the requirements of section 13(d)(1)(G)(viii) of the BHC Act.

Question 247. Does the proposed rule effectively implement the "customers of such services" requirement? If not, what alternative approach would be more effective and why? Is the proposed rule's approach consistent with the statute? Why or why not? How do banking entities currently sell or provide interests in covered funds? Do banking entities rely on a concept of "customer" by reference to other laws or regulations, and if so, what laws or regulations?

Question 248. Does the proposed rule effectively and clearly recognize the manner in which banking entities provide trust, fiduciary, investment advisory, or commodity trading advisory services to customers? If not, how should the proposed rule be modified to be more effective or clearer?

Question 249. Should the Agencies consider adopting a definition of "customer of such services" for purposes of implementing the exemption related to organizing and offering a covered fund? If so, what criteria should be included in such definition? For example, should the customer requirement specify that the relationship be pre-existing? Should the Agencies consider adopting an existing definition related to "customer" and if so, what definitions (for instance, the SEC's "pre-existing, substantive relationship" concept applicable to private offerings under its Regulation D) would provide for effective implementation of the customer requirement in section 13(d)(1)(G) of the BHC Act? If so, why and how? How should the customer requirement be applied in the context of non-U.S. covered funds? Is there an equivalent concept used for such non-U.S. covered fund offerings?

Question 250. Should the Agencies distinguish between direct and indirect customer relationships for purposes of implementing section 13(d)(1)(G) of the BHC Act? Should the rule differentiate between a customer relationship established by a customer as opposed to a banking entity? If so, why?

Question 251. Does the proposed rule effectively implement the prohibition on a banking entity guaranteeing or insuring the obligations or performance of certain covered funds? If not, what alternative approach would be more effective, and why?

Question 252. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitation on certain relationships with a covered fund contained in § __.16 of the proposed rule? If not, what alternative approach would be more effective, and why?

Question 253. Does the proposed rule effectively implement the prohibition on a covered fund sharing the same name or variation of the same name with a banking entity? If not, what alternative approach would be more effective and why? Should the prohibition on a covered fund sharing the same name be limited to specific types of banking entities (e.g., insured depository institutions and bank holding companies) or only to the banking entity that organizes and offers the fund, and if so why?

Question 254. Does the proposed rule effectively implement the limitation on director or employee investments in a covered fund organized and offered by a banking entity? If not, what alternative approach would be more effective and why? Should the agencies provide additional guidance on what "other services" should be included for purposes of satisfying § __.11(g)? Why or why not?

Question 255. Are the disclosure requirements related to organizing and offering a covered fund appropriate? If not, what alternative disclosure requirement(s) should the proposed rule include? Should the Agencies consider adoption of a model disclosure form related to this requirement? Does the timing of the proposed disclosure requirement adequately address disclosure to secondary market purchasers?

3. Section __.12: Permitted investment in a covered fund.

Section __.12 of the proposed rule describes the limited circumstances under which a banking entity may acquire or retain, as an investment, an ownership interest in a covered fund that the banking entity or one of its subsidiaries or affiliates organizes and offers. This section implements section 13(d)(4) of the BHC Act and related provisions, and describes the statutory limits on both (i) the amount and value of an investment by a banking entity in a covered fund, and (ii) the aggregate value of all investments in all covered funds made by the banking entity.

As described below, a banking entity that makes or retains an investment in a covered fund under § __.12 of the proposed rule is generally subject to three principal limitations related to such investment. First, the banking entity's investment in a covered fund may not represent more than 3 percent of the total outstanding ownership interests of such fund (after the expiration of any seeding period provided under the rule). Second, the banking entity's investment in a covered fund may not result in more than 3 percent of the losses of the covered fund being allocable to the banking entity's investment. Third, a banking entity may invest no more than 3 percent of its tier 1 capital in covered funds.[260]

[260] See, e.g., proposed rule §§ __.12(b)(2), (c).

a. Authority and limitations on permitted investments.

Section 13(d)(4) of the BHC Act permits a banking entity to acquire and retain an ownership interest in a covered fund that the banking entity organizes and offers pursuant to section 13(d)(1)(G), for the purposes of (i) establishing the covered fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors, or (ii) making a de minimis investment in the covered fund in compliance with applicable requirements.[261] Section __.12 of the proposed rule implements this authority and related limitations.

Consistent with this statutory provision, the proposed rule requires a banking entity to (i) actively seek unaffiliated investors to ensure that the banking entity's investment conforms with the limits of § __.12, and (ii) reduce through redemption, sale, dilution, or other methods the aggregate amount and value of all ownership interests of the banking entity in a single fund held under § __.12 to an amount that does not exceed 3 percent of the total outstanding ownership interests of the fund not later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to § __.12(e) of the proposed rule) (the "per-fund limitation"). Additionally, § __.12 of the proposed rule implements the statutory requirement that the aggregate value of all ownership interests of the banking entity in all

[261] See 12 U.S.C. 1851(d)(4).

covered funds held as an investment not exceed 3 percent of the tier 1 capital of the banking entity (the "aggregate funds limitation").[262]

b. Permitted investment in a single covered fund.

Section __.12(b) of the proposed rule describes the limitations and restrictions on a banking entity's ability to make or retain an investment in a single covered fund. This section implements the requirements of section 13(d)(4) of the BHC Act.[263]

Section __.12 of the proposed rule describes the manner in which the limitations on the amount and value of ownership interests in a covered fund must be calculated, in recognition of the fact that a covered fund may have multiple classes of ownership interests which possess different characteristics or values that impact a person's ownership in that fund. A banking entity must apply the limits to both the total value and amount of its investment in a covered fund. For purposes of applying these limits, the banking entity must calculate (without regard to committed funds not yet called for investment): (i) the value of all investments or capital contributions made with respect to any ownership interest by the banking entity in a covered fund, divided by the value of all investments or capital contributions made by all persons in that covered fund, and (ii) the total number of ownership interests held as an investment by the banking entity in a covered fund divided by the total number of ownership interests held by all persons in that covered fund.[264] Therefore, under the proposed rule, such calculation would

---

[262] See proposed rule at § __.12(a)(2)(ii). The process and manner in which a banking entity's 3 percent tier 1 capital limit is determined for purposes of the proposed rule is discussed in detail below in Part III.C.3 of this Supplementary Information.

[263] See 12 U.S.C. 1851(d)(4)(B).

[264] See proposed rule § __.12(b)(2).

include as the numerator the amount or value of a banking entity's investment in a covered fund, and as the denominator the amount or value (matched to the unit of measurement in the numerator) of all classes of ownership interests held by all persons in that covered fund. As noted above, the banking entity's investment in a covered fund also may not result in more than 3 percent of the losses of the covered fund being allocable to the banking entity's investment.[265]

In order to ensure that a banking entity calculates its investment in a covered fund accurately and does not evade the per-fund investment limitation, the proposed rule requires that the banking entity must calculate its investment in the same manner and according to the same standards utilized by the covered fund for determining the aggregate value of the fund's assets and ownership interests in the covered fund.[266]

Under the proposed rule, the amount and value of a banking entity's investment in any single covered fund is (i) the total amount or value held by the banking entity directly and through any entity that is controlled, directly or indirectly, by the banking entity,[267] plus (ii) the pro rata amount or value of any covered fund held by any entity (other than certain operating entities noted below) that is not controlled, directly or indirectly, by the banking entity but in which the banking entity owns, controls, or holds with the power to vote more than 5 percent of the voting shares.[268]

---

[265] Under the proposed rule, a banking entity's investment in a covered fund may not result in more than 3 percent of the losses of the covered fund being allocable to the banking entity's investment since the banking entity's permitted investment in a covered fund may be no more than 3 percent of the value and amount of such fund's total ownership interests, and the banking entity may not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund. See 12 U.S.C. 1851(d)(1)(G)(v); proposed rule § __.11(e).

[266] See proposed rule § __.12(b)(4).

[267] See proposed rule § __.12(b)(1)(A).

[268] See proposed rule § __.12(b)(1)(B). As noted above, whether or not an investment is controlled or noncontrolled will be determined consistent with the BHC Act, as implemented by the Board. See 12 U.S.C. 1841(a)(2); 12 CFR 225.2(e).

Additionally, the proposed rule provides that, to the extent that a banking entity is contractually obligated to directly invest in, or is found to be acting in concert through knowing participation in a joint activity or parallel action toward a common goal of investing in, one or more investments with a covered fund that is organized and offered by the banking entity (whether or not pursuant to an express agreement), such investment shall be included in the calculation of a banking entity's per-fund limitation.[269] In this way, the proposed rule prevents a banking entity from evading the limitations under § __.12 of the proposed rule through committed co-investments.

Section __.12(b)(3) of the proposed rule provides that the amount and value of a banking entity's investment in a covered fund may at no time exceed the 3 percent limits contained in § __.12(b) of the proposed rule after the conclusion of any conformance period, if applicable.[270] In cases where a fund calculates its value or stands ready to issue or redeem interests frequently (e.g., daily), a banking entity must calculate its per-fund limitation no less frequently than the fund performs such calculation or issues or redeems interests. In recognition of the fact that not every covered fund may calculate or determine its valuation daily (for instance, if it does not allow redemptions except infrequently or invests principally in illiquid assets for which no market price is readily available), the proposed rule would not require a daily calculation of value for such fund (unless a daily calculation is determined by the fund).[271] In such cases, the calculation of the amount and value of a banking entity's per-fund limitation must be made no

[269] See proposed rule § __.12(b)(2)(B).

[270] See proposed rule § __.12(b)(3).

[271] With respect to an issuer of asset-backed securities, depending on the transaction structure, such calculation may need to be made each time a payment is made to any holder of the issuer's asset-backed securities.

less frequently than at the end of every quarter.[272] Additionally, since a banking entity must organize and offer any covered fund in which it invests, the Agencies expect that such banking entity would closely and regularly monitor not only the value of such fund's interests, but also any changes in the fund's investors' relative ownership percentages.[273]

c. Aggregate permitted investments in all covered funds and calculation of a banking entity's tier 1 capital.

In addition to a limit on investments in a single covered fund, section 13(d)(4) of the BHC Act requires the banking entity to comply with the aggregate funds limitation on investments in all covered funds.[274] As required under section 13(d)(4)(B)(ii)(II) of the BHC Act, the proposed rule provides that the aggregate of a banking entity's ownership interests in all covered funds that are held under § __.12 of the proposed rule may not exceed 3 percent of the tier 1 capital of a banking entity.[275] In order to maintain equality in application of the aggregate funds limitation, the proposed rule provides that, for purposes of determining compliance with § __.12 of the proposed rule, the aggregate of all of a banking entity's investments in all covered funds under § __.12 of the proposed rule must be valued pursuant to applicable accounting standards.[276] This value calculation is separate and in addition to the required calculation of the

[272] The Agencies note that while calculation of a banking entity's ownership interest in a covered fund must be determined no less frequently than at the end of every quarter, it is possible that no change in a banking entity's ownership interest (e.g., no redemptions or other changes in investor composition) may occur during every quarter.

[273] For instance, where a banking entity acts as sponsor to a covered fund, in connection with the organizing and offering of that fund it may include a requirement (such as a "tag-along" redemption right) in the fund's organizational documents in order to assist the banking entity in complying with the per-fund investment limitation.

[274] As noted in the discussion regarding the per-fund limitation, the proposed rule provides that, for purposes of determining compliance with § __.12, the banking entity's permitted investment in a covered fund shall be calculated in the same manner and according to the same standards utilized by the covered fund for determining the aggregate value of the fund's assets and ownership interests. However, the value of a banking entity's aggregate permitted investments in all covered funds shall be determined in accordance with applicable accounting standards. See proposed rule § __.12(c)(1).

[275] See 12 U.S.C. 1851(d)(4)(B)(ii)(II); proposed rule § __.12(a)(2)(ii).

[276] See proposed rule § __.12(c)(1).

value of a banking entity's investment in a covered fund as part of determining compliance with the per-fund limitation.

Tier 1 capital is a banking law concept that, in the United States, is calculated and reported by certain depository institutions and bank holding companies in order to determine their compliance with regulatory capital standards. Accordingly, the proposed rule clarifies that for purposes of the aggregate funds limitation in § __.12, a banking entity that is a bank, a bank holding company, a company that controls an insured depository institution that reports tier 1 capital, or uninsured trust company that reports tier 1 capital (each a "reporting banking entity") must apply the reporting banking entity's tier 1 capital as of the last day of the most recent calendar quarter that has ended, as reported to the relevant Federal banking agency.[277]

However, not all entities subject to section 13 of the BHC Act calculate and report tier 1 capital. In order to provide a measure of equality related to the aggregate funds limitation contained in section 13(d)(4)(B)(ii)(II) of the BHC Act and § __.12(c) of the proposed rule, the proposed rule clarifies how the aggregate funds limitation shall be calculated for entities that are not required to calculate and report tier 1 capital in order to determine compliance with regulatory capital standards. Under the proposed rule, with respect to any banking entity that is not affiliated with a reporting banking entity and not itself required to report capital in accordance with the risk-based capital rules of a Federal banking agency, the banking entity's tier 1 capital for purposes of the aggregate funds limitation shall be the total amount of shareholders' equity of the top-tier entity within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.[278] For a banking entity that is not itself required to report tier 1 capital but is a subsidiary of a

---

[277] See proposed rule § __.12(c)(1)(A).

[278] See proposed rule § __.12(c)(2)(ii)(B)(2).

reporting banking entity that is a depository institution (e.g., a subsidiary of a national bank), the aggregate funds limitation shall be the amount of tier 1 capital reported by such depository institution.[279] For a banking entity that is not itself required to report tier 1 capital but is a subsidiary of a reporting banking entity that is not a depository institution (e.g., a nonbank subsidiary of a bank holding company), the aggregate funds limitation shall be the amount of tier 1 capital reported by the top-tier affiliate of such banking entity that holds and reports tier 1 capital.[280] Thus, for purposes of calculating the aggregate funds limitation under § __.12(c)(2) of the proposed rule, the tier 1 capital for the different types of banking entities would be as follows:

Type of banking entity	Tier 1 capital for purposes of § __.12
Depository institution that is a reporting banking entity (or a subsidiary thereof)	Tier 1 capital of the depository institution as of the last day of the most recent calendar quarter that has ended, as reported to the relevant Federal banking agency
Bank holding company or a subsidiary thereof (other than a reporting banking entity)	Tier 1 capital of the bank holding company as of the last day of the most recent calendar quarter that has ended, as reported to the Board
Company that controls an insured depository institution and that is a reporting banking entity (or a subsidiary thereof other than a reporting banking entity)	Tier 1 capital of the top tier entity within such organization as of the last day of the most recent calendar quarter that has ended, as reported to the Board
Other banking entity (including an industrial loan company holding company, thrift holding company, or a subsidiary thereof)	Shareholders' equity of the top-tier entity within such organization as of the last day of the most recent calendar quarter that has ended, under applicable accounting standards

Additionally, in the case of a depository institution that is itself a reporting banking entity and is also a subsidiary or affiliate of a reporting banking entity, the aggregate of all investments in all

[279] See proposed rule § __.12(c)(2)(ii)(A).

[280] See proposed rule § __.12(c)(1)(B).

covered funds held by the depository institution (including investments by its subsidiaries) may not exceed 3 percent of either the tier 1 capital of the depository institution or of the top-tier reporting banking entity that controls such depository institution.[281]

d. Deduction of an investment in a covered fund from tier 1 capital.

Section 12(d) of the proposed rule also implements the provision contained in section 13(d)(4)(b)(iii) of the BHC Act regarding the deduction of a banking entity's aggregate investment in a covered fund held under section 13(d)(4) of that Act from the assets and tangible equity of the banking entity. The statute also provides that the amount of the deduction must increase commensurate with the leverage of the underlying fund.[282]

Section __.12(d) of the proposal requires a banking entity to deduct the aggregate value of its investments in covered funds from tier 1 capital. Since § __.12 of the proposed rule implements the authorities contained in section 13(d)(4) of the BHC Act related to an investment in a fund organized and offered by the banking entity (or an affiliate or subsidiary thereof), the deduction contained in § __.12(d) applies only to those ownership interests held as an investment by a banking entity pursuant to § __.12 of the proposed rule.[283] For instance, a banking entity that acquires or retains an ownership interest in a covered fund as a permitted risk-mitigating hedge under § __.13(b) of the proposed rule, or that acquires or retains an ownership interest in the course of collecting a debt previously contracted in good faith, would not be required to

---

[281] If the aggregate value of all investments in all covered funds attributable to such a depository institution is less than 3 percent of its tier 1 capital, then that amount of capital which is greater than the amount supporting the depository institution's investments (or those held by its subsidiaries) in a covered fund, but less than 3 percent of the depository institution's tier 1 capital, may be used to support an investment in a covered fund by an affiliated banking entity that is not itself a depository institution that holds and reports tier 1 capital or controlled, directly or indirectly, by such a depository institution.

[282] See 12 U.S.C. 1851(d)(4)(B)(iii).

[283] See proposed rule § __.12(d).

deduct the value of such ownership interest from its tier 1 capital.[284] The deduction required under § __.12(d) of the proposed rule must be calculated consistent with other like deductions under the applicable risk-based capital rules.[285]

e. Extension of time to divest an ownership interest in a single covered fund.

Section 13(d)(4)(C) of the BHC Act permits the Board, upon application by a banking entity, to extend for up to 2 additional years the period of time within which a banking entity must reduce its attributable ownership interests in a covered fund to no more than 3 percent of such fund's total ownership interests.[286] The statute provides the possibility of an extension only with respect to the per-fund limitation, and not to the aggregate funds limitation.[287] Section __.12(e) of the proposed rule implements this provision of the statute. In order to grant any extension, the Board must determine that the extension would be consistent with safety and soundness and would not be detrimental to the public interest.[288]

---

[284] The Agencies note that since this deduction from capital implements Section 13(d)(4)(B)(iii) of the BHC Act, it is being included in this proposed rule which deals with Section 13 of the BHC Act. However, the Agencies may relocate this deduction as part of any later revised capital rules if, in the future, it is determined that inclusion in such rules is more appropriate.

[285] See 12 CFR part 208, Appendices A, E, and F (for a state member bank); 12 CFR part 225, Appendices A, E, and G (for a bank holding company); 12 CFR part 3, Appendices A, B, and C (for a national bank); 12 CFR part 325, Appendices A, C, and D (for a state nonmember bank); and 12 CFR part 167, Appendix C (for a federal thrift).

[286] 12 U.S.C. 1851(d)(4)(C).

[287] See id.

[288] As noted in Part III.C.2.a.ii of this Supplementary Information, the Agencies recognize the potential for evasion of the restrictions contained in section 13 of the BHC Act through organizing and offering a covered fund pursuant to the authority contained in § __.11 of the proposed rule. Therefore, in addition to taking action against a banking entity that does not actively seek unaffiliated investors to reduce or dilute the investment of the banking entity as provided under § __.12(a)(2) of the proposed rule, the Agencies expect that if a banking entity is habitually or routinely seeking an extension of the one-year period provided under § __.12(a)(2)(i)(B), this could be evidence of seeking to evade the restrictions contained in the proposed rule and, as appropriate, the Agencies may take action against such banking entity.

Section __.12(e) of the proposed rule requires any banking entity that seeks an extension of this conformance period to submit a written request to the Board. Under the proposal, any such request must: (i) be submitted in writing to the Board at least 90 days prior to the expiration of the applicable time period; (ii) provide the reasons why the banking entity believes the extension should be granted; and (iii) provide a detailed explanation of the banking entity's plan for reducing or conforming its investment(s).

In addition, the proposed rule provides that any extension request by a banking entity must address each of the following matters (to the extent they are relevant): (i) whether the investment would – (A) involve or result in material conflicts of interest between the banking entity and its clients, customers or counterparties; (B) result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies; (C) pose a threat to the safety and soundness of the banking entity; or (D) pose a threat to the financial stability of the United States; (ii) market conditions; (iii) the contractual terms governing the banking entity's interest in the covered fund; (iv) the date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the banking entity to enable the banking entity to comply with the limitations in section 12(a)(2)(i)(B) of the proposed rule; (v) the total exposure of the banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the banking entity or the financial stability of the United States; (vi) the cost to the banking entity of divesting or disposing of the investment within the applicable period; (vii) whether the divestiture or conformance of the investment would involve or result in a material conflict of interest between the banking entity and unaffiliated clients, customers or counterparties to which it owes a duty; (viii) the banking entity's prior efforts to divest or sell interests in the covered fund, including

activities related to the marketing of interests in such covered fund; and (ix) any other factor that the Board believes appropriate.[289] Under the proposed rule, the Board would consider requests for an extension in light of all relevant facts and circumstances, including the factors described above.

Section __.12(e) of the proposed rule also would allow the Board to impose conditions on any extension granted under the proposed rule if the Board determines conditions are necessary or appropriate to protect the safety and soundness of banking entities or the financial stability of the United States, address material conflicts of interest or other unsound practices, or otherwise further the purposes of section 13 of the BHC Act and the proposed rule.[290] In cases where the banking entity is primarily supervised by another Agency, the Board would consult with such Agency both in connection with its review of the application and, if applicable, prior to imposing conditions in connection with the approval of any request by the banking entity for an extension of the conformance period under the proposed rule.[291]

f. Request for comment

The Agencies request comment on the proposed rule's approach to implementing the exemption which allows a banking entity to make or retain a permitted investment in a covered

[289] See proposed rule § __.12(e)(1)(ii).

[290] Nothing in section 13 of the BHC Act or the proposed rule limits or otherwise affects the authority that the Board, the other Federal banking agencies, the SEC, or the CFTC may have under other provisions of law. In the case of the Board, these authorities include, but are not limited to, section 8 of the Federal Deposit Insurance Act and section 8 of the BHC Act. See 12 U.S.C. 1818, 1847.

[291] See proposed rule §§ __.12(e)(iii) and (iv).

fund that it organizes and offers. In particular, the Agencies request comment on the following questions:

Question 256. Is the proposed rule's approach to implementing the exemption that allows a banking entity to make or retain a permitted investment in a covered fund effective? If not, what alternative approach would be more effective and why?

Question 257. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 258. Should the proposed rule specify at what point a covered fund will be considered to have been "established" for purposes of commencing the period in which a banking entity may own more than 3 percent of the total outstanding ownership interests in such fund? If so, why and how?

Question 259. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitations on an investment in a single covered fund? If not, what alternative approach would be more effective and why?

Question 260. Does the proposed rule effectively implement the requirement that a banking entity comply with the limitations on the aggregate of all investments in all covered funds? If not, what alternative approach would be more effective and why?

Question 261. Is the proposed rule's approach to calculating a banking entity's investment in a covered fund effective? Should the per-fund calculation be based on committed capital, rather than invested capital? Why or why not? Is the timing of the calculation of a banking entity's ownership interest in a single covered fund appropriate? If not, why not, and what alternative approach would be more effective and why? For example, should the per-fund calculation be required on a less-frequent basis (e.g., monthly) for funds that compute their value and allow purchases and redemptions on a daily basis (e.g., daily)? Why or why not?

Question 262. Is the proposed rule's approach to parallel investments effective? Why or why not? Should this provision require a contractual obligation and/or knowing participation? Why or why not? How else could the proposed rule define parallel investments? What characteristics would more closely achieve the scope and intended purposes of section 13 of the BHC Act?

Question 263. Is the proposed rule's treatment of investments in a covered fund by employees and directors of a banking entity effective? If not, what alternative approach would be more effective and why?

Question 264. Is the proposed rule's approach to differentiating between controlled and noncontrolled investments in a covered fund unduly complex or burdensome? If so, what alternative approach, if any, would be more effective and why?

<u>Question 265</u>. Is the proposed rule's approach to valuing an investment in a covered fund according to the same standards utilized by the covered fund for determining the aggregate value of its assets and ownership interests effective? If not, what alternative valuation approach would be more effective and why? Should the rule specify one methodology for valuing an investment in a covered fund?

<u>Question 266</u>. Is the proposed rule's approach regarding when to require the calculation of a banking entity's aggregate investments in all covered funds effective? What is the potential impact of calculating a banking entity's aggregate investment limit under the proposed rule on a quarterly basis as opposed to solely at the time an investment in a covered fund is made? Would calculation of the aggregate investment limit solely at the time an investment in a covered fund is made be consistent with the language and purpose of the statute? Does the proposed rule provide sufficient guidance for an issuer of asset-backed securities about how and when to make such calculation? Why or why not?

<u>Question 267</u>. Is the proposed rule's approach to determining and calculating a banking entity's relevant tier 1 capital limit effective? If not, what alternative approach would be more effective and why? With respect to applying the aggregate funds limitation to a banking entity that is not affiliated with an entity that is required to hold and report tier 1 capital, is total shareholder equity on a consolidated basis as of the last day of the most recent calendar quarter that has ended an effective proxy for tier 1 capital? If not, what alternative approach would be more effective and why?

Question 268. Should the proposed rule be modified to permit a banking entity to bring its investments in covered funds into compliance with the proposed rule within a reasonable period of time if, for example, the banking entity's aggregate permitted investments in covered funds exceeds 3 percent of its tier 1 capital for reasons unrelated to additional investments (e.g., a banking entity's tier 1 capital decreases)? Why or why not?

Question 269. Does the proposed rule effectively and appropriately implement the deduction from capital for an investment in a covered fund contained in section 13(d)(4)(B)(iii) of the BHC Act? If not, what alternative approach would be more effective or appropriate, given the statutory language of the BHC Act and overall structure of section 13(d)(4), and why? What effect, if any, should the Agencies give to the cross-reference in section 13(d)(4) to section 13(d)(3) of the BHC Act, which provides Agencies with discretion to require additional capital, if appropriate, to protect the safety and soundness of banking entities engaged in activities permitted under section 13 of the BHC Act? How, if at all, should a banking entity's deduction of its investment in a covered fund be increased commensurate with the leverage of the covered fund? Should the amount of the deduction be proportionate to the leverage of the covered fund? For example, instead of a dollar-for-dollar deduction, should the deduction be set equal to the banking entity's investment in the covered fund times the difference between 1 and the covered fund's equity-to-assets ratio?

Question 270. Does the proposed rule effectively implement the Board's statutory authority to grant an extension of the period of time a banking entity may retain in excess of 3 percent of the ownership interests in a single covered fund? Are the enumerated factors that the

Board may consider in connection with reviewing such an extension appropriate (including factors related to the effect of an extension of the covered fund), and if not, why not? Are there additional factors that the Board should consider in reviewing such a request? Are there specific additional conditions or limitations that the Board should, by rule, impose in connection with granting such an extension? If so, what conditions or limitations would be more effective?

Question 271. Given that the statute does not provide for an extension of time for a banking entity to comply with the aggregate funds limitation, within what period of time should a banking entity be required to bring its investments into conformance with the aggregate funds limit? Should the proposed rule expressly contain a grace period for complying with these limits? Why or why not? If yes, what grace period would be most effective and why?

Question 272. Does the proposed rule effectively implement the prohibition on a banking entity guaranteeing or insuring the obligations or performance of certain covered funds? If not, what alternative approach would be more effective and why?

Question 273. In the context of securitization transactions, control and ownership are often completely separated. Is additional guidance necessary with respect to how control should be determined with respect to issuers of asset-backed securities for purposes of determining the calculation of the per-fund and aggregate ownership limitations?

Question 274. In many securitization transactions, the voting rights of investors are extremely limited and management may be contractually delegated to a third party (because issuers of asset-backed securities rarely have a board with any authority or any employees). The

servicer or manager has the "ability to control the decision-making and operational functions of the fund." When calculating the per-fund and aggregate ownership limitations, to whom should the proposed rule allocate "control" in this type of situation? Which participants in a securitization transaction would need to include the activities of an issuer of asset-backed securities in their calculations of per-fund and aggregate ownership, and what is the potential impact of such inclusion?

Question 275. For purposes of calculating the per-fund and aggregate ownership limitations, how should the proposed rule address those instances in which equity is issued, but the equity holder does not receive economic benefits or have any control rights? For instance, in order to enhance or achieve bankruptcy remoteness, a single purpose trust without an owner (i.e, an orphan trust) may hold all of the equity interests in a securitization vehicle. Such interests often do not have any meaningful economic or control rights.

4. Section __.13: Other permitted covered fund activities and investments.

Section 13 of the proposed rule implements the statutory exemptions described in sections 13(d)(1)(C), (E), and (I) of the BHC Act that permit a banking entity: (i) to acquire an ownership interest in, or act as sponsor to, one or more SBICs, a public welfare investment, or a certain qualified rehabilitation expenditure;[292] (ii) to acquire or retain an ownership interest in a covered fund as a risk-mitigating hedging position; and (iii) in the case of a non-U.S. banking

[292] Section __.13(a) of the proposed rule also implements a proposed determination by the Agencies under section 13(d)(1)(J) of the BHC Act that a banking entity may not only invest in such entities as provided under section 13(d)(1)(E) of the BHC Act, but also may sponsor an entity described in that paragraph and that such activity, since it generally would facilitate investment in small businesses and support the public welfare, would promote and protect the safety and soundness of banking entities and the financial stability of the United States.

entity, to acquire or retain an ownership interest in or sponsor a foreign covered fund. Additionally, § __.13 of the proposed rule implements in part the rule of construction related to the sale and securitization of loans contained in section 13(g)(2) of the BHC Act. Similar to § __.6 of the proposed rule (which implements certain permitted proprietary trading activities), § __.13 contains only the statutory exemptions contained in section 13(d)(1) of the BHC Act that the Agencies have determined apply, either by plain language or by implication, to investments in or relationships with a covered fund.[293]

a. Permitted investments in SBICs and related funds.

Section __.13(a) of the proposed rule implements sections 13(d)(1)(E) and (J) of the BHC Act[294] and permits a banking entity to acquire or retain any ownership interest in, or act as sponsor to: (i) one or more SBICs, as defined in section 102 of the Small Business Investment Act of 1958 (12 U.S.C. § 662); (ii) an investment that is designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. § 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); and (iii) an investment that is a qualified rehabilitation expenditure with respect to a qualified rehabilitation building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986

[293] In particular, § __.13 of the proposed rule does not include: (i) the exemption in section 13(d)(1)(A) of the BHC Act for trading in certain permitted government obligations; (ii) the exemption in section 13(d)(1)(H) of the BHC Act for certain foreign proprietary trading activities; and (iii) the exemption contained in section 13(d)(1)(B) of the BHC Act related to underwriting and market-making related activities. Each of these exemptions appear relevant only to covered trading activities and not to covered fund activities.

[294] Section 13(d)(1)(E) of the BHC Act permits a banking entity to make investments in one or more SBICs, investments designed primarily to promote the public welfare, investments of the type permitted under 12 U.S.C. 24(eleventh), and investments that are qualified rehabilitation expenditures with respect to a qualified rehabilitated building or certified historic structure. See 12 U.S.C. 1851(d)(1)(E).

or a similar State historic tax credit program.[295] Since section 13(d)(1)(E) of the BHC Act does not limit a banking entity's investment to a limited partnership or other non-controlling investment, § __.13(a) of the proposed rule would permit a banking entity to be a shareholder, general partner, managing member, or trustee of an SBIC without regard to whether the interest is a controlling or non-controlling interest.[296]

In addition to the acquisition or retention of an ownership interest, permitting a banking entity to act as sponsor to these types of public interest investments will provide valuable expertise and services to these types of entities, as well as help enable banking entities to provide valuable funding and assistance to small business and low- and moderate-income communities. Therefore, the Agencies believe this exemption would be consistent with the safe and sound operation of banking entities, and would also promote the financial stability of the United States.

The Agencies request comment on the proposed rule's approach to implementing the exemption for permitted investments in and relationships with SBICs and certain related funds. In particular, the Agencies request comment on the following questions:

Question 276. Is the proposed rule's approach to implementing the SBIC, public welfare and qualified rehabilitation investment exemption for acquiring or retaining an ownership interest in a covered fund effective? If not, what alternative approach would be more effective?

Question 277. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

---

[295] See proposed rule § __.13(a).

[296] Pursuant to the exemption contained in § __.13(a) of the proposed rule, a banking entity may acquire an ownership interest in, or act as sponsor to, a low income housing credit fund, if such fund qualifies as an SBIC, public welfare investment or qualified rehabilitation expenditure.

Question 278. Should the proposed rule permit a banking entity to sponsor an SBIC and other identified public interest investments? Why or why not? Does the Agencies' determination under section 13(d)(1)(J) of the BHC Act regarding sponsoring of an SBIC, public welfare or qualified rehabilitation investment effectively promote and protect the safety and soundness of banking entities and the financial stability of the United States? If not, why not?

Question 279. What would the effect of the proposed rule be on a banking entity's ability to sponsor and syndicate funds supported by public welfare investments or low income housing tax credits which are utilized to assist banks and other insured depository institutions with meeting their Community Reinvestment Act ("CRA") obligations?

Question 280. Does the proposed rule unduly constrain a banking entity's ability to meet the convenience and needs of the community through CRA or other public welfare investments or services? If so, why and how could the proposed rule be revised to address this concern?

b. Permitted risk-mitigating hedging activities.

Section __.13(b) of the proposed rule permits a banking entity to acquire and retain an ownership interest in a covered fund if the transaction is made in connection with, and related to, certain individual or aggregated positions, contracts, or other holdings of the banking entity and is designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings. This section of the proposed rule implements, in relevant part, section 13(d)(1)(C) of the BHC Act, which provides an exemption from the

prohibition on acquiring or retaining an ownership interest in a covered fund for certain risk-mitigating hedging activities.[297]

Interests by a banking entity in a covered fund may not typically be used as hedges for specific positions, contracts, or other holdings of a banking entity. However, two situations where a banking entity may potentially acquire or retain an ownership interest in a covered fund as a hedge are (i) when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund (similar to acting as a "riskless principal"),[298] and (ii) to cover a compensation arrangement with an employee of the banking entity that directly provides investment advisory or other services to that fund. Section __.13(b) of the proposed rule provides an exemption for banking entity to acquire or retain an ownership interest in a covered fund in these limited situations.[299]

i. Approach for hedges using an ownership interest in a covered fund.

As noted above in the discussion of § __.5 of the proposed rule, risk-mitigating hedging activities present certain implementation challenges because of the potential that prohibited activities or investments could be conducted in the context of, or mischaracterized as, hedging transactions. In light of these complexities, the Agencies have proposed a multi-faceted approach to implementation, which is discussed in detail above in reference to § __.5 of the

---

[297] See 12 U.S.C. 1851(d)(1)(C).

[298] In order to prevent evasion of the general limitation that a banking entity may not acquire or retain more than 3 percent of the ownership interests in any single covered fund that such banking entity organizes and offers, the proposed rule limits a banking entity's ability to acquire or retain an ownership interest in a covered fund as a permitted risk-mitigating hedge to those situations where the customer of the banking entity is not itself a banking entity. See proposed rule § __.13(b)(1)(i)(A).

[299] See proposed rule § __.13(b).

proposed rule.[300] As with the hedging exemption provided under § __.5, this multi-faceted approach is intended to clearly articulate the Agencies' expectations regarding the scope of permitted hedging activities under § __.13(b) in a manner that limits potential abuse of the hedging exemption while not unduly constraining the important risk management function that is served by a banking entity's hedging activities. However, because of the possibility that using an ownership interest in a covered fund as a hedging instrument may mask an intent to evade the limitations on the amount and value of ownership interests in a covered fund or funds under § __.12, the proposed rule contains several additional requirements related to a banking entity's ability to use an ownership interest in a covered fund as a hedging instrument.

ii. Required criteria for permitted risk-mitigating hedging activities involving a covered fund.

Section __.13(b) of the proposed rule describes the criteria that a banking entity must meet in order to rely on the hedging exemption with respect to ownership interests of a covered fund. The majority of these requirements are substantially similar to those discussed in detail above in connection with the risk-mitigating hedging exemption contained in § __.5 of the proposed rule, and include the requirements that: (i) the hedge is made in connection with and related to individual or aggregated obligations or liabilities of the banking entity that are: (A) taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or (B) directly connected to a compensation arrangement with an employee that directly provides investment advisory or other services to the covered fund; (ii) the banking entity has established the internal compliance program required by subpart D designed to ensure the

[300] See Supplementary Information, Part III.B.3.

banking entity's compliance with the requirements of this paragraph, including reasonably designed written policies and procedures regarding the instruments, techniques and strategies that may be used for hedging, internal controls and monitoring procedures, and independent testing; (iii) the transaction is designed to reduce the specific risks to the banking entity in connection with and related to such obligations or liabilities; (iv) the acquisition or retention of an ownership interest in a covered fund: (A) is made in accordance with the written policies, procedures and internal controls established by the banking entity pursuant to subpart D; (B) hedges or otherwise mitigates an exposure to a covered fund through a substantially similar offsetting exposure to the same covered fund and in the same amount of ownership interest in that covered fund that arises out of a transaction conducted solely to accommodate a specific customer request with respect to, or directly connected to its compensation arrangement with an employee that directly provides investment advisory or other services to, that covered fund; (C) does not give rise, at the inception of the hedge, to significant exposures that were not already present in individual or aggregated positions, contracts, or other holdings of a banking entity and are not hedged contemporaneously; and (D) is subject to continuing review, monitoring and management by the banking entity that: (1) is consistent with its written hedging policies and procedures; (2) maintains a substantially similar offsetting exposure to the same amount and type of ownership interest, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the purchase or sale is intended to hedge or otherwise mitigate; and (3) mitigates any significant exposure arising out of the hedge after inception; and (v) the compensation arrangements of persons performing the risk-mitigating hedging activities are designed not to reward proprietary risk-taking.[301]

[301] See proposed rule § __.13(b).

These requirements, while substantially similar to those contained in § __.5 above, are different in several material aspects. First, § __.13(b)(1)(i) of the proposed rule provides that any banking entity relying on this exemption may only hedge or otherwise mitigate one or more specific risks arising in connection with and related to the two situations enumerated in that section. These are risks taken by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or directly connected to its compensation arrangement with an employee that directly provides investment advisory or other services to the covered fund.[302] Second, § __.13(b)(2)(ii)(B) of the proposed rule requires that the acquisition or retention of an ownership interest in a covered fund hedge or otherwise mitigate a substantially similar offsetting exposure to the same covered fund and in the same amount of ownership interest in that covered fund, which requires greater equivalency between the reference asset and hedging instrument than the correlation required under § __.5. Third, § __.13(b)(3) of the proposed rule imposes a documentation requirement on all types of hedging transactions where the banking entity uses ownership interests in a covered fund as the hedging instrument. This requirement is broader than that contained in § __.5 and is reflective of the limited scope of positions or exposures for which a banking entity may acquire or retain an ownership interest in a covered fund as a hedge. Specifically, for any transaction that a banking entity acquires or retains an ownership interest in a covered fund in reliance of the hedging exemption, the banking entity must document the risk-mitigating purposes of the transaction and identify the risks of the individual or aggregated positions, contracts, or other holding of the banking entity that the transaction is designed to reduce. Such documentation must be established at the time the

---

[302] See proposed rule § __.13(b)(1)(i).

hedging transaction is effected, not after the fact. This documentation requirement establishes a contemporaneous record that will assist the Agencies in assessing the actual reasons for which the position was established.

iv. Request for comment.

In addition to those questions raised in connection with the proposed implementation of the risk-mitigating hedging exemption under § __.5 of the proposed rule, the Agencies request comment on the proposed implementation of that same exemption with respect to covered fund activities. In particular, the Agencies request comment on the following questions:

Question 281. Is the proposed rule's approach to implementing the hedging exemption for acquiring or retaining an ownership interest in a covered fund effective? If not, what alternative approach would be more effective?

Question 282. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 283. What burden will the proposed approach to implementing the hedging exemption have on banking entities? How can any burden be minimized or eliminated in a manner consistent with the language and purpose of the statute?

Question 284. Are the criteria included in § __.13(b)'s hedging exemption effective? Is the application of each criterion to potential transactions sufficiently clear? Should any of the criteria be changed or eliminated? Should other requirements be added?

Question 285. Is the requirement that an ownership interest in a covered fund may only be used as a hedge (i) by the banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or (ii) to cover compensation arrangements with an employee of the banking entity that directly provides investment advisory or other services to that fund effective? If not, what other requirements would be more effective?

Question 286. Does the proposed rule sufficiently articulate the types of risks and positions that a banking entity typically would utilize an ownership interest in a covered fund to hedge? If not, how should the proposal be changed?

Question 287. Is the requirement that that the hedging transaction involve a substantially similar offsetting exposure to the same covered fund and in the same amount of ownership interest to the risk or risks the transaction is intended to hedge or otherwise mitigate effective? If not, how should the requirement be changed? Should some other level of correlation be required? Should the proposal specify in greater detail how correlation should be measured? If not, how could it better do so?

Question 288. Is the requirement that the transaction not give rise, at the inception of the hedge, to material risks that are not themselves hedged in a contemporaneous transaction effective? Is the proposed materiality qualifier appropriate and sufficiently clear? If not, what alternative would be effective and/or clearer?

Question 289. Is the requirement that any transaction conducted in reliance on the hedging exemption be subject to continuing review, monitoring and management after the transaction is established effective? If not, what alternative would be more effective?

Question 290. Is the proposed documentation requirement effective? If not, what alternative would be more effective? What burden would the proposed documentation requirement place on covered banking entities? How might such burden be reduced or eliminated in a manner consistent with the language and purpose of the statute?

c. Permitted covered fund activities and investments outside of the United States.

Section __.13(c) of the proposed rule, which implements section 13(d)(1)(I) of the BHC Act,[303] permits certain foreign banking entities to acquire or retain an ownership interest in, or to act as sponsor to, a covered fund so long as such activity occurs solely outside of the United States and the entity meets the requirements of sections 4(c)(9) or 4(c)(13) of the BHC Act. The purpose of this statutory exemption appears to be to limit the extraterritorial application of the statutory restrictions on covered fund activities to foreign firms that, in the course of operating outside of the United States, engage outside the United States in activities permitted under relevant foreign law, while preserving national treatment and competitive equality among U.S. and foreign firms within the United States.[304] Consistent with this purpose, the proposed rule defines both the type of foreign banking entities that are eligible for the exemption and the circumstances in which covered fund activities or investments by such an entity will be considered to have occurred solely outside of the United States (including clarifying when an

[303] Section 13(d)(1)(I) of the BHC Act permits a banking entity to acquire or retain an ownership interest in, or have certain relationships with, a covered fund notwithstanding the prohibition on proprietary trading and restrictions on investments in, and relationships with, a covered fund, if: (i) such activity or investment is conducted by a banking entity pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; (ii) the activity occurs solely outside of the United States; (iii) no ownership interest in such fund is offered for sale or sold to a resident of the United States; and (iv) the banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States. See 12 U.S.C. 1851(d)(1)(I).

[304] See 156 Cong. Rec. S5897 (daily ed. July 15, 2010) (statement of Sen. Merkley).

ownership interest will be deemed to have been offered for sale or sold to a resident of the United States).

i. Foreign banking entities eligible for the exemption.

Section __.13(c)(1)(i) of the proposed rule incorporates the statutory requirement that the banking entity not be, directly or indirectly, controlled by a banking entity that is organized under the laws of the United States or of one or more States. Consistent with the statutory language, banking entities organized under the laws of the United States or of one or more States, or the subsidiaries or branches thereof (wherever organized or licensed), may not rely on the exemption. Similarly, the U.S. subsidiaries or U.S. branches of foreign banking entities would not qualify for the exemption.

Section __.13(c)(2) clarifies when a banking entity would be considered to have met the statutory requirement that the banking entity conduct the activity pursuant to paragraphs 4(c)(9) or 4(c)(13) of the BHC Act[305] Section 4(c)(9) of the BHC Act generally provides that the restrictions on nonbanking activities contained in section 4(a) of that statute do not apply to the ownership of shares held or activities conducted by any company organized under the laws of a foreign country the greater part of whose business is conducted outside the United States, if the Board by regulation or order determines that, under the circumstances and subject to the conditions set forth in the regulation or order, the exemption would not be substantially at

[305] Section __.13(c)(2) of the proposed rule only addresses when a transaction or activity will be considered to have been conducted pursuant to section 4(c)(9) of the BHC Act; although the statute also references section 4(c)(13) of the BHC Act, the Board has applied the authority contained in that section only to include certain foreign activities of U.S. banking organizations. The express language of section 13(d)(1)(I) of the BHC Act limits its availability to foreign banking entities that are not controlled by a banking entity organized under the laws of the United States or of one or more states. A foreign banking entity may not rely on the exemptive authority of section 4(c)(13) and, so, that section is not addressed in the proposed rule.

variance with the purposes of this Act and would be in the public interest.[306] The Board has, in part, implemented section 4(c)(9) through subpart B of the Board's Regulation K, which specifies a number of conditions and requirements that a foreign banking organization must meet in order to use such authority. Such conditions and requirements include, for example, a qualifying foreign banking organization test that requires the foreign banking organization to demonstrate that more than half of its worldwide business is banking and that more than half of its banking business is outside the United States.

The proposed rule makes clear that a banking entity will qualify for the foreign fund exemption if the entity is a foreign banking organization subject to subpart B of the Board's Regulation K and the transaction occurs solely outside the United States. Section 13 of the BHC Act also applies to foreign companies that are banking entities covered by Section 13 but are not currently subject either to the BHC Act generally or the Board's Regulation K, for example, because the foreign company controls a savings association or an FDIC-insured industrial loan company but not a bank or branch in the United States. Accordingly, the proposed rule clarifies when such a foreign banking entity would be considered to have conducted a transaction or activity "pursuant to section 4(c)(9)" for purposes of the exemption at § __.13(c) of the proposed rule.[307] In particular, the proposed rule proposes that to qualify for the foreign banking entity exemption, such firms must meet at least two of three requirements that evaluate the extent to which the foreign entity's business is conducted outside the United States, as measured by assets, revenues, and income. This test largely mirrors the qualifying foreign banking organization test

---

[306] See 12 U.S.C. 1843(c)(9).

[307] The Board emphasizes that this clarification would be applicable solely in the context of sections 13(d)(1)(H) and (I) of the BHC Act. The application of section 4(c)(9) to such foreign companies in other contexts is likely to involve different legal and policy issues and may therefore merit different approaches.

that is made applicable under section 4(c)(9) and § 211.23(a) of the Board's Regulation K, except that the relevant test under § __.13(c)(2)(ii) of the proposed rule does not require such a foreign entity to demonstrate that more than half of its business is banking conducted outside the United States.[308]

ii. Transactions and activities solely outside of the United States.

Section __.13(c) of the proposed rule also clarifies when a transaction or activity will be considered to have occurred solely outside of the Unites States for purposes of the exemption. In interpreting this aspect of the statutory language, the proposal focuses on the extent to which material elements of the transaction occur within, or are effected by personnel within, the United States. This aspect of the proposal reflects the apparent intent of the foreign funds exemption to avoid extraterritorial application of the restrictions on covered funds activities and investments outside the United States while preserving competitive parity within U.S. market. The proposed rule does not evaluate solely whether the risk of the transaction or activity, or management or decision-making with respect to such transaction or activity, rests outside the United States. Rather, the proposal also provides that foreign banking entities may not structure a transaction or activity so as to be "outside of the United States" for risk and booking purposes while simultaneously engaging in transactions within U.S. markets that are prohibited for U.S. banking entities.

[308] See 12 U.S.C. 1843(c)(9); 12 CFR 211.23(a); proposed rule § __.13(c)(2). This difference reflects the fact that foreign entities subject to section 13 of the BHC Act but not the BHC Act are, in many cases, predominantly commercial firms. A requirement that a firm also demonstrate that more than half of its banking business is outside the United States would likely make the exemption unavailable to many such firms and subject their global activities to the prohibition on acquiring or retaining an ownership interest in, or acting as sponsor to, a covered fund, a result that the statute does not appear to have intended.

In particular, § __.13(c)(3) of the proposed rule provides that a transaction or activity will be considered to have occurred solely outside of the United States only if all of the following three conditions are satisfied:

- The transaction or activity is conducted by a banking entity that is not organized under the laws of the United States or of one or more States;

- No subsidiary, affiliate, or employee of the banking entity that is involved in the offer or sale of an ownership interest in the covered fund is incorporated or physically located in the United States; and

- No ownership interest in such covered fund is offered for sale or sold to a resident of the United States.

These three criteria reflect statutory constraints and are intended to ensure that a transaction or activity conducted in reliance on the exemption does not involve either investors that are residents of the United States or a relevant U.S. employee of the banking entity, as such involvement would appear to constitute a sufficient locus of activity in the U.S. marketplace so as to preclude the availability of the exemption.

A resident of the United States is defined in § __.2(t) of the proposed rule, and is described in detail in Part III.B.4.d of this Supplementary Information. The proposed rule applies this definition in the context of the foreign covered funds exemption because it would appear to appropriately capture the scope of counterparties (including investors that are residents of the United States) or relevant U.S. personnel of the banking entity, that, if involved in the transaction or activity, would preclude such transaction or activity from being considered to have

occurred solely outside the United States. Under the proposed rule, an employee or entity engaged in the offer or sale of an ownership interest (or booking such transaction) must be outside of the United States; however, an employee or entity with no customer relationship and involved solely in providing administrative services or so-called "back office" functions to the fund as incident to the activity permitted under § __.13(c) of the proposed rule (such as clearing and settlement or maintaining and preserving records of the fund with respect to a transaction where no ownership interest is offered for sale or sold to a resident of the United States) would not be subject to this requirement.

iii. Request for comment.

The Agencies request comment on the proposed rule's approach to implementing the foreign covered funds activity and investment exemption. In particular, the Agencies request comment on the following questions:

Question 291. Is the proposed rule's implementation of the "foreign funds" exemption effective? If not, what alternative would be more effective and/or clearer?

Question 292. Are the proposed rule's provisions regarding when an activity will be considered to be conducted pursuant to section 4(c)(9) of the BHC Act effective and sufficiently clear? If not, what alternative would be more effective and/or clearer? Does it effectively address application of the foreign funds exemption to foreign banking entities not subject to the BHC Act generally? If not, how could it better address application of the exemption?

Question 293. Are the proposed rule's provisions regarding when a transaction or activity will be considered to have occurred solely outside the United States effective and

sufficiently clear? If not, what alternative would be more effective and/or clearer? Should additional requirements be added? If so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why or how?

Question 294. Is the proposed exemption consistent with the purpose of the statute? Is the proposed exemption consistent with respect to national treatment for foreign banking organizations? Is the proposed exemption consistent with the concept of competitive equity?

Question 295. Does the proposed rule effectively define a resident of the United States for these purposes? If not, how should the definition be altered? What definitions of resident of the United States are currently used by banking entities? Would using any one of these definitions reduce the burden of complying with section 13 of the BHC Act? Why or why not?

d. Sale and securitization of loans.

Section __.13(d) of the proposed rule permits a banking entity to acquire and retain an ownership interest in a covered fund that is an issuer of asset-backed securities, the assets or holdings of which are solely comprised of: (i) loans; (ii) contractual rights or assets directly arising from those loans supporting the asset-backed securities; and (iii) interest rate or foreign exchange derivatives that (A) materially relate to the terms of such loans or contractual rights or assets and (B) are used for hedging purposes with respect to the securitization structure.[309] The authority contained in this section of the proposed rule would therefore allow a banking entity to engage in the sale and securitization of loans by acquiring and retaining an ownership interest in certain securitization vehicles (which could qualify as a covered fund for purposes of section

[309] See proposed rule § __.13(d). The types of derivatives permitted under § __.13(d)(3) of the proposed rule are not meant to include a synthetic securitization or a securitization of derivatives, but rather to include those derivatives that are used to hedge foreign exchange or interest rate risk resulting from loans held by the issuer of asset-backed securities.

13(h)(2) of the BHC Act and the proposed rule) that the banking entity organizes and offers, or acts as sponsor to, in excess of and without being subject to the limitations contained in § __.12 of the proposed rule. Proposed § __.13(d) is designed to assist in implementing section 13(g)(2) of the BHC Act, which provides that nothing in section 13 of the BHC Act shall be construed to limit or restrict the ability of a banking entity or nonbank financial company supervised by the Board to sell or securitize loans in a manner otherwise permitted by law.[310]

The Agencies note that the phrase "materially relate to terms of such loans" is intended to quantitatively limit the derivatives permitted in a "securitization of loans" under § __.13(d) of the proposed rule to include only those derivatives where the notional amount of the derivative is tied to the outstanding principal balance of the loans supporting the asset-backed securities of such issuer, either individually or in the aggregate. Additionally, such derivatives must be used solely to hedge risks that result from a mismatch between the loans and the related asset-backed securities (e.g., fixed rate loans with floating rate asset-backed securities, loans tied to the Prime Rate with LIBOR asset-backed securities, or Euro-denominated loans with Dollar-denominated asset-backed securities). Therefore, § __.13(d)(3) of the proposed rule would not allow the use of a credit default swap by an issuer of asset-backed securities.

The Agencies request comment on the proposed rule's approach to implementing the rule of construction related to the sale and securitization of loans. In particular, the Agencies request comment on the following questions:

[310] See 12 U.S.C. 1851(g)(2).

Question 296. Is the proposed rule's implementation of the statute's "sale and securitization of loans" rule of construction effective? If not, what alternative would be more effective and/or clearer?

Question 297. Are there other entities or activities that should be included in the proposed rule's implementation of the rule of construction related to the sale and securitization of loans? If so, what entity or activity and why?

Question 298. Is the proposed rule's application of the rule of construction contained in section 13(g)(2) of the BHC Act appropriate?

Question 299. Are the proposed rule and this Supplementary Information sufficiently clear regarding which derivatives would be allowed in a "securitization of loans" under § __.13(d)(3) of the proposed rule? Is additional guidance necessary with respect to the types of derivatives that would be included in or excluded from a securitization of loans for purposes of interpreting the rule of construction contained in section 13(g)(2) of the BHC Act? If so, what topics should the additional guidance discuss and why?

Question 300. Should derivatives other than interest rate or foreign exchange derivatives be allowed in a "securitization of loans" for purposes of interpreting the rule of construction contained in section 13(g)(2) of the BHC Act? Why or why not? What would be the legal and economic impact of not allowing the use of derivatives other than interest rate or foreign exchange derivatives in a "securitization of loans" under § __.13(d)(3) of the proposed rule for existing issuers of asset-backed securities and for future issuers of asset-backed securities?

Question 301. Should the Agencies consider providing additional guidance for when a transaction with intermediate steps constitutes one or more securitization transactions that each

would be subject to the rule? For example, both auto lease securitizations and asset-backed commercial paper conduits typically involve intermediate securitizations. The asset-backed securities issued to investors in such covered funds are technically supported by the intermediate asset-backed securities. Should these kinds of securitizations be viewed as a single transaction and included within a securitization of loans for purposes of the proposed rule? Should each step be viewed as a separate securitization?

5. Section __.14: Covered fund activities and investments determined to be permissible.

Section __.14 of the proposed rule, which implements section 13(d)(1)(J) of the BHC Act,[311] permits a banking entity to engage in any covered funds activity that the Agencies determine promotes and protects the safety and soundness of a banking entity and the financial stability of the United States.[312] Any activity authorized under § __.14 of the proposed rule must still comply with the prohibition and limitations governing relationships with covered funds contained in section 13(f) of the BHC Act, as implemented by § __.16 of this proposal.[313] Additionally, like other activities permissible under section 13(d)(1) of the BHC Act and as implemented by subpart C of the proposed rule, activities found permissible under § __.14 of the proposed rule and section 13(d)(1)(J) remain subject to other provisions of section 13 of the

[311] Section 13(d)(1)(J) of the BHC Act provides the Agencies discretion to determine that other activities not specifically identified by sections 13(d)(1)(A) – (I) of the BHC Act are exempted from the general prohibitions contained in section 13(a) of that Act, and are thus permitted activities. In order to make such a determination, the Agencies must find that such activity or activities promote and protect the safety and soundness of a banking entity, as well as promote and protect the financial stability of the United States. See 12 U.S.C. 1851(d)(1)(J).

[312] See 12 U.S.C. 1851(d)(1)(J).

[313] Section 13(d)(1)(J) of the BHC Act only provides the Agencies with the ability to provide additional exemptions from the prohibitions contained in section 13(a)(1) of the BHC Act. Section 13(f) of the BHC Act, which deals with relationships and transactions with a fund that is, directly or indirectly, organized and offered or sponsored by a banking entity, operates as an independent prohibition and set of limitations on the activities of banking entities. As such, § __.14 of the proposed rule cannot and does not provide any exemptions from the prohibition on relationships or transaction with a covered fund contained in section 13(f) of the BHC Act or § __.16 of the proposed rule.

BHC Act, including the sections limiting conflicts of interest and high-risk assets or trading strategies, as well as the section designed to prevent evasion of section 13 of the BHC Act.[314]

The Agencies have proposed to permit three activities at this time under this authority. These activities involve acquiring or retaining an ownership interest in and sponsoring of (i) certain BOLI separate accounts; (ii) certain entities that, although within the definition of covered fund are, in fact, common corporate organizational vehicles; and (iii) a covered fund in the ordinary course of collecting a debt previously contracted in good faith or pursuant to and in compliance with the conformance or extended transition period provided for under the Board's rules issued under section 13(c)(6) of the BHC Act.

a. Investments in certain bank owned life insurance separate accounts.

Banking entities have for many years invested in life insurance policies that cover key employees, in accordance with supervisory policies established by the Federal banking agencies.[315] These BOLI investments are typically structured as investments in separate accounts that are excluded from the definition of "investment company" under the Investment Company Act by virtue of section 3(c)(1) or 3(c)(7) of that Act. By virtue of reliance on these exclusions, these BOLI accounts would be covered by the definition of "hedge fund" or "private equity fund" in section 13 of the BHC Act.[316]

However, when made in the normal course, these investments do not involve the speculative risks intended to be addressed by section 13 of the BHC Act. Moreover, applying

[314] See 12 U.S.C. 1851(d)(2), (e)(1).

[315] See, e.g., Bank Owned Life Insurance, Interagency Statement on the Purchase and Risk Management of Life Insurance ("Interagency BOLI Guidance") (Dec. 7, 2004).

[316] See 12 U.S.C. 1851(h)(2).

the prohibitions in section 13 to these investments would eliminate an investment that helps banking entities to reduce their costs of providing employee benefits as well as other costs.

Section __.14(a)(1) of the proposed rule permits a banking entity to acquire and retain these BOLI investments, as well as act as sponsor to a BOLI separate account.[317] The proposal includes a number of conditions designed to ensure that BOLI investments are not conducted in a manner that raises the concerns that section 13 of the BHC Act is intended to address. In particular, in order for a banking entity to invest in or sponsor a BOLI separate account, the banking entity that purchases the insurance policy: (i) may not control the investment decisions regarding the underlying assets or holdings of the separate account; and (ii) must hold its ownership interests in the separate account in compliance with applicable supervisory guidance provided by the appropriate Federal regulatory agency regarding BOLI.[318]

The Agencies have structured this exemption in the proposed rule so as to allow a banking entity to continue to manage and structure its risks and obligations related to its employee compensation or benefit plan obligations in a manner that promotes and protects the safety and soundness of banking entities, which on an industry-wide level has the concomitant effect of promoting and protecting the financial stability of the United States.

---

[317] The proposed rule defines "separate account" as "an account established and maintained by an insurance company subject to regulation by a State insurance regulatory or a foreign insurance regulator under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company." See proposed rule § __.2(z).

[318] See proposed rule § __.14(a)(1)(i) – (ii). While other guidance or requirements may be imposed by the Agencies or an individual Agency for a specific banking entity for which it serves as the primary financial regulator, the Agencies note that, at a minimum, investments under authority of this section must comply with the Interagency BOLI Guidance. This guidance requires, among other things, that a banking entity generally: (i) not control the investment decisions regarding the underlying assets or holdings of the separate account; (ii) demonstrate to the satisfaction of the relevant Agency that the potential returns from the investments in such separate account are appropriately matched to the banking entity's employee compensation or benefit plan obligations; and (iii) not use such separate account to take speculative positions or to support the general operations of the banking entity.

b. Investments in certain other covered funds.

As noted above, the definition of "covered fund" as contained in § __.10(b)(1) of the proposed rule potentially includes within its scope many entities and corporate structures that would not usually be thought of as a "hedge fund" or "private equity fund." Additionally, the Dodd-Frank Act contains other provisions that permit or require a banking entity to acquire or retain an ownership interest in or act as sponsor to a covered fund in a manner not specifically described under section 13 of the BHC Act.

Section __.14(a)(2) of the proposed rule permits a banking entity to own certain specified entities that are often part of corporate structures and that, by themselves and without other extenuating circumstances or factors, do not raise the type of concerns which section 13 of the BHC Act was intended to address but which nevertheless may be captured by the definition of "hedge fund" or "private equity fund" in section 13(h)(2) of the BHC Act. Specifically, § __.14(a)(2) of the proposed rule permits a banking entity to acquire or retain an ownership interest in or act as sponsor to (i) a joint venture between the banking entity and any other person, provided that the joint venture is an operating company and does not engage in any activity or any investment not permitted under the proposed rule; (ii) an acquisition vehicle, provided that the sole purpose and effect of such entity is to effectuate a transaction involving the acquisition or merger of one entity with or into the banking entity or one of its affiliates; and (iii) a wholly-owned subsidiary of the banking entity that is (A) engaged principally in providing bona fide liquidity management services described under § __.3(b)(2)(iii)(C) of the proposed rule, and (B) carried on the balance sheet of the banking entity.[319]

[319] See proposed rule § __.14(a)(2).

The Agencies note that these types of entities may meet the definition of covered fund contained in § __.10(b)(1) of the proposed rule (and as contained in section 13(h)(2) of the BHC Act), to the extent these entities rely solely on section 3(c)(1) or 3(c)(7) of the Investment Company Act. However, these types of entities do not engage in the type and scope of activities to which Congress intended section 13 of the BHC Act to apply.[320] Additionally, without this exemption, many entities would be forced to alter their corporate structure without achieving any reduction in risk. Permitting such investments in these entities would thus appear to promote and protect the safety and soundness of banking entities and promote and protect the financial stability of the United States.

Section __.14(a)(2) of the proposed rule also permits a banking entity to comply with section 15G of the Exchange Act (15 U.S.C. 78o-11), added by section 941 of the Dodd-Frank Act, which requires a banking entity to maintain a certain minimum interest in certain sponsored or originated asset-backed securities.[321] In order to give effect to this separate requirement under the Dodd-Frank Act, § __.14(a)(2)(iii) of the proposed rule permits a banking entity to acquire or retain an ownership interest in or act as sponsor to an issuer of asset-backed securities, but only with respect to that amount or value of economic interest in a portion of the credit risk for an asset-backed security that is retained by a banking entity that is a "securitizer" or "originator" in compliance with the minimum requirements of section 15G of the Exchange Act (15 U.S.C. 78o-11) and any implementing regulations issued thereunder.[322] The Agencies have structured this exemption to recognize that Congress imposed other requirements on firms that are banking

[320] See 156 Cong. Rec. H5226 (daily ed. June 30, 2010) (statement of Reps. Hymes and Frank).

[321] The relevant agencies issued a proposed rule to implement the requirements of section 15G of the Exchange Act, as required under section 941 of the Dodd-Frank Act. See Credit Risk Retention, 76 FR 24090 (Apr. 29, 2011).

[322] See proposed rule § __.14(a)(2)(iii).

entities under section 13 of the BHC Act. Additionally, permitting a banking entity to retain the minimum level of economic interest will incent banking entities to engage in more careful and prudent underwriting and evaluation of the risks and obligations that may accompany asset-backed securitizations, which would promote and protect the safety and soundness of banking entities and the financial stability of the United States.

Section 14(a)(2) of the proposed rule permits a banking entity to acquire and retain an ownership interest in a covered fund that is an issuer of asset-backed securities described in § 13(d) of the proposed rule, the assets or holdings of which are solely comprised of: (i) loans; (ii) contractual rights or assets directly arising from those loans supporting the asset-backed securities; and (iii) interest rate or foreign exchange derivatives that (A) materially relate to the terms of such loans or contractual rights or assets and (B) are used for hedging purposes with respect to the securitization structure. This exemption augments the authority regarding the sale and securitization of loans available under § __.13(d) of the proposed rule (which partially implements the rule of construction under section 13(g)(2) of the BHC Act) and permits a banking entity to engage in the purchase, and not only the sale and securitization, of loans through authorizing the acquisition or retention of an ownership interest in such securitization vehicles that the banking entity does not organize and offer, or for which it does not act as sponsor, provided that the assets or holdings of such vehicles are solely comprised of the instruments or obligations referenced above.[323]

Permitting banking entities to acquire or retain an ownership interest in these loan securitizations will provide a deeper and richer pool of potential participants and a more liquid

[323] See id. at § __.14(a)(2)(v).

market for the sale of such securitizations, which in turn should result in increased availability of funds to individuals and small businesses, as well as provide greater efficiency and diversification of risk. The Agencies believe this exemption would promote and protect the safety and soundness of a banking entity, and would also promote and protect the financial stability of the United States.[324]

c. Acquiring or retaining an ownership interest in or acting a sponsor to a covered fund under certain specified authorities.

Section __.14(b) of the proposed rule permits a banking entity to acquire or retain an ownership interest in or act as sponsor to a covered fund in those instances where the ownership interest is acquired or retained by a banking entity (i) in the ordinary course of collecting a debt previously contracted in good faith, if the banking entity divests the ownership interest within applicable time periods provided for by the applicable Agency, or (ii) pursuant to and in compliance with the Conformance or Extended Transition Period authorities provided for under the proposed rule.[325]

Allowing banking entities to rely on these authorities for acquiring or retaining an ownership interest in or acting as sponsor to a covered fund will enable banking entities to manage their risks and structure their business in a manner consistent with their chosen corporate form and in a manner that otherwise complies with applicable laws. Thus, permitting such activities would promote and protect the safety and soundness of a banking entity, and would also promote and protect the financial stability of the United States.

[324] The Agencies note that proposed exemption applies only to the covered fund-related provisions of the proposed rule, and not to its prohibition on proprietary trading.

[325] See proposed rule § __.14(b). The Conformance or Extended Transition period authorities are substantially similar to those proposed by the Board in its February 2011 final rule governing such conformance periods under section 13 of the BHC Act.

d. Request for comment.

The Agencies request comment on the proposed rule's approach to implementing the exemption related to activities specifically determined to be permissible under section 13(d)(1)(J) of the BHC Act. In particular, the Agencies request comment on the following questions:

Question 302. Is the proposed rule's implementation of exemptions for covered fund activities and investments pursuant to section 13(d)(1)(J) of the BHC Act effective? If not, what alternative would be more effective and/or clearer?

Question 303. Is the proposed rule's approach to utilizing section 13(d)(1)(J) of the BHC Act to permit a banking entity to acquire or retain an ownership interest in, or act as sponsor to, certain entities that would fall into the definition of covered fund effective? Why or why not? If not, what alternative would be more effective and why? What legal authority under the statute would permit such an alternative?

Question 304. Are the proposed rule's provisions regarding when a covered fund activity will be deemed to be permitted under authority of section 13(d)(1)(J) of the BHC Act effective and sufficiently clear? If not, what alternative would be more effective and/or clearer?

Question 305. Do the exemptions provided for in § __.14 of the proposed rule effectively promote and protect the safety and soundness of banking entities and the financial stability of the United States? If not, why not?

Question 306. Are the proposed rule's provisions regarding what qualifications must be satisfied in order to qualify for an exemption under § __.14 of the proposed rule effective and

sufficiently clear? If not, what alternative would be more effective and/or clearer? Should additional requirements be added? If so, what requirements and why? Should additional requirements be modified or removed? If so, what requirements and why or how?

Question 307. Does the proposed rule effectively cover the scope of covered funds activities which the Agencies should specifically determine to be permissible under section 13(d)(1)(J) of the BHC Act? If not, what activity or activities should be permitted? For additional activities that should be permitted, on what grounds would these activities promote and protect the safety and soundness of banking entities and the financial stability of the United States?

Question 308. Does the proposed rule effectively address the interplay between the restrictions on covered fund activities and investments in section 13 of the BHC Act and the requirements imposed on certain banking entities under section 15G of the Exchange Act? Why or why not?

Question 309. Rather than permitting the acquisition or retentions of an ownership interest in, or acting as sponsor to, specific covered funds under section 13(d)(1)(J) of the BHC Act, should the Agencies use the authority provided under section 13(d)(1)(J) to permit investments in a covered fund that display certain characteristics? If so, what characteristics should the Agencies consider? How would investments with such characteristics promote and protect the safety and soundness of the banking entity and promote the financial stability of the United States?

Question 310. Should venture capital funds be excluded from the definition of "covered fund"? Why or why not? If so, should the definition contained in rule 203(l)-1 under the

Advisers Act be used? Should any modification to that definition of venture capital fund be made? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?

Question 311. Should non-U.S. funds or entities be included in the definition of "covered fund"? Should any non-U.S. funds or entities be excluded from this definition? Why or why not? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?

Question 312. Should so-called "loan funds" that invest principally in loans and not equity be excluded from the definition of "covered fund"? Why or why not? What characteristics would be most effective in determining whether a fund invests principally in loans and not equity? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the BHC Act?

Question 313. Are the proposed rule's proposed determinations that the specified covered funds activities or investments promote and protect the safety and soundness of banking entities and the financial stability of the United States appropriate? If not, how should the determinations be amended or altered?

6. Section __.15: Internal Controls, reporting and recordkeeping requirements applicable to covered fund activities and investments.

Section __.15 of the proposed rule, which implements section 13(e)(1) of the BHC Act,[326] requires a banking entity engaged in covered fund activities and investments to comply with (i) the internal controls, reporting, and recordkeeping requirements required under § __.20

[326] Section 13(e)(1) of the BHC Act requires the Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with section 13. See 12 U.S.C. 1851(e)(1).

and Appendix C of the proposed rule, as applicable and (ii) such other reporting and recordkeeping requirements as the relevant supervisory Agency may deem necessary to appropriately evaluate the banking entity's compliance with this subpart C.[327] These requirements are discussed in detail in Part III.D of this Supplementary information.

7. Section __.16: Limitations on relationships with a covered fund.

Section 13(f) of the BHC Act generally prohibits a banking entity from entering into certain transactions with a covered fund that would be a covered transaction as defined in section 23A of the FR Act.[328] Section __.16 of the proposed rule implements this provision. Section __.16(a)(2) of the proposed rule clarifies that, for reasons explained in detail below, certain transactions between a banking entity and a covered fund remain permissible. Section __.16(b) of the proposed rule implements the statute's requirement that any transaction permitted under section 13(f) of the BHC Act (including a prime brokerage transaction) between the banking entity and covered fund is subject to section 23B of the FR Act,[329] which, in general, requires that the transaction be on market terms or on terms at least as favorable to the banking entity as a comparable transaction by the banking entity with an unaffiliated third party.

a. General prohibition on certain transactions and relationships.

Section 13(f)(1) of the BHC Act generally prohibits a banking entity that, directly or indirectly, serves as investment manager, investment adviser, commodity trading adviser, or sponsor to a covered fund (or that organizes and offers a covered fund pursuant to section 13(d)(1)(G) of the BHC Act) from engaging in any transaction with the covered fund, or with

[327] See proposed rule § __.15.

[328] 12 U.S.C. 371c.

[329] 12 U.S.C. 371c-1.

any covered fund that is controlled by such fund, if the transaction would be a "covered transaction" as defined in section 23A of the FR Act, as if the banking entity and any affiliate thereof were a member bank and the covered fund were an affiliate thereof.[330] Section __.16(a)(1) of the proposed rule includes this prohibition.

Consistent with the requirements of section 13(f)(1) of the BHC Act, § __.16(a)(1) of the proposed rule is more restrictive than section 23A of the FR Act because § __.16(a)(1) generally prohibits a banking entity and any of its affiliates from entering into any such transaction, while section 23A permits covered transactions with affiliates so long as the transactions meet specified quantitative and qualitative requirements.[331]

b. Transactions that would be a "covered transaction".

Section 13(f) of the BHC Act applies to covered transactions as defined in section 23A of the FR Act without incorporating any of the provisions in section 23A that provide exemptions from the prohibitions in that section for certain types of covered transactions.[332] Section __.16 of

[330] As noted above, the proposed rule implements the definition of "banking entity" in a manner that does not include covered funds for which a banking entity acts as sponsor or organizes and offers pursuant to section 13(d)(1)(G) of the BHC Act, or any covered fund in which such related covered fund invests. Accordingly, these covered funds (and any covered fund in which such covered fund acquired or retains a controlling investment) are not generally subject to the prohibitions contained in § __.16 of the proposed rule.

[331] Section 23A of the FR Act limits the aggregate amount of covered transactions by a member bank to no more than (i) 10 per centum of the capital stock and surplus of the member bank in the case of any affiliate, and (ii) 20 per centum of the capital stock and surplus of the member bank in the case of all affiliates. See 12 U.S.C. 371c(a). Conversely, section 13(f) of the BHC Act operates as a general prohibition on such transactions without providing any similar amount of permitted transactions.

[332] The term "covered transaction" is defined in section 23A of the FR Act to mean, with respect to an affiliate of a member bank: (i) a loan or extension of credit to the affiliate, including a purchase of assets subject to an agreement to repurchase; (ii) a purchase of or an investment in securities issued by the affiliate; (iii) a purchase of assets from the affiliate, except such purchase of real and personal property as may be specifically exempted by the Board by order or regulation; (iv) the acceptance of securities or other debt obligations issued by the affiliate as collateral security for a loan or extension of credit to any person or company; (v) the issuance of a guarantee, acceptance, or letter of credit, including an endorsement or standby letter of credit, on behalf of an affiliate; (vi) a transaction with an affiliate that involves the borrowing or lending of securities, to the extent that the transaction causes a member bank or subsidiary to have credit exposure to the affiliate; or (vii) a derivative transaction, as defined in paragraph (3) of section 5200(b) of the Revised Statutes of the United States (12 U.S.C. 84(b)), with an affiliate, to the extent

the proposed rule adopts the same language as the statute. The definition of "covered transaction" contained in section 23A of the FR Act itself includes an explicit exemption from the definition of "covered transaction" for "such purchase of real and personal property as may be specifically exempted by the Board by order or regulation."[333] Since these transactions are, by definition, excluded from the definition of "covered transaction," any transaction that is specifically exempted by the Board pursuant to this specific authority would not be deemed to be a covered transaction as defined in section 23A of the FR Act.

c. Certain transactions and relationships permitted.

While section 13(f)(1) of the BHC Act operates as a general prohibition on a banking entity's ability to enter into a transaction with a related covered fund that would be a covered transaction as defined under section 23A of the FR Act, other specific portions of the statute expressly provide for, or make reference to, a banking entity's ability to engage in certain transactions or relationships with such funds.[334] Section __.16(a)(2) of the proposed rule implements and clarifies these authorities.

i. Permitted investments and ownerships interests.

Section __.16(a)(2) of the proposed rule clarifies that a banking entity may acquire or retain an ownership interest in a covered fund in accordance with the requirements of subpart C of the proposed rule.[335] This clarification is proposed in order to remove any ambiguity regarding whether the section prohibits a banking entity from acquiring or retaining an interest in

---

that the transaction causes a member bank or a subsidiary to have credit exposure to the affiliate. See 12 U.S.C. 371c(b)(7), as amended by section 608 of the Dodd-Frank Act.

[333] Id. at 371c(b)(7)(C).

[334] See, e.g., 12 U.S.C. 1851(d)(1)(G), (d)(4), and (f)(3).

[335] See proposed rule § __.16(a)(2)(i).

securities issued by a related covered fund in accordance with the other provisions of the rule, since the purchase of securities of a related covered fund would be a covered transaction as defined by section 23A of the FR Act. There is no evidence that Congress intended section 13(f)(1) of the BHC Act to override the other provisions of section 13 with regard to the acquisition or retention of ownership interests specifically permitted by the section. Moreover, a contrary reading would make these more specific sections that permit covered transactions between a banking entity and a covered fund mere surplusage.

ii. Prime brokerage transactions also permitted.

Section __.16(a)(2)(ii) of the proposed rule implements section 13(f)(3)(A) of the BHC Act, which provides that a banking entity may enter into any prime brokerage transaction with a covered fund in which a covered fund managed, sponsored, or advised by such banking entity has taken an ownership interest, so long as certain enumerated conditions are satisfied.[336] The proposed rule defines "prime brokerage transaction" to mean one or more products or services provided by the banking entity to a covered fund, such as custody, clearance, securities borrowing or lending services, trade execution, or financing, and data, operational, and portfolio management support.[337] To engage in a prime brokerage transaction with a covered fund pursuant to § __.16(a)(2)(ii) of the proposed rule, a banking entity must be in compliance with the limitations set forth in § __.11 of the proposed rule with respect to a covered fund organized and offered by such banking entity. In addition, as required by statute, the chief executive officer (or equivalent officer) of the banking entity must certify in writing annually that the banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the

---

[336] See proposed rule § __.16(a)(2)(ii).

[337] See proposed rule § __.10(b)(4).

obligations or performance of the covered fund or of any covered fund in which such covered fund invests. Finally, the Board must not have determined that such transaction is inconsistent with the safe and sound operation and condition of the banking entity.

d. Restrictions on transactions with any permitted covered fund.

Section __.16(b) of the proposed rule implements sections 13(f)(2) and 13(f)(3)(B) of the BHC Act and applies section 23B of the FR Act[338] to certain transactions and investments between a banking entity and a covered fund as if such banking entity were a member bank and such covered fund were an affiliate thereof.[339] Section 23B provides that transactions between a member bank and an affiliate must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to such banking entity as those prevailing at the time for comparable transactions with or involving other unaffiliated companies or, in the absence of comparable transactions, on terms and under circumstances, including credit standards, that in good faith would be offered to, or would apply to, nonaffiliated companies.[340]

Section __.16(b) applies this requirement to transactions between a banking entity that serves as investment manager, investment adviser, commodity trading adviser, or sponsor to a covered fund and that fund and any other fund controlled by that fund. It also applies this condition to a permissible prime brokerage transaction in which a banking entity may engage pursuant to § __.16(a)(2)(ii) of the proposed rule.[341]

e. Request for comment.

---

[338] 12 U.S.C. 371c-1.

[339] See proposed rule § __.16(b).

[340] 12 U.S.C. 371c-1(a); 12 CFR 223.51.

[341] See 12 U.S.C. 1851(f)(2), (f)(3)(B); proposed rule § __.16(b).

The Agencies request comment on the proposed rule's approach to implementing the limitations on certain relationships with covered funds and, in particular, the manner in which the Agencies have proposed to apply a banking entity's ability to make explicitly permitted investments for these purposes, as described above. In particular, the Agencies request comment on the following questions:

Question 314. Is the proposed rule's approach to implementing the limitations on certain transactions with a covered fund effective? If not, what alternative approach would be more effective and why?

Question 315. Should the approach include other elements? If so, what elements and why? Should any of the proposed elements be revised or eliminated? If so, why and how?

Question 316. What types of transactions or relationships that currently exist between banking entities and a covered fund (or another covered fund in which such covered fund makes a controlling investment) would be prohibited under the proposed rule? What would be the effect of the proposed rule on banking entities' ability to continue to meet the needs and demands of their clients? Are there other transactions between a banking entity and such covered funds that are not already covered but that should be prohibited or limited under the proposed rule?

Question 317. Should the Agencies provide a different definition of "prime brokerage transaction" under the proposed rule? If so, what definition would be appropriate? Are there any transactions that should be included in the definition of "prime brokerage transaction"? Are there transactions or practices provided by banking entities that should be excluded in order to mitigate the burdens of complying with section 13 of the BHC Act?

Question 318. With respect to the CEO (or equivalent officer) certification required under section 13(f)(3)(A) (ii) of the BHC Act and § __.16(a)(2)(ii)(B) of the proposed rule, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, website certification, or certification filed directly with the relevant Agency)?

8. Section __.17: Other limitations on permitted covered funds activities.

Section __.17 of the proposed rule implements section 13(d)(2) of the BHC Act, which places certain limitations on the permitted covered fund activities and investments in which a banking entity may engage. Consistent with the statute and § __.8 of the proposed rule, § __.17 provides that no transaction, class of transactions, or activity is permissible under §§ __.11 through __.16 of the proposed rule if the transaction, class of transactions, or activity would:

- Involve or result in a material conflict of interest between the banking entity and its clients, customers, or counterparties;

- Result, directly or indirectly, in a material exposure by the banking entity to a high-risk asset or a high-risk trading strategy; or

- Pose a threat to the safety and soundness of the banking entity or the financial stability of the United States.

Section __.17 of the proposed rule further defines "material conflict of interest," "high-risk assets," and "high-risk trading strategies for these purposes, which are identical to the definitions

of the same terms for purposes of § __.8 of the proposed rule related to proprietary trading, and are described in detail in Part III.B.6 of this Supplementary Information.[342]

The Agencies request comment on the proposed limitations on permitted covered fund activities and investments, including with respect to the questions in Part III.B.6 of the Supplemental Information as they pertain to covered fund activities and investments in particular.

D. Subpart D (Compliance Program Requirement) and Appendix C (Minimum Standards for Programmatic Compliance)

Subpart D of the proposed rule, which implements section 13(e)(1) of the BHC Act,[343] requires certain banking entities to develop and provide for the continued administration of a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on covered trading activities and covered fund activities and investments set forth in section 13 of the BHC Act and the proposed rule.[344] This compliance program requirement forms a key part of the proposal's multi-faceted approach to implementing section 13 of the BHC Act, and is intended to ensure that banking entities establish, maintain and enforce compliance procedures and controls to prevent violation or evasion of the prohibitions and restrictions on covered trading activities and covered fund activities and investments.

---

[342] As noted in the discussion of the definition of "material conflict of interest in Part III.B.6 of this Supplementary Information, the proposed disclosure provisions of that definition are provided solely for purposes of the proposed rule's definition of material conflict of interest, and do not affect a banking entity's obligation to comply with additional or different disclosure or other requirements with respect to a conflict under applicable securities, banking, or other laws (e.g., section 27B of the Securities Act, which governs conflicts of interest relating to certain securitizations; section 206 of the Investment Advisers Act of 1940, which applies to conflicts of interest between investment advisers and their clients; or 12 CFR 9.12, which applies to conflicts of interest in the context of a national bank's fiduciary activities).

[343] See 12 U.S.C. 1851(e)(1).

[344] See proposed rule § __.20.

1. Section __.20: Compliance program mandate.

The proposed rule adopts a tiered approach to implementing the compliance program mandate, requiring a banking entity engaged in covered trading activities or covered fund activities and investments to establish a compliance program that contains specific elements and, if the banking entity's activities are significant, meet a number of minimum standards. If a banking entity does not engage in covered trading activities and covered fund activities and investments, it must ensure that its existing compliance policies and procedures include measures that are designed to prevent the banking entity from becoming engaged in such activities and making such investments and must develop and provide for the required compliance program under proposed § __.20(a) of the proposed rule prior to engaging in such activities or making such investments, but is not otherwise required to meet the requirements of subpart D of the proposed rule.[345]

Section __.20(a) of the proposed rule contains the core requirement that each banking entity engaged in covered trading activities or covered fund activities and investments must establish, maintain and enforce a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading activities and covered fund activities and investments set forth in section 13 of the BHC Act and the proposed rule and that such program must be suitable for the size, scope, and complexity of activities and business structure of the banking entity. Section __.20(b) of the proposed rule specifies the following six elements that each compliance program established under subpart D must provide for, at a minimum:

[345] See proposed rule § __.20(d).

- Internal written policies and procedures reasonably designed to document, describe, and monitor the covered trading activities and covered fund activities and investments of the banking entity to ensure that such activities and investments comply with section 13 of the BHC Act and the proposed rule;

- A system of internal controls reasonably designed to monitor and identify potential areas of noncompliance with section 13 of the BHC Act and the proposed rule in the banking entity's covered trading activities and covered fund activities and investments and to prevent the occurrence of activities that are prohibited by section 13 of the BHC Act and the proposed rule;

- A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and the proposed rule;

- Independent testing for the effectiveness of the compliance program, conducted by qualified banking entity personnel or a qualified outside party;

- Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

- Making and keeping records sufficient to demonstrate compliance with section 13 of the BHC Act and the proposed rule, which a banking entity must promptly provide to the relevant supervisory Agency upon request and retain for a period of no less than 5 years.

In addition, for a banking entity with significant covered trading activities or covered fund activities and investments, § __.20(c) requires the compliance program established under subpart D to meet a number of minimum standards, which are specified in Appendix C of the

proposed rule. In particular, a banking entity must comply with the minimum standards specified in Appendix C of the proposed rule if:

- With respect to its covered trading activities, it engages in any covered trading activities and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters, (i) is equal to or greater than $1 billion or (ii) equals 10 percent or more of its total assets; and

- With respect to its covered fund activities and investments, it engages in any covered fund activities and investments and either (i) has, together with its affiliates and subsidiaries, aggregate investments in one or more covered funds the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion or (ii) sponsors or advises, together with its affiliates and subsidiaries, one or more covered funds the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

The application of detailed minimum standards to these types of banking entities is intended to reflect the heightened compliance risks of large covered trading and large covered fund activities and investments and provide guidance to such banking entities regarding the minimum compliance measures that would be required under the proposed rule.

If a banking entity does not meet the thresholds specified in § __.20(c)(2), it need not comply with each of the minimum standards specified in Appendix C. However, the proposed rule would require such a banking entity to establish a compliance program that effectively implements the six elements specified in § __.20(b). Banking entities engaged in a relatively

small amount of covered fund activities are encouraged to look to the minimum standards of Appendix C for guidance. Generally, the Agencies would expect that the closer a banking entity is to the thresholds specified in § __.20(c)(2), the more its compliance program should generally include the specific requirements described in Appendix C. Within the bounds of subpart D and Appendix C, a banking entity has discretion to structure and manage its program for compliance with section 13 of the BHC Act and the proposed rule in a manner that best reflects the unique organization and operation of the banking entity and its affiliates and subsidiaries, and is suitable taking account of the size, scope, and complexity of activities in which the banking entity and its affiliates and subsidiaries engage.

As described above, § __.20(d) of the proposed rule clarifies that, if a banking entity does not engage in covered trading activities and/or covered fund activities or investments, it will have satisfied the requirements of this section if its existing compliance policies and procedures include measures that are designed to prevent the banking entity from becoming engaged in such activities or making such investments and which require the banking entity to develop and provide for the compliance program required under paragraph (a) of this section prior to engaging in such activities or making such investments.

2. Appendix C - minimum standards for programmatic compliance.

Appendix C of the proposed rule specifies a variety of minimum standards applicable to the compliance program of a banking entity with significant covered trading activities or covered fund activities and investments.[346] Section I.A of proposed Appendix C sets forth the purpose of the required compliance program, which is to ensure that each banking entity establishes,

[346] The Agencies have proposed to include these minimum standards as part of the regulation itself, rather than as accompanying guidance, reflecting the compliance program's importance within the general implementation framework.

maintains, and enforces an effective compliance program, consisting of written policies and procedures, internal controls, a management framework, independent testing, training, and recordkeeping, that:

- Is designed to clearly document, describe, and monitor the covered trading activities and covered fund activities or investments and the risks of the banking entity related to such activities or investments, identify potential areas of noncompliance, and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and the proposed rule;

- Specifically addresses the varying nature of activities or investments conducted by different units of the banking entity's organization, including the size, scope, complexity, and risks of the individual activity or investment;

- Subjects the effectiveness of the compliance program to independent review and testing;

- Makes senior management and intermediate managers accountable for the effective implementation of the compliance program, and ensures that the board of directors or chief executive office ("CEO") review the effectiveness of the compliance program; and

- Facilitate supervision of the banking entity's covered trading activities and covered fund activities or investments by the Agencies.

A banking entity's compliance program should not be developed through a generic, one-size-fits-all approach, but rather should carefully take into account and reflect the unique manner in which a banking entity operates, as well as the particular compliance risks and challenges that

its businesses present. In light of the complexities presented in differentiating prohibited proprietary trading from permitted market making-related activities in particular, the Agencies expect that such a dynamic, carefully-tailored approach to internal compliance will play an important role in ensuring that banking entities comply with section 13's prohibitions and restrictions. In addition, although this statement of purpose appears within the text of proposed Appendix C, the Agencies note the statement equally describes the general purpose of any compliance program required under subpart D of the proposed rule, regardless of whether proposed Appendix C specifically applies.

Section I.B of proposed Appendix C provides for several definitions used throughout the appendix, including the definition of "trading unit" and "asset management unit" to which the minimum standards apply. The term "trading unit" is defined in the same way as in Appendix A, as described in Part II.B.5 of the Supplementary Information, and is intended to identify multiple layers of a banking entity's organizational structure because any effective compliance program will need to manage, limit and monitor covered trading activity at each such level of organization in order to effectively support compliance with the prohibition on proprietary trading. The term "asset management unit" is defined as any unit of organization of a banking entity that makes an investment in, acts as sponsor to, or has relationships with, a covered fund that the banking entity sponsors, organizes and offers, or in which a covered fund sponsored or advised by a banking entity invests.

Section I.C of proposed Appendix C incorporates by reference the six elements that must be included in the compliance program under § __.20 of the proposed rule, and section I.D describes the structure of a compliance program meeting the minimum standards. In particular, section I.D permits a banking entity to establish a compliance program on an enterprise-wide

basis to satisfy the requirements of § __.20 of the proposed rule and the appendix, which program could cover the banking entity and all of its affiliates and subsidiaries collectively. In order to do so, the program must (i) be clearly applicable, both by its terms and in operation, to all such affiliates and subsidiaries, (ii) specifically address the requirements set forth in proposed Appendix C, (iii) take into account and address the consolidated organization's business structure, size, and complexity, as well as the particular activities, risks, and applicable legal requirements of each subsidiary and affiliate, and (iv) be determined through periodic independent testing to be effective for the banking entity and its affiliates and subsidiaries. In addition, the enterprise-wide program would be subject to supervisory review and examination by any Agency vested with rulewriting authority under section 13 of the BHC Act with respect to the compliance program and the activities of any banking entity for which the Agency has such authority. Further, such Agency would have access to all records related to the enterprise-wide compliance program pertaining to any banking entity that is supervised by the Agency vested with such rulewriting authority.

a. Internal policies and procedures.

Section II of proposed Appendix C articulates minimum standards for the first element of the compliance program, internal policies and procedures, for both covered trading activities and covered fund activities and investments. With respect to covered trading activities, the proposal would require that internal policies and procedures: (i) specify how the banking entity identifies its trading accounts; (ii) identify the trading activity in which the banking entity is engaged and how that activity is organized; (iii) thoroughly articulate the mission, strategy, risks, and compliance controls for each trading unit; (iv) include for each trader a mandate that describes the scope of his or her trading activity; (v) clearly articulate and document a comprehensive

description of the risks associated with the trading unit's activities; (vi) document a comprehensive explanation of how the mission and strategy of the trading unit, and its related risk levels, comply with the proposed rule; and (vii) require the banking entity to promptly address and remedy any violation of section 13 of the BHC Act and the proposed rule. These internal policies and procedures would require banking entities to have the data and standards to prevent prohibited proprietary trading and to identify abnormalities and discrepancies that may be indicative of prohibited proprietary trading. The internal policies and procedures should also provide the Agencies with a clear, comprehensive picture of a banking entity's covered trading activities that can be effectively reviewed. With respect to covered fund activities and investments, the proposal would require that internal policies and procedures describe all covered fund activities in which the banking entity engages and the procedures used by the banking entity to ensure that it complies with the restrictions of section 13 of the BHC Act and the proposed rule.

The Agencies expect that these internal policies and procedures will be regularly reviewed and updated to reflect changes in business practices, strategies, or laws and regulations, though frequent, unexplained changes to policies and procedures or other aspects of the compliance program – particularly changes to reduce their stringency – would warrant additional scrutiny from banking entity management, independent testing personnel, and Agency supervisors or examiners.

b. Internal controls.

Section III of proposed Appendix C articulates minimum standards for the second element of the compliance program, internal controls. With respect to covered trading activities, the proposal would require internal controls that: (i) are reasonably designed to ensure that the

covered trading activity is conducted in conformance with a trading unit's authorized risks, instruments and products, as documented in the banking entity's written policies and procedures; (ii) establish and enforce risk limits for each trading unit; and (iii) perform robust analysis and quantitative measurement of covered trading activity for conformance with section 13 of the BHC Act and the proposed rule. In particular, the banking entity must perform analysis and quantitative measurement that is reasonably designed to: (i) ensure that the activity of each trading unit is appropriate to the mission, strategy, and risk of each trading unit, as documented in the banking entity's internal written policies and procedures; (ii) monitor and assist in the identification of potential and actual prohibited trading activity; and (iii) prevent the occurrence of prohibited proprietary trading. This analysis and measurement should incorporate the quantitative measurements calculated and reported under Appendix A of the proposed rule, but should also include other analysis and measurements developed by the banking entity that are specifically tailored to the business, risks, practices, and strategies of its trading units. The Agencies expect that the thoughtful use of these types of quantitative tools to monitor the extent to which the activities of a trading unit are consistent with its stated mission, strategy, and risk profile may help identify, for both banking entities and Agencies, abnormalities or discrepancies in permitted trading activity that may be indicative of prohibited proprietary trading. In addition, these internal controls must provide for regular monitoring of the effectiveness of the banking entity's compliance program and require the banking entity to take prompt action to address and remedy any deficiencies identified and to provide timely notification to the relevant Agency of any investigation and remedial action taken.

With respect to covered fund activities and investments, the internal controls required under section III of proposed Appendix C generally focus on ensuring that a banking entity has

effective controls in place to monitor its investments in, and relationships with, covered funds to ensure its compliance with the covered fund activity and investments restrictions, including controls that relate to implementing remedies in the event of a violation of the requirements of section 13 of the BHC Act and the proposed rule.

c. Responsibility and accountability.

Section IV of proposed Appendix C articulates minimum standards for the third element of the compliance program, responsibility and accountability. These standards focus on four key constituencies – the board of directors, the CEO, senior management, and managers at each trading unit and asset management unit level. Section IV makes clear that the board of directors, or similar corporate body, and the CEO are responsible for creating an appropriate "tone at the top" by setting an appropriate culture of compliance and establishing clear policies regarding the management of covered trading activities and covered fund activities and investments. Senior management must be made responsible for communicating and reinforcing the culture of compliance established by the board of directors and the CEO, for the actual implementation and enforcement of the approved compliance program, and for taking effective corrective action, where appropriate. Managers with responsibility for one or more trading units or asset management units of the banking entity that are engaged in covered trading activity or covered fund activity and investments are accountable for effective implementation and enforcement of the compliance program for the applicable trading unit or asset management unit.

d. Independent testing.

Section V of proposed Appendix C articulates minimum standards for the fourth element of the compliance program, independent testing. A banking entity subject to the appendix must

ensure that its independent testing is conducted by a qualified independent party, such as the banking entity's internal audit department, outside auditors, consultants or other qualified independent parties. The independent testing must examine both the banking entity's compliance program and its actual compliance with the proposed rule. Such testing must include not only the general adequacy and effectiveness of the compliance program and compliance efforts, but also the effectiveness of each element of the compliance program and the banking entity's compliance with each provision of the proposed rule. This requirement is intended to ensure that a banking entity continually reviews and assesses, in an objective manner, the strength of its compliance efforts and promptly identifies and remedies any weaknesses or matters requiring attention within the compliance framework.

e. Training.

Section VI of proposed Appendix C articulates minimum standards for the fifth element of the compliance program, training. It proposes to require that a banking entity provide adequate training to its trading personnel and managers, as well as other appropriate personnel, in order to effectively implement and enforce the compliance program. In particular, personnel engaged in covered trading activities or covered fund activities and investments should be educated with respect to applicable prohibitions and restrictions, exemptions, and compliance program elements to an extent sufficient to permit them to make informed, day-to-day decisions that support the banking entity's compliance with the proposed rule and section 13 of the BHC Act. In particular, any personnel with discretionary authority to trade, in any amount, should be appropriately trained regarding the differentiation of prohibited proprietary trading and permitted trading activities and given detailed guidance regarding what types of trading activities are prohibited. Similarly, personnel providing investment management or advisory services, or

acting as general partner, managing member, or trustee of a covered fund, should be appropriately trained regarding what covered fund activities and investments are permitted and prohibited.

f. Recordkeeping.

Section VII of proposed Appendix C articulates minimum standards for the sixth element of the compliance program, recordkeeping. Generally, a banking entity must create records sufficient to demonstrate compliance and support the operation and effectiveness of its compliance program (i.e., records demonstrating the banking entity's compliance with the requirements of section 13 of the BHC Act and the proposed rule, any scrutiny or investigation by compliance personnel or risk managers, and any remedies taken in the event of a violation or non-compliance), and retain these records for no less than five years in a form that allows the banking entity to promptly produce these records to any relevant Agency upon request. Records created and retained under the compliance program shall include trading records of the trading units, including trades and positions of each such unit.

g. Request for comment.

The Agencies request comment on the compliance program requirement contained in § __.20 of the proposed rule and the minimum standards specified in proposed Appendix C. In particular, the Agencies request comment on the following questions:

Question 319. Is the proposed rule's inclusion of a compliance program requirement effective in light of the purpose and language of the statute? If not, what alternative would be more effective?

Question 320. Is the proposed application of § __.20's compliance program requirement to all banking entities engaged in covered trading activity or covered trading investments and activities and the minimum standards of proposed Appendix C to only banking entities with significant covered trading or covered fund activities, effective? If not, what alternative would be more effective? Should proposed Appendix C apply to all banking entities? If so, why? Are the thresholds proposed for determining whether a banking entity must comply with proposed Appendix C appropriate? If not, what alternative would be more effective?

Question 321. What implementation, operational, or other burdens or expenses might be associated with the compliance program requirement? How could those burdens or expenses be reduced or eliminated in a manner consistent with the purpose and language of the statute?

Question 322. Do the proposed compliance program requirement and minimum standards provide sufficient guidance and clarity regarding how compliance programs should be structured? If not, what additional guidance or clarity is needed? Do the proposed compliance program requirement and minimum standards provide sufficient discretion to banking entities to structure a compliance program that appropriately reflects the unique nature of their businesses? If not, how could additional discretion be provided in a manner consistent with the purpose and language of the statute?

Question 323. Are the six proposed elements of a required compliance program effective? If not, what alternative would be more effective? Should elements be added or removed? If so, which ones and why?

Question 324. For each of the six proposed elements of a required compliance program for which minimum standards are provided in proposed Appendix C, are the proposed minimum

standards effective? If not, what alternative would be more effective? Should minimum standards be added or removed? If so, which ones and why?

Question 325. Does the requirement that a banking entity provide timely notification to the relevant Agency provide sufficient guidance as to what activities must be reported and how and when such reporting should be made? Should more specific standards be provided (e.g., regarding the timing of reporting and the types of activities that must be reported)? If so, what additional criteria should be implemented? Should the notification requirement be applied explicitly to banking entities that are not required to comply with the minimum standards specified in Appendix C because they are below the thresholds specified in §__.20(c)(2)? Why or why not?

Question 326. Are there specific records that banking entities should be required to make and keep to document compliance with section 13 of the BHC Act and the proposed rule? Please explain.

Question 327. What process should the Agencies use in determining whether to require a banking entity that, based on its size, would not be subject to Appendix C to comply with all or portions of the appendix under section I.E of the proposed appendix? What considerations should the Agencies take into account in making such a determination? Should this requirement be implemented by an Agency order, by authority delegated to Agency staff, or a different method? Please explain.

Question 328. Should the proposed rule permit banking entities to comply with Appendix C of the proposed rule on an enterprise-wide basis? If so, why? What are the advantages and disadvantages of an enterprise-wide compliance program? Should the proposed

appendix provide additional clarity or discretion regarding how such an enterprise-wide program should be structured? If so, how? Please include a discussion relating to the infrastructure of an enterprise-wide compliance program and its management. If enterprise-wide compliance or similar programs are used in other contexts, please describe your experience with such programs and how those experiences influence your judgment concerning whether or not you would choose an enterprise-wide compliance program in this context.

Question 329. Should the proposed rule permit banking entities to comply with § __.20(b) of the proposed rule on an enterprise-wide basis? If so, why? What are the advantages and disadvantages of an enterprise-wide compliance program for smaller banking entities that are not subject to Appendix C? Please include a discussion relating to the infrastructure of an enterprise-wide compliance program and its management in the context of smaller banking entities. If enterprise-wide compliance or similar programs are used in other contexts, please describe your experience with such programs and how those experiences influence your judgment concerning whether or not you would choose an enterprise-wide compliance program in this context. Are there particular reasons why a enterprise-wide compliance program should be permitted for larger banking entities subject to the requirements of Appendix C, but not those that are subject to § __.20(b) of the proposed rule?

Question 330. What are the particular challenges that should be considered in connection with establishing a compliance program on an enterprise-wide basis? How will such challenges be addressed? Can an enterprise-wide compliance program be appropriately tailored to each of the subsidiaries and affiliates of a banking entity?

Question 331. Are there efficiencies that can be gained through an enterprise-wide compliance program? If so, how and what efficiencies?

Question 332. Would the complexities of various types of covered trading activity be adequately reflected in an enterprise-wide compliance program?

Question 333. Should only outside parties be permitted to conduct independent testing for the effectiveness of the proposed compliance program to satisfy certain minimum standards? If so, why? Under the proposal, the independent testing requirement may be satisfied by testing conducted by an internal audit department or a third party. Should the rule specify the minimum standards for "independence" as applied to internal and/or external parties testing the effectiveness of the compliance program? For example, would an internal audit be deemed to be independent if none of the persons involved in the testing are involved with, or report to persons that are involved with, activities implicated by section 13 of the BHC Act? Why or why not?

Question 334. Do you anticipate that banking entities that do not meet the thresholds specified in §_.20(c) would voluntarily comply with the proposed minimum standards in Appendix C in order to effectively implement the six elements specified in §_.20(b)? Are there specific minimum standards that would not be practical or would be unattainable for a banking entity that does not meet the §__.20(c) thresholds? Please identify the minimum standard(s) and explain.

Question 335. In light of the size, scope, complexity, and risk of covered trading activities, do commenters anticipate the need to hire new staff with particular expertise in order to establish, maintain, and enforce the proposed compliance program requirement concerning covered trading activities or any subset of covered trading activities?

Question 336. With respect to the proposed requirement that training should occur with a frequency appropriate to the size and risk profile of the banking entity's covered trading activities and covered fund activities, should there be a minimum requirement that such training shall be conducted no less than once every twelve (12) months? If so, why?

Question 337. Should proposed rule's Appendix C be revised to require a banking entity's CEO to annually certify that the banking entity has in place processes to establish, maintain, enforce, review, test and modify the compliance program established pursuant to Appendix C in a manner that is reasonably designed to achieve compliance with section 13 of the BHC Act and this proposal? If so, why? If so, what would be the most useful, efficient method of certification (e.g., a new stand-alone certification, a certification incorporated into an existing form or filing, website certification, or certification filed directly with the relevant Agency)? Would a central data repository with a CEO attestation to the Agencies be a preferable approach?

Question 338. Do the proposed rule requirements relating to establishment and implementation of a compliance program pose unique concerns or challenges to issuers of asset-backed securities that are banking entities, and if so, why? Are certain asset classes particularly impacted by the proposed rule requirements, and if so, how?

Question 339. How would existing issuers of asset-backed securities that are banking entities pay for establishing and implementing a compliance program? Should existing issuers of asset-backed securities that cannot comply with the compliance program requirements be excluded from the proposed definition of "banking entity"? Should such exclusion be limited, and if so, based on what factors? Are the proposed thresholds specified in § __.20(c) of the proposed rule and/or the allowance of an enterprise-wide compliance program as set forth in

Appendix C of the proposed rule sufficient to minimize these concerns for issuers of asset-backed securities?

Question 340. With respect to future securitizations, what would be the impact of the establishment and implementation of the compliance program related to the provisions of the proposed rule as required by § __.20 of the proposed rule (including Appendix C, where applicable)? Are the proposed thresholds specified in § __.20(c) of the proposed rule and/or the allowance of an enterprise-wide compliance program as set forth in Appendix C of the proposed rule sufficient to minimize these concerns for issuers of asset-backed securities?

Question 341. Would existing issuers of asset-backed securities that are banking entities be able to establish and implement a compliance program related to the provisions of the proposed rule as required by § __.20 of the proposed rule (including Appendix C, where applicable)? If amendments to transactional documents are necessary, are there any obstacles that would make such amendments difficult to execute? If existing issuers of asset-backed securities cannot establish and implement a compliance program, what would be the impact on such existing issuers of asset-backed securities and the holders of securities issued by a non-compliant issuer of asset-backed securities? Is the allowance of an enterprise-wide compliance program as set forth in Appendix C of the proposed rule sufficient to minimize these concerns for issuers of asset-backed securities?

Question 342. To rely on the exemptions for permitted underwriting, market making-related, and risk-mitigating hedging activities, the proposed rule requires banking entities to establish the internal compliance program under § __.20 and, where applicable, Appendix C, designed to ensure compliance with the requirements of the applicable exemption (e.g., policies

and procedures, internal controls and monitoring procedures, etc.). Do these requirements in the proposed rule impose undue cumulative burdens, such that the marginal benefit of a given requirement is not justified by the cost that the requirement imposes? If so, why does the proposed rule impose cumulative burdens and what are the costs of those burdens? Please explain the circumstances under which these burdens may arise. Is there a way to reduce or eliminate such burdens or requirements in a manner consistent with the language and purpose of the statute? For any requirements that impose undue burdens, are there other requirements that could be substituted that would more efficiently ensure compliance with the statute? Are there any requirements that the proposed rule imposes that are particularly effective, and if so, how can the Agencies make better use of these requirements?

Question 343. Are the six elements of the proposed compliance program requirement mutually reinforcing and cost effective, or are there redundancies in the six elements? Please explain any redundant requirements in the policies and procedures, internal controls, management framework, independent testing, training, and recordkeeping requirements in § __.20(b) of the proposed rule or proposed Appendix C. Why are such requirements redundant, and how should the redundancy be addressed and remedied in the rule?

Question 344. A banking entity that meets the $1 billion or greater trading assets and liabilities threshold would be required under the proposed rule to comply with both the reporting and recordkeeping requirements in Appendix A with respect to quantitative measurements and the compliance program requirement in Appendix C. Are the requirements in these appendices mutually reinforcing and cost effective, or do the appendices impose redundant requirements on banking entities that meet the $1 billion threshold? Please explain any redundant requirements in the appendices and how such redundancy should be addressed and remedied in the rule.

Question 345. Proposed Appendix C incorporates the quantitative measurements provided in proposed Appendix A in the internal controls requirement for banking entities that are engaged in covered trading activity and meet the $1 billion or greater trading assets and liabilities threshold. Do the requirements in proposed Appendix A and Appendix C impose undue cumulative burdens with respect to any elements (e.g., quantitative measurements), such that the marginal benefit of a given requirement is not justified by the cost that the requirement imposes? Please explain why the proposed appendices impose cumulative burdens, the costs of those burdens, and the circumstances under which these burdens may arise. Is there a way to reduce or eliminate such burdens or requirements in a manner consistent with the language and purpose of the statute? For any requirements in the appendices that impose undue burdens, are there other requirements that could be substituted that would more efficiently ensure compliance with the statute? Are there any requirements that the proposed appendices impose that are particularly effective, and if so, how can the Agencies make better use of these requirements?

Question 346. Should the relevant Agency prescribe any specific method by which the board of directors or similar corporate body reviews and approves the compliance program? For example, should the relevant Agency require that: (i) a chief compliance officer or similar officer present an annual compliance report including, as appropriate, recommended actions to be taken by the banking entity to improve compliance or correct any compliance deficiencies; (ii) the board review any such recommendations and determine whether to approve them; and (iii) the banking entity notify the relevant Agency if the board declines to approve such recommendations, or approves different actions than those recommended in the compliance report? What are the advantages and disadvantages of such an approach?

3. Section __.21: Termination of activities or investments; penalties for violations.

Section __.21 of the proposed rule implements section 13(e)(2) of the BHC Act, which requires the termination of activities or investments that violate or function as an evasion of section 13 of the Act.[347] In particular, § __.21(a) of the proposed rule requires any banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or the proposed rule or in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or the proposed rule, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or the proposed rule, to terminate the activity and, as relevant, dispose of the investment.[348] Section __.21(b) of the proposed rule provides that if a relevant Agency finds reasonable cause to believe any banking entity has engaged in an activity or made an investment described in paragraph (a), the relevant Agency may, after due notice and an opportunity for hearing, by order, direct the banking entity to restrict, limit, or terminate the activity and, as relevant, dispose of the investment.[349]

E. Subpart E - Conformance Provisions

Section 13(c)(6) of the BHC Act required the Board, acting alone, to adopt rules implementing those provisions of section 13 of the BHC Act that provide a banking entity or a nonbank financial company supervised by the Board a period of time after the effective date of section 13 of the BHC Act to bring the activities, investments, and relationships of the banking entity or company that were commenced, acquired, or entered into before the effective date of

[347] See 12 U.S.C. 1851(e)(2).

[348] See proposed rule § __,21(a). The Agencies have proposed to include § __.21(a), in addition to the provisions of § __.21(b) of the proposed rule, to make clear that the requirement to terminate an activity or, as relevant, dispose of an investment would be triggered where a banking entity discovers a violation or evasion, regardless of whether an Agency order has been issued.

[349] See proposed rule § __,21(b).

section 13 of the BHC Act into compliance with that section and the agencies' implementing regulations.[350] The Board's Conformance Rule, which was required under section 13(c)(6) of the BHC Act, was issued on February 8, 2011.[351] As noted in its issuing release, this period is intended to give markets and firms an opportunity to adjust to section 13 of the BHC Act.[352]

As part of the current proposal, the Board is proposing to relocate the Board's Conformance Rule, which was added as §§ 225.180-182 of the Board's Regulation Y, to subpart E of the Board's proposed rule.[353] The Board is also proposing to make certain conforming and technical changes to the language and defined terms of the Board's Conformance Rule in connection with its proposed relocation to subpart E of the Board's current proposal. The Board is not, however, proposing any substantive changes to the Board's Conformance Rule as part of this proposed rule. In particular, the Board's Conformance Rule defined certain terms related to section 13 of the BHC Act, including "banking entity," "hedge fund and private equity fund," "insured depository institution," and "Board."[354] For the sake of consistency, the Board is proposing to eliminate these definitions as they are now defined elsewhere, and in more comprehensive a manner, in the proposed rule.[355] These alternative or replacement definitions are substantially similar to those contained in the Board's Conformance Rule and are discussed in further detail in Part III.A.2 of this Supplementary Information.

---

[350] See 12 U.S.C. 1851(c)(6).

[351] See Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities, 76 FR 8265 (Feb. 14, 2011).

[352] See id. (citing 156 Cong. Rec. S5898 (daily ed. July 15, 2010) (statement of Sen. Merkley)).

[353] See Board proposed rule §§ __.30 to __.32.

[354] See Board's Conformance Rule §§ 225.180(a) – (c), (e).

[355] See proposed rule §§ __.2(e), (f), (p); __.10(b)(1).

In connection with incorporating provisions of the existing Board's Conformance Rule into the current proposal, the Board notes that the conformance period and extended transition period provided by section 13(c) of the BHC Act and the Board's Conformance Rule do not permit a banking entity to engage in any new activity or make any new investment in a covered fund without complying with the restrictions and prohibitions of section 13 of the BHC Act and implementing rules thereunder. The conformance period and extended transition period provided by the Board's Conformance Rule permit a banking entity to bring those of its existing activities and investments that do not conform to the requirements of section 13 of the BHC Act and the proposed rule into conformance. The Board's Conformance Rule does not authorize a banking entity to engage in new or additional prohibited activities or investments, and this restriction would continue to apply under the current proposed rule.

With respect to proprietary trading, the Board expects that each banking entity will identify those trading units of the banking entity that are engaged in prohibited proprietary trading as of or after the effective date of section 13 of the BHC Act and the type of proprietary trading in which they are engaged. A banking entity is expected to bring the prohibited proprietary trading activity of a trading unit into compliance with the requirements of the proposed rule as soon as practicable within the conformance period. A trading unit may not expand its activity to include prohibited proprietary trading after the effective date of the proposed rule. Similarly, a trading unit that is not identified as engaging in proprietary trading as of the effective date may not begin engaging in such activity after the effective date.

With respect to a covered fund activity or investment, the conformance period (or, in the case of an illiquid fund for which a banking entity has received Board approval, the extended transition period) generally permits a banking entity to retain an existing investment in a covered fund, make additional capital contributions to a covered fund if contractually obligated to do so, or continue certain existing relationships with a covered fund.[356] However, pursuant to the conformance period or extended transition period, a banking entity may not make a new

---

[356] For instance, under the Board's Conformance Rule and the current proposed rule, a banking entity may retain an existing ownership interest in a covered fund under authority of the conformance period or extended transition period without regard to the per-fund or aggregate fund limitations contained in § __.12 of the proposed rule. Additionally, a banking entity may continue to serve as sponsor to a covered fund under authority of the conformance period, but only if the banking entity acted as sponsor to such fund as of the effective date of section 13 of the BHC Act and the nature of the relationship was continuous. A banking entity may also serve as sponsor of an illiquid fund pursuant to the extended transition period, but only to the extent such service is related to the banking entity's retention of its permitted ownership interest in such fund.

investment or capital contribution that it is not contractually obligated to make in, or establish a new relationship with, a covered fund after the effective date of the proposed rule.[357]

Request for comment.

In light of the interplay between the Board's Conformance Rule and the current proposed rule, the Board is requesting comment on whether any of the conformance provisions should be revised. In particular, the Board requests comment on the following question:

Question 347. Should any portion of the Board's Conformance Rule be revised in light of other elements of the current proposed rule? If so, why and how?

IV. Request for Comments.

The Agencies are interested in receiving comments on all aspects of the proposed rule.

V. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Pub. L. 106-102, sec. 722, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the OCC, Board and FDIC to use plain language in all proposed and final rules published after January 1, 2000. The OCC, Board and FDIC invite public comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?

[357] In the case of a covered fund that a banking entity organizes and offers, or begins to act as sponsor to, after the effective date of section 13 of the BHC Act, the banking entity must comply with the requirements of the proposed rule with respect to its relationships with, and acquisition and retention of an ownership interest in, such covered fund. For instance, after the effective date of section 13 of the BHC Act, a banking entity may only acquire and retain an ownership interest in that covered fund as a permitted investment only (i) if the banking entity organizes and offers or acts as sponsor to that fund, and (ii) in compliance with the per-fund limitation and aggregate fund limitation of the proposed rule. Similarly, a banking entity's relationship with such covered fund would be subject to the limitations contained in the proposed rule.

- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?

- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?

- What else could we do to make the regulation easier to understand?

VI. The Economic Impact of the Proposed Rule under Section 13 of the BHC Act — Request for Comment.

Section 13 of the BHC Act imposes on all banking entities prohibitions and restrictions on proprietary trading and certain interests in, and relationships with, a covered fund,[358] which apply to banking entities whether or not the Agencies adopt implementing rules. In formulating the proposed rule to implement these provisions, which is required by statute, the Agencies have chosen a multi-faceted approach to establish a regulatory framework that provides for clear, robust, and effective implementation of the statute's provisions in a consistent manner, while also not unduly constraining the ability of banking entities to engage in permitted activities and investments.[359] The Agencies have proposed this approach after considering the Council's findings and recommendations regarding how to implement section 13 of the BHC Act and a

---

[358] As noted above in connection with the conformance and extended transition periods, the proposed rule would not require an immediate application of these restrictions for any activity or investment entered into prior to the effective date of section 13 of the BHC Act (July 21, 2012). However, any activity or investment entered into after the effective date would be required to comply with section 13 of the BHC Act and the proposed rule, if adopted. See Supplemental Information Part III.E.

[359] See Supplemental Information Part II.A.

variety of alternatives described throughout this Supplemental Information.[360] The Agencies seek comment, in particular, on the potential costs and benefits of those aspects of the proposed rule that involve choices made, or the exercise of discretion, by the Agencies in implementing section 13 of the BHC Act.

The Agencies recognize that there are economic impacts that may arise from the proposed rule and its implementation of section 13 of the BHC Act and invite comment on the manner in which the proposed rule implements section 13 of the BHC Act, including commenters' views on the potential economic impacts discussed in this Part of the Supplemental Information. In addition, the Agencies seek comment on whether the proposed rule represents a balanced and effective approach to implementing section 13 of the BHC Act or whether alternative approaches to implementing section 13 of the BHC Act exist that would provide greater benefits or involve fewer costs, consistent with the statutory purpose. We also request comment on the potential competitive effects of the manner in which the proposed rule implements the statute.[361]

In addition to the questions posed throughout Part II of the Supplemental Information with respect to the potential costs and benefits of particular aspects of the statute and proposed rule, in order to assist in the analysis of the economic impacts associated with the final rule and any alternatives the Agencies may evaluate, the Agencies encourage commenters to provide

[360] See 12 U.S.C. 1851(b)(2)(A); see also Financial Stability Oversight Council, Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds (Jan. 2011), available at http://www.treasury.gov/initiatives/Documents/Volcker%20sec%20%20619%20study%20final%201%2018%2011.%20rg.pdf.

[361] For example, implementation of section 13(d)(1)(H) of the BHC Act may result in a competitive advantage for foreign-controlled banking entities over U.S.-controlled banking entities with respect to activities that occur solely outside of the United States.

quantitative information about the rule's impact on banking entities, their clients, customers, and counterparties, specific markets or asset classes, and any other entities potentially affected by the proposed rule with respect to:

1. The direct and indirect costs and benefits of compliance with section 13 of the BHC Act, as proposed to be implemented;
2. The effect of section 13 of the BHC Act, as proposed to be implemented, on competition; and
3. Any other economic impacts of the proposal.

In addition, to assist with potential estimates of the proposed rule's quantitative impacts, we request specific comment on: (i) the extent to which banking entities currently engage in proprietary trading activity or covered funds activities or investments that are prohibited or restricted by the statute, or have otherwise divested or conformed such activities; and (ii) the potential costs and benefits or other quantitative impacts of various aspects of the proposed rule, such as the compliance program requirement, the required reporting of quantitative measurements, and the conditions and requirements for relying on the proposed exemptions.

To further facilitate public comment on the economic effects of the manner in which the proposed rule implements the statute, the Agencies have identified below a number of significant aspects of the proposed rule and potential economic impacts that may result from section 13 of the BHC Act's requirements, as proposed to be implemented. We seek commenters' views on the likelihood of the potential economic impacts identified in this Part and whether there are additional costs, benefits, or other impacts that may arise from the proposed rule. To the extent that such costs, benefits, or other impacts are quantifiable, commenters are encouraged to

identify, discuss, analyze, and supply relevant data, information, or statistics related to such costs, benefits, and other impacts and the quantification of such costs, benefits, and other impacts. In addition, commenters are asked to identify or estimate start-up, or non-recurring, costs separately from costs or effects they believe would be ongoing.

A. Proprietary Trading Provisions

1. Definition of Trading Account

Section __.3 of the proposed rule, which implements the statutory definition of "trading account," provides a multi-pronged definition of that term that is intended to ensure that banking entities do not engage in "hidden" proprietary trading by characterizing trading activity as being conducted outside a trading account. In addition to positions taken principally for the purpose of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging another trading account position, the proposed definition also includes: (i) with respect to a banking entity subject to the Federal banking agencies' Market Risk Capital Rules, all positions in financial instruments subject to the prohibition on proprietary trading that are treated as "covered positions" under those capital rules, other than certain foreign exchange and commodities positions; and (ii) all positions acquired or taken by certain registered securities and derivatives dealers (or, in the case of financial institutions that are government securities dealers, that have filed notice with an appropriate regulatory agency) in connection with their activities that require such registration or notice. Although these prongs of the definition are proposed to prevent evasion of the statutory requirements, we seek comment on the extent to which either of these two prongs may create a competitive disadvantage for certain banking

entities vis-à-vis competitors that are either not subject to section 13 of the BHC Act and/or competitors subject to different prongs of the proposed definition.

2. Exemption for Underwriting Activities

Section 13(d)(1)(B) of the BHC Act provides an exemption from the prohibition on proprietary trading for purchases and sales in connection with underwriting activities, to the extent that such activities are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties. In implementing this exemption in § __.4(a) of the proposed rule, the Agencies have endeavored to establish a regime that clearly sets forth the requirements for relying on the underwriting exemption established in the statute to facilitate banking entities' compliance with the statutory requirements. In considering potential requirements for the underwriting exemption, and assessing the potential economic impacts of each such requirement, the Agencies strived to propose an appropriate balance between considerations related to: (i) the potential for evasion of the statutory prohibition on proprietary trading through misuse of the underwriting exemption; and (ii) the potential costs that may arise from constraints on legitimate underwriting activities.

The Agencies have proposed to use, wherever practicable, common terms from existing laws and regulations in the context of underwriting to facilitate market participants' understanding and use of the exemption and to promote consistency across laws and regulations. Specifically, the proposed definitions of "distribution" and "underwriter" established in the proposed rule largely mirror the definitions provided for these terms in the SEC's Regulation M.

Because the proposed rule uses a modified version of the Regulation M definition of "underwriter" to include selling group members, the proposed definition would permit the current market practice of members of the underwriting syndicate entering into an agreement with other selling group members to collectively distribute the securities, rather than requiring all members of a distribution to join the underwriting syndicate.

In addition, the definition of "distribution" from Regulation M that the Agencies have proposed in § __.4(a) of the proposed rule is intended to ensure that the underwriting exemption does not unduly constrain banking entities from providing underwriting services, while at the same time preventing banking entities from relying on the underwriting exemption to evade the proposed rule and the statutory prohibition on proprietary trading. The Agencies anticipate that the proposed approach to implementing the underwriting exemption should permit legitimate forms of underwriting in which market participants currently engage and, thus, should not unduly burden capital formation. In addition, the proposed rule would permit underwriters to continue to employ existing practices to stabilize a distribution of securities, which stabilization promotes confidence among issuers, selling security holders, and investors and further supports capital formation.

Under the proposed rule, the underwriting activities of a banking entity must be designed to generate revenues primarily from fees, commissions, underwriting spreads or other income, not from appreciation in value of covered financial positions that the banking entity holds related to such activities or the hedging of such covered financial positions. This proposed requirement should promote investor confidence by ensuring that the activities conducted in reliance on the

underwriting exemption are designed to benefit the interests of clients seeking to bring their securities to market, not the interests of the underwriters themselves. The proposed requirement should also help prevent evasion of the statutory prohibition on proprietary trading, as trading activity designed to generate revenues from appreciation in the value of positions held by the banking entity would be indicative of prohibited proprietary trading, not underwriting activity. We seek comment on whether this approach of identifying underwriting activity by reference to revenue source could also make underwriting less profitable to the extent that it precludes or discourages certain types of profitability for bona fide underwriting services.

In addition to commenters' views on the potential economic impacts identified above, we request comment on whether the proposed rule may cause some banking entities to choose to decrease the supply of underwriting services in response to potential costs of the proposed rule and whether this result would adversely affect competition among underwriters or have a harmful impact on capital formation. In addition, if banking entities were to pass the increased costs of complying with the proposed exemption on to issuers, selling security holders, or their customers, we seek comment on whether the effect would be to increase the cost of raising capital and whether this would harm capital formation to the extent that such cost increases were sufficient to preclude issuers from accessing the capital markets. As described above, the Agencies have designed the proposal to balance such potential costs with provisions intended to permit banking entities' legitimate underwriting activities to continue as provided by the statute, while also establishing sufficient requirements to prevent evasion of the statutory goals through misuse of the underwriting exemption.

3. Exemption for Market Making-Related Activities

Section 13(d)(1)(B) of the BHC Act provides an exemption from the prohibition on proprietary trading for purchases and sales in connection with market making-related activities, to the extent that such activities are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties. In setting forth the requirements for eligibility for this exemption in § __.4(b) of the proposed rule, the Agencies have endeavored to establish a regime that clearly sets forth the requirements for relying on the exemption for market making-related activity established in the statute to facilitate banking entities' compliance with the statutory requirements. In considering potential requirements for the market-making exemption, and assessing the potential economic impacts of each such requirement, the Agencies tried to strike an appropriate balance between considerations related to: (i) the potential for evasion of the statutory prohibition on proprietary trading through misuse of the exemption for market making-related activity; (ii) the potential difficulties related to distinguishing market making-related activity from prohibited proprietary trading; and (iii) potential costs that may arise from constraints on legitimate market making-related activities.

The Agencies have proposed to use, where practicable, terms and concepts used in current laws and regulations in the context of market making to promote clarity and consistency. Recognizing that there are differences in market making activities between different types of asset classes (e.g., liquid and illiquid instruments) and market structures (e.g., organized trading facilities and the over-the-counter markets), the Agencies have proposed to implement the market-making exemption in a manner that accounts for these distinctions and permits market

making activities in different asset classes and market structures. Permitting legitimate market making in its different forms should promote market liquidity and efficiency by allowing banking entities to continue to provide customer intermediation and liquidity services in both liquid and illiquid instruments. The Agencies also recognize, however, that market making-related activities in the over-the-counter markets or activities involving less liquid instruments are sometimes less transparent than similar activities on organized trading facilities or in liquid markets. We seek comment on whether, in order to comply with the statutory prohibition on proprietary trading, some banking entities may be inclined to abstain from some market-making activities in an effort to reduce the risk of noncompliance. We also request comment on whether, if banking entities did so, this could result in reduced liquidity for certain types of trades or for certain less liquid instruments.

In addition, the proposed exemption permits anticipatory market making, block positioning, and hedging of market making positions under certain circumstances, which should further facilitate customer intermediation and market liquidity and efficiency. However, certain conditions are placed on such market making-related activities in the proposal in an effort to ensure that such activities are, in fact, market making-related activities, and are not hidden proprietary trading activities subject to the statutory prohibition.

The proposal requires that the market making-related activities be designed to generate revenues primarily from fees, commissions, bid/ask spreads or other income not attributable to appreciation in the value of covered financial positions a banking entity holds in trading accounts or the hedging of such positions. This proposed requirement should promote investor confidence

by helping to ensure that market making serves customer needs. The proposed requirement should also help prevent evasion of the statutory prohibition on proprietary trading, as trading activity designed to generate revenues from appreciation in the value of positions held by the banking entity would be indicative of prohibited proprietary trading, not market making-related activity. The Agencies request comment on whether this approach of identifying market making activity by reference to a market making trading unit's revenue source would also make market making activity less profitable and whether it would preclude or discourage certain types of profitability for bona fide market making services. Commenters should also address whether this requirement would reduce the willingness of some banking entities to continue to provide market making-related services and whether this could reduce liquidity, harm capital formation, or make market making-related services more expensive. The Agencies note that, in order to balance the potential for such effects with the statutory purpose, the proposed rule does not expressly prohibit all types of non-client income, and recognizes that the precise type and source of revenues generated by bona fide market making services can and will vary depending on the relevant market, asset, and facts and circumstances.

4. Exemption for Risk-Mitigating Hedging Activities

Section 13(d)(1)(C) provides an exemption from the prohibition on proprietary trading for risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of a banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts, or other holdings. The proposed exemption requires that the hedging transaction be reasonably correlated

to these risks that the transaction is intended to hedge or otherwise mitigate. This proposed requirement is intended to address the potential for misuse of the exemption where a transaction is not closely tied to risk mitigation, while also providing some flexibility in the degree of correlation that is required in order to promote consistency with the statutory goals and requirements.

In addition, the proposed exemption requires that the hedging transaction: (i) not give rise, at the inception of the hedge, to significant exposures that are not themselves hedged in a contemporaneous transaction; and (ii) be subject to continuing review, monitoring, and management. Together, these proposed requirements are designed to ensure that a banking entity does not use the hedging exemption to conduct prohibited proprietary trading in the guise of hedging activity and to prevent evasion of the proprietary trading prohibition contained in section 13 of the BHC Act and the proposed rule. These proposed requirements are intended to ensure that an exempt hedging transaction will mitigate, not amplify, risk. Moreover, such requirements should further the goals of compliance with the statutory requirements and reducing banking entities' risks.

We seek comment on whether the proposed requirements for relying on the hedging exemption are more restrictive than necessary to implement the statutory language and purpose, and to prevent evasion of the statutory provisions, and whether a banking entity's hedging activities could be unduly constrained by the proposed rule. Further, commenters should address the extent to which a banking entity may be unable or unwilling to execute certain hedges and whether, as a result, a banking entity could be limited in its means to reduce its risk. In addition,

would banking entities be dissuaded from engaging in other permitted activities or activities outside the scope of the statute (e.g., long-term investments) if the requirements of the proposed hedging exemption unduly limits or prevents them from mitigating the risks associated with such activities? We request comment on whether a reduction in efficiency could result from a reduced ability of covered banking entities to transfer risks to those more willing to bear them. Commenters should also address whether the proposed rule would reduce a banking entity's willingness to engage in permitted risk-mitigating hedging activities in order to avoid costs related to ensuring compliance with the exemption's requirements and whether this would increase the banking entity's risk exposure. In order to balance the potential for such effects with the statutory purpose, the proposed rule attempts to implement the risk-mitigating hedging exemption in a manner that recognizes that the precise nature and execution of risk mitigation through hedging transactions can and will vary depending on the relevant market, asset, and facts and circumstances, while also establishing requirements designed to ensure that transactions relying on the hedging exemption are, in fact, hedges and not hidden proprietary trading prohibited by the statute.

The proposed exemption would require documentation with respect to hedges established at a different level of organization than that responsible for the underlying positions or risks that are being hedged. This proposed documentation requirement is intended to facilitate review by banking entities and Agency supervisors and examiners in assessing whether the hedge position was established to hedge or otherwise mitigate another unit's risks. Without such documentation, there could be an increased risk of evasion of the statute's prohibition on proprietary trading, as it would be difficult to assess whether a purported hedging transaction

was established to mitigate another level of organization's risk or solely to profit from price appreciation of the position established by the purported hedge. We seek comment on the costs of the proposed documentation requirement for certain hedging transactions, such as the costs related to systems changes and maintenance, employee resources and time, and recordkeeping.[362] The Agencies also request comment on the extent to which the proposed documentation requirement would reduce the speed in which a banking entity could execute a hedge at a different level within the entity and whether this could reduce efficiency or result in a banking entity being exposed to a greater amount of risk. Further, we seek commenters' views on whether potentially slower execution times could also reduce profitability associated with the position as it remains unhedged (or, alternatively, increase profitability, depending on whether the value of the unhedged position is increasing or decreasing in the market). To balance the potential for such consequences with the statutory purpose, the Agencies have proposed to apply the documentation requirement to only a subset of hedging transactions that pose the greatest compliance risk (i.e., hedges that are established at a different level of organization than that establishing or responsible for the underlying positions or risks that are being hedged). In addition, the Agencies expect that the preparation of required documentation would become less burdensome and more efficient over time as systems are developed and personnel become more accustomed to the proposed requirement.

5. Compensation Related to Permitted Activities

The proposed rule would require that the compensation arrangements of persons performing underwriting, market making-related, and risk-mitigating hedging activities be designed not to reward proprietary risk-taking. These proposed requirements are intended to

[362] The Agencies note that, for some costs of the proposed rule, hour burden estimates are provided in Part [internal cite to PRA] of this Supplementary Information for purposes of the Agencies' compliance with the Paperwork Reduction Act.

reduce incentives for personnel of the banking entity to violate the statutory prohibition on proprietary trading and expose the banking entity to risks arising from prohibited proprietary trading. We request comment on whether the proposed rule's requirements regarding compensation arrangements would reduce the banking entity's ability to attract talented and experienced trading personnel or would harm the banking entity's ability to compete with entities that are not subject to section 13 of the BHC Act and the proposed rule. In order to balance the potential for such effects with the statutory goals, the proposed rule does not expressly prescribe how a banking entity must compensate its personnel or prohibit all types of compensation incentives related to non-client income, but instead proposes an approach that leaves banking entities with a degree of flexibility to compensate their personnel as they deem appropriate.

6. Exemption for Trading on Behalf of Customers

Section __.6(b) of the proposed rule implements section 13(d)(1)(D) of the BHC Act, which permits a banking entity, notwithstanding the prohibition on proprietary trading, to purchase or sell a covered financial position on behalf of customers. Because the statute does not define when a transaction would be conducted on behalf of customers, the proposed rule identifies three categories of transactions that would qualify under this exemption. By providing that only transactions meeting the terms of the three categories would be considered to be on behalf of customers for purposes of the exemption, the proposed rule addresses the potential for evasion of the statutory prohibition. At the same time, the proposed rule also would not permit banking entities to rely on the exemption with respect to other, unanticipated transactions that

banking entities may undertake on behalf of customers. The Agencies seek comment on whether banking entities currently engage in principal transactions on behalf of customers that are not covered by the proposed exemption or other permitted activities and whether the lack of an exemption in the proposed rule for such activities would impact beneficial customer facilitation, market liquidity, efficiency, or capital formation.

7. Exemption for Trading Outside of the United States

Section __.6(d) of the proposed rule implements section 13(d)(1)(H) of the BHC Act, which permits certain foreign banking entities to engage in proprietary trading that occurs "solely outside of the United States." The proposed exemption provides a number of specific criteria for determining when trading will be considered to have occurred solely outside of the United States to help prevent evasion of the statutory restriction. The proposed exemption also provides a definition of "resident of the United States" that is similar to the SEC's definition of "U.S. person" in Regulation S, which should promote consistency and understanding among market participants that have experience with the concept from the SEC's Regulation S. In addition, the proposed exemption clarifies when a foreign banking entity will be considered to engage in such trading pursuant to sections 4(c)(9) and 4(c)(13) of the BHC Act, as required by the statute, including with respect to a foreign banking entity that is not a "foreign banking organization" under the Board's Regulation K. This implementation of section 13(d)(1)(H) of the BHC Act would permit certain foreign banking entities that are not "qualifying foreign banking organizations" under the Board's Regulation K to also rely on the exemption, notwithstanding the fact such foreign banking entities are not currently subject to the BHC Act

generally or the Board's Regulation K. As a result, such foreign banking entities should encounter fewer costs related to complying with the proprietary trading prohibitions than if they were unable to rely on the exemption in section 13(d)(1)(H) of the BHC Act.

Despite the reference to section 4(c)(13) of the BHC Act, the statute provides that the exemption for trading outside of the United States is only available to banking entities that are not directly or indirectly controlled by U.S. banking entities (i.e., not any U.S. banking entities or their foreign subsidiaries and affiliates). Under the statute, the prohibition on proprietary trading applies to the consolidated, worldwide operations of U.S. firms. As required by statute, the proposal prohibits U.S. banking entities from engaging in proprietary trading unless the requirements of one or more relevant exemptions (other than the exemption for trading by foreign banking entities) are satisfied. As a result, the statute creates a competitive difference between the foreign activities of U.S. banking entities, which must monitor and limit their foreign activities in accordance with the requirements of section 13 of the BHC Act, relative to the foreign activities of foreign-based banking entities, which may not be subject to restrictions similar to those in section 13 of BHC Act. The Agencies seek commenters' views on whether the proposed rule's implementation of section 13(d)(1)(H) of the BHC Act imposes additional competitive differences, beyond those recognized above, and the potential economic impact of such competitive differences.

8. Quantitative Measurements

Section __.7 of the proposed rule, which implements in part section 13(e)(1) of the BHC Act,[363] requires certain banking entities to comply with the reporting and recordkeeping requirements specified in Appendix A of the proposed rule. Proposed Appendix A requires a banking entity with significant trading activities to furnish periodic reports to the relevant Agency regarding various quantitative measurements of its trading activities and create and retain records documenting the preparation and content of these reports. The proposed measurements would vary depending on the scope, type, and size of trading activities. In addition, proposed Appendix B contains a detailed commentary regarding the characteristics of permitted market making-related activities and how such activities may be distinguished from trading activities that, even if conducted in the context of banking entity's market making operations, would constitute prohibited proprietary trading. These proposed requirements are intended, in particular, to address some of the difficulties associated with (i) identifying permitted market making-related activities and distinguishing such activities from prohibited proprietary trading and (ii) identifying certain trading activities resulting in material exposure to high-risk assets or high-risk strategies. In combination, § __.7 and Appendix A of the proposed rule provide a quantitative overlay designed to help banking entities and the Agencies identify trading activities that warrant further analysis or review in a variety of levels and contexts.

The various quantitative measurements that would be required to be reported focus on assessing banking entities' risk management, sources of revenue, revenues in relation to risk, customer servicing, and fee generation. Aberrant patterns among the measurements with respect to these areas would warrant further review to determine whether trading activities have occurred

[363] Section 13(e)(1) of the BHC Act requires the Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with section 13. See 12 U.S.C. 1851(e)(1). Section __.20 and Appendix C of the proposed rule also implement section 13(e)(1) of the BHC Act.

that are proprietary in nature and whether such activities may be exposing banking entities to disproportionate risk. For example, quantitative measurements should provide banking entities with a useful starting point for assessing whether their trading activities are consistent with the proposed rule and whether traders are exposing the entity to disproportionate risks. In addition, proposed Appendix A applies a standardized description and general method of calculating each quantitative measurement that, while taking into account the potential variation among trading practices and asset classes, is intended to facilitate reporting of sufficiently uniform information across different banking entities so as to permit horizontal reviews and comparisons of the quantitative profile of trading units across firms. This proposed approach, which recognizes that quantitative measurements must be applied with respect to differences within a banking entity's structure, business lines, and trading desks, should facilitate efficient application within firms and efficient examination across firms. The proposed use of a suite of quantitative measurements for these purposes may also limit erroneous indications of potential violations or erroneous indications of compliance (i.e., false positives and false negatives), thus allowing banking entities and examiners and supervisors to focus upon the measurements that may be most relevant in identifying prohibited conduct. The uniformity of the proposed measurements across different types of banking entities is also intended to ensure that banking entities are calculating comparable measurements consistently and that comparable measurements are being evaluated consistently by Agencies. The Agencies expect that as the implementation of quantitative measurements and the internal compliance and external oversight processes become more efficient over time, banking entities will find compliance efforts less burdensome.

The Agencies seek comment on the extent to which banking entities will incur costs associated with implementing, monitoring, and attributing financial and personnel resources for purposes of complying with the requirements of proposed Appendix A. Specifically, please discuss the extent to which banking entities are unlikely to currently calculate certain quantitative measurements in the manner required under the proposal (e.g., Spread Profit and Loss or Customer-facing Trade Ratio) and whether this may result in significant start-up costs associated with developing these measurements. Under the proposal, banking entities would also need to dedicate personnel and supervisory staff to review for potential aberrant patterns of activity that warrant further review, as well as maintain appropriate records of that review. In order to limit these calculation and surveillance costs to the greatest extent practicable, the Agencies have proposed measurements that, in many cases, are already calculated by many banking entities to measure and manage trading risks and activities. The costs to banking entities associated with calculating the proposed quantitative metrics should also be mitigated by the tiered application of Appendix A, which would require banking entities with the most extensive trading activities to report the largest number of quantitative measurements, while imposing fewer or no reporting requirements on banking entities with smaller trading activities. By limiting the application of aspects of Appendix A to firms with greater than $1 billion in trading assets and liabilities, and all aspects of the appendix only to entities with greater than $5 billion in trading assets and liabilities, the costs imposed should be proportional to the market reach and complexity of a banking entity's trading activities.

B. Covered Fund Activities

Subpart C implements the statutory provisions of section 13(a)(1)(B) of the BHC Act, which prohibit banking entities from acquiring or retaining any equity, partnership, or other ownership interest in, or sponsoring, a covered fund, and other provisions of section 13 of the BHC Act which provide exemptions from, or otherwise relate to, that prohibition. In implementing the covered funds provisions of section 13 of the BHC Act, the Agencies have proposed to define and interpret several terms used in implementing these provisions and the goals of section 13. We seek comment on whether the proposed rule represents a balanced and effective approach to implementing the covered fund provisions of the statute.

1. General Scope

For banking entities that invest in, sponsor or have relationships with one or more covered funds, the economic impact of complying with the statute and the implementing rule will vary, depending on the size, scope and complexity of their respective business, operations and relationships with clients, customers and counterparties. Moreover, the types of covered funds advised or sponsored by an adviser, the types of business and other relationships that an adviser may conduct with such funds and the adviser's other business activities, including relationships with other third party advised covered funds, will affect whether a covered fund activity would be subject to the statutory prohibition, eligible for a particular exemption or subject to particular internal control requirements as specified by the proposed rule.

For example, with respect to a banking entity that does not "sponsor," invest in, or otherwise provide "prime brokerage transactions" to, a "covered fund," the statute, as implemented by the proposed rule, would not substantively restrict the banking entity's activity; instead, the proposed rule would only require the minimum internal controls reasonably designed to prevent the entity from engaging in the prohibited activities. As a result, we do not expect that the proposed rule would have a significant effect on most banking entities, such as investment advisers, that are primarily engaged in providing bona fide trust, fiduciary, or advisory services to unrelated parties. Although such advisers may incur some incremental costs to develop and implement a compliance program reasonably designed to ensure that they do not engage in otherwise prohibited activities, there should be no significant costs associated with modifying existing business practices and procedures. We request comment on the extent to which such banking entities would be required to modify their existing business practices and procedures to comply with the proposed rule. For instance, would a registered investment adviser that only advises registered investment companies and that does not trade for its own account incur costs, benefits or other impacts in addition to costs to implement the minimum internal controls reasonably designed to prevent it from engaging in prohibited activities? Would an adviser that trades on behalf of itself incur, with respect to such trading activities, additional costs, benefits or other impacts described above relating to the proposed restrictions on proprietary trading?

In contrast, a banking entity that seeks to invest in a covered fund could only do so in reliance on an exemption specified in the statute or the proposed rule, such as the exemption for organizing and offering certain covered funds provided in section 13(d)(1)(G), as implemented in §__.11 of the proposed rule. Similarly, a banking entity that seeks to enter into "prime

brokerage transactions" with a covered fund could only do so by meeting certain requirements under the proposed rule. Accordingly, the economic impact of the proposed rule will depend on whether an adviser's activities fall within the scope of the terms as proposed such that the banking entity would be subject to the limitations on covered fund activities. To the extent that these terms or exemptions would result in more, or fewer, activities being captured by the proposed rule, what are the attendant costs and benefits that a covered banking may incur? We request commenters provide empirical data where possible.

Definition of Covered Fund. The proposed rule's definition of "covered fund" includes hedge funds and private equity funds as defined by statute, but also identifies two types of similar funds – commodity pools and certain non-U.S. funds – that are subject to the covered fund restrictions and prohibitions of section 13 of the BHC Act, as implemented by the proposed rule. The Agencies have proposed to include these funds since they are generally managed and structured similar to a covered fund, but are not generally subject to the Federal securities laws due to the instruments in which they invest or the fact that they are not organized in the United States or one or more States. We request comment on whether applying the definition of covered fund in this way as proposed would increase the number of investment vehicles or similar entities that would be subject to the limitations under the proposed rule. Would this approach increase compliance costs for banking entities that sponsor, invest in, or have certain relationships with these types of funds?

The proposed rule also excludes certain types of investments in covered funds, pursuant to section 13(d)(1)(J) of the BHC Act, which authorizes the Agencies to exclude from the

general covered fund activity prohibition those activities that would promote the safety and soundness of a banking entity. Section __.14 of the proposed rule would exclude from the prohibition, among other things, a banking entity's investments in covered funds related to bank owned life insurance, certain joint ventures and interests in securitization vehicles retained in compliance with the minimum credit risk retention requirements of section 15G of the Exchange Act. We request comment on the potential economic impact of the proposal to exclude these types of investments from the general prohibition. For banking entities whose only covered fund activities are those described in §__.14, what economic impact would be attributed to complying with this provision of the proposed rule? Would these costs and benefits differ from those of banking entities that conduct covered fund activities as well as engage in activities described in §__.14? As described in the Supplementary Information, a banking entity that generally does not engage in any prohibited activities is only required to adopt and implement a compliance program reasonably designed to ensure that the entity does not engage in prohibited activities. To what extent will the proposed provisions in §__.14 increase or mitigate any costs, benefits or other impacts associated with the foregoing minimum internal controls requirement?

Definition of Sponsor. Under the proposed rule, the term "sponsor" is defined by incorporating the definition set forth in section 13(h)(5) of the BHC Act, but the Agencies have proposed to clarify that the term trustee, as used in the definition of sponsor, does not include a trustee that does not provide discretionary investment services to a covered fund. This exception distinguishes a trustee providing non-discretionary advisory services from trustees providing services similar to those associated with entities serving as general partner, managing member, commodity pool operator or investment adviser of a covered fund. We request

comment on the economic impact associated with the proposed definition of "sponsor." Will the economic impact differ depending on the scope of a banking entity's covered fund activities? For example, a banking entity whose only relationship with a covered fund involves the provision of non-discretionary investment services would not be a sponsor under the proposed rule. We request comment on whether such a banking entity would benefit from this exception. We also request comment on whether a covered fund's investors and counterparties would bear any costs associated with a banking entity's modification of its business practices or its relationship to the covered fund.

Other Definitions. The covered fund provisions also define, among other things, "director" and "prime brokerage transaction." What are the costs, benefits or other impacts associated with the way the proposed rule defines these terms? For example, would the proposed definition of "prime brokerage transaction" enable a banking entity to provide services to a covered fund that would not ordinarily be understood to be prime brokerage as long as it met certain conditions? What costs, or benefits, for banking entities, clients, customers or counterparties may be associated with this approach to defining prime brokerage transaction?

2. Exemptions

In implementing the covered funds provisions of section 13 of the BHC Act, the Agencies also have interpreted or defined terms contained in the three principal exemptions related to covered fund activities by a banking entity: (i) the exemption for organizing and offering covered funds; (ii) the exemption for investment in a covered fund in the case of risk-mitigating hedging; and (iii) the exemption for covered fund activities outside of the United States. We request comment generally on the potential impact of these statutory exemptions, as implemented by the proposed rule. The Agencies note that there are multiple factors that could

affect the impact of the statute and the proposed rule on a banking entity's covered fund activities, including other conditions set forth in the statute or the proposed rule that could mitigate costs or enhance benefits associated with a particular element or condition of an exemption.

Organize and Offer Exemption. Section __.11 of the proposed rule implements the exemption set forth in section 13(d)(1)(G) of the BHC Act and generally incorporates all of the conditions specified in the statute. As required by the statute, the exemption for organizing and offering covered funds is available only to banking entities that provide bona fide trust, fiduciary, commodity trading or investment advisory services, which must meet certain requirements. As a result, the exemption should not preclude banking entities, such as registered advisers or other advisers, from providing trust or advisory services to their clients. We request comment on whether the proposed requirements of the exemption would result in a banking entity modifying its business practices or bearing higher costs to comply with the limitations and requirements applicable to this statutory exemption, as implemented by the proposed rule. These costs may include, for example, developing a credible plan that documents how advisory services would be provided to banking entity customers through organizing and offering covered funds and making the specified disclosures required by the exemption. We also request comment on whether the banking entity will pass these costs on to covered fund investors and counterparties.

In implementing this statutory exemption, the Agencies have defined or clarified several key terms or requirements, including (i) the definition of ownership interest and (ii) the method for calculating the 3% ownership interest limit. The proposed definition of ownership interest is designed to describe the typical types of relationships through which an investor has exposure to the profits and losses of a covered fund. Consistent with this approach, carried interest is not

included within the proposed definition of ownership interest. As discussed in the Supplementary Information above, carried interest generally entitles service providers, such as banking entities that provide advisory services, to receive compensation for such services determined as a share of a covered fund's profits. As a result, the proposed rule does not treat carried interest as an ownership interest, which could have costs and benefits. To help discern these costs and benefits, we request comment on whether this is consistent with how providers of advisory services view the receipt of such "carried interest" (i.e., as compensation for services rather than as an "ownership interest" equivalent to an investor's interest that shares in a fund's profits and losses). The proposed definition of carried interest has limitations designed to prevent a banking entity from circumscribing the proposed rule's limitations on ownership. For instance, among other things, the proposed definition requires that the "sole purpose and effect of the interest is to allow banking entity . . . to share in the profits of the covered fund."[364] For banking entities receiving compensation that would satisfy all of the elements of the proposed definition, there should be no burden associated with modifying existing business practices. For other banking entities, however, the conditions specified in the proposed definition could result in more banking entities being deemed to hold "ownership interests" and hence subject to the limitations under the statute and the proposed rule, including the limitations on material conflicts of interest, high-risk trading activities and exposure to high-risk assets. We request comment on whether these banking entities would need to modify their existing practices and develop alternatives, and, if so, whether these modifications will impose costs and benefits. For example, costs associated with modifying business practices could include developing and implementing a compliance program in accordance with the proposed rule; benefits that may arise as a result of

[364] Proposed rule §__.10(b)(3)(i).

modifying business practices could include limiting the extent to which material conflicts of interest may arise between clients, customer and counterparties of banking entities. We also request comment on whether such costs, if any, are likely to be passed on to fund investors, clients and counterparties.

As required by statute, a banking entity that seeks to invest in a covered fund under the exemption for organizing and offering covered funds could not, after the expiration of an initial one-year period (plus any applicable extensions), hold more than 3% of the total outstanding ownership interests of such fund. The proposed rule would require that a banking entity calculate the per-fund limit whenever the covered fund calculates its value or permits investor investments or redemptions, but in no case less frequently than quarterly. We request comment on whether this approach will limit any additional burden associated with calculating the per-fund limit for banking entities that invest in covered funds that determine their value on at least a quarterly basis. We also request comment on whether such banking entities will incur any additional significant costs in determining their compliance with the 3% ownership limitation.

Risk-mitigating Hedging Exemption. The proposed rule specifies an exemption from the general prohibition on covered fund activities in the case of risk-mitigating hedging. Similar to the hedging exemption in the case of proprietary trading (discussed above), the hedging exemption for covered fund activities specifies a number of conditions that are identical except for two conditions. In the case of the hedging exemption for covered fund activities, the hedging must generally "offset" the exposure of the banking entity to the liabilities associated with (i) the facilitation of customer transactions or (ii) compensation arrangements for certain employees. Consistent with the statute, the proposed exemption would enable a banking entity to invest in a covered fund without limit if the investment is for risk-mitigating hedging purposes.

We request comment on whether the proposed requirements will have benefits of furthering the goals of compliance with the statute and reducing banking entities' risks. We also request comment on whether the proposed requirements are more restrictive than necessary to implement the statute and whether they could unnecessarily limit a banking entity's hedging activities and ability to reduce risk. Commenters should also address whether the proposed requirements will dissuade banking entities from engaging in other permitted activities (e.g., organizing and offering covered funds) or those activities outside the scope of the statute to the extent that the exemption prevents them from mitigating the risks associated with such activities. We request comment on whether a reduction in efficiency could result from a reduced ability of covered banking entities to transfer risks to those more willing to bear them. Commentators should also address whether the proposed rule could reduce a banking entity's willingness to engage in permitted risk-mitigating hedging activities in order to avoid costs related to ensuring compliance with the exemption's requirements, and whether this would increase the banking entity's risk exposure.

Exemption for Covered Fund Activities Outside of the United States. Section __.13(c) of the proposed rule implements section 13(d)(1)(I) of the BHC Act, which permits certain foreign banking entities to sponsor or invest in covered funds "solely outside of the United States," so long as the covered fund is not offered or sold to a resident of the United States. The proposed exemption provides a number of specific criteria for determining when a banking entity will be considered to have invested or sponsored a covered fund solely outside of the United States. The proposed exemption provides a definition of "resident of the United States" that is similar, but not identical, to the SEC's definition of "U.S. person" in Regulation S, which should promote

consistency and understanding among market participants that have experience with the concept from the SEC's Regulation S. In addition, the proposed exemption clarifies when a foreign banking entity will be considered to engage in such trading pursuant to sections 4(c)(9) and 4(c)(13) of the BHC Act, as required by the statute, including with respect to a foreign banking entity that is not a "foreign banking organization" under the Board's Regulation K. This implementation of section 13(d)(1)(I) of the BHC Act would permit certain foreign banking entities that are not "qualifying foreign banking organizations" under the Board's Regulation K to also rely on the exemption, notwithstanding the fact such foreign banking entities are not currently subject to the BHC Act generally or the Board's Regulation K. As a result, such foreign banking entities should encounter fewer costs related to complying with the covered fund activity prohibitions than if they were unable to rely on the exemption in section 13(d)(1)(I) of the BHC Act.

Despite the reference to section 4(c)(13) of the BHC Act, the statute provides that the exemption for covered fund activities outside of the United States is only available to banking entities that are not directly or indirectly controlled by U.S. banking entities (i.e., not any U.S. banking entities or their foreign subsidiaries and affiliates). Under the statute, the prohibition and restrictions on covered fund activities apply to the consolidated, worldwide operations of U.S. firms. As required by statute, the proposal prohibits U.S. banking entities from investing in or sponsoring covered funds unless the requirements of one or more relevant exemptions (other than the exemption for trading by foreign banking entities) are satisfied. As a result, the statute creates a competitive difference between the foreign activities of U.S. banking entities, which must monitor and limit their foreign activities in accordance with the requirements of section 13 of the BHC Act, relative to the foreign activities of foreign-based banking entities, which may

not be subject to restrictions similar to those in section 13 of BHC Act. The Agencies seek commenters' views on whether the proposed rule's implementation of section 13(d)(1)(I) of the BHC Act imposes additional competitive differences, beyond those discussed above, and the potential economic impact of such competitive differences.

3. Securitizations

The Agencies recognize that by defining "covered fund" and "banking entity" broadly, securitization vehicles may be affected by the restrictions and requirements of the proposed rule, and this may give rise to various economic effects. The Agencies preliminarily believe that the proposed rule should mitigate the impact of securitization market participants and investors in some non-loan asset classes (including, for example, banking entities that are participants in a securitization that may acquire or retain ownership interests in a securitization vehicle that falls within the definition of covered fund) by excluding loan securitizations from the restrictions on sponsoring or acquiring and retaining ownership interests in covered funds.

Costs may be incurred to establish internal compliance programs to track compliance for any securitization vehicle that falls within the definition of banking entity. These costs may be minimized for future securitization vehicles, however, because such securitizations may be able both to incorporate any internal compliance program requirements into their documentation prior to execution, and to minimize (or eliminate) any activities that may trigger greater compliance costs. The proposed rule should further minimize the costs of the internal compliance programs by (i) allowing for enterprise-wide compliance programs and minimal requirements for banking entities that do not engage in covered trading activities and/or covered fund activities or investments (each as described below), and (ii) allowing for reduced compliance program

requirements by establishing financial thresholds for "significant" covered trading activities or covered fund activities or investments (as described below).

There could be initial costs both for banking entities that have an ownership interest in a securitization vehicle and for other securitization participants to determine if a particular vehicle falls within the definition of covered fund. Additional costs could be incurred to the extent that banking entities divest their ownership interests in any securitization vehicle that is a covered fund and is not otherwise eligible for one of the exceptions allowed under the proposed rule. This divestment could result in selling pressure that may have a negative impact on the market prices for the vehicles that fall within the definition of covered fund, which in turn could impact all investors in those securitization vehicles. Additionally, under the proposed rule banking entities would no longer be allowed to acquire and retain such ownership interests, which may result in fewer potential investors and reduced liquidity in the market for ownership interests in these covered funds.

For example, the proposed rule could lead to significant potential market impacts if, with respect to an issuance of asset-backed securities secured by assets which are not loans, the market requires credit risk retention in excess of the minimum requirements to be adopted pursuant to Section 941 of the Dodd-Frank Act (i.e., the market believes that 5% credit risk retention is insufficient to address potential misalignment of incentives in a particular transaction). In such circumstances, the proposed rule could reduce potential investors' demand for such securitizations and could make such securitizations more expensive.

C. <u>Limitations on Permitted Activities for Material Conflicts of Interest and High-Risk Assets and High-Risk Trading Strategies</u>

Section 13(d)(2)(A)(i) of the BHC Act provides that an otherwise-permitted activity would not qualify for a statutory exemption if it would involve or result in a material conflict of interest. The proposed rule's definition of material conflict of interest, as discussed in more detail in Part II of the Supplemental Information, would provide flexibility to banking entities and their clients, customers, and counterparties with respect to how transactions are structured, while also establishing a structure to prevent banking entities from engaging in transactions and activities in reliance on a statutory exemption when the transaction or activity would have a materially adverse effect on the clients, customers, or counterparties of the banking entity. Specifically, the proposed definition would permit the use of timely and effective disclosure and/or information barriers in certain circumstances to address and mitigate conflicts of interest, while prohibiting transactions or activities where such a conflict of interest cannot be addressed or mitigated in the specified manner. The Agencies have endeavored to establish a workable definition that sets forth when a banking entity may not rely on an exemption because it would involve or result in a material conflict of interest, consistent with the statutory goals, to facilitate banking entities' compliance with the statutory requirements. We seek comment on whether the statutory prohibition, as implemented by the proposal, may impose costs on banking entities or their clients, customers, or counterparties. For instance, by permitting a client, customer or counterparty the option of negating or mitigating the conflict after the banking entity has disclosed the conflict, would the banking entity incur certain costs related to terminating the transaction, providing compensation or other means of mitigating the conflict, or administrative costs associated with negotiating the extent of any such compensation or other means of

mitigating the conflict, depending on the actions of the client, customer, or counterparty in response to the disclosure?

In addition, section 13(d)(2)(A)(ii) of the BHC Act provides that an otherwise-permitted activity would not qualify for a statutory exemption if it would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies. This statutory limitation, as implemented in the proposed rule, would prevent a banking entity from engaging in certain high-risk activity. The Agencies request comment on whether the proposed definitions of high-risk asset and high-risk trading strategy would potentially reduce liquidity or create a reduction in efficiency for assets or markets related to that high-risk activity.

D. Compliance Program

Under § __.20 of the proposed rule, all covered banking entities that are engaged in covered trading activities or covered fund activities or investments would be required to have a compliance program that provides for the following six elements, at a minimum: (i) internal written policies and procedures; (ii) internal controls; (iii) a management framework; (iv) independent testing; (v) training; and (vi) recordkeeping. For those banking entities with significant covered trading activities or covered fund activities or investments under § __.20(c) of the proposed rule, additional standards in proposed Appendix C must be met with respect to these six elements.[365] Collectively, the six proposed requirements would facilitate a banking entity's review and assessment of its compliance with section 13 of the BHC Act and the proposed rule, including identifying potential areas of deficiency in a banking entity's

[365] Proposed rule § __.20 and Appendix C implement section 13(e) of the BHC Act, which requires the Agencies to issue regulations regarding internal controls and recordkeeping to ensure compliance with section 13.

compliance program and providing the banking entity the opportunity to take appropriate corrective or disciplinary action, where warranted. The proposed compliance program would also facilitate Agency examination and supervision for compliance with the requirements of the statute and the proposed rule. By requiring that a banking entity have in place specific, documented elements (e.g., written policies and procedures and internal controls, recordkeeping requirements), the proposed rule would ensure that Agency examiners and supervisors can effectively review a banking entity's activities and investments to assess compliance and, where a banking entity is not in compliance with the proposed rule, take appropriate action.

Beyond the benefits recognized above, the individual elements of the proposed compliance program should also provide certain benefits. For example, the proposed management framework requirement is designed to give management a greater incentive to comply with the proposed rule and to ascertain that the employees they are responsible for overseeing are also complying with the proposed rule. Further, by establishing a management framework for compliance, the banking entity would be required to set a strong compliance tone at the top of the banking entity's organization and signal to its employees that management is serious about compliance, which should foster a strong culture of compliance throughout the banking entity. Similarly, the proposed independent testing requirement would provide a third-party assessment of a banking entity's compliance with the proposed rule, which should provide assurances to the banking entity, its clients, customers, and counterparties, and current or prospective investors that the banking entity is in compliance with the proposed rule. In addition, the proposed training requirement should help the various employees of a banking entity that have responsibilities and obligations under the proposed rule (e.g., complying with the

requirements for permitted market making-related activity) understand such responsibilities and obligations and facilitate the banking entity's compliance with the proposed rule. This proposed requirement may also promote market confidence by assuring that trading personnel, and other appropriate personnel of the banking entity, are familiar with their regulatory responsibilities and are complying with the applicable laws and regulations in their interactions with clients, customers, and counterparties.

Because the six elements would be required to be established by all banking entities, other than those that are not engaged in covered trading activities or covered fund activities or investments, the proposed compliance program requirement should promote consistency across banking entities. However, the proposed elements are also intended to give a banking entity a degree of flexibility in establishing and maintaining its compliance program in order to address the varying nature of activities or investments conducted by different units of the banking entity's organization, including the size, scope, complexity, and risks of the activity or investment.

We seek comment on whether developing and providing for the continued administration of a compliance program under § __.20 of the proposed rule is likely to impose material costs on banking entities. Costs related to the proposed compliance program requirement are likely to be higher for those banking entities that are engaged in significant covered trading or covered fund activities or investments and, as a result, are required to comply with the more detailed, specific requirements of proposed Appendix C. Potential costs related to implementation of a compliance program under the proposal include those associated with: hiring additional personnel or other personnel modifications, new or additional systems (including computer hardware or software), developing exception reports, and consultation with outside experts (e.g.,

attorneys, accountants). The proposed compliance program requirement would also impose ongoing costs related to maintenance and enforcement of the compliance program elements, which may include those associated with: ongoing system maintenance, surveillance (e.g., reviewing and monitoring exception reports), recordkeeping, independent testing, and training. For example, the independent testing requirement in the proposal may necessitate that additional resources be provided to the internal audit department of the covered banking entity that is a registered broker-dealer or security-based swap dealer, if such testing is conducted by a qualified internal tester. Alternatively, if an outside party is used to conduct the independent testing, the covered banking entity would incur costs associated with paying the qualified outside party's for its services. The Agencies do not anticipate significant costs related to the proposed management framework requirement, as banking entities should already have relevant management structures in place.

The tiered approach with which the proposal applies the proposed compliance program requirement to banking entities of varying size should reduce the costs associated with developing and providing for the continued administration of a compliance program. In setting forth the proposed compliance program requirement in § __.20 of the proposed rule and Appendix C, the Agencies have taken into consideration the size, scope, and complexity of a banking entity's covered trading activities and covered fund activities and investments in developing requirements targeted to the compliance risks of large and small banking entities. Specifically, banking entities that do not meet the thresholds established in § __.20(c) of the proposed rule would not be required to comply with the more detailed and burdensome requirements set forth in Appendix C. In addition, banking entities that do not engage in covered

trading activities and covered fund activities and investments would not be required to establish a compliance program under the proposed rule, and therefore should incur only minimal costs associated with adding measures to their existing compliance policies and procedures to prevent the banking entity from becoming engaged in such activities or making such investments. Together, these provisions have been proposed in order to permit a banking entity to tailor its compliance program to its activities and investments and, where possible, leverage its existing compliance structures, all of which should minimize the incremental costs associated with establishing a compliance program under the proposed rule. However, banking entities that are engaged in significant covered trading and covered fund activities and investments and thereby present a heightened compliance risk due to the size and nature of their activities and investments would be required to comply with the additional standards set forth in proposed Appendix C.

Costs associated with the requirements of proposed Appendix C should also be reduced by aspects of the proposed rule that would permit a banking entity to establish an enterprise-wide compliance program under certain circumstances. An enterprise-wide compliance program would generally permit one compliance program to be established for a banking entity and all of its affiliates and subsidiaries collectively, rather than each legal entity being required to establish its own separate compliance program. The Agencies expect that an enterprise-wide compliance program should promote efficiencies and economies of scale, and reduce costs, associated with establishing separate compliance programs.

E. Additional Request for Comment

In addition to the requests for comment discussed above, we seek commenters' views on the following additional questions related to the potential economic impacts of the proposed framework for implementing section 13 of the BHC Act:

Question 348. What are the expected costs and benefits of complying with the requirements of the proposed rule? We seek commenters' estimates of the aggregate cost or benefit that would be incurred or received by banking entities subject to section 13 of the BHC Act to comply. We also ask commenters to break out the costs or benefits of compliance to banking entities with each individual aspect of the proposed rule. Please provide an explanation of how cost or benefit estimates were derived. Please also identify any costs or benefits that would occur on a one time basis and costs that would recur. Would particular costs or benefits decrease or increase over time? If certain costs or benefits cannot be estimated, please discuss why such costs or benefits cannot be estimated.

Question 349. Please identify any costs or benefits that would occur on a one-time basis and costs or benefits that would recur (e.g., training and compliance monitoring). Please identify any costs or benefits that you believe would decrease over time. Please identify any costs or benefits that you believe may increase over time or remain static.

Question 350. Are there circumstances in which registered dealers, security-based swap dealers, and/or swap dealers (i) hold accounts other than trading accounts or (ii) hold investment positions for activities for which they are required to be registered? If so, would including all

such dealer positions within the trading account definition create competitive burdens as well as additional burdens on the operations of such dealers that may not be consistent with the language and purpose of the statute? Please describe how this may occur, and to what extent it may occur.

Question 351. Please identify the ways, if any, that banking entities might alter the ways they currently conduct business as a result of the costs that could be incurred to comply with the requirements of the proposed rule. Do you anticipate that banking entities will terminate any services or products currently offered to clients, customers, or counterparties due to the proposed rule, if adopted? Please explain.

Question 352. How would trading systems and practices used in today's marketplace be impacted by the proposed rule? What would be the costs and/or benefits of such changes in trading practices and systems?

Question 353. Would the proposed rule create any additional implementation or operational costs or benefits associated with systems (including computer hardware and software), surveillance, procedural, recordkeeping, or personnel modifications, beyond those discussed in the above analysis? Would smaller banking entities be disproportionately impacted by any of these additional implementation or operational costs?

Question 354. We seek specific comments on the costs and benefits associated with systems changes on banking entities with respect to the proposed rule, including the type of systems changes necessary and quantification of costs associated with changing the systems,

including both start-up and maintenance costs. We request comments on the types of jobs and staff that would be affected by systems modifications and training with respect to the proposed rule, the number of labor hours that would be required to accomplish these matters, and the compensation rates of these staff members.

Question 355. Please discuss any human resources costs associated with the proposed rule, along with any associated overhead costs.

Question 356. What are the benefits and costs associated with the requirements for relying on the underwriting exemption? What impact will these requirements have on capital formation, efficiency, competition, liquidity, price efficiency, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 357. What are the benefits and costs associated with the requirements for relying on the exemption for market making-related activity, including the requirement that such activity be consistent with the commentary in Appendix B? What impact will these requirements have on liquidity, price efficiency, capital formation, efficiency, and competition, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 358. What are the benefits and costs associated with the requirements for relying on the exemption for risk-mitigating hedging activity, including the requirement that certain hedge transactions be documented? What impact will these requirements have on liquidity, price efficiency, capital formation, efficiency, and competition, if any? Please estimate any resulting benefits and costs or discuss why such benefits and costs cannot be estimated. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 359. Are there traditional risk management activities of banking entities that are not covered by the liquidity management and risk-mitigating hedging exemptions as currently proposed? What risks do banking entities face that go beyond market, counterparty/credit, currency/foreign exchange, interest rate, and basis risk? Could the proposed construction of the liquidity management and risk-mitigating hedging exemptions increase the costs of management or impede the ability of banking entities to effectively manage risk?

Question 360. To rely on the exemptions from the proposed rule for permitted underwriting, market making-related activity, and risk-mitigating hedging, banking entities must establish, maintain, and enforce a compliance program, including written policies and procedures and internal controls. Please discuss how the costs incurred, or benefits received, by banking entities related to initial implementation and ongoing maintenance of the compliance program would impact their customers and their businesses with respect to underwriting, market making, and hedging activity.

Question 361. Please discuss benefits and costs related to the limitations on permitted activities for material conflicts of interest, high-risk assets and trading strategies, and threats to the safety and soundness of banking entities or to the financial stability of the U.S in the proposed rule. Are there particular benefits and costs related to the proposed definitions of material conflict of interest, high-risk asset, and high-risk trading strategy in the proposed rule? Would these definitions have any unintended costs, such as creating undue burdens and limitations on permitted underwriting, market making-related, or hedging activity? Please explain. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 362. Please discuss the benefits and costs related to the definition of derivative in the proposed rule and the application of the restrictions on proprietary trading to transactions in the different types of derivatives covered by the definition. What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 363. What costs and benefits would be associated with calculating, reviewing, and analyzing the proposed quantitative measurements? What costs and benefits would be associated with reporting the proposed quantitative measurements to an Agency? Please identify any of the proposed quantitative measurements that are already reported to an Agency and discuss whether the current reporting regime would mitigate costs associated with the proposed rule. With respect to any quantitative measurement that is not already reported to an Agency, what are the costs and benefits of beginning to report the measurement? Would banking entities have to create or purchase new systems or implement changes to existing systems in order to

report these quantitative measurements? Please discuss the costs and benefits associated with such systems changes.

Question 364. How much of the data necessary to calculate the quantitative measurements in Appendix A is currently captured, retained, and utilized by banking entities? If the applicable data is not currently used by banking entities, is it readily available? Is it possible to collect all of the data that is necessary for calculating the required measurements? Please identify any data that banking entities do not currently utilize that would need to be captured and retained for purposes of proposed Appendix A and discuss the costs and benefits of capturing and retaining such data.

Question 365. Do the costs and benefits of calculating, analyzing, and reporting certain or all quantitative measurements differ between trading units and their trading activities, including trading strategies, asset classes, market structure, experience and market share, and market competitiveness? Are any quantitative measurements particularly costly to calculate or analyze for specific trading activities or, alternatively, particularly beneficial? If so, which quantitative measurement, what type of trading activity, and what factor(s) of that trading activity makes the quantitative measurement particularly costly or beneficial? Please discuss how these costs, if any, could be mitigated or benefits, if any, could be enhanced.

Question 366. The proposed definition of trading unit would require a tiered approach to calculating and reporting quantitative measurements, such that the measurements would be calculated and reported for different levels within the banking entity, with higher levels

encompassing smaller units (e.g., trading desks, business lines, and all trading operations). What are the costs and benefits of calculating the quantitative measurements for each level within the definition of trading unit? Can the higher level calculations incorporate the lower level calculations such that the higher level calculations result in small, incremental costs? Why or why not? Are there particular costs or benefits associated with calculating, analyzing, and reporting a quantitative measurement at one of the levels within the definition of trading unit that would not be experienced at the other levels? Please explain. What are the costs, if any, of "noise," "false positives," or "false negatives" with respect to the quantitative measurements and calculations at different levels? Can these costs be mitigated and, if so, how? What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 367. We seek comment on whether the requirement that banking entities employ a suite of quantitative measurements may lead to redundancies and/or inefficiencies in the application of the measurements for some types of trading units within some banking entities. Despite the flexibility of Appendix A via recognition that quantitative measurements will be applied with respect to differences within a banking entity's structure, business lines, and trading desks, we seek comment on whether the requirement of a mandatory suite of quantitative measurements may prove burdensome. For instance, is the application of certain quantitative measurements not efficient, appropriate, or calculable for certain asset classes or trading units or would the benefits of applying such quantitative measurements be negligible in relation to the costs of applying such measurements? In addition, would the overlay divert a banking entity

from allocating resources toward quantitative – or other – measurements that might prove more useful and better tailored to its specific and unique trading practices?

Question 368. What are the benefits and costs of the recordkeeping requirement in proposed Appendix A? Please explain and quantify, to the extent possible. To what extent would the proposed recordkeeping requirement impose new or additional costs and benefits beyond the current recordkeeping obligations of different types of banking entities (e.g., affiliated broker-dealers, affiliated investment advisers, insured depository institutions, etc.)? What alternatives, if any, may be more cost-effective while still being consistent with the purpose and language of the statute?

Question 369. Please identify any cost savings that would be achieved through the use of an enterprise-wide compliance program. Alternatively, would you expect certain costs to increase when using an enterprise-wide compliance program? Please explain. Please identify any benefits that might be amplified or reduced when using an enterprise-wide compliance program.

Question 370. Are there tools or elements in the contents of the compliance program set forth in § __.20(b) for which the costs may be negligible because banking entities use the same or similar elements for other purposes (e.g., satisfying other regulatory requirements, risk management, etc.) and could utilize existing infrastructure for purposes of the proposed rule? For example, could existing trader mandates or an existing training program be expanded to meet the requirements of the proposed rule, rather than developing an entirely new infrastructure?

Alternatively, would the proposed rule require redundancies or duplications within a banking entity's infrastructure (e.g., the trader mandates currently used for one purpose do not conform to the requirements of the proposed rule, so a banking entity would have to utilize both in different circumstances)? Please identify and explain any such redundancies and how the rule could be modified to reduce or eliminate such redundancies, if possible.

Question 371. How would the proposed rule affect compliance costs (e.g., personnel or system changes) or benefits for each category of banking entity: small, medium, and large? Please discuss any differences between the costs and benefits of the compliance program required under § __.20(b) for smaller banking entities and the compliance program requirements of Appendix C for larger banking entities. Are the differences between these benefits and costs justified due to the differences in size and complexity of smaller and larger banking entities?

Question 372. The definition of trading unit in proposed Appendix C covers different levels of a banking entity and, as a result, requires a tiered approach to establishing, maintaining, and enforcing the compliance program requirements with respect to covered trading activities. What are the costs and benefits of applying the compliance program requirements at several levels within the banking entity? To what extent does the ability to incorporate written policies and procedures of lower-level units by reference, rather than establishing separate written policies and procedures, mitigate the costs of the proposed requirements? Are there other ways that the proposed requirements could be made more cost-effective for the different levels within the banking entity?

Question 373. How will the proposed definition of "covered fund" affect a banking entity's investment advisory activities, in particular activities and relationships with investment funds that would be treated as "covered funds"? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.

Question 374. How have banking entities traditionally organized and offered covered funds? What are the benefits and costs associated with the proposed requirements for relying on the exception for organizing and offering covered funds? Please estimate any resulting costs or benefits or discuss why such costs or benefits cannot be estimated.

Question 375. What are the costs and benefits associated with the way the proposed rule implements the "customers of such services" requirement in the exception for organizing and offering covered funds? What alternative, if any, may be more cost-effective while still being consistent with the language and purpose of the statute?

Question 376. Is it common for a banking entity to share a name with the covered funds that it invests in or sponsors? If yes, what entity in the banking structure typically shares a name with such covered funds? What costs and benefits will result from the proposed rule's implementation of the name sharing requirement in exception for organizing and offering a covered fund? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?

Question 377. Under what circumstances do directors and employees of a banking entity invest in covered funds? What are the benefits and costs associated with the proposed provisions regarding director and employee investments in covered funds? What alternatives, if any, may be more cost-effective while still being consistent with the purpose of the statute?

Question 378. Do banking entities currently invest in or sponsor SBICs and public welfare and qualified rehabilitation investments? If yes, to what extent? What are the benefits and costs associated with the proposed rule's implementation of the exception for investment in SBICs and public welfare and qualified rehabilitation investments?

Question 379. Do banking entities currently invest in or sponsor each of the vehicles that the proposed rule permits banking entities to continue to invest in and sponsor under section 12(d)(1)(J) of the BHC Act? If yes, to what extent? What are the benefits and costs associated with the proposed rule's implementation of these exceptions?

Question 380. For banking entities that are affiliated investment advisers, are there additional costs or benefits to complying with section 13 of the BHC Act and the proposed rule? For example, do affiliated investment advisers typically maintain records that would enable them to demonstrate compliance with the 3% ownership limits or restrictions on transactions that would be subject to sections 23A and 23B of the FR Act?

Question 381. Would complying with section 13 of the BHC Act and the proposed rule affect an affiliated investment adviser's other business activities (benefit or burden) that are not

subject to restrictions on proprietary trading or other covered fund activities? For example, would advisers incur additional burdens to distinguish covered fund activities from non-covered fund activities?

Question 382. For banking entities that are affiliated investment advisers, are there particular costs or benefits to complying with the portions of Appendix C that are applicable to each asset management unit of the adviser? Do these costs and benefits differ depending on whether the adviser complies with Appendix C individually or on an enterprise basis? Does the rule provide sufficient clarify for how Appendix C applies to unregistered affiliates of an affiliated investment adviser?

Question 383. To the extent applicable, please address each of the questions above with respect to securitization vehicles that would be included in the proposed definition of covered fund.

VII. Administrative Law Matters.

A. Paperwork Reduction Act Analysis

Request for Comment on Proposed Information Collection

In accordance with section 3512 of the Paperwork Reduction Act of 1995 (44 U.S.C. § 3501-3521) ("PRA"), the Agencies may not conduct or sponsor, and a respondent is not required to respond to, an information collection unless it displays a currently valid Office of Management and Budget ("OMB") control number. The OCC, FDIC, and Board will obtain

OMB control numbers. The information collection requirements contained in this joint notice of proposed rulemaking, to the extent they apply to insured financial institutions that are not under a holding company, have been submitted by the OCC and FDIC to OMB for review and approval under section 3506 of the PRA and section 1320.11 of OMB's implementing regulations (5 C.F.R. § 1320). The Board reviewed the proposed rule under the authority delegated to the Board by OMB. The Board will submit to OMB once the final rule is published and the submission will include burden for Federal Reserve-supervised institutions, as well as burden for OCC-, FDIC-, SEC-, and CFTC-supervised institutions under a holding company. The OCC and the FDIC will take burden for banking entities that are not under a holding company. The CFTC has stated that it will be publishing a separate proposed rulemaking in the near future. The burden estimates for CFTC-supervised institutions, published in this proposed rule, are based on the requirements set forth below and the assumption that the CFTC's proposed rulemaking would contain substantively similar requirements.

The proposed rule contains requirements subject to the PRA. The reporting requirements are found in sections __.7(a) and __.12(d); the recordkeeping requirements are found in sections __.3(b)(2)(iii)(C), __.5(c), __.7(a), __.11(b), __.13(b)(3), __.20(b), __.20(c), and __.20(d); and the disclosure requirement is found in section __.11(h)(1). The recordkeeping and disclosure burden for the following sections is accounted for in the __.20(b) burden: __.4(a)(2)(i), __.4(b)(2)(i), __.5(b)(1), __.5(b)(2)(i), __.5(b)(2)(v), __.13(b)(2)(i), __.13(b)(2)(ii)(A), __.13(b)(2)(ii)(D), __.15(a)(1), and __.17(b)(1). These information collection requirements would implement section 619 of the Dodd-Frank Act, as mentioned in the Abstract below. The respondent/recordkeepers are for-profit financial institutions, including small businesses. A

covered entity must retain these records for a period that is no less than 5 years in a form that allows it to promptly produce such records to [Agency] on request.

Comments are invited on:

(a) Whether the collections of information are necessary for the proper performance of the Agencies' functions, including whether the information has practical utility;

(b) The accuracy of the estimates of the burden of the information collections, including the validity of the methodology and assumptions used;

(c) Ways to enhance the quality, utility, and clarity of the information to be collected;

(d) Ways to minimize the burden of the information collections on respondents, including through the use of automated collection techniques or other forms of information technology; and

(e) Estimates of capital or start up costs and costs of operation, maintenance, and purchase of services to provide information.

All comments will become a matter of public record. Comments on aspects of this notice that may affect reporting, recordkeeping, or disclosure requirements and burden estimates should be sent to the addresses listed in the ADDRESSES section of this Supplementary Information. A copy of the comments may also be submitted to the OMB desk officer for the Agencies: By mail to U.S. Office of Management and Budget, 725 17th Street, NW, #10235, Washington, DC 20503

or by facsimile to 202-395-5806, Attention, Commission and Federal Banking Agency Desk Officer.

Proposed Information Collection

Title of Information Collection: Reporting, Recordkeeping, and Disclosure Requirements Associated with Restrictions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds.

Frequency of Response: Annual, monthly, and on occasion.

Affected Public: Businesses or other for-profit.

Respondents:

Board: State member banks, bank holding companies, savings and loan holding companies, mutual holding companies, foreign banking organizations, and other holding companies that control an insured depository institution. The Board will take burden for all institutions under a holding company including:

- OCC-supervised institutions,
- FDIC-supervised institutions,
- Banking entities for which the CFTC is the primary financial regulatory agency, as defined in section 2(12)(C) of the Dodd-Frank Act, and
- Banking entities for which the SEC is the primary financial regulatory agency, as defined in section 2(12)(B) of the Dodd-Frank Act.

OCC: National banks, federal savings associations, and federal savings banks not under a holding company, and their respective subsidiaries, and their affiliates not under a holding company. The OCC will take the burden with respect to registered investment advisers and

commodity trading advisers and commodity pool operators that are subsidiaries of national banks, federal savings associations, and federal savings banks not under a bank holding company.

FDIC: State nonmember banks not under a holding company; state savings associations and state savings banks not under a holding company; subsidiaries of state nonmember banks, state savings associations and state savings banks not under a holding company; and foreign banks having an insured branch.

<u>Abstract</u>: Section 619 of the Dodd-Frank Act added a new section 13 to the BHC Act (to be codified at 12 U.S.C. § 1851) that generally prohibits any banking entity from engaging in proprietary trading or from investing in, sponsoring, or having certain relationships with a hedge fund or private equity fund, subject to certain exemptions. New section 13 of the BHC Act also provides for nonbank financial companies supervised by the Board that engage in such activities or have such investments or relationships to be subject to additional capital requirements, quantitative limits, or other restrictions.

Section __.3(b)(2)(iii)(C) would require a covered banking entity to establish a documented liquidity management plan in order to rely on an exclusion from the definition of "trading account" for certain positions taken for the bona fide purpose of liquidity management.

Section __.5(c) would require that, with respect to any purchase, sale, or series of purchases or sales conducted by a covered banking entity pursuant to section __.5 for risk-mitigating hedging purposes that is established at a level of organization that is different than the level of organization establishing the positions, contracts, or other holdings the risks of which the purchase, sale, or series of purchases or sales are designed to reduce, the covered banking entity document, at the time the purchase, sale, or series of purchases or sales are conducted:

(1) The risk-mitigating purpose of the purchase, sale, or series of purchases or sales;

(2) The risks of the individual or aggregated positions, contracts, or other holdings of a covered banking entity that the purchase, sale, or series of purchases or sales are designed to reduce; and

(3) The level of organization that is establishing the hedge.

Section __.7(a) would require a covered banking entity engaged in any proprietary trading activity pursuant to sections __.4 through __.6 to comply with the reporting and recordkeeping requirements described in Appendix A if the covered banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion, as well as such other reporting and recordkeeping requirements as a relevant Agency may impose to evaluate the covered banking entity's compliance with this subpart.

Section __.11(b) would require that, with respect to any covered fund that is organized and offered by a covered banking entity in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and to persons that are customers of such services of the covered banking entity, the covered banking entity document how the covered banking entity intends to provide advisory or similar services to its customers through organizing and offering such fund.

Section __.11(h)(1) would require that, with respect to any covered fund that is organized and offered by a covered banking entity in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and to persons that are customers of such services of the covered banking entity, the covered banking entity clearly and conspicuously disclose, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(1) That "any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the covered banking entity and its affiliates or subsidiaries]; therefore, [the covered banking entity's and its affiliates' or subsidiaries'] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by the [covered banking entity and its affiliates or subsidiaries] in their capacity as investors in the [covered fund]";

(2) That such investor should read the fund offering documents before investing in the covered fund;

(3) That the "ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity" (unless that happens to be the case); and

(4) The role of the covered banking entity and its affiliates, subsidiaries and employees in sponsoring or providing any services to the covered fund

Section __.12(d) would extend the time to divest an ownership interest in a covered fund. Upon receipt of an application from a covered banking entity, the Board may extend the period of time to meet the requirements under paragraphs (a)(2)(i)(A) and (B) of that section for

up to 2 additional years, if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(1) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(2) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of that section; and

(3) Explain the covered banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2)(i) of that section.

Section __.13(b)(3) would require that, with respect to any acquisition or retention of an ownership interest in a covered fund by a covered banking entity pursuant to § __.13(b), the covered banking entity must document, at the time the transaction is conducted:

(1) The risk-mitigating purpose of the acquisition or retention of an ownership interest in a covered fund;

(2) The risks of the individual or aggregated obligation or liability of a covered banking entity that the acquisition or retention of an ownership interest in a covered fund is designed to reduce; and

(3) The level of organization that is establishing the hedge.

Section __.20(b) would require a compliance program with respect to covered fund activities and investments that shall, at a minimum, include:

(1) Internal written policies and procedures reasonably designed to document, describe, and monitor the covered trading and covered fund activities and investments of the covered banking entity to ensure that such activities and investments are compliant with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor and identify potential areas of noncompliance with section 13 of the BHC Act and this part in the covered banking entity's covered trading and covered fund activities and investments and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part;

(4) Independent testing for the effectiveness of the compliance program conducted by qualified personnel of the covered banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Maintenance of records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a covered banking entity must promptly provide to the Agency upon request and retain for a period of no less than 5 years.

Section __.20(c) would require the compliance program of a covered banking entity to also comply with the requirements and other standards contained in Appendix C if the covered

banking entity: (i) engages in proprietary trading and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters (A) is equal to or greater than $1 billion, or (B) equals 10 percent or more of its total assets; or (ii) invests in, or has relationships with, a covered fund and (A) the covered banking entity has, together with its affiliates and subsidiaries, aggregate investments in one or more covered funds, the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion, or (B) sponsors and advises, together with its affiliates and subsidiaries, one or more covered funds, the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion.

Section __.20(d) would require a covered banking entity that does not engage in activities or investments prohibited or restricted in subpart B or subpart C of the proposed rule, in order be deemed to have satisfied the requirements of § __.20, to ensure that its existing compliance policies and procedures include measures that are designed to prevent the covered banking entity from becoming engaged in such activities or making such investments and which require the covered banking entity to develop and provide for establishment of the compliance program required under § __.20(a) of the proposed rule prior to engaging in such activities or making such investments.

Estimated Paperwork Burden

In determining the method for estimating the paperwork burden the Agencies made the assumption that affiliated entities under a holding company would act in concert with one another to take advantage of efficiencies that may exist. The Agencies invite comment on whether it is reasonable to assume that affiliated entities would act jointly to implement a firm-wide program or whether they would act independently to implement programs tailored to each entity. In addition, the Agencies invite comment as to the accuracy of our estimates of the burdens concerning the proposed collections of information and whether all banking entities subject to the rule are appropriately accounted for by the Agencies.

Estimated Burden per Response:

Section __.3(b)(2)(iii)(C) recordkeeping – 1 hour (Initial setup 3 hours).

Section __.5(c) recordkeeping – 6 hours for entities with $1 billion or more in trading assets/liabilities, 35 hours for entities with $5 billion or more in trading assets/liabilities.

Section __.7(a) reporting – 2 hours for entities with $1 billion or more in trading assets/liabilities, 2 hours for entities with $5 billion or more in trading assets/liabilities (Initial setup 6 hours for entities with $1 billion or more in trading assets/liabilities, 6 hours for entities with $5 billion or more in trading assets/liabilities).

Section __.7(a) recordkeeping – 350 hours for entities with $1 billion or more in trading assets/liabilities, 440 hours for entities with $5 billion or more in trading assets/liabilities.

Section __.11(b) recordkeeping – 10 hours.

Section __.11(h)(1) disclosure – 0.10 hours.

Section __.12(d) reporting – 20 hours (Initial setup 50 hours).

Section __.13(b)(3) recordkeeping – 10 hours.

Section __.20(b) recordkeeping – 265 hours (Initial setup 795 hours).[366]

Section __.20(c) recordkeeping – 1,200 hours (Initial setup 3,600 hours).

Section __.20(d) recordkeeping – 8 hours.

Board

Number of respondents: 10,000.

Total estimated annual burden: 6,283,620 hours (4,541,070 hours for initial setup and 1,742,550 hours for ongoing compliance).

FDIC

Number of respondents: 1,139.

Total estimated annual burden: 46,428 hours (29,934 hours for initial setup and 16,494 hours for ongoing compliance).

OCC

Number of respondents: 469.

Total estimated annual burden: 253,796 hours (187,643 hours for initial setup and 66,153 hours for ongoing compliance).

B. Initial Regulatory Flexibility Act Analysis

[366] For the Board, the section __.20(b) burden hours are 266 hours (ongoing) and 796 hours (initial setup) because the Board is accounting for the 1 hour disclosure burden for certain SEC- and CFTC-supervised entities.

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601 et seq., requires an agency to consider whether the rules it proposes will have a significant economic impact on a substantial number of small entities.[367] If so, the agency must prepare an initial and final regulatory flexibility analysis respecting the significant economic impact. Pursuant to section 605(b) of the RFA, the regulatory flexibility analysis otherwise required under sections 603 and 604 of the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. The Agencies have considered the potential impact of the proposed rule on small entities in accordance with the RFA. The proposed rule would not appear to have a significant economic impact on small entities for several reasons.

First, while the proposed rule will affect all banking organizations, including those that have been defined to be "small businesses" under the RFA, only certain limited requirements would be imposed on entities that engage in little or no covered trading activities or covered fund activities and investments. Significantly, the reporting and recordkeeping requirements of § _.7 and Appendix A of the proposed rule apply only to banking entities with average trading assets and liabilities on a consolidated, worldwide basis equal to or greater than $1 billion for the preceding year. This is a threshold that a small banking entity typically would not meet.

Second, the scope and size of the compliance program requirements set forth in subpart D and Appendix C of the proposed rule would vary based on the size and activities of each covered banking entity. Only banking entities with average trading assets and liabilities on a worldwide

[367] A banking organization is generally considered to be a small banking entity for the purposes of the RFA if it has assets less than or equal to $175 million. See also 13 CFR § 121.1302(a)(6) (noting factors that the Small Business Administration considers in determining whether an entity qualifies as a small business, including receipts, employees, and other measures of its domestic and foreign affiliates).

consolidated basis equal to or greater than $1 billion or 10 percent or more of their total assets, or that have aggregate investments in, or sponsor or advise, covered funds with aggregate total assets of more than $1 billion must establish, maintain and enforce a full compliance program under the proposed rule. Banking entities that engage in trading activities or covered fund activities and investments under these thresholds must adopt, at a minimum, only the six core compliance requirements set forth in §_.20 of the proposed rule. Banking entities that do not engage in any covered trading or fund activities, typical of small banking entities, must ensure only that their compliance programs include measures designed to prevent the entities from becoming engaged in covered activities unless they first adopt a compliance program. These compliance requirements would not appear to have a significant economic impact on a substantial number of small entities.

OCC, FDIC, and SEC: For the reasons stated above, the head of the OCC, FDIC, and the SEC certifies, for the covered banking entities subject to each such Agency's jurisdiction, that the proposed rule would not result in a significant economic impact on a substantial number of small entities. The OCC, FDIC, and SEC encourage written comments regarding this certification, and request that commenters describe the nature of any impact on small entities and provide empirical data to illustrate and support the extent of the impact.

Board: For the reasons stated above, the proposed rules would not appear to have a significant economic impact on small entities subject to the Board's jurisdiction. The Board welcomes written comments regarding this initial regulatory flexibility analysis, and 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. A final regulatory flexibility analysis will be conducted after consideration of comment received during the public comment period.

C. OCC Unfunded Mandates Reform Act of 1995 Determination

Section 202 of the Unfunded Mandates Reform Act of 1995, Pub. L. 104-4 (2 U.S.C. 1532) ("Unfunded Mandates Act"), requires that an agency prepare a budgetary impact statement before promulgating any rule likely to result in a Federal mandate that may result in the expenditure by state, local, and tribal governments, in the aggregate, or by the private sector of $100 million or more, as adjusted by inflation, in any one year. If a budgetary impact statement is required, Section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule.

The OCC has completed an assessment whether any mandates imposed by the proposed rule may result in expenditures of $100 million or more annually, as adjusted by inflation, by state, local, and tribal governments, or by the private sector as required by the Unfunded Mandates Act. The OCC focused its analysis on the impact of the various compliance, recordkeeping, reporting, disclosure, and training requirements in the proposed rule and, as provided for under section 201 of the Unfunded Mandates Act (2 U.S.C. 1531), excluded the cost of requirements specifically set forth in the statute. Overall, the OCC determined that this proposed rule will not result in expenditures by state, local, and tribal governments, or by the private sector, of $100 million or more in any one year. Accordingly, this proposal is not subject to Section 202 of the Unfunded Mandates Act.

The OCC also will need to prepare an impact statement for the final rule, for purposes of the Unfunded Mandates Act and the Congressional Review Act, Pub. L. 104-121 (5 U.S.C.

§§801-808). Comments provided on the costs and benefits of the proposed rule, in response to the analysis and questions posed in the Supplemental Information Part VII.D, will help to inform this assessment.

D. SEC: Small Business Regulatory Enforcement Fairness Act

Under the Small Business Regulatory Enforcement Fairness Act of 1996,[368] a rule is "major" if it has resulted, or is likely to result, in:

- An annual effect on the U.S. economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

The SEC requests comment on whether its proposed rule would be a "major" rule for purposes of the Small Business Regulatory Enforcement Fairness Act. In addition, the SEC solicits comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumer or individual industries; and
- Any potential effect on competition, investment, or innovation.

VIII. SEC: Additional Matters

A. Statutory Authority and "Covered Banking Entity" Definition

[368] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

1. Statutory authority.

Section __.1 of the proposed rule implementing section 13 of the BHC Act cites section 13 of the BHC Act, pursuant to which the SEC is adopting the entirety of the proposed rule with respect to "covered banking entities," as that term is defined in the SEC's proposed rule.[369] Section __.1 also cites the SEC's independent authority under certain sections of the Exchange Act to adopt §§ __.5(c), __.7(a), __.20, and Appendices A and C of the proposed rule.[370] Compliance with such provisions, if adopted, will be subject to examination and enforcement under the Exchange Act for certain covered banking entities.

2. "Covered Banking Entity" Definition.

The proprietary trading and covered fund activity prohibition set forth in section 13 of the BHC Act, as proposed to be implemented in § __.3(a) and § __.10(a) of the proposed rule, would apply to any "covered banking entity."[371] The term "banking entity" is generally defined under section 13 of the BHC Act to include any insured depository institution, any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and any affiliates

[369] The SEC notes that the SEC is only proposing rules as they would be applicable to the banking entities for which the SEC has regulatory authority, as set forth in section 13(b)(2)(B)(IV) of the BHC Act, e.g., registered broker-dealers. Accordingly, the SEC proposal should be read in the context of these regulated entities and comments to the SEC should focus on these entities. For instance, the SEC is particularly interested in the impact of the proposed rules on the activities of such entities.

[370] 15 U.S.C. 78o(c)(3)(A), 78o-10(f), (j), 78q(a), 78w.

[371] Proposed rule § __.3(a) provides "Except as otherwise provided in this subpart, a covered banking entity may not engage in proprietary trading." Proposed rule § __.10(a) provides "Except as otherwise provided in this subpart, a covered banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund."

and subsidiaries of these entities.[372] Section __.2(j) of the proposed rule implementing section 13 of BHC Act would define the term "covered banking entity." This term is used in each Agency's proposed rule to describe the specific types of banking entities to which that Agency's rule would apply.

As discussed in Part I of the Supplementary Information, the authority for adopting regulations to implement section 13 of the BHC Act is divided between the Agencies in the manner provided in section 13(b)(2).[373] Section 13 of the BHC Act generally prohibits a banking entity from engaging in proprietary trading or investing in or sponsoring a hedge fund or private equity fund, and section 13(b)(2)(B)(i)(IV) of the BHC Act directs the SEC to issue rules implementing that section with respect to any entity for which the SEC is the primary financial regulatory agency, as that term is defined in section 2 of the Dodd-Frank Act.[374] The SEC has

---

[372] See 12 U.S.C. 1851(h)(1); proposed rule § __.2(e).

[373] See 12 U.S.C. 1851(b)(2). Under section 13(b)(2)(B) of the BHC Act, rules implementing section 13's prohibitions and restrictions must be issued by: (i) the appropriate Federal banking agencies (i.e., the Board, the OCC, and the FDIC), jointly, with respect to insured depository institutions; (ii) the Board, with respect to any company that controls an insured depository institution, or that is treated as a bank holding company for purposes of section 8 of the International Banking Act, any nonbank financial company supervised by the Board, and any subsidiary of any of the foregoing (other than a subsidiary for which an appropriate Federal banking agency, the SEC, or the CFTC is the primary financial regulatory agency); (iii) the CFTC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act; and (iv) the SEC with respect to any entity for which it is the primary financial regulatory agency, as defined in section 2 of the Dodd-Frank Act. See id.

[374] Under section 2(12)(B) of the Dodd-Frank Act, the term "primary financial regulatory agency" means the SEC with respect to (i) SEC-registered brokers and dealers, with respect to the activities of the broker or dealer that require the broker or dealer to be registered as such under the Exchange Act; (ii) SEC-registered investment companies, with respect to the activities of the investment company that require the investment company to be registered under the Investment Company Act; (iii) SEC-registered investment advisers, with respect to the investment advisory activities of such company and activities that are incidental to such advisory activities; (iv) SEC-registered clearing agencies, with respect to the activities of the clearing agency that require the agency to be registered under the Exchange Act; (v) SEC-registered nationally recognized statistical rating organizations; (vi) SEC-registered transfer agents; (vii) national securities exchanges registered with the SEC; (viii) national securities associations registered with the SEC; (ix) SEC-registered securities information processors; (x) the Municipal Securities Rulemaking Board; (xi) the Public Company Accounting Oversight Board; (xii) the Securities Investor Protection Corporation; and (xiii) SEC-registered security-based swap execution facilities, security-based swap data repositories, security-based swap dealers, and major security-based swap participants, with respect to the security-

proposed to restate that statutory provision in defining "covered banking entity" for purposes of the SEC's proposed rule.[375]

The SEC recognizes that some entities that would be included in the SEC's proposed definition of "covered banking entity" generally do not engage in covered trading activities and covered fund activities and investments. The SEC notes that, to the extent the covered banking entity does not engage in activities and investments covered by section 13 of the BHC Act and the proposed rule, the proposal is reasonably designed to reduce and alleviate any burdens on such a covered banking entity, while also preventing evasion of the proposed rule. Specifically, a covered banking entity that does not engage in activities and investments prohibited or restricted by section 13 of the BHC Act and the proposed rule would only be required to include measures in its existing compliance policies and procedures that are reasonably designed to prevent the covered banking entity from becoming engaged in such activities and making such investments under the proposed rule.[376]

---

based swap activities of the person that require such person to be registered under the Exchange Act. See section 2(12)(B) of the Dodd-Frank Act. The SEC notes that, with respect to SEC-registered clearing agencies, to the extent a clearing agency acquires or takes a position in one or more covered financial positions in connection with clearing securities transactions, such positions would be excluded from the definition of trading account under the proposal. See proposed rule § __.3(b)(2)(iii)(D). As a result of this proposed exclusion, clearing agencies' positions taken in connection with clearing securities transactions would not involve proprietary trading, as defined under the proposal, and would not be subject to the prohibition on proprietary trading in § __.3(a) of the proposed rule. As discussed further below, the proposal is designed to reduce any burdens on covered banking entities that do not engage in proprietary trading and covered fund activities and investments.

[375] See SEC proposed rule § __.2(j).

[376] See proposed rule § __.20(d). However, to the extent that the covered banking entity becomes engaged in such activities or investments, it would be required to develop a more detailed compliance program, as set forth in § __.20(b) of the proposed rule.

The SEC requests comment on the proposed definition of "covered banking entity." In particular, the SEC requests comment on the following questions:

Question SEC-1. Is the SEC's proposed definition of the term "covered banking entity" sufficiently clear? If not, why not? Please suggest an alternative definition.

Question SEC-2. Is the SEC's proposed definition of the term covered banking entity appropriate, or is it over- or under-inclusive? Please explain.

Question SEC-3. Should any of the covered banking entities included in the SEC's proposed definition of "covered banking entity" be excluded? If so, which entities, why, and on what basis? Should the SEC's proposed rule provide specific guidance or exemptions for any such entities?

Question SEC-4. Would particular types of entities incur costs or burdens that are greater than other types of entities that are included in the SEC's proposed definition of "covered banking entity"? If so, should any such difference be addressed or mitigated? How?

Question SEC-4. Are all of the provisions in the proposed rule relevant to the business conducted by SEC covered banking entities? If not, which provisions are not relevant and how should this be addressed in the rule? Are there differences between the SEC's covered banking entities and other types of banking entities subject to the rules of the Federal banking agencies or the CFTC that have not been sufficiently accounted for in the proposed rule? If so, what are

these differences and how should the SEC's rule account for such differences in a manner that is consistent with the statutory requirement that the Agencies' rules be consistent and comparable, to the extent possible?

B. Consideration of the Impact of Reporting and Recordkeeping and Compliance Program Proposed Rules on Competition and on the Promotion of Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the SEC, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.[377] In addition, section 23(a)(2) of the Exchange Act requires the SEC, when adopting rules under the Exchange Act, to consider the impact such rules would have on competition.[378] Section 23(a)(2) of the Exchange Act also prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The SEC's consideration of the factors specified in Exchange Act sections 3(f) and 23(a)(2) is limited to those portions of the proposal that, in addition to being proposed under section 13 of the BHC Act, are also being proposed pursuant to the SEC's authority under the Exchange Act with respect to covered banking entities that are registered broker-dealers and security-based swap dealers. The remaining portions of the joint proposed rule are being proposed exclusively under

[377] 15 U.S.C. 78c(f).

[378] 15 U.S.C. 78w(a)(2).

the authority set forth in Section 13 of the BHC Act, which does not require consideration of the factors specified in Exchange Act sections 3(f) and 23(a)(2).

As discussed above in Part III.B.5 of the Supplementary Information, § __.7(a) of the proposed rule and proposed Appendix A require covered banking entities that meet, together with their affiliates and subsidiaries, the $1 billion gross trading assets and liabilities threshold to: (i) calculate and report certain quantitative measurements, and (ii) create and retain records related to such quantitative measurements. Further, under § __.7(a) of the proposed rule and proposed Appendix A, a larger number of quantitative measurements are required to be calculated and reported by covered banking entities that, together with their affiliates and subsidiaries, have over $5 billion gross trading assets and liabilities. In addition, such measurements are required to be calculated and reported for a broader scope of trading activities if a covered banking entity meets the $5 billion threshold.

The reporting and recordkeeping requirements in § __.7(a) and Appendix A of the proposed rule are likely to impose certain costs on covered banking entities that meet the $1 billion gross trading assets and liabilities threshold, including costs associated with implementing, monitoring, and attributing financial and personnel resources for purposes of complying with the reporting and recordkeeping requirements. Moreover, such costs will likely be greater for covered banking entities that meet the $5 billion threshold. Incurring these costs may marginally reduce the ability of covered banking entities that are registered broker-dealers and security-based swap dealers to compete with their non-banking entity counterparts or with banking entities that do not meet the $1 billion threshold. Further, as a result of these costs, the

proposal may impose additional competitive burdens on registered broker-dealers and security-based swap dealers that, together with their affiliates and subsidiaries, meet the $5 billion threshold, and may affect their ability to compete with: (i) banking entities with $1 to $5 billion gross trading assets and liabilities; (ii) banking entities below the $1 billion threshold; and (iii) non-banking entities. In addition, registered broker-dealers and security-based swap dealers that are covered banking entities meeting the $1 billion threshold may need to redirect resources from other functions of the broker-dealer or security-based swap dealer in order to comply with the reporting and recordkeeping requirements. Reallocating available resources within the registered broker-dealer or security-based swap dealer may reduce efficiency within the covered banking entity and may have a marginal negative impact on the extent to which the registered broker-dealer or security-based swap dealer continues to perform certain functions, which may include those that serve customers or provide other market benefits. If this were to occur, registered broker-dealers and security-based swap dealers that are covered banking entities meeting the $5 billion threshold may face greater efficiency effects because they will likely need to devote more time and resources to the enhanced reporting and recordkeeping requirements set forth in the proposal for such covered banking entities. The increased cost of doing business that may result from the proposed reporting and recordkeeping requirements could also cause a registered broker-dealer or security-based swap dealer that is a covered banking entity to pass some of the costs along to customers and clients of their services, such as market making or underwriting. On the other hand, the reporting and recordkeeping requirements in § __.7(a) and Appendix A could have positive efficiency effects because these measures generally may improve compliance within covered banking entities and thereby reduce the potential consequences associated with noncompliance.

The reporting and recordkeeping requirements may create an incentive for covered banking entities that are registered broker-dealers and security-based swap dealers to reduce their average gross sum of trading assets and liabilities, together with their affiliates and subsidiaries, below the $5 billion threshold or $1 billion in order to avoid the costs of complying with some or all of the requirements in § __.7(a) of the proposed rule and Appendix A. To the extent the proposed rule creates such an incentive, a covered banking entity that is a registered broker-dealer or security-based swap dealer may reduce the amount of its trading activities to be below the applicable threshold. If a registered broker-dealer or security-based swap dealer that is a covered banking entity decreased the extent to which it engaged in trading activities, the resulting effects could be decreased competitiveness of the registered broker-dealer or security-based swap dealer in the broader market and reduced market efficiency and liquidity. Whether there will be a competitive impact will depend on the way in which a registered broker-dealer or security-based swap dealer that is a covered banking entity chooses to reduce its trading activities. For example, if the reporting and recordkeeping requirement lead a covered banking entity to minimize its trading in a particular product, this may lead to a decreased competitiveness in the trading of that particular product. The reporting and recordkeeping requirements, however, could enhance efficiency by improving covered banking entities' compliance and thereby reduce the potential consequences associated with noncompliance.

Further, a majority of the quantitative measurements in proposed Appendix A would only be required to be calculated and reported for trading units engaged in market making-related activity under § __.4(b) of the proposed rule. To the extent that the costs associated with the

requirements in Appendix A create a disincentive for covered banking entities that are registered broker-dealers or security-based swap dealers to engage in the full range of market making-related activity that is permitted under the rule, such covered banking entities may reduce the size or scope of their market making activities. If this were to occur to a significant extent, the overall reduction in market making activities would likely have a negative impact on market efficiency and liquidity and, as a related matter, capital formation by causing certain banking entities to provide fewer market making-related services. This potential reduction in market making on the part of certain registered broker-dealers or security-based swap dealers that are covered banking entities may cause some demand for market making-related services to migrate to smaller banking entities not meeting the $1 billion threshold and non-banking entities. At the same time, the quantitative measurements required under Appendix A could have positive efficiency effects by generally improving compliance and thereby reduce the potential consequences associated with noncompliance.

The documentation requirements of § __.5(c) of the proposed rule, which provides that risk-mitigating hedging transactions must be documented in a specified manner if the hedging transaction is established at a level of organization that is different than the level of organization establishing or responsible for the position, contract, or other holding that is being hedged, may have a negative impact on efficiency by reducing the speed with which a covered banking entity could execute a hedge at a different level within the entity. To the extent that the proposed documentation requirement makes it more costly or difficult for a covered banking entity that is a registered broker-dealer or security-based swap dealer to establish hedges at a different level within the entity, this requirement may result in increased risks or reduced profitability of the

broker-dealer or security-based swap dealer, which could negatively affect the competitiveness of the broker-dealer or security-based swap dealer. Further, greater difficulties or increased costs, such as those related to potential systems changes and maintenance, employee resources and time, and recordkeeping, related to establishing a hedge at a different level within the covered banking entity may cause the registered broker-dealer or security-based swap dealer to reduce its underwriting or market making-related activities under the proposed rule in order to avoid costs related to hedging underwriting or market making positions, which could likewise harm efficiency and capital formation. Alternatively, such costs could be passed through to clients or customers of the registered broker-dealer or security-based swap dealer which, in turn, could harm capital formation.

As discussed above in Part III.D of the Supplemental Information, § __.20 of the proposed rule requires all covered banking entities to develop and provide for the continued administration of a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions of section 13 of the BHC Act and the proposed rule, unless such covered banking entity does not engage in activities or investments prohibited or restricted by subpart B or subpart C of the proposed rule.[379] In addition, covered banking entities that meet the thresholds in § __.20(c) of the proposed rule are required to satisfy the additional standards and requirements in proposed Appendix C with respect to their compliance program.

The SEC recognizes that the compliance program requirements in the proposal are likely to impose certain costs, including implementation and ongoing maintenance costs associated

[379] See proposed rule §§ __.20(a), (d).

with hiring additional personnel or other personnel modifications, new or additional systems (including computer hardware or software), ongoing system maintenance, developing exception reports, surveillance (e.g., reviewing and monitoring exception reports), consultation with outside experts (e.g., attorneys, accountants), recordkeeping, independent testing, and training. These costs may increase competitive burdens on registered broker-dealers and security-based swap dealers that are covered banking entities. For example, the increased compliance costs related to implementation and ongoing maintenance of the six elements of the compliance program (i.e., written policies and procedures, internal controls, a management framework, independent testing, training, and recordkeeping), as part of the overall cost of doing business, may make it more difficult for covered banking entities that are registered broker-dealers and security-based swap dealers to compete with non-banking entity broker-dealers and security-based swap dealers. Further, there may be additional competitive burdens for covered banking entities that are registered broker-dealers and security-based swap dealers that, together with their affiliates and subsidiaries, meet the thresholds in § __.20(c), which determines the covered banking entities that must comply with the minimum standards in proposed Appendix C, as there are likely to be increased compliance costs related to the more specific requirements for the compliance program requirements set forth in Appendix C. Since the thresholds in § __.20(c) are based on the size of the registered broker-dealer or security-based swap dealer, together with its affiliates and subsidiaries, and the size of their collective covered trading activities and covered fund activities and investments, the demand for these trading activities may migrate to smaller banking entities or non-banking entities.

In addition, the costs associated with implementation and ongoing maintenance of the compliance program requirements in § __.20 of the proposed rule and Appendix C, where applicable, could cause the covered banking entity to redirect resources from other business activities that are generally beneficial to market efficiency, such as market making and other customer-related services. This potential reallocation of resources could have a marginal negative effect on competition, efficiency, and capital formation. For example, the independent testing requirement in the proposal may necessitate that additional resources be provided to the internal audit department of the covered banking entity that is a registered broker-dealer or security-based swap dealer, if such testing is conducted by a qualified internal tester. Alternatively, if an outside party is used to conduct the independent testing, the covered banking entity would incur costs associated with paying the qualified outside party's for its services, which would reduce the resources available for other activities of the covered banking entity.

Further, §§ __.4(a), __.4(b), and __.5 of the proposed rule, which permit underwriting, market making-related, and risk-mitigating hedging activities, require a covered banking entity to establish the compliance program required in the proposed rule in order to rely on the exemptions. To the extent that the burdens associated with the compliance program requirements in the proposed rule create an incentive for registered broker-dealers and security-based swap dealers that are covered banking entities to forgo these permitted activities, rather than incur the costs related to establishing and maintaining a compliance program, there would likely be a negative impact on efficiency, competition, and capital formation as a result of reduced market making and underwriting services available to customers and clients of such services.

The SEC requests comment on the competitive or anticompetitive effects of the elements of the proposed rule that are proposed under Exchange Act authority with respect to covered banking entities that are registered broker-dealers and security-based swap dealers. The SEC also seeks comment on the efficiency and capital formation effects of these components of the proposal, if adopted. The SEC encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such effects.

C. Registered Investment Advisers

As discussed above, under the proposed rule, a covered banking entity as defined in § __.2(j) would generally be subject to the substantive requirements contained in the SEC's rule. These substantive requirements implement the provisions on proprietary trading and covered fund activities under section 13 of the BHC Act. Thus for example, a covered banking entity that is a registered dealer would be required to comply with subparts A through D of the SEC's proposed rule, including Appendices A, B and C, where applicable. With respect to covered fund activities, investments or relationships set forth in subpart C and § __.20 of subpart D ("covered fund restrictions"), however, the SEC's proposed rule would require that a covered banking entity that is a covered banking entity because it is an investment adviser for which the SEC is the primary financial regulatory agency under section 2(12)(B)(iii) of the Dodd-Frank Act (a "registered adviser") comply with the covered fund restrictions issued by the appropriate Federal banking agency that regulates the banking entity specified in § __.2(e)(1), (2) and (3)

with which the registered adviser is affiliated.[380] Under this approach, a registered adviser would be required to comply with the rules and related guidance issued by the appropriate Federal banking agency. The SEC would, however, retain enforcement authority over all activities of registered advisers (i.e., both proprietary trading and covered fund restrictions).

The covered fund restrictions of section 13 of the BHC Act and the proposed implementing rules make reference to or incorporate a number of banking law and supervision concepts that traditionally appear in Federal banking law and are interpreted and applied by the Federal banking agencies. For example, as discussed in greater detail in the Supplementary Information, the limitations on ownership interests in a covered fund set forth in the statute and the proposed rule generally reference the tier 1 capital of the affiliated insured depository institution or the affiliated holding company. Similarly, capital deductions under the proposed rule refer to the tier 1 capital of the affiliated insured depository institution or the affiliated holding company. In addition, the covered fund restrictions of the statute and the proposed rule incorporate by reference sections 23A and 23B of the FR Act and are administered by the Federal banking agencies. These sections of the FR Act restrict and limit transactions between certain banking organizations and their affiliates, some of which are based on a percentage of bank capital. Further, other covered fund restrictions, including for example exemptions for investments involving the public welfare and bank-owned life insurance and the extension of time to divest of investments after the seeding period, reference other banking laws or regulations that are administered by the Federal banking agencies.

[380] A registered adviser would, however, be required comply with the provisions that implement the proprietary trading restrictions set forth in subparts A, B and § __.20 of subpart D of the proposed rule as promulgated by the SEC, including Appendix C, where applicable.

In light of these considerations, the SEC's proposed rule would require a registered adviser to comply with the covered fund restrictions contained in subpart C and §.__20 of subpart D of rules implementing section 13 of the BHC that are issued by the appropriate Federal banking agency that regulates the banking entity with which the registered adviser is affiliated. Under the proposed approach, a registered adviser complying with the SEC's rule would do so by complying with the rule issued by the appropriate Federal banking agency, including any related interpretations or guidance regarding such requirements. Similarly, under the proposed approach, the foregoing determinations regarding capital or other banking law requirements that may be applicable to a registered adviser would be made by the appropriate Federal banking agency that regulates the banking entity with which the registered adviser is affiliated. This approach would mitigate the burdens of complying with the covered fund restrictions for registered advisers and would avoid creating incentives for covered fund activities to be moved from a registered adviser to a bank.[381]

The SEC's proposed rule specifies that a registered adviser must comply with the covered fund restrictions contained in subpart C and §__.20 of subpart D that are issued by the appropriate Federal banking agency that regulates the banking entity with which the registered adviser is affiliated. Subpart C, which uses terms defined in subpart A, specifies the covered fund restrictions. Subpart D §__.20 requires the establishment of a compliance program when engaging in covered fund activities. A registered adviser complying with subpart C and §__.20 of subpart D, as issued by the appropriate Federal banking agency, would also rely on

[381] Unless it advises a registered investment company, a bank (as defined in section 202(a)(2) of the Advisers Act) that relies on the exclusion from the definition of investment adviser under section 202(a)(11)(A) of the Advisers Act would not be required to register under the Advisers Act. If such a bank provided advisory services, the bank would not be a "covered banking entity" under the SEC's proposed rules because its primary financial regulatory agency would not be the SEC.

interpretative guidance issued by the appropriate Federal banking agency with respect to those subparts of the proposed rule. Because §__.20 of subpart D relates to both the prohibitions and restrictions on proprietary trading activity as well as the prohibitions and restrictions on covered fund activities and investments, a registered adviser would be required to comply with the relevant covered fund provisions issued by the appropriate Federal banking agency. A registered adviser, however, would be subject to the provisions set forth in subpart D of the SEC's proposed rule, including §__.20, that relate to covered trading activities.

Nothing set forth in the discussion above, or in § __.10(a)(2) of the SEC's proposed rule, however, is intended, or shall be deemed, to limit the SEC's authority under any other provision of law, including pursuant to section 13 of the BHC Act.

The SEC request comment on the its proposed approach to implementing section 13 of the BHC Act as it applies to registered advisers with respect to the covered fund restrictions. In particular, the SEC requests comment on the following:

Question SEC-5. Should the SEC instead require registered advisers to comply with the covered fund restrictions proposed by the SEC, instead of those issued the appropriate Federal banking agency? If so, could this create incentives to move the advisory business between the registered adviser and its affiliated bank? Are there benefits to this alternate approach? If so, please explain.

Question SEC-6. Are there other alternative approaches to the proposed rule that would be more effective? If yes, what alternatives and why?

Question SEC-7. Would registered advisers affiliated with insured depository institutions benefit from the proposed approach? Why or why not?

Question SEC-8. Would a registered adviser that is affiliated with insured depository institutions that are regulated by multiple Federal banking agencies encounter additional burdens in implementing the proposed approach? With respect to these registered advisers, which Federal banking agency's rules should be applicable to the registered adviser? For example, should the registered adviser be subject to the rules applicable to the registered adviser's immediate parent that is an insured depository institution?

Question SEC-9. Is the proposed requirement that registered advisers comply with the covered fund restrictions in § __.20 issued by the Federal banking agency that regulates the banking entity specified in § __.2(e)(1), (2) and (3) of the proposed rule with which the registered adviser is affiliated sufficiently clear? Are there particular compliance program requirements in § __.20 with respect to the covered fund restrictions that overlap with the proprietary trading restrictions, such that it would be difficult to identify which requirements are related to the covered fund restrictions and which requirements are related to the proprietary trading restrictions? If so, which requirements and how should this overlap be addressed? Should registered advisers be required to comply with § __.20 of the SEC's rule in its entirety? Why or why not?

Question SEC-10. Will the SEC's proposed approach limit the potential for inconsistent application of the proposed rules with respect to affiliates of entities specified in § __.2(e)(1), (2) and (3)? Why or why not?

Question SEC-11. Will the SEC's proposed approach be effective in avoiding the creation of incentives for covered fund activities to move from a registered adviser to a bank? Why or why not?

Text of the Proposed Common Rules

(All Agencies)

The text of the proposed common rules appears below:

PART [ ] —PROPRIETARY TRADING AND CERTAIN INTERESTS IN AND RELATIONSHIPS WITH COVERED FUNDS

Subpart A -- Authority and Definitions

Sec.

____.1 Authority, purpose, scope, and relationship to other authorities. [Reserved]

____.2 Definitions.

Subpart B -- Proprietary Trading

____.3 Prohibition on proprietary trading.

____.4 Permitted underwriting and market making-related activities.

____.5 Permitted risk-mitigating hedging activities.

____.6 Other permitted proprietary trading activities.

___.7 Reporting and recordkeeping requirements applicable to trading activities.

___.8 Limitations on permitted proprietary trading activities.

___.9 [Reserved]

Subpart C -- Covered Fund Activities and Investments

___.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

___.11 Permitted organizing and offering of a covered fund.

___.12 Permitted investment in a covered fund.

___.13 Other permitted covered fund activities and investments.

___.14 Covered fund activities and investments determined to be permissible.

___.15 Internal controls, reporting and recordkeeping requirements applicable to covered fund activities and investments.

___.16 Limitations on relationships with a covered fund.

___.17 Other limitations on permitted covered fund activities and investments.

___.18 [Reserved]

___.19 [Reserved]

Subpart D -- Compliance Program Requirement; Violations

___.20 Program for monitoring compliance; enforcement.

___.21 Termination of activities or investments; penalties for violations.

Appendix A to Part [ ] -- Reporting and Recordkeeping Requirements for Covered Trading Activities

Appendix B to Part [ ] -- Commentary Regarding Identification of Permitted Market Making-Related Activities

Appendix C to Part [ ] -- Minimum Standards for Programmatic Compliance

SUBPART A – Authority and Definitions

§ ___.1 Authority, purpose, scope, and relationship to other authorities. [Reserved]

§ ___.2 Definitions.

Unless otherwise specified, for purposes of this part:

(a) Affiliate has the same meaning as in section 2(k) of the BHC Act (12 U.S.C. 1841(k)).

(b) Applicable accounting standards means U.S. generally accepted accounting principles or such other accounting standards applicable to a covered banking entity that [Agency] determines are appropriate, that the covered banking entity uses in the ordinary course of its business in preparing its consolidated financial statements.

(c) BHC Act means the Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.).

(d) Bank holding company has the same meaning as in section 2 of the BHC Act (12 U.S.C. 1841).

(e) Banking entity means:

(1) Any insured depository institution;

(2) Any company that controls an insured depository institution;

(3) Any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106); and

(4) Any affiliate or subsidiary of any entity described in paragraphs (e)(1), (2), or (3) of this section, other than an affiliate or subsidiary that is:

(i) A covered fund that is organized, offered and held by a banking entity pursuant to § __.11 and in accordance with the provisions of subpart C of this part, including the provisions governing relationships between a covered fund and a banking entity; or

(ii) An entity that is controlled by a covered fund described in paragraph (e)(4)(i) of this section.

(f) Board means the Board of Governors of the Federal Reserve System.

(g) Buy and purchase each include any contract to buy, purchase, or otherwise acquire. For security futures products, such terms include any contract, agreement, or transaction

for future delivery. With respect to a commodity future, such terms include any contract, agreement, or transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(h) CFTC means the Commodity Futures Trading Commission.

(i) Commodity Exchange Act means the Commodity Exchange Act (7 U.S.C. 1 et seq.).

(j) [Reserved]

(k) Depository institution has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)).

(l) (i) Derivative means:

(A) Any swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)), and as those terms are further jointly defined by the CFTC and SEC by joint regulation, interpretation, guidance, or other action, in consultation with the Board pursuant to section 712(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (15 U.S.C. 8302(d));

(B) Any purchase or sale of a nonfinancial commodity for deferred shipment or delivery that is intended to be physically settled;

(C) Any foreign exchange forward (as that term is defined in section 1a(24) of the Commodity Exchange Act (7 U.S.C. 1a(24)) or foreign exchange swap (as that term is defined in section 1a(25) of the Commodity Exchange Act (7 U.S.C. 1a(25));

(D) Any agreement, contract, or transaction in foreign currency described in section 2(c)(2)(C)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(C)(i));

(E) Any agreement, contract, or transactions in a commodity other than foreign currency described in section 2(c)(2)(D)(i) of the Commodity Exchange Act (7 U.S.C. 2(c)(2)(D)(i)); and

(F) Any transaction authorized under section 19 of the Commodity Exchange Act (7 U.S.C. 23(a) or (b));

(ii) A derivative does not include:

(A) Any consumer, commercial, or other agreement, contract, or transaction that the CFTC and SEC have further defined by joint regulation, interpretation, guidance, or other action as not within the definition of swap, as that term is defined in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)), or security-based swap, as that term is defined in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68));

(B) Any identified banking product, as defined in section 402(b) of the Legal Certainty for Bank Products Act of 2000 (7 U.S.C. 27(b)), that is subject to section 403(a) of that Act (7 U.S.C. 27a(a)).

(m) Exchange Act means the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.).

(n) Federal banking agencies means the Board, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation.

(o) Foreign banking organization has the same meaning as in § 211.21(o) of the Board's Regulation K (12 CFR 211.21(o)).

(p) Insured depository institution has the same meaning as in section 3(c) of the Federal Deposit Insurance Act (12 U.S.C. 1813(c)), but does not include any insured depository institution that is described in section 2(c)(2)(D) of the BHC Act (12 U.S.C. 1841(c)(2)(D)).

(q) Loan means any loan, lease, extension of credit, or secured or unsecured receivable.

(r) Nonbank financial company supervised by the Board has the meaning specified in section 102 of the Financial Stability Act of 2010 (12 U.S.C. 5311).

(s) Qualifying foreign banking organization means a foreign banking organization that qualifies as such under § 211.23(a) of the Board's Regulation K (12 CFR 211.23(a)).

(t) Resident of the United States means:

(1) Any natural person resident in the United States;

(2) Any partnership, corporation or other business entity organized or incorporated under the laws of the United States or any State;

(3) Any estate of which any executor or administrator is a resident of the United States;

(4) Any trust of which any trustee, beneficiary or, if the trust is revocable, any settlor is a resident of the United States;

(5) Any agency or branch of a foreign entity located in the United States;

(6) Any discretionary or non-discretionary account or similar account (other than an estate or trust) held by a dealer or fiduciary for the benefit or account of a resident of the United States;

(7) Any discretionary account or similar account (other than an estate or trust) held by a dealer or fiduciary organized or incorporated in the United States, or (if an individual) a resident of the United States; or

(8) Any person organized or incorporated under the laws of any foreign jurisdiction formed by or for a resident of the United States principally for the purpose of engaging in one or more transactions described in § __.6(d)(1) or § __.13(c)(1).

(u) SEC means the Securities and Exchange Commission.

(v) Sale and sell each include any contract to sell or otherwise dispose of. For security futures products, such terms include any contract, agreement, or transaction for future delivery. With respect to a commodity future, such terms include any contract, agreement, or

transaction for future delivery. With respect to a derivative, such terms include the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing of rights or obligations under, a derivative, as the context may require.

(w) Security has the meaning specified in section 3(a)(10) of the Exchange Act (15 U.S.C. 78c(a)(10)).

(x) Security future has the meaning specified in section 3(a)(55) of the Exchange Act (15 U.S.C. 78c(a)(55)).

(y) Securities Act means the Securities Act of 1933 (15 U.S.C. 77a et seq.).

(z) Separate account means an account established and maintained by an insurance company subject to regulation by a State insurance regulator or a foreign insurance regulator under which income, gains, and losses, whether or not realized, from assets allocated to such account, are, in accordance with the applicable contract, credited to or charged against such account without regard to other income, gains, or losses of the insurance company.

(aa) State means any State, territory or possession of the United States, and the District of Columbia.

(bb) Subsidiary has the same meaning as in section 2(d) of the BHC Act (12 U.S.C. 1841(d)).

SUBPART B – Proprietary Trading

§ ___.3 Prohibition on proprietary trading.

(a) Prohibition. Except as otherwise provided in this subpart, a covered banking entity may not engage in proprietary trading.

(b) Definition of "proprietary trading" and related terms. For purposes of this subpart:

(1) Proprietary trading means engaging as principal for the trading account of the covered banking entity in any purchase or sale of one or more covered financial positions. Proprietary trading does not include acting solely as agent, broker, or custodian for an unaffiliated third party.

(2) Trading account.

(i) Trading account means any account that is used by a covered banking entity to:

(A) Acquire or take one or more covered financial positions principally for the purpose of:

(1) Short-term resale;

(2) Benefitting from actual or expected short-term price movements;

(3) Realizing short-term arbitrage profits; or

(4) Hedging one or more positions described in paragraphs (b)(2)(i)(A)(1), (2), or (3) of this section;

(B) Acquire or take one or more covered financial positions, other than positions that are foreign exchange derivatives, commodity derivatives, or contracts of sale of a commodity for

future delivery, that are market risk capital rule covered positions, if the covered banking entity, or any affiliate of the covered banking entity that is a bank holding company, calculates risk-based capital ratios under the market risk capital rule as defined in paragraph (c)(8) of this section; or

(C) Acquire or take one or more covered financial position for any purpose, if the covered banking entity is:

(1) A dealer or municipal securities dealer that is registered with the SEC under the Exchange Act, to the extent the position is acquired or taken in connection with the activities of the dealer or municipal securities dealer that require it to be registered under that Act;

(2) A government securities dealer that is registered, or that has filed notice, with an appropriate regulatory agency (as that term is defined in section 3(a)(34) of the Exchange Act (15 U.S.C. 78c(a)(34)), to the extent the position is acquired or taken in connection with the activities of the government securities dealer that require it to be registered, or to file notice, under that Act;

(3) A swap dealer that is registered with the CFTC under the Commodity Exchange Act, to the extent the position is acquired or taken in connection with the activities of the swap dealer that require it to be registered under that Act;

(4) A security-based swap dealer that is registered with the SEC under the Exchange Act, to the extent the position is acquired or taken in connection with the activities of the security-based swap dealer that require it to be registered under that Act; or

(5) Engaged in the business of a dealer, swap dealer, or security-based swap dealer outside of the United States to the extent the position is acquired or taken in connection with the activities of such business.

(ii) Rebuttable presumption for certain positions. An account shall be presumed to be a trading account if it is used to acquire or take a covered financial position, other than a covered financial position described in paragraph (b)(2)(i)(B) or (C) of this section, that the covered banking entity holds for a period of sixty days or less, unless the covered banking entity can demonstrate, based on all the facts and circumstances, that the covered financial position, either individually or as a category, was not acquired or taken principally for any of the purposes described in paragraph (b)(2)(i)(A) of this section.

(iii) An account shall not be deemed a trading account for purposes of paragraph (b)(2)(i) of this section to the extent that such account is used to acquire or take a position in one or more covered financial positions:

(A) That arise under a repurchase or reverse repurchase agreement pursuant to which the covered banking entity has simultaneously agreed, in writing, to both purchase and sell a stated asset, at stated prices, and on stated dates or on demand with the same counterparty;

(B) That arise under a transaction in which the covered banking entity lends or borrows a security temporarily to or from another party pursuant to a written securities lending agreement under which the lender retains the economic interests of an owner of such security, and has the right to terminate the transaction and to recall the loaned security on terms agreed by the parties;

(C) For the bona fide purpose of liquidity management and in accordance with a documented liquidity management plan of the covered banking entity that:

(1) Specifically contemplates and authorizes the particular instrument to be used for liquidity management purposes, its profile with respect to market, credit and other risks, and the liquidity circumstances in which the particular instrument may or must be used;

(2) Requires that any transaction contemplated and authorized by the plan be principally for the purpose of managing the liquidity of the covered banking entity, and not for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes;

(3) Requires that any position taken for liquidity management purposes be highly liquid and limited to financial instruments the market, credit and other risks of which the covered banking entity does not expect to give rise to appreciable profits or losses as a result of short-term price movements;

(4) Limits any position taken for liquidity management purposes, together with any other positions taken for such purposes, to an amount that is consistent with the banking entity's near-term funding needs, including deviations from normal operations, as estimated and documented pursuant to methods specified in the plan; and

(5) Is consistent with [Agency]'s supervisory requirements, guidance and expectations regarding liquidity management; or

(D) That are acquired or taken by a covered banking entity that is a derivatives clearing organization registered under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) or a clearing agency registered with the SEC under section 17A of the Exchange Act (15 U.S.C. 78q-1) in connection with clearing derivatives or securities transactions.

(3) Covered financial position.

(i) Covered financial position means any position, including any long, short, synthetic or other position, in:

(A) A security, including an option on a security;

(B) A derivative, including an option on a derivative; or

(C) A contract of sale of a commodity for future delivery, or option on a contract of sale of a commodity for future delivery.

(ii) A covered financial position does not include any position that is:

(A) A loan;

(B) A commodity; or

(C) Foreign exchange or currency.

(c) Definition of other terms related to proprietary trading. For purposes of this subpart:

(1) Commodity has the same meaning as in section 1a(9) of the Commodity Exchange Act (7 U.S.C. 1a(9)), except that a commodity does not include any security;

(2) Contract of sale of a commodity for future delivery means a contract of sale (as that term is defined in section 1a(13) of the Commodity Exchange Act (7 U.S.C. 1a(13)) for future delivery (as that term is defined in section 1a(27) of the Commodity Exchange Act (7 U.S.C. 1a(27)).

(3) Exempted security has the same meaning as in section 3(a)(12)(A) of the Exchange Act (15 U.S.C. 78c(a)(12)(A)).

(4) Foreign insurance regulator means the insurance commission, or a similar official or agency, of one or more countries other than the United States that is engaged in the supervision of insurance companies under foreign insurance law.

(5) General account means, with respect to an insurance company, all of the assets of the insurance company that are not legally segregated and allocated to separate accounts under applicable State or foreign law.

(6) Government securities has the same meaning as in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)).

(7) Market risk capital rule covered position means a covered position as that term is defined for purposes of:

(i) In the case of a covered banking entity that is a bank holding company or insured depository institution, the market risk capital rule that is applicable to the covered banking entity; and

(ii) In the case of a covered banking entity that is affiliated with a bank holding company, other than a covered banking entity to which a market risk capital rule is applicable, the market risk capital rule that is applicable to the affiliated bank holding company.

(8) Market risk capital rule means 12 CFR 3, Appendix B, 12 CFR 208, Appendix E, 12 CFR 225, Appendix E, and 12 CFR 325, Appendix C, as applicable.

(9) Municipal securities has the same meaning as in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)).

(10) Security-based swap has the meaning specified in section 3(a)(68) of the Exchange Act (15 U.S.C. 78c(a)(68)).

(11) Swap has the meaning specified in section 1a(47) of the Commodity Exchange Act (7 U.S.C. 1a(47)).

(12) State insurance regulator means the insurance commission, or a similar official or agency, of a State that is engaged in the supervision of insurance companies under State insurance law.

§ ___.4 Permitted underwriting and market making-related activities.

(a) Underwriting activities.

(1) Permitted underwriting activities. The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity that is made in connection with the covered banking entity's underwriting activities.

(2) Requirements. For purposes of paragraph (a)(1) of this section, a purchase or sale of a covered financial position shall be deemed to be made in connection with a covered banking entity's underwriting activities only if:

(i) The covered banking entity has established the internal compliance program required by subpart D of this part that is designed to ensure the covered banking entity's compliance with the requirements of paragraph (a)(2) of this section, including reasonably designed written policies and procedures, internal controls, and independent testing;

(ii) The covered financial position is a security;

(iii) The purchase or sale is effected solely in connection with a distribution of securities for which the covered banking entity is acting as underwriter;

(iv) The covered banking entity is:

(A) With respect to a purchase or sale effected in connection with a distribution of one or more covered financial positions that are securities, other than exempted securities, security-based swaps, commercial paper, bankers' acceptances, or commercial bills:

(1) A dealer that is registered with the SEC under section 15 of the Exchange Act (15 U.S.C. 78o), or a person that is exempt from registration or excluded from regulation as a dealer thereunder; or

(2) Engaged in the business of a dealer outside of the United States and subject to substantive regulation of such business in the jurisdiction where the business is located;

(B) With respect to a purchase or sale effected as part of a distribution of one or more covered financial positions that are municipal securities, a municipal securities dealer that is registered under section 15B of the Exchange Act (15 U.S.C. 78o-4) or exempt from registration thereunder; or

(C) With respect to a purchase or sale effected as part of a distribution of one or more covered financial positions that are government securities, a government securities dealer that is registered, or that has filed notice, under section 15C of the Exchange Act (15 U.S.C. 78o-5) or exempt from registration thereunder;

(v) The underwriting activities of the covered banking entity with respect to the covered financial position are designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties;

(vi) The underwriting activities of the covered banking entity are designed to generate revenues primarily from fees, commissions, underwriting spreads or other income not attributable to:

(A) Appreciation in the value of covered financial positions related to such activities; or

(B) The hedging of covered financial positions related to such activities; and

(vii) The compensation arrangements of persons performing underwriting activities are designed not to reward proprietary risk-taking.

(3) Definition of distribution. For purposes of paragraph (a) of this section, a distribution of securities means an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.

(4) Definition of underwriter. For purposes of paragraph (a) of this section, underwriter means:

(i) A person who has agreed with an issuer of securities or selling security holder:

(A) To purchase securities for distribution;

(B) To engage in a distribution of securities for or on behalf of such issuer or selling security holder; or

(C) To manage a distribution of securities for or on behalf of such issuer or selling security holder; and

(ii) A person who has an agreement with another person described in paragraph (a)(4)(i) of this section to engage in a distribution of such securities for or on behalf of the issuer or selling security holder.

(b) Market making-related activities.

(1) Permitted market making-related activities. The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity that is made in connection with the covered banking entity's market making-related activities.

(2) Requirements. For purposes of paragraph (b)(1) of this section, a purchase or sale of a covered financial position shall be deemed to be made in connection with a covered banking entity's market making-related activities only if:

(i) The covered banking entity has established the internal compliance program required by subpart D that is designed to ensure the covered banking entity's compliance with the requirements of paragraph (b)(2) of this section, including reasonably designed written policies and procedures, internal controls, and independent testing;

(ii) The trading desk or other organizational unit that conducts the purchase or sale holds itself out as being willing to buy and sell, including through entering into long and short positions in, the covered financial position for its own account on a regular or continuous basis;

(iii) The market making-related activities of the trading desk or other organizational unit that conducts the purchase or sale are, with respect to the covered financial position, designed not to exceed the reasonably expected near term demands of clients, customers, or counterparties;

(iv) The covered banking entity is:

(A) With respect to a purchase or sale of one or more covered financial positions that are securities, other than exempted securities, security-based swaps, commercial paper, bankers' acceptances, or commercial bills:

(1) A dealer that is registered with the SEC under section 15 of the Exchange Act (15 U.S.C. 78o), or a person that is exempt from registration or excluded from regulation as a dealer thereunder; or

(2) Engaged in the business of a dealer outside of the United States and subject to substantive regulation of such business in the jurisdiction where the business is located;

(B) With respect to a purchase or sale of one or more covered financial positions that are swaps:

(1) A swap dealer that is registered with the CFTC under the Commodity Exchange Act (7 U.S.C. 1a) or a person that is exempt from registration thereunder; or

(2) Engaged in the business of a swap dealer outside the United States and subject to substantive regulation of such business in the jurisdiction where the business is located;

(C) With respect to a purchase or sale of one or more covered financial positions that are security-based swaps:

(1) A security-based swap dealer that is registered with the SEC under section 15F of the Exchange Act (15 U.S.C. 78o-10) or a person that is exempt from registration thereunder; or

(2) Engaged in the business of a security-based swap dealer outside of the United States and subject to substantive regulation of such business in the jurisdiction where the business is located;

(D) With respect to a purchase or sale of one or more covered financial positions that are municipal securities, a municipal securities dealer that is registered under section 15B of the Exchange Act (15 U.S.C. 78o-4) or a person that is exempt from registration thereunder; or

(E) With respect to a purchase or sale of one or more covered financial positions that are government securities, a government securities dealer that is registered, or that has filed

notice, under section 15C of the Exchange Act (15 U.S.C. 78o-5) or a person that is exempt from registration thereunder;

(v) The market making-related activities of the trading desk or other organizational unit that conducts the purchase or sale are designed to generate revenues primarily from fees, commissions, bid/ask spreads or other income not attributable to:

(A) Appreciation in the value of covered financial positions it holds in trading accounts; or

(B) The hedging of covered financial positions it holds in trading accounts;

(vi) The market making-related activities of the trading desk or other organizational unit that conducts the purchase or sale are consistent with the commentary provided in Appendix B; and

(vii) The compensation arrangements of persons performing the market making-related activities are designed not to reward proprietary risk-taking.

(3) Market making-related hedging. For purposes of paragraph (b)(1) of this section, a purchase or sale of a covered financial position shall also be deemed to be made in connection with a covered banking entity's market making-related activities if:

(i) The covered financial position is purchased or sold to reduce the specific risks to the covered banking entity in connection with and related to individual or aggregated positions, contracts, or other holdings acquired pursuant to paragraph (b) of this section; and

(ii) The purchase or sale meets all of the requirements described in § __.5(b) and, if applicable, § __.5(c).

§ ___.5 Permitted risk-mitigating hedging activities.

(a) Permitted risk-mitigating hedging activities. The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity that is made in connection with and related to individual or aggregated positions, contracts, or other holdings of a covered banking entity and is designed to reduce the specific risks to the covered banking entity in connection with and related to such positions, contracts, or other holdings.

(b) Requirements. For purposes of paragraph (a) of this section, a purchase or sale of a covered financial position shall be deemed to be in connection with and related to individual or aggregated positions, contracts, or other holdings of a covered banking entity and designed to reduce the specific risks to the covered banking entity in connection with and related to such positions, contracts, or other holdings only if:

(1) The covered banking entity has established the internal compliance program required by subpart D designed to ensure the covered banking entity's compliance with the requirements of paragraph (b) of this section, including reasonably designed written policies and procedures regarding the instruments, techniques and strategies that may be used for hedging, internal controls and monitoring procedures, and independent testing;

(2) The purchase or sale:

(i) Is made in accordance with the written policies, procedures and internal controls established by the covered banking entity pursuant to subpart D of this part;

(ii) Hedges or otherwise mitigates one or more specific risks, including market risk, counterparty or other credit risk, currency or foreign exchange risk, interest rate risk, basis risk, or similar risks, arising in connection with and related to individual or aggregated positions, contracts, or other holdings of a covered banking entity;

(iii) Is reasonably correlated, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the purchase or sale is intended to hedge or otherwise mitigate;

(iv) Does not give rise, at the inception of the hedge, to significant exposures that were not already present in the individual or aggregated positions, contracts, or other holdings of a covered banking entity and that are not hedged contemporaneously;

(v) Is subject to continuing review, monitoring and management by the covered banking entity that:

(A) Is consistent with the written hedging policies and procedures required under paragraph (b)(1) of this section; and

(B) Maintains a reasonable level of correlation, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the purchase or sale is intended to hedge or otherwise mitigate; and

(C) Mitigates any significant exposure arising out of the hedge after inception; and

(vi) The compensation arrangements of persons performing the risk-mitigating hedging activities are designed not to reward proprietary risk-taking.

(c) Documentation. With respect to any purchase, sale, or series of purchases or sales conducted by a covered banking entity pursuant to this § __.5 for risk-mitigating hedging purposes that is established at a level of organization that is different than the level of organization establishing or responsible for the positions, contracts, or other holdings the risks of which the purchase, sale, or series of purchases or sales are designed to reduce, the covered banking entity must, at a minimum, document, at the time the purchase, sale, or series of purchases or sales are conducted:

(1) The risk-mitigating purpose of the purchase, sale, or series of purchases or sales;

(2) The risks of the individual or aggregated positions, contracts, or other holdings of a covered banking entity that the purchase, sale, or series of purchases or sales are designed to reduce; and

(3) The level of organization that is establishing the hedge.

§ ___.6 Other permitted proprietary trading activities.

(a) Permitted trading in government obligations.

(1) The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale by a covered banking entity of a covered financial position that is:

(i) An obligation of the United States or any agency thereof;

(ii) An obligation, participation, or other instrument of or issued by the Government National Mortgage Association, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, a Federal Home Loan Bank, the Federal Agricultural Mortgage Corporation or a Farm Credit System institution chartered under and subject to the provisions of the Farm Credit Act of 1971 (12 U.S.C. 2001 et seq.); or

(iii) An obligation of any State or any political subdivision thereof.

(2) An obligation or other instrument described in paragraphs (a)(1)(i), (ii) or (iii) of this section shall include both general obligations and limited obligations, such as revenue bonds.

(b) Permitted trading on behalf of customers. (1) The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity on behalf of customers.

(2) For purposes of paragraph (b)(1) of this section, a purchase or sale of a covered financial position by a covered banking entity shall be considered to be on behalf of customers if:

(i) The purchase or sale:

(A) Is conducted by a covered banking entity acting as investment adviser, commodity trading advisor, trustee, or in a similar fiduciary capacity for a customer;

(B) Is conducted for the account of the customer; and

(C) Involves solely covered financial positions of which the customer, and not the covered banking entity or any subsidiary or affiliate of the covered banking entity, is beneficial

owner (including as a result of having long or short exposure under the relevant covered financial position);

(ii) The covered banking entity is acting as riskless principal in a transaction in which the covered banking entity, after receiving an order to purchase (or sell) a covered financial position from a customer, purchases (or sells) the covered financial position for its own account to offset a contemporaneous sale to (or purchase from) the customer; or

(iii) The covered banking entity is an insurance company that purchases or sells a covered financial position for a separate account, if:

(A) The insurance company is directly engaged in the business of insurance and subject to regulation by a State insurance regulator or foreign insurance regulator;

(B) The insurance company purchases or sells the covered financial position solely for a separate account established by the insurance company in connection with one or more insurance policies issued by that insurance company;

(C) All profits and losses arising from the purchase or sale of a covered financial position are allocated to the separate account and inure to the benefit or detriment of the owners of the insurance policies supported by the separate account, and not the insurance company; and

(D) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment and other laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled.

(c) Permitted trading by a regulated insurance company. The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by an insurance company or any affiliate of an insurance company if:

(1) The insurance company is directly engaged in the business of insurance and subject to regulation by a State insurance regulator or foreign insurance regulator;

(2) The insurance company or its affiliate purchases or sells the covered financial position solely for the general account of the insurance company;

(3) The purchase or sale is conducted in compliance with, and subject to, the insurance company investment laws, regulations, and written guidance of the State or jurisdiction in which such insurance company is domiciled; and

(4) The appropriate Federal banking agencies, after consultation with the Financial Stability Oversight Council and the relevant insurance commissioners of the States, have not jointly determined, after notice and comment, that a particular law, regulation, or written guidance described in paragraph (c)(3) of this section is insufficient to protect the safety and soundness of the covered banking entity, or of the financial stability of the United States.

(d) Permitted trading outside of the United States.

(1) The prohibition on proprietary trading contained in § __.3(a) does not apply to the purchase or sale of a covered financial position by a covered banking entity if:

(i) The covered banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The purchase or sale is conducted pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act; and

(iii) The purchase or sale occurs solely outside of the United States.

(2) A purchase or sale shall be deemed to be conducted pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act only if:

(i) With respect to a covered banking entity that is a foreign banking organization, the banking entity is a qualifying foreign banking organization and is conducting the purchase or sale in compliance with subpart B of the Board's Regulation K (12 CFR 211.20 through 211.30); or

(ii) With respect to a covered banking entity that is not a foreign banking organization, the covered banking entity meets at least two of the following requirements:

(A) Total assets of the covered banking entity held outside of the United States exceed total assets of the covered banking entity held in the United States;

(B) Total revenues derived from the business of the covered banking entity outside of the United States exceed total revenues derived from the business of the covered banking entity in the United States; or

(C) Total net income derived from the business of the covered banking entity outside of the United States exceeds total net income derived from the business of the covered banking entity in the United States.

(3) A purchase or sale shall be deemed to have occurred solely outside of the United States only if:

(i) The covered banking entity conducting the purchase or sale is not organized under the laws of the United States or of one or more States;

(ii) No party to the purchase or sale is a resident of the United States;

(iii) No personnel of the covered banking entity who is directly involved in the purchase or sale is physically located in the United States; and

(iv) The purchase or sale is executed wholly outside of the United States.

§ ___.7 Reporting and recordkeeping requirements applicable to trading activities.

A covered banking entity engaged in any proprietary trading activity permitted under §§ __.4 through __.6 shall comply with:

(a) The reporting and recordkeeping requirements described in Appendix A to this part, if the covered banking entity has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion;

(b) The recordkeeping requirements required under § __.20 and appendix C to this part, as applicable; and

(c) Such other reporting and recordkeeping requirements as [Agency] may impose to evaluate the covered banking entity's compliance with this subpart.

§ ___.8 **Limitations on permitted proprietary trading activities.**

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ ___.4 through ___.6 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the covered banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the covered banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the covered banking entity or to the financial stability of the United States.

(b) Definition of material conflict of interest. For purposes of this section, a material conflict of interest between a covered banking entity and its clients, customers, or counterparties exists if the covered banking entity engages in any transaction, class of transactions, or activity that would involve or result in the covered banking entity's interests being materially adverse to the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, unless:

(1) Timely and effective disclosure and opportunity to negate or substantially mitigate. Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, for which a conflict of interest may arise, the covered banking entity:

(i) Makes clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a

reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(ii) Makes such disclosure explicitly and effectively, and in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(2) Information barriers. The covered banking entity has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the covered banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A covered banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the covered banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) Definition of high-risk asset and high-risk trading strategy. For purposes of this section:

(1) High-risk asset means an asset or group of related assets that would, if held by a covered banking entity, significantly increase the likelihood that the covered banking entity would incur a substantial financial loss or would fail.

(2) High-risk trading strategy means a trading strategy that would, if engaged in by a covered banking entity, significantly increase the likelihood that the covered banking entity would incur a substantial financial loss or would fail.

___.9 [Reserved]

SUBPART C – Covered Funds Activities and Investments

§ __.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

(a) Prohibition. Except as otherwise provided in this subpart, a covered banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

(b) Definitions. For purposes of this part:

(1) Covered fund means:

(i) An issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act (15 U.S.C. 80a-3(c)(1) or (7));

(ii) A commodity pool, as defined in section 1a(10) of the Commodity Exchange Act (7 U.S.C. 1a(10));

(iii) Any issuer, as defined in section 2(a)(22) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(22)), that is organized or offered outside of the United States that would be a covered fund as defined in paragraphs (b)(1)(i), (ii), or (iv) of this section, were it organized or

offered under the laws, or offered to one or more residents, of the United States or of one or more States; and

(iv) Any such similar fund as the appropriate Federal banking agencies, the SEC, and the CFTC may determine, by rule, as provided in section 13(b)(2) of the BHC Act.

(2) Director has the same meaning as provided in § 215.2(d)(1) of the Board's Regulation O (12 CFR 215.2(d)(1)).

(3) Ownership interest.

(i) Ownership interest means any equity, partnership, or other similar interest (including, without limitation, a share, equity security, warrant, option, general partnership interest, limited partnership interest, membership interest, trust certificate, or other similar instrument) in a covered fund, whether voting or nonvoting, or any derivative of such interest.

(ii) Ownership interest does not include, with respect to a covered fund:

(A) Carried interest. An interest held by a covered banking entity (or an affiliate, subsidiary or employee thereof) in a covered fund for which the covered banking entity (or an affiliate, subsidiary or employee thereof) serves as investment manager, investment adviser or commodity trading adviser, so long as:

(1) The sole purpose and effect of the interest is to allow the covered banking entity (or the affiliate, subsidiary or employee thereof) to share in the profits of the covered fund as performance compensation for services provided to the covered fund by the covered banking entity (or the affiliate, subsidiary or employee thereof), provided that the covered banking entity

(or the affiliate, subsidiary or employee thereof) may be obligated under the terms of such interest to return profits previously received;

(2) All such profit, once allocated, is distributed to the covered banking entity (or the affiliate, subsidiary or employee thereof) promptly after being earned or, if not so distributed, the reinvested profit of the covered banking entity (or the affiliate, subsidiary or employee thereof) does not share in the subsequent profits and losses of the covered fund;

(3) The covered banking entity (or the affiliate, subsidiary or employee thereof) does not provide funds to the covered fund in connection with acquiring or retaining this interest; and

(4) The interest is not transferable by the covered banking entity (or the affiliate, subsidiary or employee thereof) except to another affiliate or subsidiary thereof.

(4) Prime brokerage transaction means one or more products or services provided by a covered banking entity to a covered fund, such as custody, clearance, securities borrowing or lending services, trade execution, or financing, data, operational, and portfolio management support.

(5) Sponsor, with respect to a covered fund, means:

(i) To serve as a general partner, managing member, trustee, or commodity pool operator of a covered fund;

(ii) In any manner to select or to control (or to have employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a covered fund; or

(iii) To share with a covered fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.

(6) Trustee. (i) For purposes of this subpart, a trustee does not include a trustee that does not exercise investment discretion with respect to a covered fund, including a directed trustee, as that term is used in section 403(a)(1) of the Employee's Retirement Income Security Act (29 U.S.C. 1103(a)(1)).

(ii) Any covered banking entity that directs a person identified in paragraph (b)(6)(i) of this section, or that possesses authority and discretion to manage and control the assets of a covered fund for which such person identified in paragraph (b)(6)(i) of this section serves as trustee, shall be considered a trustee of such covered fund.

§ __.11 Permitted organizing and offering of a covered fund.

Section __.10(a) does not prohibit a covered banking entity from, directly or indirectly, organizing and offering a covered fund, including serving as a general partner, managing member, trustee, or commodity pool operator of the covered fund and in any manner selecting or controlling (or having employees, officers, directors, or agents who constitute) a majority of the directors, trustees, or management of the covered fund, including any necessary expenses for the foregoing, only if:

(a) The covered banking entity provides bona fide trust, fiduciary, investment advisory, or commodity trading advisory services;

(b) The covered fund is organized and offered only in connection with the provision of bona fide trust, fiduciary, investment advisory, or commodity trading advisory services and

only to persons that are customers of such services of the covered banking entity, pursuant to a credible plan or similar documentation outlining how the covered banking entity intends to provide advisory or similar services to its customers through organizing and offering such fund;

(c) The covered banking entity does not acquire or retain an ownership interest in the covered fund except as permitted under this subpart;

(d) The covered banking entity complies with the restrictions under § __.16 of this subpart;

(e) The covered banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests;

(f) The covered fund, for corporate, marketing, promotional, or other purposes:

(1) Does not share the same name or a variation of the same name with the covered banking entity (or an affiliate or subsidiary thereof); and

(2) Does not use the word "bank" in its name;

(g) No director or employee of the covered banking entity takes or retains an ownership interest in the covered fund, except for any director or employee of the covered banking entity who is directly engaged in providing investment advisory or other services to the covered fund; and

(h) The covered banking entity:

(1) Clearly and conspicuously discloses, in writing, to any prospective and actual investor in the covered fund (such as through disclosure in the covered fund's offering documents):

(i) That "any losses in [such covered fund] will be borne solely by investors in [the covered fund] and not by [the covered banking entity and its affiliates or subsidiaries]; therefore, [the covered banking entity's and its affiliates' or subsidiaries'] losses in [such covered fund] will be limited to losses attributable to the ownership interests in the covered fund held by the [covered banking entity and its affiliates or subsidiaries] in their capacity as investors in the [covered fund]";

(ii) That such investor should read the fund offering documents before investing in the covered fund;

(iii) That the "ownership interests in the covered fund are not insured by the FDIC, and are not deposits, obligations of, or endorsed or guaranteed in any way, by any banking entity" (unless that happens to be the case);

(iv) The role of the covered banking entity and its affiliates, subsidiaries and employees in sponsoring or providing any services to the covered fund; and

(2) Complies with any additional rules of the appropriate Federal banking agencies, the SEC, or the CFTC, as provided in section 13(b)(2) of the BHC Act, designed to ensure that losses in such covered fund are borne solely by investors in the covered fund and not by the covered banking entity and its affiliates or subsidiaries.

§ __.12 **Permitted investment in a covered fund.**

(a) Authority and limitations on permitted investments in covered funds. (1) The prohibition contained in § __.10(a) does not apply with respect to a covered banking entity acquiring and retaining any ownership interest in a covered fund that the covered banking entity or an affiliate or subsidiary thereof organizes and offers, for the purposes of:

(i) Establishment. Establishing the covered fund and providing the fund with sufficient initial equity for investment to permit the fund to attract unaffiliated investors as required by paragraph (a)(2)(i) of this section; or

(ii) De minimis investment. Making and retaining an investment in the covered fund that does not exceed 3 percent of the total outstanding ownership interests in the fund.

(2) Ownership limits.

(i) With respect to an investment in any covered fund pursuant to paragraph (a)(1)(i) of this section, the covered banking entity:

(A) Must actively seek unaffiliated investors to reduce through redemption, sale, dilution, or other methods the aggregate amount of all ownership interests of the covered banking entity in any covered fund under § __.12 to the amount permitted in paragraph (a)(2)(i)(B) of this section; and

(B) May not exceed 3 percent of the total amount or value of outstanding ownership interests of the fund not later than 1 year after the date of establishment of the fund (or such longer period as may be provided by the Board pursuant to paragraph (e) of this section); and

(ii) The aggregate value of all ownership interests of the covered banking entity in all covered funds under § __.12 may not exceed 3 percent of the tier 1 capital of the covered banking entity, as provided under paragraph (c) of this section.

(b) Limitations on investments in a single covered fund. For purposes of determining whether a covered banking entity is in compliance with the limitations and restrictions on permitted investments in covered funds contained in paragraph (a) of this section, a covered banking entity shall calculate its amount and value of a permitted investment in a single covered fund as follows:

(1) Attribution of ownership interests to a covered banking entity. The amount and value of a banking entity's permitted investment in any single covered fund shall include:

(i) Controlled investments. Any ownership interest held under § __.12 by any entity that is controlled, directly or indirectly, by the covered banking entity for purposes of this part; and

(ii) Noncontrolled investments. The pro rata share of any ownership interest held under § __.12 by any covered fund that is not controlled by the covered banking entity but in which the covered banking entity owns, controls, or holds with the power to vote more than 5 percent of the voting shares.

(2) Calculation of amount of ownership interests in a single covered fund. For purposes of determining whether an investment in a single covered fund does not exceed 3 percent of the total outstanding ownership interests of the fund under paragraph (a)(2)(i)(B) of this section:

(i) The aggregate amount of all ownership interests of the covered banking entity shall be the greater of (without regard to committed funds not yet called for investment):

(A) The value of any investment or capital contribution made with respect to all ownership interests held under § __.12 by the covered banking entity in the covered fund, divided by the value of all investments or capital contributions, respectively, made by all persons in that covered fund; or

(B) The total number of ownership interests held under § __.12 by the covered banking entity in a covered fund divided by the total number of ownership interests held by all persons in that covered fund.

(ii) Inclusion of certain parallel investments. To the extent that a covered banking entity is contractually obligated to directly invest in, or is found to be acting in concert through knowing participation in a joint activity or parallel action toward a common goal of investing in, one or more investments with a covered fund that is organized and offered by the covered banking entity, whether or not pursuant to an express agreement, such investments shall be included in any calculation required under paragraph (a)(2) of this section.

(3) Timing of single covered fund investment calculation. The aggregate amount of all ownership interests of a covered banking entity in a single covered fund may at no time exceed the limits in this paragraph after the conclusion of the period provided in paragraph (a)(2)(i)(B) of this section.

(4) Methodology and standards for calculation. For purposes of determining the amount or value of its investment in a covered fund under this paragraph (b), a covered banking

entity must calculate its investment in the same manner and according to the same standards utilized by the covered fund for determining the aggregate value of the fund's assets and ownership interests.

(c) Aggregate permitted investments in all covered funds. (1) For purposes of determining the aggregate value of all permitted investments in all covered funds by a covered banking entity under paragraph (a)(2)(ii) of this section, the aggregate value of all ownership interests held by that covered banking entity shall be the sum of the value of each investment in a covered fund held under § __.12, as determined in accordance with applicable accounting standards.

(2) Calculation of tier 1 capital. For purposes of determining compliance with paragraph (a)(2)(ii) of this section:

(i) Entities that are required to hold and report tier 1 capital. If a covered banking entity is required to calculate and report tier 1 capital, the covered banking entity's tier 1 capital shall be equal to the amount of tier 1 capital calculated by that covered banking entity as of the last day of the most recent calendar quarter that has ended, as reported to its primary financial regulatory agency, as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act; and

(ii) If a covered banking entity is not required to calculate and report tier 1 capital, the covered banking entity's tier 1 capital shall be determined to be equal to:

(A) In the case of a covered banking entity that is controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital, the amount of tier 1 capital reported by such controlling depository institution pursuant to paragraph (c)(2)(i) of this section;

(B) In the case of a covered banking entity that is not controlled, directly or indirectly, by a depository institution that calculates and reports tier 1 capital:

(1) Bank holding company subsidiaries. If the covered banking entity is a subsidiary of a bank holding company or company that is treated as a bank holding company, the amount of tier 1 capital reported by the top-tier affiliate of such covered banking entity that calculates and reports tier 1 capital, pursuant to paragraph (c)(2)(i) of this section; and

(2) Other holding companies and any subsidiary or affiliate thereof. If the covered banking entity is not a subsidiary of a bank holding company or a company that is treated as a bank holding company, the total amount of shareholders' equity of the top-tier affiliate within such organization as of the last day of the most recent calendar quarter that has ended, as determined under applicable accounting standards.

(3) A covered banking entity's aggregate permitted investment in all covered funds shall be calculated as of the last day of each calendar quarter.

(d) Capital treatment for a permitted investment in a covered fund. For purposes of calculating capital pursuant to the applicable capital rules, a covered banking entity shall deduct the aggregate value of all permitted investments in all covered funds made or retained by a covered banking entity pursuant to this section (as determined under paragraph (c)(1) of this

section) from the banking entity's tier 1 capital (as determined under paragraph (c)(2) of this section).

(e) Extension of time to divest an ownership interest. (1) Upon application by a covered banking entity, the Board may extend the period of time to meet the requirements under paragraphs (a)(2)(i)(A) and (B) of this section for up to 2 additional years, if the Board finds that an extension would be consistent with safety and soundness and not detrimental to the public interest. An application for extension must:

(i) Be submitted to the Board at least 90 days prior to the expiration of the applicable time period;

(ii) Provide the reasons for application, including information that addresses the factors in paragraph (e)(2) of this section; and

(iii) Explain the covered banking entity's plan for reducing the permitted investment in a covered fund through redemption, sale, dilution or other methods as required in paragraph (a)(2)(i) of this section.

(2) Factors governing Board determinations. In reviewing any application under paragraph (e)(1) of this section, the Board may consider all the facts and circumstances related to the permitted investment in a covered fund, including:

(i) Whether the investment would:

(A) Involve or result in material conflicts of interest between the covered banking entity and its clients, customers or counterparties;

(B) Result, directly or indirectly, in a material exposure by the covered banking entity to high-risk assets or high-risk trading strategies;

(C) Pose a threat to the safety and soundness of the covered banking entity; or

(D) Pose a threat to the financial stability of the United States;

(ii) Market conditions;

(iii) The contractual terms governing the covered banking entity's interest in the covered fund;

(iv) The date on which the covered fund is expected to have attracted sufficient investments from investors unaffiliated with the covered banking entity to enable the covered banking entity to comply with the limitations in paragraph (a)(2)(i) of this section;

(v) The total exposure of the covered banking entity to the investment and the risks that disposing of, or maintaining, the investment in the covered fund may pose to the covered banking entity and the financial stability of the United States;

(vi) The cost to the covered banking entity of divesting or disposing of the investment within the applicable period;

(vii) Whether the divestiture or conformance of the investment would involve or result in a material conflict of interest between the covered banking entity and unaffiliated clients, customers or counterparties to which it owes a duty;

(viii) The covered banking entity's prior efforts to reduce through redemption, sale, dilution, or other methods its ownership interests in the covered fund, including activities related to the marketing of interests in such covered fund; and

(ix) Any other factor that the Board believes appropriate.

(3) Consultation. In the case of a covered banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to approval of an application by the covered banking entity for an extension under paragraph (e)(1) of this section.

(4) Authority to impose restrictions on activities or investment during any extension period. (i) The Board may impose such conditions on any extension approved under paragraph (e)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the covered banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act (12 U.S.C. 1851) and this part.

(ii) Consultation. In the case of a covered banking entity that is primarily regulated by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to imposing conditions on the approval of a request by the covered banking entity for an extension under paragraph (e)(1) of this section.

§ __.13 Other permitted covered fund activities and investments.

(a) Permitted investments in SBICs and related investments. The prohibition contained in § __.10(a) does not apply with respect to acquiring or retaining an ownership

interest in, or acting as sponsor to, a covered fund by a covered banking entity or an affiliate or subsidiary thereof:

(1) In one or more small business investment companies, as defined in section 102 of the Small Business Investment Act of 1958 (15 U.S.C. 662);

(2) That is designed primarily to promote the public welfare, of the type permitted under paragraph (11) of section 5136 of the Revised Statutes of the United States (12 U.S.C. 24), including the welfare of low- and moderate-income communities or families (such as providing housing, services, or jobs); or

(3) That is a qualified rehabilitation expenditure with respect to a qualified rehabilitation building or certified historic structure, as such terms are defined in section 47 of the Internal Revenue Code of 1986 or a similar State historic tax credit program.

(b) <u>Permitted risk-mitigating hedging activities</u>.

(1) The prohibition contained in § ___.10(a) does not apply with respect to an ownership interest in a covered fund by a covered banking entity, provided that the acquisition or retention of the ownership interest is:

(i) Made in connection with and related to individual or aggregated obligations or liabilities of the covered banking entity that are:

(A) Taken by the covered banking entity when acting as intermediary on behalf of a customer that is not itself a banking entity to facilitate the exposure by the customer to the profits and losses of the covered fund, or

(B) Directly connected to a compensation arrangement with an employee that directly provides investment advisory or other services to the covered fund; and

(ii) Designed to reduce the specific risks to the covered banking entity in connection with and related to such obligations or liabilities.

(2) Requirements. For purposes of paragraph (b)(1) of this section, acquiring or retaining an ownership interest in a covered fund by a covered banking entity shall be a permissible risk-mitigating hedging activity under this section only if:

(i) The covered banking entity has established the internal compliance program required by subpart D designed to ensure the covered banking entity's compliance with the requirements of this paragraph (b)(2) of this section including reasonably designed written policies and procedures regarding the instruments, techniques and strategies that may be used for hedging, internal controls and monitoring procedures, and independent testing;

(ii) The acquisition or retention of an ownership interest in a covered fund:

(A) Is made in accordance with the written policies, procedures and internal controls established by the covered banking entity pursuant to subpart D;

(B) Hedges or otherwise mitigates an exposure to a covered fund through an offsetting exposure to the same covered fund and in the same amount of ownership interest in that covered fund that:

(1) Arises out of a transaction conducted solely to accommodate a specific customer request with respect to, or

(2) Is directly connected to its compensation arrangement with an employee that directly provides investment advisory or other services to, that covered fund;

(C) Does not give rise, at the inception of the hedge, to significant exposures that were not already present in individual or aggregated positions, contracts, or other holdings of a covered banking entity and that are not hedged contemporaneously; and

(D) Is subject to continuing review, monitoring and management by the covered banking entity that:

(1) Is consistent with its written hedging policies and procedures;

(2) Maintains a substantially similar offsetting exposure to the same amount and type of ownership interest, based upon the facts and circumstances of the underlying and hedging positions and the risks and liquidity of those positions, to the risk or risks the purchase or sale is intended to hedge or otherwise mitigate; and

(3) Mitigates any significant exposure arising out of the hedge after inception; and

(iii) The compensation arrangements of persons performing the risk-mitigating hedging activities are designed not to reward proprietary risk-taking.

(3) Documentation. With respect to any acquisition or retention of an ownership interest in a covered fund by a covered banking entity pursuant to this paragraph (b), the covered banking entity must document, at the time the transaction is conducted:

(i) The risk-mitigating purpose of the acquisition or retention of an ownership interest in a covered fund;

(ii) The risks of the individual or aggregated obligation or liability of a covered banking entity that the acquisition or retention of an ownership interest in a covered fund is designed to reduce; and

(iii) The level of organization that is establishing the hedge.

(c) Certain permitted covered fund activities and investments outside of the United States.

(1) The prohibition contained in § __.10(a) does not apply to the acquisition or retention of any ownership interest in, or the sponsorship of, a covered fund by a covered banking entity if:

(i) The covered banking entity is not directly or indirectly controlled by a banking entity that is organized under the laws of the United States or of one or more States;

(ii) The activity is conducted pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act;

(iii) No ownership interest in such covered fund is offered for sale or sold to a resident of the United States; and

(iv) The activity occurs solely outside of the United States.

(2) An activity shall be considered to be conducted pursuant to paragraph (9) or (13) of section 4(c) of the BHC Act only if:

(i) With respect to a covered banking entity that is a foreign banking organization, the covered banking entity is a qualifying foreign banking organization and is conducting the activity in compliance with subpart B of the Board's Regulation K (12 CFR 211.20 et seq.); or

(ii) With respect to a covered banking entity that is not a foreign banking organization, the covered banking entity meets at least two of the following requirements:

(A) Total assets of the covered banking entity held outside of the United States exceed total assets of the covered banking entity held in the United States;

(B) Total revenues derived from the business of the covered banking entity outside of the United States exceed total revenues derived from the business of the covered banking entity in the United States; or

(C) Total net income derived from the business of the covered banking entity outside of the United States exceeds total net income derived from the business of the covered banking entity in the United States.

(3) An activity shall be considered to have occurred solely outside of the United States only if:

(i) The covered banking entity engaging in the activity is not organized under the laws of the United States or of one or more States;

(ii) No subsidiary, affiliate, or employee of the covered banking entity that is involved in the offer or sale of an ownership interest in the covered fund is incorporated or physically located in the United States or in one or more States; and

(iii) No ownership interest in such covered fund is offered for sale or sold to a resident of the United States.

(d) Loan securitizations. The prohibition contained in § __.10(a) does not apply with respect to the acquisition or retention by a covered banking entity of any ownership interest in, or acting as sponsor to, a covered fund that is an issuer of asset-backed securities, the assets or holdings of which are solely comprised of:

(1) Loans;

(2) Contractual rights or assets directly arising from those loans supporting the asset-backed securities; and

(3) Interest rate or foreign exchange derivatives that:

(i) Materially relate to the terms of such loans or contractual rights or assets; and

(ii) Are used for hedging purposes with respect to the securitization structure.

§ __.14 Covered fund activities determined to be permissible.

(a) The prohibition contained in § __.10(a) does not apply to the acquisition or retention by a covered banking entity of any ownership interest in or acting as sponsor to:

(1) Bank owned life insurance. A separate account which is used solely for the purpose of allowing a covered banking entity to purchase an insurance policy for which the covered banking entity is the beneficiary, provided that the covered banking entity that purchases the insurance policy:

(i) Does not control the investment decisions regarding the underlying assets or holdings of the separate account; and

(ii) Holds its ownership interest in the separate account in compliance with applicable supervisory guidance regarding bank owned life insurance.

(2) Certain other covered funds. Any of the following entities that would otherwise qualify as a covered fund:

(i) A joint venture between the covered banking entity or one of its affiliates and any other person, provided that the joint venture:

(A) Is an operating company; and

(B) Does not engage in any activity or make any investment that is prohibited under this part;

(ii) An acquisition vehicle, provided that the sole purpose and effect of such entity is to effectuate a transaction involving the acquisition or merger of one entity with or into the covered banking entity or one of its affiliates;

(iii) An issuer of an asset-backed security, but only with respect to that amount or value of economic interest in a portion of the credit risk for an asset-backed security that is retained by a covered banking entity that is a "securitizer" or "originator" in compliance with the minimum requirements of section 15G of the Exchange Act (15 U.S.C. 78o-11) and any implementing regulations issued thereunder;

(iv) A wholly-owned subsidiary of the covered banking entity that is:

(A) Engaged principally in performing bona fide liquidity management activities described in § __.3(b)(2)(iii)(C), and

(B) Carried on the balance sheet of the covered banking entity; and

(v) A covered fund that is an issuer of asset-backed securities described in § __.13(d), the assets or holdings of which are solely comprised of:

(A) Loans;

(B) Contractual rights or assets directly arising from those loans supporting the asset-backed securities; and

(C) Interest rate or foreign exchange derivatives that:

(1) Materially relate to the terms of such loans or contractual rights or assets, and

(2) Are used for hedging purposes with respect to the securitization structure.

(b) The prohibition contained in § __.10(a) does not apply to the acquisition or retention by a covered banking entity of any ownership interest in, or acting as sponsor to, a covered fund, but only if such ownership interest is acquired or retained by a covered banking entity (or an affiliate or subsidiary thereof):

(1) In the ordinary course of collecting a debt previously contracted in good faith, if the covered banking entity divests the ownership interest within applicable time periods provided for by [Agency]; or

(2) Pursuant to and in compliance with the conformance or extended transition period authorities provided for in subpart E of the Board's rules implementing section 13 of the BHC Act (12 CFR 248.30 through 248.35).

§ __.15 Internal controls, reporting and recordkeeping requirements applicable to covered fund activities and investments.

A covered banking entity engaged in any covered fund activity or making or holding any investment permitted under this subpart shall comply with:

(a) The internal controls, reporting, and recordkeeping requirements required under § __.20 and appendix C to this part, as applicable; and

(b) Such other reporting and recordkeeping requirements as [Agency] may deem necessary to appropriately evaluate the covered banking entity's compliance with this subpart.

§ __.16 Limitations on relationships with a covered fund.

(a) Relationships with a covered fund.

(1) Except as provided for in paragraph (a)(2) of this section, no covered banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § __.11, and no affiliate of such entity, may enter into a transaction with the covered fund, or with any other covered fund that is controlled by such covered fund, that would be a covered transaction as defined in section 23A of the Federal Reserve Act (12 U.S.C. 371c),

as if such covered banking entity and the affiliate thereof were a member bank and the covered fund were an affiliate thereof.

(2) Notwithstanding paragraph (a)(1) of this section, a covered banking entity may:

(i) Acquire and retain any ownership interest in a covered fund in accordance with the requirements of this subpart; and

(ii) Enter into any prime brokerage transaction with any covered fund in which a covered fund managed, sponsored, or advised by such covered banking entity (or an affiliate or subsidiary thereof) has taken an ownership interest, if:

(A) The covered banking entity is in compliance with each of the limitations set forth in § __.11 with respect to a covered fund organized and offered by such covered banking entity (or an affiliate or subsidiary thereof);

(B) The chief executive officer (or equivalent officer) of the top-tier affiliate of the covered banking entity certifies in writing annually (with a duty to update the certification if the information in the certification materially changes) that the covered banking entity does not, directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the covered fund or of any covered fund in which such covered fund invests; and

(C) The Board has not determined that such transaction is inconsistent with the safe and sound operation and condition of the covered banking entity.

(b) Restrictions on transactions with covered funds. A covered banking entity that serves, directly or indirectly, as the investment manager, investment adviser, commodity trading

advisor, or sponsor to a covered fund, or that organizes and offers a covered fund pursuant to § __.11, shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1), as if such covered banking entity were a member bank and such covered fund were an affiliate thereof.

(c) Restrictions on prime brokerage transactions. A prime brokerage transaction permitted under paragraph (a)(2)(ii) of this section shall be subject to section 23B of the Federal Reserve Act (12 U.S.C. 371c-1) as if the counterparty were an affiliate of the covered banking entity.

§ __.17 Other limitations on permitted covered fund activities.

(a) No transaction, class of transactions, or activity may be deemed permissible under §§ __.11 through __.14 and § __.16 if the transaction, class of transactions, or activity would:

(1) Involve or result in a material conflict of interest between the covered banking entity and its clients, customers, or counterparties;

(2) Result, directly or indirectly, in a material exposure by the covered banking entity to a high-risk asset or a high-risk trading strategy; or

(3) Pose a threat to the safety and soundness of the covered banking entity or the financial stability of the United States.

(b) Definition of material conflict of interest. For purposes of this section, a material conflict of interest between a covered banking entity and its clients, customers, or counterparties exists if the covered banking entity engages in any transaction, class of transactions, or activity that would involve or result in the covered banking entity's interests being materially adverse to

the interests of its client, customer, or counterparty with respect to such transaction, class of transactions, or activity, unless:

(1) Timely and effective disclosure and opportunity to negate or substantially mitigate. Prior to effecting the specific transaction or class or type of transactions, or engaging in the specific activity, for which a conflict of interest may arise, the covered banking entity:

(i) Makes clear, timely, and effective disclosure of the conflict of interest, together with other necessary information, in reasonable detail and in a manner sufficient to permit a reasonable client, customer, or counterparty to meaningfully understand the conflict of interest; and

(ii) Makes such disclosure explicitly and effectively, and in a manner that provides the client, customer, or counterparty the opportunity to negate, or substantially mitigate, any materially adverse effect on the client, customer, or counterparty created by the conflict of interest; or

(2) Information barriers. The covered banking entity has established, maintained, and enforced information barriers that are memorialized in written policies and procedures, such as physical separation of personnel, or functions, or limitations on types of activity, that are reasonably designed, taking into consideration the nature of the covered banking entity's business, to prevent the conflict of interest from involving or resulting in a materially adverse effect on a client, customer, or counterparty. A covered banking entity may not rely on such information barriers if, in the case of any specific transaction, class or type of transactions or activity, the banking entity knows or should reasonably know that, notwithstanding the covered

banking entity's establishment of information barriers, the conflict of interest may involve or result in a materially adverse effect on a client, customer, or counterparty.

(c) Definition of high-risk asset and high-risk trading strategy. For purposes of this section:

(1) High-risk asset means an asset or group of related assets that would, if held by a covered banking entity, significantly increase the likelihood that the covered banking entity would incur a substantial financial loss or would fail.

(2) High-risk trading strategy means a trading strategy that would, if engaged in by a covered banking entity, significantly increase the likelihood that the covered banking entity would incur a substantial financial loss or would fail.

___.18 [Reserved]

___.19 [Reserved]

SUBPART D – Compliance Program Requirement; Violations

§ __.20 Program for monitoring compliance; enforcement.

(a) Program requirement. Except as provided in paragraph (d) of this section, each covered banking entity shall develop and provide for the continued administration of a program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities and investments set forth in section 13 of the BHC Act and this part, and such program shall be appropriate for the size, scope and complexity of activities and business structure of the covered banking entity.

(b) Contents of compliance program. The compliance program required by paragraph (a) of this section, at a minimum, shall include:

(1) Internal written policies and procedures reasonably designed to document, describe, and monitor trading activities subject to subpart B of this part and activities and investments with respect to a covered fund subject to subpart C of this part (including those permitted under §§ __.4 through __.6 or §§ __.11 through __.16) to ensure that such activities and investments comply with section 13 of the BHC Act and this part;

(2) A system of internal controls reasonably designed to monitor and identify potential areas of noncompliance with section 13 of the BHC Act and this part in the covered banking entity's trading activities subject to subpart B of this part and activities and investments with respect to a covered fund subject to subpart C of this part (including those permitted under §§ __.4 through __.6 or §§ __.11 through __.16) and to prevent the occurrence of activities or investments that are prohibited by section 13 of the BHC Act and this part;

(3) A management framework that clearly delineates responsibility and accountability for compliance with section 13 of the BHC Act and this part;

(4) Independent testing for the effectiveness of the compliance program conducted by qualified personnel of the covered banking entity or by a qualified outside party;

(5) Training for trading personnel and managers, as well as other appropriate personnel, to effectively implement and enforce the compliance program; and

(6) Making and keeping records sufficient to demonstrate compliance with section 13 of the BHC Act and this part, which a covered banking entity must promptly provide to [Agency] upon request and retain for a period of no less than 5 years.

(c) Additional standards. (1) In the case of any covered banking entity described in paragraph (c)(2) of this section, the compliance program required by paragraph (a) of this section shall also satisfy the requirements and other standards contained in Appendix C to this part.

(2) A covered banking entity is subject to paragraph (c)(1) of this section if:

(i) The covered banking entity engages in proprietary trading and has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis), as measured as of the last day of each of the four prior calendar quarters:

(A) Is equal to or greater than $1 billion; or

(B) Equals 10 percent or more of its total assets;

(ii) The covered banking entity invests in, or has relationships with, a covered fund and:

(A) The covered banking entity has, together with its affiliates and subsidiaries, aggregate investments in one or more covered funds, the average value of which is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion; or

(B) Sponsors or advises, together with its affiliates and subsidiaries, one or more covered funds, the average total assets of which are, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion; or

(iii) [The Agency] deems it appropriate.

(d) No program required for certain banking entities. To the extent that a covered banking entity does not engage in activities or investments prohibited or restricted by subpart B or subpart C of this part, a covered banking entity will have satisfied the requirements of this section if its existing compliance policies and procedures include measures that are designed to prevent the covered banking entity from becoming engaged in such activities or making such investments and which require the covered banking entity to develop and provide for the compliance program required under paragraph (a) of this section prior to engaging in such activities or making such investments.

§ __.21 Termination of activities or investments; penalties for violations.

(a) Any covered banking entity that engages in an activity or makes an investment in violation of section 13 of the BHC Act or this part or in a manner that functions as an evasion of the requirements of section 13 of the BHC Act or this part, including through an abuse of any activity or investment permitted under subparts B or C, or otherwise violates the restrictions and requirements of section 13 of the BHC Act or this part, shall terminate the activity and, as relevant, dispose of the investment.

(b) After due notice and an opportunity for hearing, if [Agency] finds reasonable cause to believe any covered banking entity has engaged in an activity or made an investment

described in paragraph (a), the [Agency] may, by order, direct the banking entity to restrict, limit, or terminate the activity and, as relevant, dispose of the investment.

(c) [Reserved]

Appendix A to Part [ ] -- Reporting and Recordkeeping Requirements for Covered Trading Activities

I. Purpose

This appendix sets forth reporting and recordkeeping requirements that certain covered banking entities must satisfy in connection with the restrictions on proprietary trading set forth in subpart B of this part ("proprietary trading restrictions"). Pursuant to § __.7, this appendix generally applies to a covered banking entity that has, together with its affiliates and subsidiaries, trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion. These entities are required to furnish periodic reports to [Agency] regarding a variety of quantitative measurements of their covered trading activities, which vary depending on the scope and size of covered trading activities, and create and maintain records documenting the preparation and content of these reports. The requirements of this appendix should be incorporated into the covered banking entity's internal compliance program under § __.20 and appendix C to this part.

The purpose of this appendix is to assist covered banking entities and [Agency] in:

(i) Better understanding and evaluating the scope, type, and profile of the covered banking entity's trading activities;

(ii) Monitoring the covered banking entity's trading activities;

(iii) Identifying trading activities that warrant further review or examination by the covered banking entity to verify compliance with the proprietary trading restrictions;

(iv) Evaluating whether the trading activities of trading units engaged in market making-related activities subject to § __.4(b) are consistent with the requirements governing permitted market making-related activities;

(v) Evaluating whether the covered trading activities of trading units that are engaged in permitted trading activity subject to §§ __.4, __.5, or __.6(a) (i.e., underwriting and market making-related related activity, risk-mitigating hedging, or trading in certain government obligations) are consistent with the requirement that such activity not result, directly or indirectly, in a material exposure to high-risk assets or high-risk trading strategies;

(vi) Identifying the profile of particular trading activities of the covered banking entity, and the individual trading units of the banking entity, to help establish the appropriate frequency and scope of examination by [Agency] of such activities; and

(vii) Assessing and addressing the risks associated with the covered banking entity's covered trading activities.

The quantitative measurements that must be furnished pursuant to this appendix are <u>not</u> intended to serve as a dispositive tool for the identification of permissible or impermissible activities.

In addition to the quantitative measurements required in this appendix, a covered banking entity may need to develop and implement other quantitative measurements in order to

effectively monitor its covered trading activities for compliance with section 13 of the BHC Act and this part and to have an effective compliance program, as required by § __.20 and appendix C to this part. The effectiveness of particular quantitative measurements may differ based on the profile of the banking entity's businesses in general and, more specifically, of the particular trading unit, including types of instruments traded, trading activities and strategies, and history and experience (e.g., whether the trading desk is an established, successful market maker or a new entrant to a competitive market). In all cases, covered banking entities must ensure that they have robust measures in place to identify and monitor the risks taken in their trading activities, to ensure that the activities are within risk tolerances established by the covered banking entity, and to monitor and examine for compliance with the proprietary trading restrictions in this part.

On an ongoing basis, covered banking entities should carefully monitor, review, and evaluate all furnished quantitative measurements, as well as any others that they choose to utilize in order to maintain compliance with section 13 of the BHC Act and this part. All measurement results that indicate a heightened risk of impermissible proprietary trading, including with respect to otherwise-permitted activities under §§ __.4 through __.6 that result in a material exposure to high-risk assets or high-risk trading strategies, should be escalated within the banking entity for review, further analysis, explanation to [Agency], and remediation, where appropriate. Many of the quantitative measurements discussed in this appendix will also be helpful to covered banking entities in identifying and managing the risks related to their covered trading activities.

II. Definitions

The terms used in this appendix have the same meanings as set forth in §§ __.2 and __.3. In addition, for purposes of this appendix, the following definitions apply:

Covered trading activity means proprietary trading, as defined in paragraph (b)(1) of § __.3.

Trading unit means each of the following units of organization of a covered banking entity:

(i) Each discrete unit that is engaged in the coordinated implementation of a revenue-generation strategy and that participates in the execution of any covered trading activity;[1]

(ii) Each organizational unit that is used to structure and control the aggregate risk-taking activities and employees of one or more trading units described in paragraph (i);[2]

(iii) All trading operations, collectively; and

(iv) Any other unit of organization specified by [Agency] with respect to a particular banking entity.

Calculation period means the period of time for which a particular quantitative measurement must be calculated.

III. Reporting and Recordkeeping of Quantitative Measurements

---

[1] [The Agency] expects that this will generally be the smallest unit of organization used by the covered banking entity to structure and control its risk-taking activities and employees, and will include each unit generally understood to be a single "trading desk."

[2] [The Agency] expects that this will generally include management or reporting divisions, groups, sub-groups, or other intermediate units of organization used by the covered banking entity to manage one or more discrete trading units (e.g., "North American Credit Trading," "Global Credit Trading," etc.).

A. Scope of Required Reporting

General scope. The quantitative measurements that must be furnished by a covered banking entity depend on the aggregate size of the covered banking entity's trading activities and the activities in which its trading units engage, as follows:

(i) With respect to any covered banking entity that is engaged in any covered trading activity, and has trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $5 billion:

(a) Each trading unit of the covered banking entity that is engaged in market making-related activities subject to § __.4(b) must furnish the following quantitative measurements, calculated in accordance with this appendix:

- Value-at-Risk and Stress VaR;
- VaR Exceedance;
- Risk Factor Sensitivities;
- Risk and Position Limits;
- Comprehensive Profit and Loss;
- Portfolio Profit and Loss;
- Fee Income and Expense;

- Spread Profit and Loss;
- Comprehensive Profit and Loss Attribution;
- Pay-to-Receive Spread Ratio;
- Unprofitable Trading Days Based on Comprehensive Profit and Loss and Unprofitable Trading Days Based on Portfolio Profit and Loss;
- Skewness of Portfolio Profit and Loss and Kurtosis of Portfolio Profit and Loss;
- Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss;
- Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio;
- Inventory Risk Turnover;
- Inventory Aging; and
- Customer-facing Trade Ratio; and

(b) Each trading unit of the covered banking entity that is engaged in permitted trading activity subject to §§ __.4(a), __.5, or __.6(a) must furnish the following quantitative measurements, calculated in accordance with this appendix:

- Value-at-Risk and Stress VaR;
- Risk Factor Sensitivities;

- Risk and Position Limits;
- Comprehensive Profit and Loss; and
- Comprehensive Profit and Loss Attribution; and

(ii) With respect to any covered banking entity that is engaged in any covered trading activity, and has trading assets and liabilities the average gross sum of which (on a worldwide consolidated basis) is, as measured as of the last day of each of the four prior calendar quarters, equal to or greater than $1 billion and less than $5 billion, each trading unit of the covered banking entity that is engaged in market making-related activities under § __.4(b) must furnish the following quantitative measurement, calculated in accordance with this appendix:

- Comprehensive Profit and Loss;
- Portfolio Profit and Loss;
- Fee Income and Expense;
- Spread Profit and Loss;
- Value-at-Risk;
- Comprehensive Profit and Loss Attribution;
- Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss; and

- Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio.

B. Frequency of Required Calculation and Reporting

A covered banking entity must calculate any applicable quantitative measurement for each trading day. A covered banking entity must report each applicable quantitative measurement to [Agency] on a monthly basis, or on any other reporting schedule requested by [Agency]. All quantitative measurements for any calendar month must be reported to [Agency] no later than 30 days after the end of that calendar month or on any other time basis requested by [Agency].[3]

C. Recordkeeping

A covered banking entity must, for any quantitative measurement furnished to [Agency] pursuant to this appendix and § __.7, create and maintain records documenting the preparation and content of these reports, as well as such information as is necessary to permit [Agency] to verify the accuracy of such reports, for a period of 5 years.

IV. Quantitative Measurements

A. Risk-Management Measurements

1. Value-at-Risk and Stress Value-at-Risk

[3] For example, under section IV.B.1 of this appendix, a banking entity is required to report to [Agency] the Comprehensive Profit and Loss quantitative measurement, as calculated for all trading days in June of any year, no later than July 30 of that year.

Description: For purposes of this appendix, Value-at-Risk ("VaR") is the commonly used percentile measurement of the risk of future financial loss in the value of a given portfolio over a specified period of time, based on current market conditions. For purposes of this appendix, Stress Value-at-Risk ("Stress VaR") is the percentile measurement of the risk of future financial loss in the value of a given portfolio over a specified period of time, based on market conditions during a period of significant financial stress.

General Calculation Guidance: Banking entities should compute and report VaR and Stress VaR by employing generally accepted standards and methods of calculation. VaR should reflect a loss in a trading unit that is expected to be exceeded less than one percent of the time over a one-day period. For those banking entities that are subject to regulatory capital requirements imposed by a Federal banking agency, VaR and Stress VaR should be computed and reported in a manner that is consistent with such regulatory capital requirements. In cases where a trading unit does not have a standalone VaR or Stress VaR calculation but is part of a larger portfolio for which a VaR or Stress VaR calculation is performed, a VaR or Stress VaR calculation that includes only the trading unit's holdings should be performed consistent with the VaR or Stress VaR model and methodology used by the larger portfolio.

Calculation Period: One trading day.

2. VaR Exceedance

Description: For purposes of this appendix, VaR Exceedance is the difference between VaR and Portfolio Profit and Loss, exclusive of Spread Profit and Loss, for a trading unit for any given calculation period.

Calculation Period: One trading day.

3. Risk Factor Sensitivities

Description: For purposes of this appendix, Risk Factor Sensitivities are changes in a trading unit's Portfolio Profit and Loss, exclusive of Spread Profit and Loss, that are expected to occur in the event of a change in a trading unit's "risk factors" (i.e., one or more underlying market variables that are significant sources of the trading unit's profitability and risk).

General Calculation Guidance: A covered banking entity should report the Risk Factor Sensitivities that are monitored and managed as part of the trading unit's overall risk management policy. The underlying data and methods used to compute a trading unit's Risk Factor Sensitivities should depend on the specific function of the trading unit and the internal risk management models employed. The number and type of Risk Factor Sensitivities that are monitored and managed by a trading unit, and furnished to [Agency], should depend on the explicit risks assumed by the trading unit. In general, however, reported Risk Factor Sensitivities should be sufficient to account for a preponderance of the price variation in the trading unit's holdings.

Trading units should take into account any relevant factors in calculating Risk Factor Sensitivities, including, for example, the following with respect to particular asset classes:

- Commodity derivative positions: sensitivities with respect to the related commodity type (e.g., precious metals, oil and petroleum or agricultural products), the maturity of the positions, volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

- Credit positions: sensitivities with respect to credit spread factors that are sufficiently granular to account for specific credit sectors and market segments, the maturity profile of the positions, and sensitivities to interest rates at all relevant maturities;

- Credit-related derivative positions: credit positions sensitivities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

- Equity positions: sensitivity to equity prices and sensitivities that differentiate between important equity market sectors and segments, such as a small capitalization equities and international equities;

- Equity derivative positions: equity position sensitivities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), and the maturity profile of the positions;

- Foreign exchange derivative positions: sensitivities with respect to major currency pairs and maturities, sensitivity to interest rates at relevant maturities, and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions; and

- Interest rate positions, including interest rate derivative positions: sensitivities with respect to major interest rate categories and maturities and volatility and/or correlation sensitivities (expressed in a manner that demonstrates any significant non-linearities), as well as the maturity profile of the positions.

The methods used by a covered banking entity to calculate sensitivities to a common factor shared by multiple trading units, such as an equity price factor, should be applied consistently across its trading units so that the sensitivities can be compared from one trading unit to another.

Calculation Period: One trading day.

4. Risk and Position Limits

Description: For purposes of this appendix, Risk and Position Limits are the constraints that define the amount of risk that a trading unit is permitted to take at a point in time, as defined by the covered banking entity for a specific trading unit.

General Calculation Guidance: Risk and Position Limits should be reported in the format used by the covered banking entity for the purposes of risk management of each trading unit. Risk and Position Limits are often expressed in terms of risk measures, such as VaR and Risk Factor Sensitivities, but may also be expressed in terms of other observable criteria, such as net open positions. When criteria other than VaR or Risk Factor Sensitivities are used to define the Risk and Position Limits, both the value of the Risk and Position Limits and the value of the variables used to assess whether these limits have been reached should be reported.

Calculation Period: One trading day.

B. Source-of-Revenue Measurements

1. Comprehensive Profit and Loss

Description: For purposes of this appendix, Comprehensive Profit and Loss is the net profit or loss of a trading unit's material sources of trading revenue, including, for example, dividend and interest income and expense, over a specific period of time. A trading unit's Comprehensive Profit and Loss for any given calculation period should generally equal the sum of the trading unit's (i) Portfolio Profit and Loss and (ii) Fee Income.

General Calculation Guidance: Comprehensive Profit and Loss generally should be computed using data on the value of a trading unit's underlying holdings, the prices at which those holdings were bought and sold, and the value of any fees, commissions, sales credits, spreads, dividends, interest income and expense, or other sources of income from trading activities, whether realized or unrealized. Comprehensive Profit and Loss should not include: (i) compensation costs or other costs required to operate the unit, such as information technology costs; or (ii) charges and adjustments made for internal reporting and management purposes, such as accounting reserves.

Calculation Period: One trading day.

2. Portfolio Profit and Loss

Description: For purposes of this appendix, Portfolio Profit and Loss is a trading unit's net profit or loss on its underlying holdings over a specific period of time, whether realized or unrealized. Portfolio Profit and Loss should generally include any increase or decrease in the market value of a trading unit's holdings, including, for example, any dividend, interest income, or expense of a trading unit's holdings. Portfolio Profit and Loss should not include direct fees, commissions, sales credits, or other sources of trading revenue that are not directly related to the market value of the trading unit's holdings.

General Calculation Guidance: In general, Portfolio Profit and Loss should be computed using data on a trading unit's underlying holdings and the prices at which those holdings are marked for valuation purposes. Portfolio Profit and Loss should not include: compensation costs or other costs required to operate the trading unit, such as information technology costs; or charges and adjustments made for internal reporting and management purposes, such as accounting reserves.

Calculation Period: One trading day.

3. Fee Income and Expense

Description: For purposes of this appendix, Fee Income and Expense generally includes direct fees, commissions and other distinct income for services provided by or to a trading unit over a specific period of time.

General Calculation Guidance: Fee Income and Expense should be computed using data on direct fees that are earned by the trading unit for services it provides to clients, customers, or counterparties, such as fees earned for structured transactions or sales commissions and credits earned for fulfilling a customer request, whether realized or unrealized, and similar fees paid by the trading unit to other service providers.

Calculation Period: One trading day.

4. Spread Profit and Loss

Description: For purposes of this appendix, Spread Profit and Loss is the portion of Portfolio Profit and Loss that generally includes revenue generated by a trading unit from

charging higher prices to buyers than the trading unit pays to sellers of comparable instruments over the same period of time (i.e., charging a "spread," such as the bid-ask spread).

General Calculation Guidance: Spread Profit and Loss generally should be computed using data on the prices at which comparable instruments are either bought or sold by the trading unit, as well as the turnover of these instruments. Spread Profit and Loss should be measured with respect to both the purchase and the sale of any position, and should include both (i) the spreads that are earned by the trading unit to execute transactions (expressed as positive amounts), and (ii) the spreads that are paid by the trading unit to initiate transactions (expressed as negative amounts). Spread Profit and Loss should be computed by calculating the difference between the bid price or the ask price (whichever is paid or received) and the mid-market price. The mid-market price is the average of bid and ask.

For some asset classes in which a trading unit is engaged in market making-related activities, bid-ask or similar spreads are widely disseminated, constantly updated, and readily available, or otherwise reasonably ascertainable. For purposes of calculating the Spread Profit and Loss attributable to a transaction in such asset classes, the trading unit should utilize the prevailing bid-ask or similar spread on the relevant position at the time the purchase or sale is completed.

For other asset classes in which a trading unit is engaged in market making-related activities, bid-ask or similar spreads may not be widely disseminated on a consistent basis or otherwise reasonably ascertainable. A covered banking entity must identify any trading unit engaged in market making-related activities in an asset class for which the covered banking entity believes bid-ask or similar spreads are not widely disseminated on a consistent basis or are

not otherwise reasonably ascertainable and must be able to demonstrate that bid-ask or similar spreads for the asset class are not reasonably ascertainable. In such cases, the trading unit should calculate the Spread Profit and Loss for the relevant purchase or sale of a position in a particular asset class by using whichever of the following three alternatives the banking entity believes more accurately reflects prevailing bid-ask or similar spreads for transactions in that asset class:

(i) End of Day Spread Proxy: A proxy based on the bid-ask or similar spread that is used to estimate, or is otherwise implied by, the market price at which the trading entity marks (or in the case of a sale, would have marked) the position for accounting purposes at the close of business on the day it executes the purchase or sale ("End of Day Spread Proxy");

(ii) Historical Data Spread Proxy: A proxy based on historical bid-ask or similar spread data in similar market conditions ("Historical Data Spread Proxy"); or

(iii) Any other proxy that the banking entity can demonstrate accurately reflects prevailing bid-ask or similar spreads for transactions in the specific asset class.

A covered banking entity selecting any of these alternatives should be able to demonstrate that the alternative it has chosen most accurately reflects prevailing bid-ask or similar spreads for the relevant asset class. If a covered banking entity chooses to calculate Spread Profit and Loss for a particular trading unit using the End of Day Spread Proxy, then the banking entity should separately identify the portion of Spread Profit and Loss that is attributable to positions acquired and disposed of on the same trading day. If a banking entity chooses to calculate Spread Profit and Loss for a particular trading unit using the Historical Data Spread Proxy, the covered banking entity should be able to demonstrate that the Historical Data Proxy is

appropriate and continually monitor market conditions and adjust, as necessary, the Historical Data Proxy to reflect any changes.

Calculation Period: One trading day.

5. Comprehensive Profit and Loss Attribution

Description: For purposes of this appendix, Comprehensive Profit and Loss Attribution is an attribution analysis that divides the trading unit's Comprehensive Profit and Loss into the separate sources of risk and revenue that have caused any observed variation in Comprehensive Profit and Loss. This attribution analysis should attribute Comprehensive Profit and Loss to specific market and risk factors that can be accurately and consistently measured over time. Any component of Comprehensive Profit and Loss that cannot be specifically identified in the attribution analysis should be identified as an unexplained portion of the Comprehensive Profit and Loss.

General Calculation Guidance: The specific market and risk factors used by a trading unit in the attribution analysis should be tailored to the trading activities undertaken by the unit. These factors should be measured consistently over time to facilitate historical comparisons. The attribution analysis should also identify any significant factors that have a consistent and regular influence on Comprehensive Profit and Loss, such as Risk Factor Sensitivities that have a significant influence on portfolio income, customer spreads, bid-ask spreads, or commissions that are earned. Factors that influence Comprehensive Profit and Loss across different trading units should be measured and included in the attribution analysis in a comparable fashion.

Calculation Period: One trading day.

C. Revenue-Relative-to-Risk Measurements

1. Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss

Description: For purposes of this appendix, Volatility of Comprehensive Profit and Loss generally is the standard deviation of the trading unit's Comprehensive Profit and Loss estimated over a given calculation period. For purposes of this appendix, Volatility of Portfolio Profit and Loss generally is the standard deviation of the trading unit's Portfolio Profit and Loss, exclusive of Spread Profit and Loss, estimated over a given calculation period.

Calculation Period: 30 days, 60 days, and 90 days.

2. Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio

Description: For purposes of this appendix, Comprehensive Profit and Loss to Volatility Ratio is a ratio of Comprehensive Profit and Loss to the Volatility of Comprehensive Profit and Loss for a trading unit over a given calculation period. For purposes of this appendix, Portfolio Profit and Loss to Volatility Ratio is a ratio of Portfolio Profit and Loss, exclusive of Spread Profit and Loss, to the Volatility of Portfolio Profit and Loss, exclusive of Spread Profit and Loss, for a trading unit over a given calculation period.

Calculation Period: 30 days, 60 days, and 90 days.

3. Unprofitable Trading Days Based on Comprehensive Profit and Loss and Unprofitable Trading Days Based on Portfolio Profit and Loss

Description: For purposes of this appendix, Unprofitable Trading Days Based on Comprehensive Profit and Loss is the number or proportion of trading days on which a trading unit's Comprehensive Profit and Loss is less than zero over a given calculation period. For purposes of this appendix, Unprofitable Trading Days Based on Portfolio Profit and Loss, exclusive of Spread Profit and Loss, is the number or proportion of trading days on which a trading unit's Portfolio Profit and Loss, exclusive of Spread Profit and Loss, is less than zero over a given calculation period.

Calculation Period: 30 days, 90 days, and 360 days.

4. Skewness of Portfolio Profit and Loss and Kurtosis of Portfolio Profit and Loss

Description: Skewness of Portfolio Profit and Loss and Kurtosis of Portfolio Profit and Loss should be calculated using standard statistical methods with respect to Portfolio Profit and Loss, exclusive of Spread Profit and Loss.

Calculation Period: 30 days, 60 days, and 90 days.

D. Customer-Facing Activity Measurements

1. Inventory Risk Turnover

Description: For purposes of this appendix, Inventory Risk Turnover is a ratio that measures the amount of risk associated with a trading unit's inventory, as measured by Risk Factor Sensitivities, that is turned over by the trading unit over a specific period of time. For each Risk Factor Sensitivity, the numerator of the Inventory Risk Turnover ratio generally should be the absolute value of the Risk Factor Sensitivity associated with each transaction over

the calculation period. The denominator of the Inventory Risk Turnover ratio generally should be the value of each Risk Factor Sensitivity for all of the trading unit's holdings at the beginning of the calculation period.

General Calculation Guidance: As a general matter, a trading unit should measure and report the Inventory Risk Turnover ratio for each of the Risk Factor Sensitivities calculated and furnished for that trading unit.

Calculation Period: 30 days, 60 days, and 90 days.

2. Inventory Aging

Description: For purposes of this appendix, Inventory Aging generally describes the trading unit's aggregate assets and liabilities and the amount of time that those assets and liabilities have been held for the following periods: 0-30 days; 30-60 days; 60-90 days; 90-180 days; 80-360 days; and greater than 360 days. Inventory Aging should measure the age profile of the trading unit's assets and liabilities.

General Calculation Guidance: In general, Inventory Aging should be computed using a trading unit's trading activity data and should identify the trading unit's aggregate assets and liabilities. In addition, Inventory Aging should include two schedules, an asset-aging schedule and a liability-aging schedule. The asset-aging schedule should record the value of the trading unit's assets that have been held for: 0-30 days; 30-60 days; 60-90 days; 90-180 days; 180-360 days; and greater than 360 days. The liability-aging schedule should record the value of the trading unit's liabilities that have been held for: 0-30 days; 30-60 days; 60-90 days; 90-180 days; 180-360 days; and more than 360 days.

Calculation Period: 30 days, 60 days, and 90 days.

3. Customer-Facing Trade Ratio

Description: For purposes of this appendix, the Customer-Facing Trade Ratio is a ratio comparing the number of transactions involving a counterparty that is a customer of the trading unit to the number of transactions involving a counterparty that is not a customer of the trading unit. For purposes of calculating the Customer-Facing Trade Ratio, a counterparty is considered to be a customer of the trading unit if the counterparty is neither a counterparty to a transaction executed on a designated contract market registered under the Commodity Exchange Act or national securities exchange registered under the Exchange Act, nor a broker-dealer, swap dealer, security-based swap dealer, any other entity engaged in market making-related activities, or any affiliate thereof. A broker-dealer, swap dealer, or security-based swap dealer, any other entity engaged in market making-related activities, or any affiliate thereof may be considered a customer of the trading unit for these purposes if the covered banking entity treats that entity as a customer and has documented how and why the entity is treated as such.

Calculation Period: 30 days, 60 days, and 90 days.

E. Payment of Fees, Commissions, and Spreads Measurement

1. Pay-to-Receive Spread Ratio

Description: For purposes of this appendix, the Pay-to-Receive Spread Ratio is a ratio comparing the amount of Spread Profit and Loss and Fee Income that is earned by a trading unit to the amount of Spread Profit and Loss and Fee Income that is paid by the trading unit.

General Calculation Guidance: The Pay-to-Receive Spread Ratio will depend on the amount of Spread Profit and Loss and Fee Income that is earned by the trading unit for facilitating buy and sell orders and the amount of Spread Profit and Loss that is paid by a trading unit as it initiates buy and sell orders. The Pay-to-Receive Spread Ratio generally should be computed using the calculation of Spread Profit and Loss described in this appendix, except that spread paid should include the aggregate Spread Profit and Loss of all transactions producing a negative Spread Profit and Loss, and spread received should include the aggregate Spread Profit and Loss of all transactions producing a positive Spread Profit and Loss.

Calculation Period: One trading day.

Appendix B: Commentary Regarding Identification of Permitted Market Making-Related Activities

I. Purpose

This appendix provides commentary describing the features of permitted market making-related activities and distinctions between permitted market making-related activities and prohibited proprietary trading. The appendix applies to all covered banking entities that are engaged in market making-related activities in reliance on § __.4(b). The following commentary must be incorporated into the covered banking entity's internal compliance program under § __.20, as applicable.

II. Definitions

The terms used in this appendix have the same meanings as those set forth in §§ __.2 and __.3 and Appendix A.

III. Commentary

Section 13 of the BHC Act and § __.3 prohibit any covered banking entity from engaging in proprietary trading, which is generally defined as engaging as principal for the trading account of the covered banking entity in any transaction to purchase or sell a covered financial position. However, section 13(d)(1)(B) of the BHC Act and § __.4(b) permit a covered banking entity to engage in proprietary trading that would otherwise be prohibited if the activity is conducted in connection with the covered banking entity's market making-related activities, to the extent that such activities are designed not to exceed the reasonably expected near term demands of clients, customers, and counterparties. This commentary is intended to assist covered banking entities in identifying permitted market making-related activities and distinguishing such activities from trading activities that, even if conducted in the context of the covered banking entity's market making operations, would constitute prohibited proprietary trading.

A. Overview of Market Making-Related Activities

In the context of trading activities in which a covered banking entity acts as principal, market making-related activities generally involve the covered banking entity either (i) in the case of market making in a security that is executed on an organized trading facility or exchange, passively providing liquidity by submitting resting orders that interact with the orders of others on an organized trading facility or exchange and acting as a registered market maker, where such

exchange or organized trading facility provides the ability to register as a market maker,[1] or (ii) in other cases, providing an intermediation service to its customers by assuming the role of a counterparty that stands ready to buy or sell a position that the customer wishes to sell or buy. A market maker's "customers" generally vary depending on the asset class and market in which the market maker is providing intermediation services. In the context of market making in a security that is executed on an organized trading facility or an exchange, a "customer" is any person on behalf of whom a buy or sell order has been submitted by a broker-dealer or any other market participant. In the context of market making in a covered financial position in an over-the-counter market, a "customer" generally would be a market participant that makes use of the market's maker intermediation services, either by requesting such services or entering into a continuing relationship with the market maker with respect to such services.[2]

The primary purpose of market making-related activities is to intermediate between buyers and sellers of similar positions, for which service market makers are compensated, resulting in more liquid markets and less volatile prices. The purpose of such activities is not to earn profits as a result of movements in the price of positions and risks acquired or retained; rather, a market maker generally manages and limits the extent to which it is exposed to movements in the price of principal positions and risks that it acquires or retains, or in the price of one or more material elements of those positions. To the extent that it can, a market maker will eliminate some or all of the price risks to which it is exposed. However, in some cases, the

[1] The status of being a registered market maker is not, on its own, a sufficient basis for relying on the exemption for market making-related activity contained in § __.4(b). Registration as a market maker generally involves filing a prescribed form with an exchange or organized trading facility, in accordance with its rules and procedures, and complying with the applicable requirements for market makers set forth in the rules of that exchange or organized trading facility. See, e.g., Nasdaq Rule 4612, New York Stock Exchange Rule 104, CBOE Futures Exchange Rule 515, BATS Exchange Rule 11.5.

[2] In certain cases, depending on the conventions of the relevant market (e.g., the over-the-counter derivatives market), such a "customer" may consider itself or refer to itself more generally as a "counterparty."

risks posed by one or more positions may be sufficiently complex or specific that the risk cannot be fully hedged. In other cases, although it may be possible to hedge the risks posed by one or more positions, the cost of doing so may be so high as to effectively make market making in those positions uneconomic if complete hedges were acquired. In such cases, in order to provide effective intermediation services, market makers are required to retain at least some risk for at least some period of time with respect to price movements of retained principal positions and risks. The size and type of risk that must be retained in such cases may vary widely depending on the type and size of the positions, the liquidity of the specific market, and the market's structure. As the liquidity of positions increases, the frequency with which a market maker must take or retain risk in order to make a market in those positions generally decreases.

The profitability of market making-related activities relies on forms of revenues that reflect the value of the intermediation services that are provided to the market maker's customers. These revenues typically take the form of explicit fees and commissions or, in markets where no such fees or commission are charged, a bid-ask or similar spread that is generated by charging higher prices to buyers than is paid to sellers of comparable instruments. In the case of a derivative contract, these revenues reflect the difference between the cost of entering into the derivative contract and the cost of hedging incremental, residual risks arising from the contract. These types of "customer revenues" provide the primary source of a market maker's profitability. Typically, a market maker holds at least some risk with respect to price movements of retained principal positions and risks. As a result, the market maker also incurs losses or generates profits as price movements actually occur, but such losses or profits are incidental to customer revenues and significantly limited by the banking entity's hedging activities. Customer revenues, not revenues from price movements, predominate. The

appropriate proportion of "customer revenues" to profits and losses resulting from price movements of retained principal positions and risks varies depending on the type of positions involved, the typical fees, commissions, and spreads payable for transactions in those positions, and the risks of those positions. As a general matter, the proportion of "customer revenues" generated when making a market in certain positions increases as the fees, commissions, or spreads payable for those positions increase, the volatility of those positions' prices decrease, and the prices for those positions are less transparent.

Because a market maker's business model entails managing and limiting the extent to which it is exposed to movements in the prices of retained principal positions and risks while generating customer revenues that are earned, regardless of movements in the price of retained principal positions and risks, a market maker typically generates significant revenue relative to the risks that it retains. Accordingly, a market maker will typically demonstrate consistent profitability and low earnings volatility under normal market conditions. The appropriate extent to which a market maker will demonstrate consistent profitability and low earnings volatility varies depending on the type of positions involved, the liquidity of the positions, the price transparency of the positions, and the volatility of the positions' prices. As a general matter, consistent profitability will decrease and earnings volatility will increase as the liquidity of the positions decrease, the volatility of the positions' prices increase, and the prices for the positions are less transparent.

As the primary purpose of market making-related activities is to provide intermediation services to its customers, market makers focus their activities on servicing customer demands and typically only engage in transactions with non-customers to the extent that these transactions directly facilitate or support customer transactions. In particular, a market maker generally only

transacts with non-customers to the extent necessary to hedge or otherwise manage the risks of its market making-related activities, including managing its risk with respect to movements of the price of retained principal positions and risks, to acquire positions in amounts consistent with reasonably expected near term demand of its customers, or to sell positions acquired from its customers. The appropriate proportion of a market maker's transactions that are with customers versus non-customers varies depending on the type of positions involved and the extent to which the positions are typically hedged in non-customer transactions. In the case of a derivatives market maker that engages in dynamic hedging, the number of non-customer transactions significantly outweighs the number of customer transactions, as the derivatives market maker must constantly enter into transactions to appropriately manage its retained principal positions and risks as market prices for the positions and risks move and additional transactions with customers change the risk profile of the market makers retained principal positions.

Because a market maker generates revenues primarily by transacting with, and providing intermediation services to, customers, a market maker typically engages in transactions that earn fees, commissions, or spreads as payment for its services. Transactions in which the market maker pays fees, commissions, or spreads – i.e., where it pays another market maker for providing it with liquidity services–are much less frequent, although in some cases obtaining liquidity services from another market maker and paying fees, commissions, or spreads may be necessary to prudently manage its risk with respect to price movements of retained principal positions and risks. The appropriate proportion of a market maker's transactions that earn, rather than pay, fees, commissions or spreads varies depending on the type of positions involved, the liquidity of the positions, and the extent to which market trends increase the volatility of its risk with respect to price movements of retained principal positions and risks. As a general matter,

the proportion of a market maker's transactions that earn rather than pay fees, commissions or spreads decreases as the liquidity of the positions decreases, and the extent to which the price volatility of retained principal positions and risks increases.

Finally, because the primary purpose of market making-related activities is to provide intermediation services to its customers, a market maker does not provide compensation incentives to its personnel that primarily reward proprietary risk-taking. Although a market maker may take into account revenues resulting from movements in the price of retained principal positions and risks to the extent that such revenues reflect the effectiveness with which personnel have effectively managed the risk of movements in the price of retained principal positions and risks, a market maker that provides compensation incentives relating to revenues generally does so through incentives that primarily reward customer revenues and effective customer service.

B. Overview of Prohibited Proprietary Trading Activities

Like permitted market making-related activities, prohibited proprietary trading involves the taking of principal positions by a covered banking entity. Unlike permitted market making-related activities, the purpose of prohibited proprietary trading is to generate profits as a result of, or otherwise benefit from, changes in the price of positions and risks taken. Whereas a market maker attempts to eliminate some or all of the price risks inherent in its retained principal positions and risks by hedging or otherwise managing those risks in a reasonable period of time after positions are acquired or risks arise, a proprietary trader seeks to capitalize on those risks, and generally only hedges or manages a portion of those risks when doing so would improve the potential profitability of the risk it retains. A proprietary trader does not have "customers"

because a proprietary trader simply seeks to obtain the best price and execution in purchasing or selling its proprietary positions. A proprietary trader generates few if any fees, commissions, or spreads from its trading activities because it is not providing an intermediation service to any customer or other third party. Instead, a proprietary trader is likely to pay fees, commissions, or spreads to other market makers when obtaining their liquidity services is beneficial to execution of its trading strategy. Because a proprietary trader seeks to generate profits from changes in the price of positions taken, a proprietary trader typically provides compensation incentives to its personnel that primarily reward successful proprietary risk taking.

C. Distinguishing Permitted Market Making-Related Activities from Prohibited Proprietary Trading

Because both permitted market making-related activities and prohibited proprietary trading involve the taking of principal positions, certain challenges arise in distinguishing permitted market making-related activities and prohibited proprietary trading, particularly in cases where both of these activities occur in the context of a market making operation. Particularly during periods of significant market disruption, it may be difficult to distinguish between retained principal positions and risks that appropriately support market making-related activities and positions taken, or positions or risks not hedged, for proprietary purposes.

In connection with these challenges, [Agency] will apply the following factors in distinguishing permitted market making-related activities from trading activities that, even if conducted in the context of the covered banking entity's market making operations, would constitute prohibited proprietary trading. The particular types of trading activity described in this appendix may involve the aggregate trading activities of a single trading unit, a significant

number or series of transactions occurring at one or more trading units, or a single significant transaction, among other potential scenarios. In addition to meeting the terms of this appendix, any transaction or activity for which a covered banking entity intends to rely on the market making exemption in § __.4(b) must also satisfy all the requirements specified in § __.4(b), as well as the other applicable requirements and conditions of this part.

1. Risk Management

Absent explanatory facts and circumstances, particular trading activity in which a trading unit retains risk in excess of the size and type required to provide intermediation services to customers will be considered to be prohibited proprietary trading, and not permitted market making-related activity.

[The Agency] will base a determination of whether a trading unit retains risk in excess of the size and type required for these purposes on all available facts and circumstances, including a comparison of retained principal risk to: the amount of risk that is generally required to execute a particular market making function; hedging options that are available in the market and permissible under the covered banking entity's hedging policy at the time the particular trading activity occurred; the trading unit's prior levels of retained risk and its hedging practices with respect to similar positions; and the levels of retained risk and the hedging practices of other trading units with respect to similar positions.

To help assess the extent to which a trading unit's risks are potentially being retained in excess of amounts required to provide intermediation services to customers, [Agency] will utilize the VaR and Stress VaR, VaR Exceedance, and Risk Factor Sensitivities quantitative measurements, as applicable, among other risks measurements described in appendix A to this

part and any other relevant factor. This assessment will focus primarily on the risk measurements relative to: the risk required for conducting market making-related activities, and any significant changes in the risk over time and across similarly-situated trading units and banking entities.

Explanatory facts and circumstances might include, among other things, market-wide changes in risk, changes in the specific composition of market making-related activities, temporary market disruptions, or other market changes that result in previously-used hedging or other risk management techniques no longer being possible or cost-effective.

2. Source of Revenues

Absent explanatory facts and circumstances, particular trading activity in which a trading unit primarily generates revenues from price movements of retained principal positions and risks, rather than customer revenues, will be considered to be prohibited proprietary trading, and not permitted market making-related activity.

[The Agency] will base a determination of whether a trading activity primarily generates revenues from price movements of retained principal positions and risks, rather than customer revenues, on all available facts and circumstances, including: an evaluation of the revenues derived from price movements of retained principal positions and risks relative to its customer revenues; and a comparison of these revenue figures to the trading unit's prior revenues with respect to similar positions, and the revenues of other covered banking entities' trading units with respect to similar positions.

To help assess the extent to which a trading unit's revenues are potentially derived from movements in the price of retained principal positions and risks, [Agency] will utilize the Comprehensive Profit and Loss, Portfolio Profit and Loss, Fee Income and Expense, and Spread Profit and Loss quantitative measurements, as applicable, both individually and in combination with one another (e.g., by comparing the ratio of Spread Profit and Loss to Portfolio Profit and Loss), and any other relevant factor.

Explanatory facts and circumstances might include, among other things: general upward or downward price trends in the broader markets in which the trading unit is making a market, provided revenues from price movements in retained principal positions and risks are consistent; sudden market disruptions or other changes causing significant, unanticipated alterations in the price of retained principal positions and risks; sudden and/or temporary changes in the market (e.g., narrowing of bid/ask spreads) that cause significant, unanticipated reductions in customer revenues; or efforts to expand or contract a trading unit's market share.

3. Revenues Relative to Risk

Absent explanatory facts and circumstances, particular trading activity will be considered to be prohibited proprietary trading, and not permitted market making-related activity, if the trading unit: generates only very small or very large amounts of revenue per unit of risk taken; does not demonstrate consistent profitability; or demonstrates high earnings volatility.

[The Agency] will base such a determination on all available facts and circumstances, including: an evaluation of the amount of revenue per unit of risk taken, earnings volatility, profitability, exposure to risks, and overall level of risk taking for the particular trading activities; and a comparison of these figures to the trading unit's prior results with respect to similar

positions, and the results of other covered banking entities' trading units with respect to similar positions.

To help assess the riskiness of revenues and the amount of revenue per unit of risk taken, [Agency] will utilize the Volatility of Comprehensive Profit and Loss and Volatility of Portfolio Profit and Loss, Comprehensive Profit and Loss to Volatility Ratio and Portfolio Profit and Loss to Volatility Ratio, and Comprehensive Profit and Loss Attribution quantitative measurements, as applicable, and any other relevant factor.

To help assess the extent to which a trading unit demonstrates consistent profitability, [Agency] will utilize the Unprofitable Trading Days Based on Comprehensive Profit and Loss and Unprofitable Trading Days Based on Portfolio Profit and Loss quantitative measurements, as applicable, and any other relevant factor.

To help assess the extent to which a trading unit is exposed to outsized risk, [Agency] will utilize the Skewness of Portfolio Profit and Loss and Kurtosis of Profit and Loss quantitative measurements, as applicable, and any other relevant factor.

Explanatory facts and circumstances might include, among other things: market disruptions or other changes causing significant, unanticipated increases in a trading unit's risk with respect to movements in the price of retained principal positions and risks; market disruptions or other changes causing significant, unanticipated increases in the volatility of positions in which the trading unit makes a market; sudden and/or temporary changes in the market (e.g., narrowing of bid-ask spreads) that cause significant, unanticipated reductions in customer revenues and decrease overall profitability; or efforts to expand or contract a trading unit's market share.

4. Customer-Facing Activity

Absent explanatory facts and circumstances, particular trading activity will be considered to be prohibited proprietary trading, and not permitted market making-related activity, if the trading unit: does not transact through a trading system that interacts with orders of others or primarily with customers of the banking entity's market making desk to provide liquidity services; or retains principal positions and risks in excess of reasonably expected near term customer demands.

[The Agency] will base such a determination on all available facts and circumstances, including, among other things: an evaluation of the extent to which a trading unit's transactions are with customers versus non-customers and the frequency with which the trading unit's retained principal positions and risks turn over; and a comparison of these figures to the trading unit's prior results with respect to similar positions and market situations, and the results of other covered banking entities' trading units with respect to similar positions.

To help assess the extent to which a trading unit's transactions are with customers versus non-customers, [Agency] will utilize the Customer-Facing Trade Ratio quantitative measurement, as applicable, and any other relevant factor. To help assess the frequency with which the trading unit's retained principal positions and risks turn over, [Agency] will utilize the Inventory Risk Turnover and Inventory Aging quantitative measurements, as applicable, and any other relevant factor.

With respect to a particular trading activity in which a trading unit either does not transact through a trading system that interacts with orders of others or primarily with customers of the banking entity's market making desk to provide liquidity services, explanatory facts and

circumstances might include, among other things: sudden market disruptions or other changes causing significant increases in a trading unit's hedging transactions with non-customers; or substantial intermediary trading required to satisfy customer demands and hedging management. With respect to particular trading activity in which a trading unit retains principal positions and risks in excess of reasonably expected near term customer demands, explanatory facts and circumstances might include, among other things: sudden market disruptions or other changes causing a significant reduction in actual customer demand relative to expected customer demand; documented and reasonable expectations for temporary increases in customer demand in the near term; and sudden market disruptions or other changes causing a significant reduction in the value of retained principal positions and risks, such that it would be imprudent for the trading unit to dispose of the positions in the near term.

5. Payment of Fees, Commissions, and Spreads

Absent explanatory facts and circumstances, particular trading activity in which a trading unit routinely pays rather than earns fees, commissions, or spreads will be considered to be prohibited proprietary trading, and not permitted market making-related activity.

[The Agency] will base such a determination on all available facts and circumstances, including, among other things: an evaluation of the frequency with which the trading unit pay fees, commissions, or spreads and the relative amount of fees, commissions, or spreads that is paid versus earned; and a comparison of these figures to the trading unit's prior results with respect to similar positions, and the results of other covered banking entities' trading units with respect to similar positions.

To help assess the extent to which a trading unit is paying versus earning fees, commissions, and spreads, [Agency] will utilize the Pay-to-Receive Spread Ratio quantitative measurement, as applicable, and any other relevant factor.

Explanatory facts and circumstances might include, among other things, sudden market disruptions or other changes causing significant, increases in a trading unit's hedging transactions with non-customers for which it must pay fees, commissions, or spreads, sudden, unanticipated customer demand for liquidity that requires the trading unit itself to pay fees, commissions, or spreads to other market makers for liquidity services to obtain the inventory needed to meet that customer demand, or significant, unanticipated reductions in fees, commissions, or spreads earned by the trading unit. Explanatory facts and circumstances might also include a trading unit's efforts to expand or contract its market share.

6. Compensation Incentives

Absent explanatory facts and circumstances, the trading activity of a trading unit that provides compensation incentives to employees that primarily reward proprietary risk taking will be considered to be prohibited proprietary trading, and not permitted market making-related activity.

[The Agency] will base such a determination on all available facts and circumstances, including, among other things, an evaluation of: the extent to which compensation incentives are provided to trading unit personnel that reward revenues from movements in the price of retained principal positions and risks; the extent to which compensation incentives are provided to trading unit personnel that reward customer revenues; and the compensation incentives provided by other covered banking entities to similarly-situated personnel.

*****

Appendix C: Minimum Standards for Programmatic Compliance

I. Overview

A. Purpose

This appendix sets forth the minimum standards with respect to the establishment, maintenance, and enforcement by banking entities of internal compliance programs for ensuring and monitoring compliance with the prohibitions and restrictions on proprietary trading and covered fund activities or investments set forth in section 13 of the BHC Act and this part.

This appendix requires that banking entities establish, maintain, and enforce an effective compliance program, consisting of written policies and procedures, internal controls, a management framework, independent testing, training, and recordkeeping, that:

- Is reasonably designed to clearly document, describe, and monitor the covered trading and covered fund activities or investments and the risks of the covered banking entity related to such activities or investments, identify potential areas of noncompliance, and prevent activities or investments prohibited by, or that do not comply with, section 13 of the BHC Act and this part;

- Specifically addresses the varying nature of activities or investments conducted by different units of the covered banking entity's organization, including the size, scope, complexity, and risks of the individual activities or investments;

- Subjects the effectiveness of the compliance program to independent review and testing;

- Makes senior management and intermediate managers accountable for the effective implementation of the compliance program, and ensures that the board of directors and CEO review the effectiveness of the compliance program; and

- Facilitates supervision and examination of the covered banking entity's covered trading and covered fund activities or investments by the Agencies.

B. Definitions

The terms used in this Appendix have the same meanings as set forth in §§ __.2, __.3, and __.10. In addition, for purposes of this appendix, the following definitions apply:

Asset management unit means any unit of organization of a covered banking entity that makes investments in, or acts as sponsor to, covered funds, or has relationships with covered funds, that the covered banking entity (or an affiliate of subsidiary thereof) has sponsored, organized and offered, or in which a covered fund sponsored or advised by the covered banking entity invests.

Compliance program means the internal compliance program established by a covered banking entity in accordance with § __.20 and this appendix.

Covered fund activity or investment means sponsoring any covered fund or making investments in, or otherwise having relationships with, any covered fund for which the covered banking entity (or an affiliate or subsidiary thereof) acts as sponsor or organizes and offers.

Covered fund restrictions means the restrictions on covered fund activities or investments set forth in subpart C.

Covered trading activity means proprietary trading, as defined in § __.3(b)(1).

Trading unit means each of the following units of organization of a covered banking entity:

(i) Each discrete unit that is engaged in the coordinated implementation of a revenue-generation strategy and that participates in the execution of any covered trading activity;[1]

(ii) Each organizational unit that is used to structure and control the aggregate risk-taking activities and employees of one or more trading units described in paragraph (i);[2]

(iii) All trading operations, collectively; and

(iv) Any other unit of organization specified by [Agency] with respect to a particular banking entity.

---

[1] [The Agency] expects that this will generally be the smallest unit of organization used by the covered banking entity to structure and control its risk-taking activities and employees, and will include each unit generally understood to be a single "trading desk."

[2] [The Agency] expects that this will generally include management or reporting divisions, groups, sub-groups, or other intermediate units of organization used by the covered banking entity to manage one or more discrete trading units (e.g., "North American Credit Trading," "Global Credit Trading," etc.).

C. Required Elements

Section __.20 requires that covered banking entities establish, maintain, and enforce a compliance program reasonably designed to ensure and monitor compliance with the prohibitions and restrictions on proprietary trading and covered fund activities or investments that effectively implements, at a minimum, the six elements required under paragraph (b) of § __.20.

D. Compliance Program Structure

Each covered banking entity subject to § __.20(c) must be governed by a compliance program meeting the requirements of this appendix. A covered banking entity may establish a compliance program on an enterprise-wide basis to satisfy the requirements of § __.20 and this appendix with respect to the covered banking entity and all of its affiliates and subsidiaries collectively, provided that: the program is clearly applicable, both by its terms and in operation, to all such affiliates and subsidiaries; the program specifically addresses the requirements set forth in this appendix; the program takes into account and addresses the consolidated organization's business structure, size, and complexity, as well as the particular activities, risks, and applicable legal requirements of each subsidiary and affiliate; and the program is determined through periodic independent testing to be effective for the covered banking entity and all of its subsidiaries and affiliates. An enterprise-wide program established pursuant to this Appendix will be subject to supervisory review and examination by any Agency vested with rulewriting authority under section 13 of the BHC Act with respect to the compliance program and the activities or investments of any banking entity for which the Agency has such authority. Further, such Agency will have access to all records related to the enterprise-wide compliance program

pertaining to any banking entity that is supervised by the Agency vested with such rulewriting authority.

E. Applicability

This appendix applies only to covered banking entities described in § __.20(c)(2). In addition, [Agency] may require any covered banking entity to comply with all or portions of this appendix if [Agency] deems it appropriate for purposes the covered banking entity's compliance with this part.

Nothing in this appendix limits the authority of [Agency] under any other provision of law or regulation to take supervisory, examination, or enforcement action, including action to address unsafe or unsound practices or conditions, deficient capital levels, or violations of law.

II. Internal Policies and Procedures

A. Covered Trading Activities

A covered banking entity must establish, maintain, and enforce written policies and procedures reasonably designed to document, describe, and monitor the covered banking entity's covered trading activities and the risks taken in these activities, as follows:[3]

Identification of trading account: The covered banking entity's policies and procedures must specify how the banking entity evaluates the covered financial positions it acquires or takes and determines which of its accounts are trading accounts for purposes of subpart B of this part.

---

[3] These policies and procedures must be updated with a frequency sufficient for the covered banking entity to adequately control the applicable trading unit for purposes of this part.

Identification of trading units and organization structure: The covered banking entity's written policies and procedures must identify and document each trading unit within the organization and map each trading unit to the division, business line, or other organizational structure that the covered banking entity uses to manage or oversee the trading unit's activities.

Description of missions and strategies: The covered banking entity's written policies and procedures for each trading unit must clearly articulate and document a comprehensive description of the mission (i.e., the nature of the business conducted) and strategy (i.e., business model for the generation of revenues) of the trading unit, and include a description of:

- How revenues are intended to be generated by the trading unit;
- The activities that the trading unit is authorized to conduct, including (i) authorized instruments and products and (ii) authorized hedging strategies and instruments;
- The expected holding period of, and the market risk associated with, covered financial positions in its trading account;
- The types of clients, customers, and counterparties with whom trading is conducted by the trading unit;
- How the trading unit, if engaged in market making-related activity under §_.4(b) of this part, identifies its customers for purposes of computing the Customer-Facing Trade Ratio, if applicable, including documentation explaining when, how, and why a broker-dealer, swap dealer, security-based swap dealer, any other entity engaged in market making-related activities, or any affiliate thereof is considered to be a customer of the trading unit for those purposes; and

- The compensation structure of the employees associated with the trading unit.

Trader mandates: The covered banking entity must establish, maintain, document, and enforce trader mandates for each trading unit. At a minimum, trader mandates must:

- Clearly inform each trader of the prohibitions and requirements set forth in section 13 of the BHC Act and this part and his or her responsibilities for compliance with such requirements;

- Set forth appropriate parameters for each trader engaged in covered trading activities, including:

  - The conditions for relying on the applicable exemptions in §§ __.4 through __.6;

  - The financial contracts, products, and underlying assets that the trader is permitted to trade pursuant to the covered banking entity's internal controls;

  - The risk limits of the trader's trading unit, and the types and levels of risk that may be taken; and

  - The applicable trading unit's hedging policy.

Description of risks and risk management processes: The written policies and procedures for each trading unit must clearly articulate and document a comprehensive description of the risks associated with the trading unit. Such descriptions must include, at a minimum, the following elements:

- A description of the supervisory and risk management structure governing the trading units, including a description of processes for initial and senior-level review of new products and new strategies;

- A description of the types of risks that may be taken to implement the mission and strategy of the trading unit, including an enumeration of material risks resulting from the activities in which the trading unit is engaged (including but not limited to all significant price risks, such as basis, volatility and correlation risks, as well as any significant counterparty credit risk associated with the trading activity);

- An articulation of the amount of risk allocated by the covered banking entity to such trading unit to implement the documented mission and strategy of the trading unit;

- An explanation of how the risks allocated to such trading unit will be measured; and

- An explanation of why the allocated risk levels are appropriate to the mission and strategy of the trading unit.

Hedging policies and procedures. The covered banking entity must establish, maintain, and enforce policies and procedures for all of its trading units regarding the use of risk-mitigating hedging instruments and strategies. At a minimum, these hedging policies and procedures must articulate the following:

- The manner in which the covered banking entity will determine that the risks generated by each trading unit have been properly and effectively hedged;

- The instruments, techniques and strategies the covered entity will use to hedge the risk of the positions or portfolios;
- The level of the organization at which hedging activity and management will occur;
- The manner in which hedging strategies will be monitored;
- The risk management processes used to control unhedged or residual risks; and
- The independent testing of hedging techniques and strategies.

Explanation of compliance. The covered banking entity's written policies and procedures must clearly articulate and document a comprehensive explanation of how the mission and strategy of each trading unit, and its related risk levels, comply with this part. Such explanation must:

- Identify which portions of the risk-taking activity of the trading unit would or would not constitute covered trading activity;
- Identify activities of the trading unit that will be conducted in reliance on exemptions contained in §§ __.4 through __.6, including an explanation of:
    - How and where the activity occurs; and
    - Which exemption is being relied on and how the activity meets the specific requirements for reliance on the applicable exemption.

- Describe how the covered banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each trading unit, which must take into account potential or actual exposure to:

    - Assets whose values cannot be externally priced or, where valuation is reliant on pricing models, whose model inputs cannot be externally validated;

    - Assets whose changes in values cannot be adequately mitigated by effective hedging;

    - New products with rapid growth, including those that do not have a market history;

    - Assets or strategies that include significant embedded leverage;

    - Assets or strategies that have demonstrated significant historical volatility;

    - Assets or strategies for which the application of capital and liquidity standards would not adequately account for the risk; and

    - Assets or strategies that result in large and significant concentrations to sectors, risk factors, or counterparties;

- Explain how each trading unit will comply with the reporting and recordkeeping requirements of § __.7 and Appendix A ;

- Describe how the covered banking entity monitors for and prohibits potential or actual material conflicts of interest between the covered banking entity and its clients, customers, or counterparties present in each trading unit; and

- Describe how the covered banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the covered banking entity.

Remediation of violations. The covered banking entity's written policies and procedures must require the covered banking entity to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. Further, such policies and procedures must include specific procedures that are reasonably designed to implement and monitor any required remediation and that assess the extent to which any violation indicates that modification to the covered banking entity's compliance program is warranted.

With respect to any trading unit that is either used by the covered banking entity to structure and control the aggregate risk-taking activities and employees of one or more other trading units, or comprised of the entire trading operation of the covered banking entity, the description of missions and strategies, description of risks and risk management processes, and explanation of compliance for such trading units may incorporate by reference the policies and procedures of the underlying trading units that the trading unit oversees and manages in the aggregate.

B. Covered Fund Activities or Investments

A covered banking entity must establish, maintain, and enforce written policies and procedures that are reasonably designed to document, describe, and monitor the covered banking entity's covered fund activities or investments and the risks taken in these activities or investments, as follows.

Identification of covered funds: The covered banking entity's policies and procedures must specify how the covered banking entity identifies covered funds that the covered banking entity sponsors, organizes and offers, or in which covered banking entity invests.

Identification of asset management units and organization structure: The covered banking entity's written policies and procedures must identify and document each asset management unit within the organization and map each asset management unit to the division, business line, or other organizational structure that the covered banking entity uses to manage or oversee the asset management unit's activities or investments.

Description of sponsorship activities related to covered funds: The covered banking entity's written policies and procedures for each asset management unit must clearly articulate and document a comprehensive description of the mission (i.e., the nature of the business conducted) and strategy (i.e., business model for the generation of revenues) of the asset management unit related to its sponsorship or organizing and offering of covered funds, including a description of how such activities comply with this part and, in particular:

- The activities that the asset management unit is authorized to conduct, including the nature of any trust, fiduciary, investment advisory, or commodity trading advisory services offered to customers of the covered banking entity;

- The types of customers to whom the asset management unit provides such services and to whom ownership interests in covered funds are sold;

- The extent of any co-investment activities of the covered banking entity (including its directors or employees) in covered funds offered to such customers; and

- How the asset management unit complies with the requirements of subpart C of this part.

Description of investment activities of covered funds: The covered banking entity's written policies and procedures for each asset management unit must clearly articulate and document a comprehensive description of the mission (i.e., the nature of the business conducted) and strategy (i.e., business model for the generation of revenues) of the asset management unit related to its investments in covered funds, including a description of how such activities comply with this part and, in particular:

- The asset management unit's practices with respect to seed capital investments in covered funds, including how the asset management unit reduces its investments in covered funds to amounts that are permitted de minimis investments within the required period of time;

- The asset management unit's practices with respect to co-investments in covered funds, including certain parallel investments as identified in § __.12;

- How the asset management unit complies with the requirements of § __.12 with respect to individual and aggregate investments in covered funds;

- With respect to other permitted covered fund activities or investment, how the asset management unit complies with the requirements of §§ __.13 and __.14;

- How the asset management unit complies with the limitations on relationships with a covered fund under § __.16;

- How the covered banking entity monitors for and prohibits potential or actual material conflicts of interest between the covered banking entity and its clients, customers, or counterparties related to the asset management unit;

- How the covered banking entity monitors for and prohibits potential or actual transactions or activities that may threaten the safety and soundness of the covered banking entity related to the asset management unit; and

- How the covered banking entity monitors for and prohibits potential or actual material exposure to high-risk assets or high-risk trading strategies presented by each asset management unit.

Remediation of violations. The covered banking entity's written policies and procedures must require the covered banking entity to promptly document, address and remedy any violation of section 13 of the BHC Act or this part, and document all proposed and actual remediation efforts. Further, such policies and procedures must include specific procedures that are designed to implement, monitor, and enforce any required remediation and that assess the extent to which

any violation indicates that modification to the covered banking entity's compliance program is warranted.

III. Internal Controls

A. Covered Trading Activities

A covered banking entity must establish, maintain, and enforce written internal controls that are reasonably designed to ensure that the trading activity of each trading unit is appropriate and consistent with the description of mission, strategy, and risk mitigation for each trading unit contained in its written policies and procedures. These written internal controls must also be reasonably designed and established to effectively monitor and identify for further analysis any covered trading activity that may indicate potential violations of section 13 of the BHC Act and this part and to prevent actual violations of section 13 of the BHC Act and this part. Further, the internal controls must describe procedures for remedying violations of section 13 of the BHC Act and this part. The written internal controls must include, at a minimum, the following.

Authorized risks, instruments, and products. The covered banking entity must implement and enforce internal controls for each trading unit that are reasonably designed to ensure that trading activity is conducted in conformance with the trading unit's authorized risks, instruments, and products, as documented in the covered banking entity's written policies and procedures and trader mandates. At a minimum, these internal controls must monitor and govern:

- The types and levels of risks that may be taken by each trading unit, consistent with the covered banking entity's written policies and procedures;

- The type of hedging instruments used, hedging strategies employed, and the amount of risk effectively hedged, consistent with the covered banking entity's written policies and procedures; and

- The financial contracts, products and underlying assets that the trading unit may trade, consistent with covered banking entity's written policies and procedures.

Risk limits. The covered banking entity must establish and enforce risk limits appropriate for each trading unit, which shall include limits based on probabilistic and non-probabilistic measures of potential loss (e.g., Value-at-Risk and notional exposure, respectively), measured under normal and stress market conditions.

Analysis and quantitative measurements. The covered banking entity must perform robust analysis and quantitative measurement of its covered trading activities that is reasonably designed to ensure that the trading activity of each trading unit is consistent with its mission, strategy and risk management process, as documented in the covered banking entity's written policies and procedures; monitor and assist in the identification of potential and actual prohibited proprietary trading activity; and prevent the occurrence of prohibited proprietary trading. In addition to the quantitative measurements reported by the covered banking entity to [Agency] pursuant to appendix A to this part, each covered banking must develop and implement, to the extent necessary to facilitate compliance with this part, additional quantitative measurements specifically tailored to the particular risks, practices, and strategies of its trading units. The covered banking entity's analysis and quantitative measurement must incorporate the quantitative measurements reported by the covered banking entity to [Agency] pursuant to Appendix A and include, at minimum, the following:

- Internal controls and written policies and procedures reasonably designed to ensure the accuracy and integrity of quantitative measurements;

- Ongoing, timely monitoring and review of calculated quantitative measurements;

- Heightened review of a quantitative measurement when such quantitative measurement raises any question regarding compliance with section 13 of the BHC Act and this part, which shall include in-depth analysis, appropriate escalation procedures, and documentation related to the review, including the establishment of numerical thresholds for each trading unit for purposes of triggering such heightened review; and

- Immediate review and compliance investigation of the trading unit's activities, escalation to senior management with oversight responsibilities for the applicable trading unit, timely notification to [Agency], appropriate remedial action (e.g., divesting of impermissible positions, cessation of impermissible activity, disciplinary actions), and documentation of the investigation findings and remedial action taken when the quantitative measurement, considered together with the facts and circumstances, suggests a reasonable likelihood that the trading unit has violated any part of section 13 of the BHC Act and this part.

Surveillance of compliance program effectiveness. The covered banking entity must regularly monitor the effectiveness of its compliance program and take prompt action to address and remedy any deficiencies identified. Any actions taken to remedy deficiencies and violations shall be documented and maintained as a record of the banking entity.

B. Covered Fund Activities

A covered banking entity must establish, maintain, and enforce internal controls that are reasonably designed to ensure that the covered fund activities or investments of its asset management units are appropriate and consistent with the description of the asset management unit's mission, strategy, and risk management process contained in the covered banking entity's written policies and procedures. The internal controls must, at a minimum, be designed to ensure that the covered banking entity complies with the requirements of § __.11 for any covered fund in which it invests, acts as sponsor, or organizes and offers, as well as the following:

Monitoring investments in a covered fund. The covered banking entity must implement and enforce internal controls in a way that monitors and limits the covered banking entity's individual and aggregate investments in covered funds. At a minimum, the covered banking entity shall establish, maintain, and enforce internal controls reasonably designed to ensure that such investments are in compliance with section 13 of the BHC Act and this part at all times, including:

- Monitoring the amount and timing of seed capital investments for compliance with the limitations (including but not limited to the redemption, sale or disposition requirements of § __.12);
- Calculating the individual and aggregate levels of ownership interests in covered funds required by § __.12;
- Describing procedures for remedying violations of section 13 of the BHC Act and this part;

- Attributing the appropriate instruments to the individual and aggregate ownership interest calculations above; and

- Making the appropriate required disclosures, in writing, to prospective and actual investors in any covered fund organized and offered or sponsored by the covered banking entity, as provided under § __.11(h).

Monitoring relationships with a covered fund. The covered banking entity must implement and enforce internal controls in a way that monitors and limits the covered banking entity's sponsorship of, and relationships with, covered funds. At a minimum, the covered banking entity shall establish, maintain, and enforce internal controls reasonably designed to ensure that such activities and relationships are in compliance with section 13 of the BHC Act and this part at all times, including monitoring for and preventing any relationship or transaction between the covered banking entity and a covered fund that is prohibited under § __.16.

Surveillance of compliance program effectiveness. The covered banking entity must regularly monitor the effectiveness of its compliance program and take prompt action to address and remedy any deficiencies identified. Any actions taken to remedy deficiencies and violations shall be documented and maintained as a record of the covered banking entity.

IV. Responsibility and Accountability for the Compliance Program

A covered banking entity must establish, maintain, and enforce a management framework to manage its business and employees with a view to preventing violations of section 13 of the BHC Act and this part. A covered banking entity must have an appropriate management framework reasonably designed to ensure that: appropriate personnel are made responsible and

accountable for the effective implementation and enforcement of the compliance program; a clear reporting line with a chain of responsibility is delineated; and the board of directors, or similar corporate body, and CEO reviews and approves the compliance program. This management framework must include, at a minimum:

Corporate governance. The covered banking entity must ensure that its compliance program is reduced to writing, approved by the board of directors or similar corporate body, and noted in the minutes.

Trader mandates. The covered banking entity must establish, maintain, and enforce the trader mandates required by this appendix to clearly inform each trader within a trading unit of his or her responsibilities for compliance with section 13 of the BHC Act and this part.

Management procedures. The covered banking entity must establish, maintain, and enforce management procedures that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, which, at a minimum, provide for:

- The designation of at least one person with authority to carry out the management responsibilities of the covered banking entity for each trading unit;

- Written procedures addressing the management of the activities of the covered banking entity that are reasonably designed to achieve compliance with section 13 of the BHC Act and this part, including:

    - Procedures for the review by a manager of activities of the trading unit and the quantitative measurements pursuant to appendix A and any other quantitative

measurements developed and tailored to the particular risks, practices, and strategies of the covered banking entity's trading units;

- A description of the management system, including the titles, qualifications, and locations of managers and the specific responsibilities of each person with respect to the covered banking entity's trading units; and

- Procedures for determining compensation arrangements for traders engaged in underwriting or market making-related activities under § __.4 or risk-mitigating hedging activities under § __.5 so that such compensation arrangements are designed not to reward proprietary risk taking.

Business line managers. Managers with responsibility for one or more trading units or asset management units of the covered banking entity engaged in covered trading activities or covered fund activities or investments are accountable for the effective implementation and enforcement of the compliance program with respect to the applicable trading unit or asset management unit.

Senior management. Senior management is responsible for communicating and reinforcing the culture of compliance with section 13 of the BHC Act and this part, as established by the board of directors or similar corporate body, and implementing and enforcing the approved compliance program. Senior management must also ensure that effective corrective action is taken when failures in compliance with section 13 of the BHC Act and this part are identified.[4] Senior management and control personnel charged with overseeing compliance with

[4] Such corrective action may include, among other things divesture of the position, cessation of the activity, or disciplinary measures.

section 13 of the BHC Act and this part should report to the board, or an appropriate committee thereof, on the effectiveness of the compliance program and compliance matters with a frequency appropriate to the size, scope, and risk profile of the covered banking entity's covered trading activities and covered fund activities or investments, which shall be at least once every twelve months.

Board of directors, or similar corporate body, and CEO. The board of directors, or similar corporate body, and CEO are responsible for setting an appropriate culture of compliance with this part and establishing clear policies regarding the management of covered trading activities and covered fund activities or investments in compliance with section 13 of the BHC Act and this part. The board of directors or similar corporate body must ensure that senior management is fully capable, qualified, and properly motivated to manage compliance with this part in light of the organization's business activities. The board of directors or similar corporate body must also ensure that senior management has established appropriate incentives to support compliance with this part, including the implementation of a compliance program meeting the requirements of this appendix into management goals and compensation structures across the covered banking entity.

V. Independent Testing

A covered banking entity must ensure that independent testing is conducted by a qualified independent party, such as the covered banking entity's internal audit department, outside auditors, consultants, or other qualified independent parties, regarding the effectiveness of the covered banking entity's compliance program established pursuant to this appendix and § __.20 and the covered banking entity's compliance with this part. A banking entity must take

appropriate action to remedy any concerns identified by the independent testing (e.g., remedying deficiencies in its written policies and procedures and internal controls, etc.).

The required independent testing must occur with a frequency appropriate to the size, scope, and risk profile of the covered banking entity's covered trading and covered fund activities or investments, which shall be no less than once every twelve months. This independent testing must include an evaluation of:

- The overall adequacy and effectiveness of the covered banking entity's compliance program, including an analysis of the extent to which the program contains all the required elements of this appendix;
- The effectiveness of the covered banking entity's written policies and procedures;
- The effectiveness of the covered banking entity's internal controls, including an analysis and documentation of instances in which such internal controls have been breached, and how such breaches were addressed and resolved; and
- The effectiveness of the covered banking entity's management procedures.

VI. Training

Covered banking entities must provide adequate training to trading personnel and managers of the covered banking entity, as well as other appropriate personnel, as determined by the covered banking entity, in order to effectively implement and enforce the compliance program. This training should occur with a frequency appropriate to the size and the risk profile of the covered banking entity's covered trading activities and covered fund activities or

investments. The training may be conducted by internal personnel or independent parties deemed appropriate by the covered banking entity based on its size and risk profile.

VII. Recordkeeping

Covered banking entities must create and retain records sufficient to demonstrate compliance and support the operations and effectiveness of the compliance program. A covered banking entity must retain these records for a period that is no less than 5 years in a form that allows it to promptly produce such records to [Agency] on request.

END OF COMMON RULE

[END OF COMMON TEXT]

Adoption of the Common Rule Text

The proposed adoption of the common rules by the agencies, as modified by agency-specific text, is set forth below:

DEPARTMENT OF THE TREASURY

Office of the Comptroller of the Currency

12 CFR Chapter I

List of Subjects in 12 CFR Part 44

Banks, Banking, Compensation, Credit, Derivatives, Government securities, Insurance, Investments, National banks, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Trusts and trustees

Authority and Issuance

For the reasons stated in the Common Preamble, the Office of the Comptroller of the Currency proposes to amend chapter I of Title 12, Code of Federal Regulations as follows:

PART 44 – PROPRIETARY TRADING AND CERTAIN INTEREST IN AND RELATIONSHIPS WITH COVERED FUNDS

1. The authority citation for part 44 is added to read as follows:

Authority: 7 U.S.C. 27 et seq., 12 U.S.C. 1, 24, 92a, 93a, 161, 1461, 1462a, 1463, 1464, 1813(q), 1818, 1851, 3101 3102, 3108, 5412.

2. Part 44 is added as set forth at the end of the Common Preamble.

3. Part 44 is amended by

a. Removing "[Agency]" wherever it appears and adding in its place "the OCC"; and

b. Removing "[The Agency]" wherever it appears and adding in its place "The OCC".

4. Section 44.1 is added to read as follows:

§ 44.1 Authority, purpose, and scope.

(a) Authority. This part is issued by [Agency] under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) Purpose. Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including national banks, Federal branches and agencies of foreign banks, Federal savings associations, and certain subsidiaries thereof. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) Scope. This part implements section 13 of the Bank Holding Company Act with respect to covered banking entities described in § 44.2(j). This part takes effect on July 21, 2012.

(d) Relationship to other authorities. Except as otherwise provided under section 13 of the Bank Holding Company Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of Bank Holding Company Act shall apply to the activities of a covered banking entity, even if such activities are authorized for a covered banking entity under other applicable provisions of law.

(e) Preservation of authority. Nothing in this part limits in any way the authority of the OCC to impose penalties for violation of this part by any covered banking entity provided under any other applicable statute.

5. Paragraph (j) of § 44.2 is added to read as follows:

§ 44.2 Definitions.

* * * * *

(j) Covered banking entity means any banking entity that is:

(1) A national bank;

(2) A Federal branch or agency of a foreign bank;

(3) A Federal savings association or a Federal savings bank; and

(4) Any subsidiary of a company described in paragraph (j)(1) through (3) of this section, other than a subsidiary for which the CFTC or SEC is the primary financial regulatory agency as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

* * * * *

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

12 CFR Chapter II

List of Subjects in 12 CFR Part 248

Administrative practice and procedure, Banks and banking, Capital, Compensation, Conflict of interests, Credit, Derivatives, Foreign banking, Government securities, Holding companies, Insurance, Insurance companies, Investments, Penalties, Reporting and recordkeeping requirements, Risk, Risk retention, Securities, Trusts and trustees

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Board of Governors of the Federal Reserve System proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 248 to 12 CFR Chapter II as follows:

PART 248 — PROPRIETARY TRADING AND RELATIONSHIPS WITH COVERED FUNDS (REGULATION VV)

6. The authority citation for part 248 is added to read as follows:

Authority: 12 U.S.C. 1851, 12 U.S.C. 221 et seq., 12 U.S.C. 1818, 12 U.S.C. 1841 et seq., and 12 U.S.C. 3103 et seq.

7. Part 248 is added as set forth at the end of the Common Preamble.

8. Part 248 is amended by:

   A. Removing "[Agency]" wherever it appears and adding in its place "the Board"; and

   B. Removing "[The Agency]" wherever it appears and adding in its place "The Board".

9. Section 248.1 is added to read as follows:

§ 248.1 Authority, purpose, scope, and relationship to other authorities.

(a) Authority. This part[1] (Regulation VV) is issued by the Board under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851), as well as under the

[1] Code of Federal Regulations, title 12, chapter II, part 248.

Federal Reserve Act, as amended (12 U.S.C. 221 et seq.); section 8 of the Federal Deposit Insurance Act, as amended (12 U.S.C. 1818); the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1841 et seq.); and the International Banking Act of 1978, as amended (12 U.S.C. 3101 et seq.).

(b) Purpose. Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including state members banks, bank holding companies, savings and loan holding companies, other companies that control an insured depository, foreign banking organizations, and certain subsidiaries thereof. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) Scope. This part implements section 13 of the Bank Holding Company Act with respect to covered banking entities described in § 248.2(j). This part takes effect on July 21, 2012.

(d) Relationship to other authorities. Except as otherwise provided in under section 13 of the Bank Holding Company Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of Bank Holding Company Act shall apply to the activities of a covered banking entity, even if such activities are authorized for a covered banking entity under other applicable provisions of law.

10. In § 248.2, paragraph (c) is revised, and paragraph (j) is added to read as follows:

§ 248.2 **Definitions.**

* * * * *

(c) Nothing in this part limits in any way the authority of the Board, under the BHC Act (including section 8 of such Act) and other provisions of law, to impose penalties for violation by any company or individual.

* * * * *

(j) Covered banking entity means any banking entity that is:

(1) A state member bank (as defined in 12 CFR 208.2(g));

(2) A bank holding company;

(3) A savings and loan holding company (as defined in 12 U.S.C. 1467a);

(4) A foreign banking organization (as defined in 12 CFR 211.21(o));

(5) Any company that controls an insured depository institution; and

(6) Any subsidiary of a company described in paragraph (j)(1) through (5) of this section, other than a subsidiary for which the OCC, FDIC, CFTC, or SEC is the primary financial regulatory agency (as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)).

11-12. Add subpart E to read as follows:

Subpart E – Conformance Period and Extended Transition Period Authorities

Sec.

248.30 Definitions.

248.31 Conformance periods for banking entities engaged in prohibited proprietary trading or covered fund activities or investments.

248.32 Conformance period for nonbank financial companies supervised by the Board engaged in prohibited proprietary trading or covered fund activities and investments.

Subpart E – Conformance Period and Extended Transition Period Authorities

§ 248.30 Definitions.

For purposes of this subpart:

(a) Illiquid fund means a covered fund that:

(1) As of May 1, 2010:

(i) Was principally invested in illiquid assets; or

(ii) Was invested in, and contractually committed to principally invest in, illiquid assets; and

(2) Makes all investments pursuant to, and consistent with, an investment strategy to principally invest in illiquid assets.

(b) Illiquid assets means any real property, security, obligation, or other asset that:

(1) Is not a liquid asset;

(2) Because of statutory or regulatory restrictions applicable to the covered fund or asset, cannot be offered, sold, or otherwise transferred by covered fund to a person that is unaffiliated with the relevant banking entity; or

(3) Because of contractual restrictions applicable to the covered fund or asset, cannot be offered, sold, or otherwise transferred by the covered fund for a period of 3 years or more to a person that is unaffiliated with the relevant banking entity.

(c) Liquid asset means:

(1) Cash or cash equivalents;

(2) An asset that is traded on a recognized, established exchange, trading facility or other market on which there exist independent, bona fide offers to buy and sell so that a price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined for the particular asset almost instantaneously;

(3) An asset for which there are bona fide, competitive bid and offer quotations in a recognized inter-dealer quotation system or similar system or for which multiple dealers furnish bona fide, competitive bid and offer quotations to other brokers and dealers on request;

(4) An asset the price of which is quoted routinely in a widely disseminated publication that is readily available to the general public or through an electronic service that provides indicative data from real-time financial networks;

(5) An asset with an initial term of one year or less and the payments on which at maturity may be settled, closed-out, or paid in cash or one or more other liquid assets described in paragraphs (c)(1), (2), (3), or (4) of this section; and

(6) Any other asset that the Board determines, based on all the facts and circumstances, is a liquid asset.

(d) Principally invested and related definitions.—A covered fund:

(1) Is principally invested in illiquid assets if at least 75 percent of the fund's consolidated total assets are—

(i) Illiquid assets; or

(ii) Risk-mitigating hedges entered into in connection with and related to individual or aggregated positions in, or holdings of, illiquid assets;

(2) Is contractually committed to principally invest in illiquid assets if the fund's organizational documents, other documents that constitute a contractual obligation of the fund, or written representations contained in the fund's offering materials distributed to potential investors provide for the fund to be principally invested in assets described in paragraph (d)(1) of this section at all times other than during temporary periods, such as the period prior to the initial receipt of capital contributions from investors or the period during which the fund's investments are being liquidated and capital and profits are being returned to investors; and

(3) Has an investment strategy to principally invest in illiquid assets if the fund:

(i) Markets or holds itself out to investors as intending to principally invest in assets described in paragraph (d)(1) of this section; or

(ii) Has a documented investment policy of principally investing in assets described in paragraph (d)(1) of this section.

§ 248.31 Conformance periods for banking entities engaged in prohibited proprietary trading or covered fund activities or investments.

(a) Conformance Period. (1) In general.—Except as provided in paragraph (a)(2) or (3) of this section, a banking entity shall bring its activities and investments into compliance with the requirements of section 13 of the BHC Act (12 U.S.C. 1851) and this part no later than 2 years after July 21, 2012

(2) New banking entities.—A company that was not a banking entity, or a subsidiary or affiliate of a banking entity, as of July 21, 2010, and becomes a banking entity, or a subsidiary or affiliate of a banking entity, after that date shall bring its activities and investments into compliance with the requirements of section 13 of the BHC Act (12 U.S.C. 1851) and this part before the later of:

(i) The conformance date determined in accordance with paragraph (a)(1) of this section; or

(ii) 2 years after the date on which the company becomes a banking entity or a subsidiary or affiliate of a banking entity.

(3) Extended conformance period. The Board may extend the two-year period under paragraph (a) (1) or (2) of this section by not more than three separate one-year periods, if, in the judgment of the Board, each such one-year extension is consistent with the purposes of section 13 of the BHC Act (12 U.S.C. 1851) and this part and would not be detrimental to the public interest.

(b) Illiquid funds. (1) Extended transition period. The Board may further extend the period provided by paragraph (a) of this section during which a banking entity may acquire or retain an ownership interest in, or otherwise provide additional capital to, a covered fund if:

(i) The fund is an illiquid fund; and

(ii) The acquisition or retention of such interest, or provision of additional capital, is necessary to fulfill a contractual obligation of the banking entity that was in effect on May 1, 2010.

(2) Duration limited. The Board may grant a banking entity only one extension under paragraph (b)(1) of this section and such extension:

(i) May not exceed 5 years beyond any conformance period granted under paragraph (a)(3) of this section; and

(ii) Shall terminate automatically on the date during any such extension on which the banking entity is no longer under a contractual obligation described in paragraph (b)(1)(ii) of this section.

(3) Contractual obligation. For purposes of this paragraph (b):

(i) A banking entity has a contractual obligation to take or retain an ownership interest in an illiquid fund if the banking entity is prohibited from redeeming all of its ownership interests in the fund, and from selling or otherwise transferring all such ownership interests to a person that is not an affiliate of the banking entity—

(A) Under the terms of the banking entity's ownership interest in the fund or the banking entity's other contractual arrangements with the fund or unaffiliated investors in the fund; or

(B) If the banking entity is the sponsor of the fund, under the terms of a written representation made by the banking entity in the fund's offering materials distributed to potential investors;

(ii) A banking entity has a contractual obligation to provide additional capital to an illiquid fund if the banking entity is required to provide additional capital to such fund—

(A) Under the terms of its ownership interest in the fund or the banking entity's other contractual arrangements with the fund or unaffiliated investors in the fund; or

(B) If the banking entity is the sponsor of the fund, under the terms of a written representation made by the banking entity in the fund's offering materials distributed to potential investors; and

(iii) A banking entity shall be considered to have a contractual obligation for purposes of paragraph (b)(3)(i) or (ii) of this section only if:

(A) The obligation may not be terminated by the banking entity or any of its subsidiaries or affiliates under the terms of its agreement with the fund; and

(B) In the case of an obligation that may be terminated with the consent of other persons, the banking entity and its subsidiaries and affiliates have used their reasonable best efforts to obtain such consent and such consent has been denied.

(c) Approval Required to Hold Interests in Excess of Time Limit. The conformance period in paragraph (a) of this section may be extended in accordance with paragraph (a)(3) or (b) only with the approval of the Board. A banking entity that seeks the Board's approval for an extension of the conformance period under paragraph (a)(3) or for an extended transition period under paragraph (b)(1) must:

(1) Submit a request in writing to the Board at least 180 days prior to the expiration of the applicable time period;

(2) Provide the reasons why the banking entity believes the extension should be granted, including information that addresses the factors in paragraph (d)(1) of this section; and

(3) Provide a detailed explanation of the banking entity's plan for divesting or conforming the activity or investment(s).

(d) Factors governing Board determinations.

(1) Extension requests generally.—In reviewing any application by a specific company for an extension under paragraph (a)(3) or (b)(1) of this section, the Board may

consider all the facts and circumstances related to the activity, investment, or fund, including, to the extent relevant:

(i) Whether the activity or investment:

(A) Involves or results in material conflicts of interest between the banking entity and its clients, customers or counterparties;

(B) Would result, directly or indirectly, in a material exposure by the banking entity to high-risk assets or high-risk trading strategies;

(C) Would pose a threat to the safety and soundness of the banking entity; or

(D) Would pose a threat to the financial stability of the United States;

(ii) Market conditions;

(iii) The nature of the activity or investment;

(iv) The date that the banking entity's contractual obligation to make or retain an investment in the fund was incurred and when it expires;

(v) The contractual terms governing the banking entity's interest in the fund;

(vi) The degree of control held by the banking entity over investment decisions of the fund;

(vii) The types of assets held by the fund, including whether any assets that were illiquid when first acquired by the fund have become liquid assets, such as, for example, because

any statutory, regulatory, or contractual restrictions on the offer, sale, or transfer of such assets have expired;

(viii) The date on which the fund is expected to wind up its activities and liquidate, or its investments may be redeemed or sold;

(ix) The total exposure of the banking entity to the activity or investment and the risks that disposing of, or maintaining, the investment or activity may pose to the banking entity or the financial stability of the United States;

(x) The cost to the banking entity of divesting or disposing of the activity or investment within the applicable period;

(xi) Whether the divestiture or conformance of the activity or investment would involve or result in a material conflict of interest between the banking entity and unaffiliated clients, customers or counterparties to which it owes a duty;

(xii) The banking entity's prior efforts to divest or conform the activity or investment(s), including, with respect to an illiquid fund, the extent to which the banking entity has made efforts to terminate or obtain a waiver of its contractual obligation to take or retain an equity, partnership, or other ownership interest in, or provide additional capital to, the illiquid fund; and

(xiii) Any other factor that the Board believes appropriate.

(2) Timing of Board review. The Board will seek to act on any request for an extension under paragraph (a)(3) or (b)(1) of this section no later than 90 calendar days after the receipt of a complete record with respect to such request.

(3) Consultation. In the case of a banking entity that is primarily supervised by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to the approval of a request by the banking entity for an extension under paragraph (a)(3) or (b)(1) of this section.

(e) Authority to impose restrictions on activities or investments during any extension period.

(1) In general. The Board may impose such conditions on any extension approved under paragraph (a)(3) or (b)(1) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the banking entity or the financial stability of the United States, address material conflicts of interest or other unsound banking practices, or otherwise further the purposes of section 13 of the BHC Act (12 U.S.C. 1851) and this part.

(2) Consultation. In the case of a banking entity that is primarily supervised by another Federal banking agency, the SEC, or the CFTC, the Board will consult with such agency prior to imposing conditions on the approval of a request by the banking entity for an extension under paragraph (a)(3) or (b)(1) of this section.

§ 248.32 Conformance period for nonbank financial companies supervised by the Board engaged in prohibited proprietary trading or covered fund activities and investments.

(a) Divestiture requirement. A nonbank financial company supervised by the Board shall come into compliance with all applicable requirements of section 13 of the Bank Holding Company Act (12 U.S.C. 1851) and this subpart, including any capital requirements or quantitative limitations adopted thereunder and applicable to the company, not later than 2 years after the date the company becomes a nonbank financial company supervised by the Board.

(b) Extensions. The Board may, by rule or order, extend the two-year period under paragraph (a) of this section by not more than three separate one-year periods, if, in the judgment of the Board, each such one-year extension is consistent with the purposes of section 13 of the BHC Act (12 U.S.C. 1851) and this part and would not be detrimental to the public interest.

(c) Approval required to hold interests in excess of time limit. A nonbank financial company supervised by the Board that seeks the Board's approval for an extension of the conformance period under paragraph (b) of this section must:

(1) Submit a request in writing to the Board at least 180 days prior to the expiration of the applicable time period;

(2) Provide the reasons why the nonbank financial company supervised by the Board believes the extension should be granted; and

(3) Provide a detailed explanation of the company's plan for conforming the activity or investment(s) to any applicable requirements established under section 13(a)(2) or (f)(4) of the Bank Holding Company Act (12 U.S.C. 1851(a)(2) and (f)(4)).

(d) Factors governing Board determinations.

(1) In general. In reviewing any application for an extension under paragraph (b) of this section, the Board may consider all the facts and circumstances related to the nonbank financial company and the request including, to the extent determined relevant by the Board, the factors described in § 225.181(d)(1) of this chapter.

(2) Timing. The Board will seek to act on any request for an extension under paragraph (b) of this section no later than 90 calendar days after the receipt of a complete record with respect to such request.

(e) Authority to impose restrictions on activities or investments during any extension period. The Board may impose conditions on any extension approved under paragraph (b) of this section as the Board determines are necessary or appropriate to protect the safety and soundness of the nonbank financial company or the financial stability of the United States, address material conflicts of interest or other unsound practices, or otherwise further the purposes of section 13 of the BHC Act (12 U.S.C. 1851) and this part.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Chapter III

List of Subjects in 12 CFR Part 351

Banks, banking, Capital, Compensation, Conflict of interests, Credit, Derivatives, Government securities, Insurance, Insurance companies, Investments, Penalties, Reporting and

recordkeeping requirements, Risk, Risk retention, Securities, State nonmember banks, State savings associations, Trusts and trustees

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Federal Deposit Insurance Corporation proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 351 to chapter III of Title 12, Code of Federal Regulations, modified as follows:

PART 351 — PROPRIETARY TRADING AND RELATIONSHIPS WITH COVERED FUNDS

13. The authority citation for part 351 is added to read as follows:

Authority: 12 U.S.C. 1851; 12 U.S.C. 1801 et seq., and 3103 et seq.

14. Part 351 is added as set forth at the end of the Common Preamble.

15. Part 351 is amended by:

a. Removing "[Agency]" wherever it appears and adding in its place "the FDIC"; and

b. Removing "[The Agency]" wherever it appears and adding in its place "The FDIC".

16. Section 351.1 is added to read as follows:

§ 351.1 Authority, purpose, scope, and relationship to other authorities.

(a) Authority. This part is issued by the FDIC under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851).

(b) Purpose. Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including any insured depository institution for which the FDIC is the appropriate Federal banking agency. This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) Scope. This part implements section 13 of the Bank Holding Company Act with respect to any insured depository institution for which the FDIC is the appropriate Federal banking agency. This part takes effect on July 21, 2012.

(d) Relationship to other authorities. Except as otherwise provided in under section 13 of the Bank Holding Company Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of Bank Holding Company Act shall apply to the activities of a covered banking entity, even if such activities are authorized for a covered banking entity under other applicable provisions of law.

17. Paragraph (j) of § 351.2 is added to read as follows:

§ 351.2 Definitions.

* * * * *

(j) Covered banking entity means any banking entity that is an insured depository institution for which the FDIC is the appropriate Federal banking agency, as that term is defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

* * * * *

SECURITIES AND EXCHANGE COMMISSION

List of Subjects in 17 CFR Part 255

Banks, Brokers, Dealers, Investment advisers, Recordkeeping, Reporting, Securities

Authority and Issuance

For the reasons set forth in the Supplementary Information, the Securities and Exchange Commission proposes to add the text of the common rule as set forth at the end of the Supplementary Information as Part 255 to chapter II of Title 17, Code of Federal Regulations, modified as follows:

PART 255 — PROPRIETARY TRADING AND RELATIONSHIPS WITH COVERED FUNDS

18. The authority for part 255 is added to read as follows:

Authority: 12 U.S.C. 1851, 15 U.S.C. 78o(c)(3)(A), 78o-10(f), (j), 78q(a), 78w.

19. Part 255 is added as set forth at the end of the Common Preamble.

20. Part 255 is amended by:

a. Removing "[Agency]" wherever it appears and adding in its place "SEC"; and

b. Removing "[The Agency]" wherever it appears and adding in its place "The SEC."

21. Section 255.1 is added to read as follows:

§ 255.1 Authority, purpose, scope, and relationship to other authorities.

(a) Authority. This part[1] is issued by the SEC under section 13 of the Bank Holding Company Act of 1956, as amended (12 U.S.C. 1851) and sections 15(c)(3)(A), 15F(f), 15F(j), 17(a), and 23 of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(3)(A), 78o-10(f), (j), 78q(a), 78w.).

(b) Purpose. Section 13 of the Bank Holding Company Act establishes prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds by certain banking entities, including registered broker-dealers, registered investment advisers, and registered security-based swap dealers, among others identified in section 2(12)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12)(B)). This part implements section 13 of the Bank Holding Company Act by defining terms used in the statute and related terms, establishing prohibitions and restrictions on proprietary trading and investments in or relationships with covered funds, and explaining the statute's requirements.

(c) Scope. This part implements section 13 of the Bank Holding Company Act with respect to covered banking entities described in § 255.2(j). This part takes effect on July 21, 2012.

[1] Code of Federal Regulations, title 17, chapter II, part 255.

(d) Relationship to other authorities. Except as otherwise provided in under section 13 of the BHC Act, and notwithstanding any other provision of law, the prohibitions and restrictions under section 13 of BHC Act shall apply to the activities of a covered banking entity, even if such activities are authorized for a covered banking entity under other applicable provisions of law.

22. Paragraph (j) of § 255.2 is added to read as follows:

§ 225.2 Definitions.

* * * * *

(j) Covered banking entity means any entity described in paragraph (e) of this section for which the SEC is the primary financial regulatory agency, as defined in section 2(12)(B) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (12 U.S.C. 5301(12)(B)).

23. Section 225.10(a) is revised to read as follows:

§ 255.10 Prohibition on acquiring or retaining an ownership interest in and having certain relationships with a covered fund.

* * * * *

(a)(1) General prohibition. Except as otherwise provided in this subpart, a covered banking entity may not, as principal, directly or indirectly, acquire or retain any ownership interest in or sponsor a covered fund.

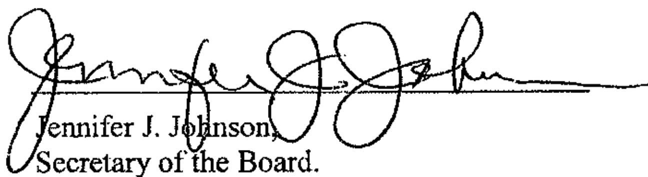
(2) Registered investment advisers. A covered banking entity that is a covered banking entity because it is an investment adviser identified in section 2(12)(B)(iii) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 shall comply with the restrictions on covered fund activities or investments set forth in subpart C and § __.20 of subpart D issued by the agency identified in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)) that regulates the banking entity described in § 255.2 (e)(1), (2) or (3) with which the investment adviser is affiliated.

Note to paragraph (a): Nothing set forth in paragraph (a)(2) of this section shall limit the SEC's authority under any other provision of law, including pursuant to section 13 of the Bank Holding Company Act.

* * * * *

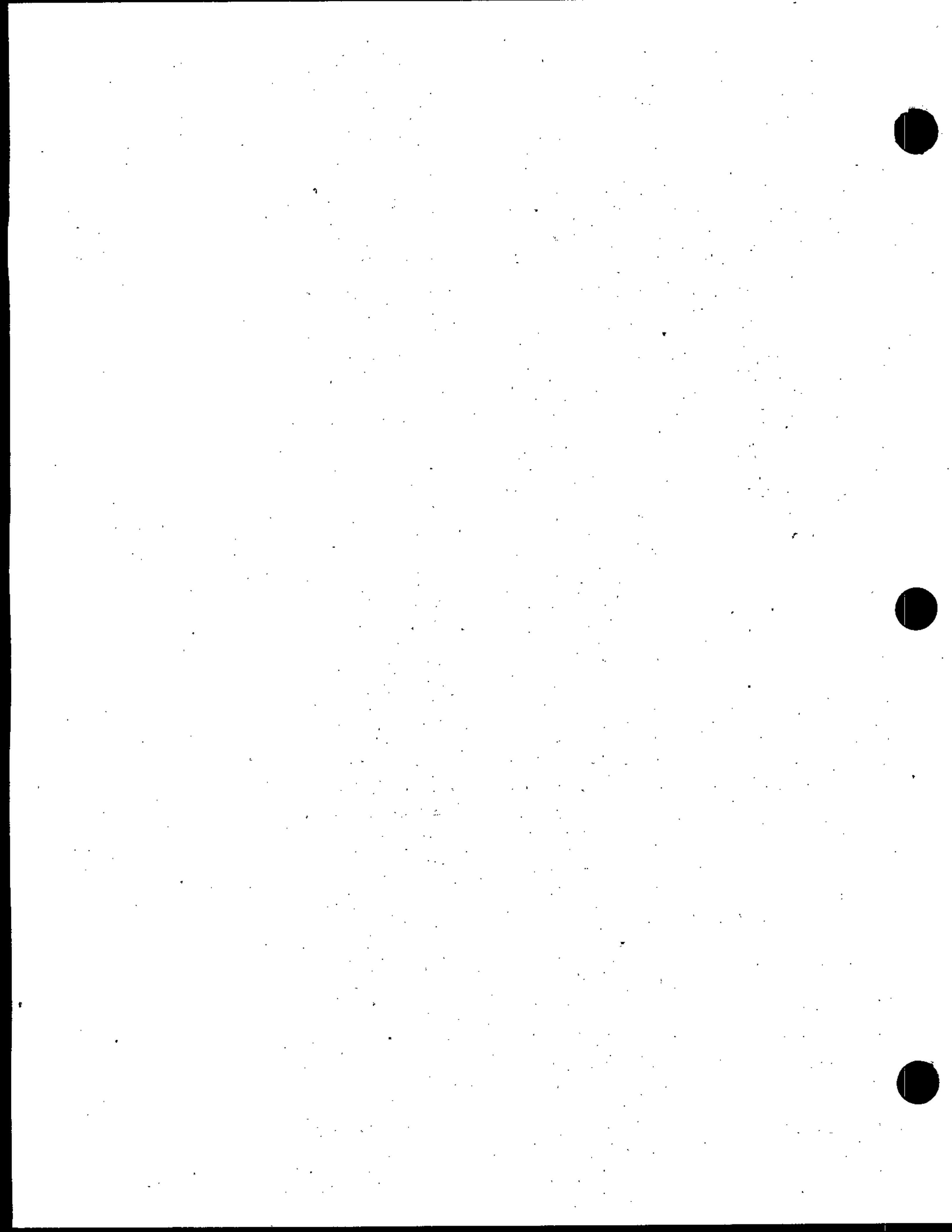
[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE OF PROPOSED RULE ENTITLED "PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS"]

By order of the Board of Governors of the Federal Reserve System, October 11, 2011.



Jennifer J. Johnson,
Secretary of the Board.

BILLING CODE 6210-01-P

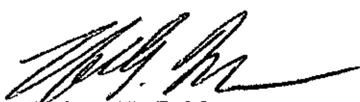


[THIS SIGNATURE RELATES TO NOTICE OF PROPOSED RULEMAKING RE PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS]

By order of the Board of Directors.

Dated at Washington, DC this 11th day of October, 2011.

Federal Deposit Insurance Corporation



Robert E. Feldman,

Executive Secretary

073251

[Seal]

[THIS SIGNATURE PAGE RELATES TO THE PROPOSED RULE ~~IMPLEMENTING SECTION 619 OF THE DODD-FRANK ACT~~] Re: PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS.]

John Walsh

Date:
10-7-11

John Walsh

Acting Comptroller of the Currency.

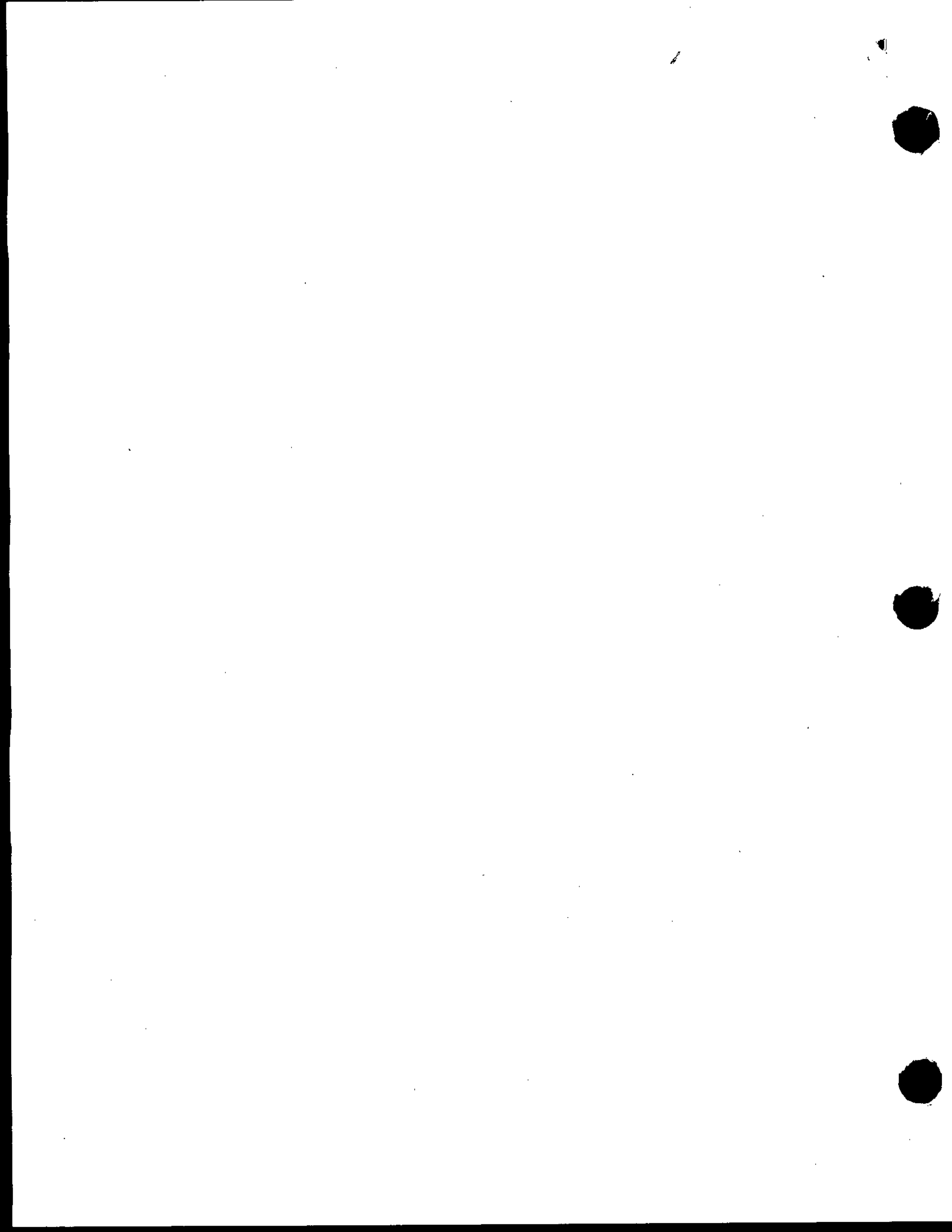
[THIS SIGNATURE PAGE PERTAINS TO THE SECURITIES AND EXCHANGE COMMISSION'S PORTION OF THE NOTICE OF PROPOSED RULEMAKING ENTITLED "PROHIBITIONS AND RESTRICTIONS ON PROPRIETARY TRADING AND CERTAIN INTERESTS IN, AND RELATIONSHIPS WITH, HEDGE FUNDS AND PRIVATE EQUITY FUNDS"]

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: October 12, 2011



Commissioner Paredes Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

Release No. 34-65543; File No. S7-40-11

RIN 3235-AL05

Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: Section 764(a) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") requires the Securities and Exchange Commission ("Commission") to issue rules to provide for the registration of security-based swap dealers ("SBS Dealers") and major security-based swap participants (collectively, "SBS Entities"). Pursuant to this requirement, the Commission is proposing new Rules 15Fb1-1 through 15Fb6-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to provide for the registration of SBS Entities. The Commission is also proposing forms to facilitate registration (and withdrawal from registration) of these entities.

DATES: Comments should be received on or before December 19, 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 S7-40-11 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 S7-40-11. 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 will also be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: David W. Blass, Chief Counsel; Joseph Furey, Assistant Chief Counsel; or Bonnie Gauch, Special Counsel, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

Table of Contents:

I. Introduction
   A. Background
   B. General Approach to the SBS Entity Registration Process
      1. Conditional Registration
         i. Implementation Plan and the Last Compliance Date
         ii. Major Security-Based Swap Participant Applicants Registering After the Last Compliance Date
      2. Ongoing Registration
      3. Solicitation of Comments on the General Approach to the SBS Entity Registration Process
II. Proposed Exchange Act Rules and Forms
   A. Registration Application and Amendment

1. Proposed Rule 15Fb2-1
    - i. Form of Application
    - ii. Senior Officer Certification
    - iii. Electronic Filing
    - iv. Standards for Granting or Denying Applications
    - v. Request for Comment on Additional Registration Considerations
2. Amendments to Application Forms: Proposed Rule 15Fb2-3

B. Associated Persons
1. Certification
2. Alternative Process

C. Termination of Registration
1. Expiration: Proposed Rule 15Fb3-1
2. Withdrawal: Proposed Rule 15Fb3-2
3. Cancellation and Revocation: Proposed Rule 15Fb3-3

D. Special Requirements for Nonresident SBS Entities
1. United States Agent for Service of Process
2. Access to Books and Records of Nonresident SBS Entity

E. Special Situations
1. Succession: Proposed Rule 15Fb2-5
2. Insolvency: Proposed Rule 15Fb2-6

F. Technical Rules
1. Electronic Signatures
2. Temporary Rule to Facilitate Paper Filing of Forms

G. Forms
1. Form SBSE
2. Form SBSE-A
3. Form SBSE-BD
4. Form SBSE-C
5. Form SBSE-W
6. Tagged Data Formats

H. Alternative Approaches Considered

III. Request for Comment

IV. Paperwork Reduction Act

A. Summary of Collection of Information

B. Proposed Use of Information

C. Respondents

D. Total Initial and Annual Reporting and Recordkeeping Burdens
1. Burden Associated with Filing Application Forms
2. Burden Associated with Amending Application Forms
3. Burden Associated with Certification
4. Burdens Relating to Associated Persons
5. Burdens on Nonresident SBS Entities
6. Burden Related to Retention of Manually Signed Signature Pages
7. Burden Associated with Filing Withdrawal Form
8. Burden Associated with Proposed Temporary Rule 15Fb2-2T
9. Request for Comment on Burden Estimates

E. Retention Period of Recordkeeping Requirements
F. Collection of Information is Mandatory
G. Confidentiality
H. Request for Comment
V. Economic Analysis
A. Benefits
B. Costs
1. Costs Attributable to Filing the Forms
2. Costs of Certification
3. Costs Relating to Associated Persons
4. Costs to Nonresident SBS Entities
5. Cost of Retaining Manually Signed Signature Pages
6. Costs Associated with Proposed Temporary Rule 15Fb2-2T
C. Request for Comment
VI. Consideration of Impact on the Economy
VII. Regulatory Flexibility Act Certification
VIII. Statutory Basis and Text of Proposed Rules

I. Introduction

A. Background

On July 21, 2010, the President signed the Dodd-Frank Act into law.[1] The Dodd-Frank Act was designed to promote, among other things, the financial stability of the United States by improving accountability and transparency in the financial system.[2] Among other measures, the Dodd-Frank Act provides the Commission and the Commodity Futures Trading Commission ("CFTC") with authority to regulate certain aspects of the over-the-counter ("OTC") derivatives market, where the recent financial crisis demonstrated a need for enhanced regulation. The Dodd-Frank Act is intended to provide the Commission and the CFTC with effective new regulatory tools to oversee that market, which has grown exponentially in recent years and is capable of affecting significant sectors of the U.S. economy.

---

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2] See id., at Preamble.

Title VII of the Dodd-Frank Act broadly categorizes covered products as "swaps",[3] regulated primarily by the CFTC, "security-based swaps",[4] regulated primarily by the Commission, or "mixed swaps," jointly regulated by the Commission and the CFTC.[5] Among other things, the Dodd-Frank Act prohibits any person from acting as a "security-based swap dealer"[6] or "major security-based swap participant"[7] without being registered with the Commission, and requires that the Commission issue rules to provide for registration of these SBS Entities.[8]

---

[3] Defined in Section 1a of the Commodity Exchange Act ("CEA").

[4] Defined in Section 3(a)(68) of the Exchange Act. All references to the Exchange Act contained in this release refer to the Securities Exchange Act of 1934, as modified by the Dodd-Frank Act.

[5] In addition, Section 712(d)(1) of the Dodd-Frank Act directs the Commission and the CFTC, in consultation with the Board of Governors of the Federal Reserve System, to propose rules and interpretative guidance to further define, among other things, the terms "security-based swap," "swap dealer," "security-based swap dealer," "major swap participant," and "major security-based swap participant." The Commission and CFTC jointly proposed further rules and guidance with respect to the dealer and participant definitions on December 7, 2010. 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. 10, 2010) (the "Intermediary Definitions Release"). The Commission and CFTC jointly proposed further rules and guidance with respect to the definitions of "swap", "security-based swap", and other terms on April 29, 2011. Further Definition of "Swap, " "Security-Based Swap, " and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, Exchange Act Release No. 64372 (Apr. 29, 2011), 76 FR 29818 (May 23, 2011)).

[6] Subject to certain exceptions, Exchange Act Section 3(a)(71)(A) defines "security-based swap dealer" to mean any person who: (i) holds themself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps. See also supra note 5.

[7] Exchange Act Section 3(a)(67)(A) defines "major security-based swap participant" to mean "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

The Commission is proposing Rules 15Fb1-1 to 15Fb6-1 under the Exchange Act to establish procedures for an SBS Entity to register with the Commission and additional provisions related to such registration, including: (1) a requirement to amend an inaccurate application for registration; (2) procedures for succession to, or withdrawal from, registration; and (3) procedures for the Commission to cancel or revoke registration.[9] The proposed rules would also establish a requirement for an SBS Entity to certify that none of its associated persons that effect, or are involved in effecting, security-based swaps on the SBS Entity's behalf is subject to statutory disqualification. The Commission is proposing forms to facilitate SBS Entities' registration and withdrawal from registration.

---

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) maintáins a substantial position in outstanding security-based swaps in any major security-based swap category, as such categories are determined by the Commission." See also supra note 5.

8 The Commission has concluded that SBS Entities that were not registered with the Commission as of the July 16, 2011, effective date of Section 15F of the Exchange Act are permitted to lawfully continue their business absent Commission action with respect to the SBS Entity registration regime. See 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, Exchange Act Release No. 64678 (Jun. 15, 2011), 76 FR 36287, 36299-300 (Jun. 22, 2011) (the "Effective Date Release").

9 The Exchange Act gives the Commission broad authority to craft a registration regime for SBS Entities that helps the Commission accomplish its missions of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation. For example, Section 15F(b)(2) of the Exchange Act states that an application for registration "shall be made in such form and manner as prescribed by the Commission, and shall contain such information as the Commission considers necessary concerning the business in which the applicant is or will be engaged." In addition, Section 15F(d)(1) of the Exchange Act directs the Commission to "adopt rules for persons that are registered as [SBS Entities] under [Section 15F]."

The proposed rules and forms would address additional registration requirements applicable to nonresident SBS Entities, including requirements to appoint a U.S. agent for service of process, and to provide an opinion of counsel regarding the entity's ability to (1) provide the Commission with prompt access to books and records, and (2) be subject to onsite examinations and inspections by the Commission.

In proposing these rules and forms, the Commission is mindful that there are similarities and differences among SBS Entities that hold substantial positions in security-based swaps and dealers and participants that hold substantial positions in other financial products. The Commission also understands that there are similarities and differences between the security-based swap market and the markets for other financial products. The Commission believes that, both over time and as a result of Commission proposals to implement the Dodd-Frank Act, further information concerning the application of existing registration and regulatory regimes to SBS Entities and the development of the security-based swap market may alter certain considerations relating to the registration of SBS Entities. During the process of implementing the Dodd-Frank Act and beyond, the Commission intends to closely monitor developments relating to SBS Entities and the security-based swap markets. In particular, the Commission intends to evaluate further information concerning the range of market participants that may register as SBS Entities, the activities of and services provided by such market participants, whether these activities and services are identical or similar to activities and services already regulated by the federal securities laws or other laws, and how applicable existing registration and regulatory regimes interact with one another and apply to SBS Entities.

B. General Approach to the SBS Entity Registration Process

The Commission's proposed registration requirements for SBS Entities largely are modeled after the registration regime applicable to broker-dealers,[10] while also taking into account the CFTC's registration requirements for intermediaries.[11] We preliminarily believe that because the proposed requirements would closely align with current requirements for our other registrants, and would be similar to the registration regime for CFTC registrants, this approach would provide the Commission and the staff with key information about registrants while leveraging Commission staff experience and standing procedures to facilitate a substantive review of applications for registration and inspections of registrants. In addition, the broker-dealer registration regime should be familiar to, and understood by, many SBS Entities. In particular, SBS Dealers may already be registered and regulated as broker-dealers or may be affiliated with a broker-dealer. Moreover, if an SBS Dealer enters into security-based swap transactions with persons that are not eligible contract participants, it must register as a broker-dealer unless an exemption or exception applies.[12] The proposed approach would seek to ensure that a market participant registered as both an SBS Entity and a broker-dealer is subject to a similar and complementary registration regime. It could therefore both ease the regulatory burden on such entities and help to establish a consistent regime for regulating SBS Dealers and dealers of other securities.

As explained below, our proposed approach to the application process would build on our existing broker-dealer registration forms – most notably, Form BD – but also is designed to avoid

---

[10] This includes rules promulgated under Sections 15(b) and 17(a) of the Exchange Act.

[11] 17 CFR 3.1 et. seq. Futures commission merchants ("FCMs") and introducing brokers presently register with the CFTC by filing Form 7-R with the National Futures Association. The CFTC has proposed to register swap dealers and major swap participants through this same process. See 75 FR 71379, at 71382 (Nov. 23, 2010).

[12] See 15 U.S.C. 78c(a)(5) and 78o(a).

unnecessary duplication by permitting SBS Entities that are otherwise registered or registering as intermediaries with either the Commission or the CFTC to complete simplified application forms. Under this process, SBS Entities registered or registering with the Commission as broker-dealers or with the CFTC as swap dealers or major swap participants would submit a shorter SBS Entity registration form along with a copy of their existing registration form.

An SBS Entity would be permitted to file an application for registration as soon as final registration rules and forms are adopted. Further, each SBS Entity would need to be registered (at least conditionally) by the compliance date set forth in the final registration rules. In certain circumstances, SBS Entities would be required to apply for conditional registration, which they could convert to ongoing registration by fulfilling the applicable requirements set forth in the proposed rules. As discussed in more detail below, those requirements would differ depending on whether: (1) the application was filed with the Commission before or after the compliance dates for certain new rules to be adopted pursuant to Section 15F of the Exchange Act; and (2) the applicant is an SBS Dealer or instead is a major security-based swap participant. Conditional registration would expire after a specified time, and a conditionally registered SBS Entity would be required to cease its security-based swap business if it had not satisfied the applicable conditions to convert its registration to an ongoing registration. The Commission could, however, extend any conditional registration for good cause.

Although the Commission may be familiar with SBS Entities that are already registered with the Commission (e.g., broker-dealers or investment advisers), the Commission is mindful that SBS Entities will nonetheless constitute a new class of registrants that may present business models and practices with which the Commission will need to gain experience. Accordingly, the Commission expects that its careful review of each application for registration and each certification on Form

SBSE-C (the "Senior Officer Certification" described further below) will not only facilitate the Commission's decision to grant or deny registration to an SBS Entity, but also help to develop this experience and aid in the identification of areas for further inquiry, including, as may be appropriate, examinations of particular firms or business units by the Commission's Office of Compliance Inspections and Examinations ("OCIE"), in order to establish an effective ongoing examination program for such entities.[13]

OCIE currently uses risk-based methodologies to focus Commission examination resources on firms and activities that could pose the greatest risk to investors and the integrity of the markets. Consistent with that general approach, OCIE and the Division of Trading and Markets intend jointly to perform a substantive review of applications and Senior Officer Certifications received for registration of SBS Entities to determine whether additional Commission action is appropriate and to evaluate potential registrants' risk for purposes of prioritizing examinations.

---

13 In addition to SBS Entities, the Dodd-Frank Act requires the Commission to register for the first time security-based swap execution facilities, security-based swap data repositories, municipal advisors, and certain private fund advisers. In light of these new categories of registrants, the Commission is presently reviewing the various standards and processes it uses to facilitate registration of the many types of entities required to register with it – including broker-dealers, investment advisers, nationally recognized statistical rating organizations, transfer agents, clearing agencies, exchanges, national securities associations, and others. In this regard, the Commission plans to issue a concept release designed to collect information and evaluate different aspects of these registration standards and processes. In particular, the Commission intends to consider the policy objectives of registration, how best to achieve those policy objectives through registration and other means, and the relative benefits and costs of the various means available. Through such a concept release, the Commission would hope to gain insight into how evolving market practices, technology, and other considerations could affect or be affected by the Commission's approach to the registration processes for various types of entities. Recognizing that the Commission has finite resources to allocate to registration, examination, and enforcement functions, the Commission intends to use the concept release to seek comment as to how it can most effectively and efficiently utilize these registration and other functions to help ensure that entities registered by the Commission to perform important financial intermediary and other functions in the securities markets have the capability to carry out those functions and to fully comply with all applicable regulatory requirements.

1. Conditional Registration

Under the proposed rules, an SBS Entity seeking Commission registration generally would be required to apply for conditional registration by submitting a complete application to the Commission. The Commission would then grant conditional registration if it finds that the SBS Entity's application is complete, except that the Commission may institute proceedings to determine whether the Commission should deny conditional registration if the applicant is subject to a statutory disqualification or the Commission is aware of inaccurate statements in the application.[14] The Commission would notify the entity electronically when conditional registration is granted, and would make information regarding registration status publicly available.

For an SBS Entity to convert its conditional registration to ongoing registration, it would be required to submit a Senior Officer Certification signed by one of its knowledgeable senior officers. The contents of the Senior Officer Certification and the time frame within which it must be submitted to the Commission are described more fully below and specified in the rule. Generally, however, the Senior Officer Certification would state that, after due inquiry, the senior officer has reasonably determined that the SBS Entity has the operational, financial, and compliance capabilities to act as an SBS Dealer or a major security-based swap participant, as applicable, and has documented the process by which he or she reached such determination. We preliminarily believe that this certification requirement would help to protect both investors and markets from potential problems arising from SBS Entities that may lack the capabilities necessary to operate their businesses in compliance with their regulatory obligations.

---

14 Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing, and that at the conclusion of such proceedings, the Commission would grant or deny such registration. See proposed Rule 15Fb2-1(d)(1).

i. Implementation Plan and the Last Compliance Date

After proposing all of the key rules under Title VII, the Commission intends to seek public comment on a detailed implementation plan that will permit a roll-out of the new securities-based swap requirements in a logical, progressive, and efficient manner, while minimizing unnecessary disruption and costs to the markets. Among other things, the implementation plan would inform the timing of the requirement for SBS Entities to register with the Commission, including whether such registration requirement would exist prior to the latest date, designated by the Commission, by which SBS Dealers and major security-based swap participants must begin complying with all of the initial rules promulgated under Section 15F of the Exchange Act ("Last Compliance Date").[15]

The Commission believes it is possible that SBS Entities may be required to register before the Last Compliance Date.[16] For these "transitional" applicants, whether SBS Dealer or major security-based swap participant, there would be a period of time before the Last Compliance Date when the Senior Officer Certification would be either unduly burdensome for registrants (e.g., a rule has been promulgated by the Commission under Section 15F of the Exchange Act, but compliance with that rule is not yet required) or inappropriate for meeting the goals of the certification (e.g., the Commission has not yet adopted a significant rule under Section 15F of the Exchange Act, so the certification would not cover compliance in an important regulatory area).

To address this potential transition issue, we preliminarily believe it is appropriate to propose a conditional registration process that would permit registration without a Senior Officer

---

15 The term "Last Compliance Date" is defined in proposed Rule 15Fb2-1(e). The Commission anticipates that the Last Compliance Date would be clearly stated in the relevant adopting release and prominently announced on the Commission's web site.

16 The Commission notes that, regardless of the timing of the Last Compliance Date, a registered SBS Entity would be required to comply with certain self-operative provisions in Exchange Act Section 15F upon registration (conditional or otherwise), absent further Commission action. See Effective Date Release, supra note 8.

Certification prior to the Last Compliance Date. This process would be available to all applicants (whether SBS Dealer or major security-based swap participant) and would, among other things, facilitate the identification of existing SBS Entities in advance of the compliance date of certain substantive requirements. Conditional registration would be effective once the Commission grants such conditional registration and would expire on the Last Compliance Date (unless conditional registration was extended pursuant to paragraphs (b) or (c) of proposed Rule 15Fb3-1). Ongoing registration of these conditionally registered SBS Entities would be conditioned on, among other things, the registrant providing the Senior Officer Certification to the Commission on or before the Last Compliance Date. As described above, fulfillment of this requirement by an SBS Entity would provide the Commission with some assurance that the SBS Entity understands and has the ability to undertake its business in compliance with the applicable requirements. Once a registrant submits its Senior Officer Certification, the Commission would consider converting its conditional registration to an ongoing registration.[17] However, whether or not a conditional registrant provides the Senior Officer Certification on or before the Last Compliance Date, the Commission would retain the flexibility to extend conditional registration for good cause.

Once the Last Compliance Date has occurred, the conditional registration process for SBS Dealers would effectively collapse into the ongoing registration process and any SBS Dealer would need to submit its Senior Officer Certification with its application (i.e., after the Last Compliance Date, SBS Dealers could only apply for ongoing registration). Major securities-based swap participants could still conditionally register (as described below) because of challenges separate and apart from implementation of Section 15F of the Exchange Act.

---

[17] Submission of a Senior Officer Certification also would toll expiration of the SBS Entity's conditional registration for thirty days, if necessary to facilitate the Commission's review, or such longer period as the Commission finds for good cause (see proposed Rule 15Fb3-1).

ii. Major Security-Based Swap Participant Applicants Registering After the Last Compliance Date

As noted in the proposed definition of major security-based swap participant,[18] an entity whose security-based swap portfolio crosses established thresholds in a fiscal quarter would have a two-month grace period following the end of that quarter to submit a complete application for registration as a major security-based swap participant. The Commission preliminarily believes that, while there is likely to be some advance notice of an impending status change due to ongoing monitoring of portfolios in the ordinary course of business, an entity that would likely fall within the definition of a "major security-based swap participant" because of activities in a given fiscal quarter may not have adequate compliance systems in place within two months after the end of the triggering quarter to allow the entity to provide the Commission with a Senior Officer Certification. Therefore, the Commission proposes to conditionally register such new participants based on their filing of a complete application before the expiration of the two-month grace period, subject to a requirement that they provide a Senior Officer Certification to the Commission within four months of the submission of their complete application (i.e., within six months after the end of the triggering quarter). This proposal is intended to balance the additional time a new major security-based swap participant may require to build out its compliance structure with the Commission's strong interest in having new registrants promptly comply with applicable federal securities laws. Such conditional registration would be effective once the Commission grants conditional registration and would expire four months after receipt of that application unless the firm files a Senior Officer Certification with the Commission within that time frame.

As with conditional registrations granted prior to the Last Compliance Date, once a major security-based swap participant that applies for registration after the Last Compliance Date submits

18 See Intermediary Definitions Release, supra note 5, at 103.

its Senior Officer Certification, the Commission could consider converting its conditional registration to an ongoing registration, as described below. In addition, whether or not a conditionally registered major security-based swap participant provides the Senior Officer Certification within four months after submitting its application, the Commission retains the flexibility to extend the conditional registration for good cause.

The Commission notes that the conditional registration mechanism for major security-based swap participants would remain in place even after the Last Compliance Date (i.e., major security-based swap participants could always avail themselves of a conditional registration period).

2. Ongoing Registration

The proposed rules would provide for the ongoing registration of all conditionally registered SBS Entities following their fulfillment of the applicable requirements, as well as SBS Dealers registering with the Commission after the Last Compliance Date (and, therefore would not be required to conditionally register). As described above, an SBS Entity would need to submit both a completed application and a Senior Officer Certification to obtain ongoing registration. An SBS Entity that was conditionally registered would not be required to submit a new application. At the time it applies for ongoing registration, however, the SBS Entity would be required to amend its application to correct any information that has become inaccurate for any reason.

The Commission would grant ongoing registration if it finds that the requirements of Section 15F(b) of the Exchange Act are satisfied, but the Commission would institute proceedings to determine whether the Commission should deny ongoing registration if the Commission does not make such a finding, if it finds that the applicant is subject to a statutory disqualification, or if it is aware of inaccurate statements in the application or certification.[19] The Commission would notify

---

[19] Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing, and that at the conclusion of such proceedings, the Commission

the entity electronically when ongoing registration is granted, and would make information regarding registration status publicly available. Pursuant to proposed Rule 15Fb3-1(a), ongoing registration would be effective until any cancellation, revocation or withdrawal of the registration or on any other event the Commission determines should trigger expiration.

3. Solicitation of Comments on the General Approach to the SBS Entity Registration Process

We request comment on this approach to the SBS Entity registration process.

Q-1. Should the Commission model the registration regime applicable to SBS Entities more closely after one or more other registration regimes regulated by the Commission (e.g., securities exchanges or associations,[20] clearing agencies,[21] or investment advisers[22]), self regulatory organizations ("SROs"),[23] or other regulators[24]? If so, please describe which model should be followed and why.

Q-2. Does the conditional process for SBS Entity registration outlined above provide a practicable solution to the potential timing issues raised by the implementation of Section 15F of the Exchange Act? Are there additional or alternative conditions or mechanisms that would be appropriate for addressing those issues?

Q-3. Does the conditional process for major security-based swap participant registration outlined above provide a practicable solution to the potential timing issues raised by the look-back

---

would grant or deny such registration. See proposed Rule 15Fb2-1(d)(2).

20 15 U.S.C. 78f(b)(1) and 15 U.S.C. 78o-3(b)(1) - (2).

21 15 U.S.C. 78q-1(b)(3)(A).

22 15 U.S.C. 80b-3(c).

23 See, e.g., National Association of Securities Dealers Rules 1013 and 1014; Chicago Board Options Exchange Rules 3.5(c)(ii), 8.83(b), and 44.12(b); and NYSE Arca Rule 7.22(a).

24 See, e.g., National Futures Association Registration Rules (which can be found at http://www.nfa.futures.org/nfamanual/NFAManualTOC.aspx?Section=8).

features in the proposed definition of "major security-based swap participant" definition? Are there additional or alternative conditions or mechanisms that would be appropriate for addressing those issues?

Q-4. Should the Commission delay all registrations until the Last Compliance Date instead of adopting a conditional registration process? Why or why not?

Q-5. Should the Commission consider granting conditional registration automatically based on the receipt of a completed application or some other or additional documents? If so, why?

Q-6. Should the Commission notify the SBS Entity that it has granted conditional or ongoing registration prior to making the SBS Entity's registration status publicly available? If so, why and what should be the timing difference?

Q-7. Should the Commission provide additional guidance regarding the process for institution of proceedings? For instance, should the Commission include timeframes within which proceedings would be instituted and/or a decision to grant or deny registration based on those proceedings should be provided (e.g., Exchange Act Section 15(b)(1))? If so, what timeframes or other guidance would be appropriate and why?

Q-8. Is it appropriate to seek to minimize duplication by permitting registered intermediaries to follow a registration process that uses simplified forms? Why or why not?

Q-9. Should these intermediaries be required to file their existing registration forms with the Commission as part of this process, or should they be required to authorize the Commission to obtain access to those forms at the relevant repository (e.g., the Financial Industry Regulatory Authority ("FINRA") or the National Futures Association ("NFA"))?

Q-10. Should SBS Entities be afforded more time (beyond the Last Compliance Date) to prepare and provide their Senior Officer Certification? Why or why not? If so, how much additional time would be appropriate?

Q-11. Should major security-based swap participants that file applications after the Last Compliance Date be afforded more or less than four months to prepare and provide their Senior Officer Certification? Why or why not?

Q-12. What would be the advantages and disadvantages and costs and benefits of the Commission adopting an approach to SBS Entity registration that encompasses a more substantive inquiry concerning the business of an applicant? What would be the impact on market participants, including investors?

Q-13. Are there additional or alternative mechanisms that the Commission could employ to better protect markets and market participants and minimize the burden on registrants while meeting the regulatory objectives of a registration scheme for SBS Entities?

Commenters are encouraged to identify other possible solutions that would allow the Commission to promptly review and consider SBS Entity registration applications so they would not experience undue interruptions in business while also providing the Commission reasonable assurance that they have the ability to carry out their business and are able to comply with applicable federal securities laws.

II. Proposed Exchange Act Rules and Forms

A. Registration Application and Amendment

1. Proposed Rule 15Fb2-1

Proposed Rule 15Fb2-1 would set forth the method through which SBS Entities could apply for registration with the Commission. Essentially, the forms and process for filing applications and

other documents electronically with the Commission would be identical for SBS Dealers and major security-based swap participants. This proposed rule also would describe the timing of such filings and the standard of review applied by the Commission in determining whether to grant or deny registration, which may differ slightly for SBS Dealers and major security-based swap participants, depending on the type of registration the firm is seeking. While it may be appropriate for certain rules applicable to SBS Dealers to differ from those applicable to major security-based swap participants, the Commission preliminarily believes that the registration rules and forms need not differ significantly because the information the Commission would need to determine whether registration is appropriate is similar for both types of entities.

i. Form of Application

Paragraph (a) of proposed Rule 15Fb2-1 would provide that an SBS Entity would apply for registration electronically on Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, in accordance with the instructions to the form. In general:

- SBS Entities registered or registering with the Commission as broker-dealers would apply for registration using Form SBSE-BD;
- SBS Entities registered or registering with the CFTC as swap dealers or major swap participants (and not also registered or registering with the Commission as broker-dealers) would apply for registration using Form SBSE-A; and
- SBS Entities that do not fit either of the above categories would apply for registration using Form SBSE.

Specifics regarding each of these forms and their differences and uses are discussed in more detail below. These forms would be used to register with the Commission regardless of whether an SBS Entity was applying for conditional or ongoing registration.

The Commission solicits comment on the use of forms to register with the Commission.

Q-14. Would an alternative mechanism be more appropriate for registering SBS Entities? If so, which one and why?

Q-15. Should the registration forms differ based on whether the entity is registering as an SBS Dealer or major security-based swap participant? If so, how?

ii. Senior Officer Certification

Paragraph (b) of proposed Rule 15Fb2-1 would require that each SBS Entity provide the Commission with a certification on Form SBSE-C to facilitate the Commission's review of each firm's application for ongoing registration. A knowledgeable senior officer of the SBS Entity would be required to sign the certification,[25] which is designed to provide the Commission with the applicant's assurance that the applicant has the capabilities necessary to operate as an SBS Entity and, therefore, that the applicant should qualify for registration under Exchange Act Section 15F(b). Accordingly, the certification would assist the Commission in determining whether to grant the SBS Entity ongoing registration. Such an informed determination, based in part on the certification, will help the Commission maintain orderly and efficient markets and protect investors by helping to ensure that the Commission only grants registration to SBS Entities that can attest that they possess the operational, financial, and compliance capabilities to conduct business as an SBS Entity. Specifically, under the proposal, each SBS Entity must have a senior officer certify that, after due inquiry, he or she has reasonably determined that the SBS Entity has the operational,[26] financial,[27]

---

[25] In accordance with Proposed Rule 15Fb1-1(b), the SBS Entity will need to maintain a manually signed copy of this certification as part of its books and records until at least three years after the certification was filed with the Commission.

[26] The concept of "operational capability" can be an important regulatory consideration because an SBS Entity with insufficient infrastructure, technology, and human resources presents operational risks that may adversely impact its counterparties and the broader market – e.g., if transactions are inaccurately documented, not documented at all, or if

and compliance[28] capabilities to act as an SBS Entity. In addition, the proposal would require that the senior officer certify that he or she has documented the process by which he or she reached that determination. While the Commission has required regulated entities to provide a certification in other contexts,[29] a requirement that an applicant or regulated entity certify as to its ability to engage in the business it would be registered to do is relatively new.[30]

---

insufficient margin is collected. See Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859, at 3860 (Jan. 21, 2011) (proposing release) (discussing the recognition by various parties of the importance of operational infrastructure in the over-the-counter derivatives market) (the "Trade Acknowledgement Proposing Release"). The Commission expects that a key foundation for the Senior Officer Certification would be the capability of an SBS Entity to comply with the obligations that would be imposed by the Trade Acknowledgment Proposing Release, if adopted, other legal obligations applicable to the operations of an SBS Entity, and the capability of the SBS Entity to conduct its business as represented in the SBS Entity's application for ongoing registration.

27 The concept of "financial capability" can be an important regulatory consideration because of, among other things, the role adequate financing plays in protecting an SBS Entity's counterparties and the broader market by ensuring that the SBS Entity has sufficient working capital and liquidity for its security-based swap business consistent with regulatory requirements and as needed to respond to market conditions. The Commission will separately propose capital rules for SBS Entities, as required by the Dodd Frank Act. 15 U.S.C. 78o-10(e). The Commission expects that the capability of an SBS Entity to comply with these obligations, if adopted, would form a key foundation for the Senior Officer Certification.

28 The concept of "compliance capability" can be an important regulatory consideration because of, among other things, the wholesale creation of a new regulatory regime for security-based swaps under the Dodd-Frank Act. For example, in proposing business conduct rules for SBS Entities, the Commission proposed to require that each SBS Entity "[establish, maintain, and enforce] written policies and procedures addressing the supervision of the types of security-based swap business in which the [SBS Entity] is engaged that are reasonably designed to achieve compliance with applicable securities laws and the rules and regulations thereunder." Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (Jun. 29, 2011), 76 FR 42396, (Jul. 18, 2011), as corrected by Exchange Act Release No. 64766, 76 FR 46668 (Aug. 3, 2011) (proposing release). The Commission expects that development and implementation of such a compliance regime, if adopted, would serve as a key foundation for the Senior Officer Certification.

29 See, e.g., 17 CFR 240.15c3-5, 17 CFR 240.13a-14, and 17 CFR 270.30a-2

30 See, e.g., Registration of Municipal Advisors, Exchange Act Release No. 63576 (Dec. 20,

The Commission preliminarily believes that receipt of a Senior Officer Certification would provide assurances to the Commission that each SBS Entity has the requisite capabilities to operate in the capacity for which it seeks registration. The Senior Officer Certification is designed to require a deliberate and thoughtful self-assessment by each SBS Entity of its capabilities and thus should provide assurances to potential investors, customers of, and counterparties to an SBS Entity that the SBS Entity has the requisite capabilities to act in that capacity. Further, this Senior Officer Certification requirement could help prevent disorderly and unstable markets that could result from the failure of a registered SBS Entity that lacks the requisite capabilities to operate its business in a registered capacity. The Senior Officer Certification also may enhance market participants' ability to assess the counterparty credit risk associated with a particular SBS Entity counterparty. In this way, the Senior Officer Certification should help to protect investors and other market participants from SBS Entities that are not competent to engage in that business, lack the financial resources to do so, or are unable or unwilling to comply with applicable law. The Commission thus preliminarily believes that the Senior Officer Certification could help the efficient functioning of the market and enhance the confidence of investors and other market participants.

The Senior Officer Certification requirement, in other words, is meant to address many of the same considerations that arise during the in-depth review by the Commission and its staff, or, in some cases, SROs, prior to granting registration to certain applicants.[31] For example, under

---

2010), 76 FR 824, (Jan. 6, 2011) (proposing release) (the "Registration of Municipal Advisors Proposing Release").

[31] See, e.g., 15 U.S.C. 78f(b)(1) (regarding registration of national securities exchanges), and 15 U.S.C. 78q-1(b)(3)(A) (regarding registration of clearing agencies). See also 15 U.S.C. 78o-3(b)(1) and (2) (regarding registration of national securities associations). In addition, the Commission recently proposed rules governing the registration of security-based swap data repositories ("SDRs"), security-based swap execution facilities ("SB SEFs"), security-based swap clearing agencies ("SBS CAs"), and municipal advisors that relate to potential registrants' operational, financial, and compliance capabilities. For example, the proposed

registration rules for security-based swap data repositories are intended to, among other things, assure the Commission that "an SDR is so organized, and has the capacity, to be able to assure the prompt, accurate, and reliable performance of its functions as an SDR, comply with any applicable provision of the Federal securities laws and the rules and regulations thereunder, and carry out its functions in a manner consistent with the purposes of Exchange Act." These proposed rules may also require an SDR to file with the Commission, as a condition of registration or continued registration, a review relating to the SDR's operational capacity and ability to meet its regulatory obligations. Such review could be in the form of a report conducted by the SDR, an independent third party, or both. Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010) (proposing release). Similarly, the proposed registration rules for security-based swap execution facilities are designed to assure the Commission that a registrant "has adequate financial, operational, and managerial resources to discharge each responsibility of the SB SEF, as determined by the Commission." Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (proposing release). Among other things, these rules state in part that "the financial resources of a SB SEF shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the SB SEF to cover its operating costs for a one year period." The Commission also proposed registration rules for security-based swap clearing agencies that require, among other things, registrants to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that their systems provide adequate levels of capacity, resiliency, and security. Such policies and procedures shall, at a minimum: (i) establish reasonable current and future capacity estimates; (ii) conduct periodic capacity stress tests of critical systems to determine such systems' ability to process transactions in an accurate, timely, and efficient manner; (iii) develop and implement reasonable procedures to review and keep current its system development and testing methodology; (iv) review the vulnerability of its systems and data center computer operations to internal and external threats, physical hazards, and natural disasters; and (v) establish adequate contingency and disaster recovery plans. These rules further require that clearing agencies that provide central counterparty ("CCP") services need to have a qualified person conduct a review of models that are used to set margin levels, along with related parameters and assumptions, in order to assure that the models perform in a manner that facilitates prompt and accurate clearance and settlement of transactions. In determining whether a person is qualified to conduct the model validation, clearing agencies providing CCP services could consider several factors, including the person's experience in validating margin models, expertise in risk management generally, and understanding of the clearing agency's operations and procedures. Clearing Agency Standards for Operation and Governance, Exchange Act Release No. 64017 (Mar. 3, 2011), 76 FR 14472 (Mar. 16, 2011) (proposing release) (the "Clearing Agency Standards Proposing Release"). Finally, the proposed registration rules for municipal advisors would require municipal advisors to certify that they have: "1) sufficient qualifications, training, experience, and competence to effectively carry out their designated functions; 2) met, or within any applicable timeframe will meet, such standards of training experience, and competence, and such other qualifications, including testing, for a municipal advisor, required by the Commission, the MSRB or any other relevant self-regulatory organization; and 3) the necessary understanding of, and ability to comply with,

Sections 6(b) and 19(a) of the Exchange Act, an exchange may not be registered unless the Commission finds that the exchange "is so organized and has the capacity to be able to carry out the purposes of the Exchange Act and to comply, and [. . .] to enforce compliance by its members and persons associated with its members, with the provisions of [the Exchange Act], the rules and regulations thereunder, and the rules of the exchange."[32] Similarly, under Section 17A of the Exchange Act, a clearing agency may not be registered unless the Commission finds that the agency "has the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts and transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, to comply with the provisions of [the Exchange Act] and the rules and regulations thereunder, [and] to enforce [...] compliance by its participants with the rules of the clearing agency, and to carry out the purposes of this section."[33] To this end, the Commission has published a series of standards "that the [staff] will use in reviewing the organizations, capacities and rules of clearing agencies that currently are registered temporarily with the Commission and of clearing agencies that may apply for registration . . . ."[34] Broker-dealers that register with the Commission under Section 15(b) also must become a member of an SRO, and SRO rules generally incorporate membership application procedures that include, among other things, assessments by the SRO of the broker-

---

all applicable regulatory obligations." Registration of Municipal Advisors Proposing Release, supra note 30.

32 15 U.S.C. 78f(b)(1).

33 15 U.S.C. 78q-1(b)(3)(A).

34 The Commission has established a series of standards "that the [staff] will use in reviewing the organizations, capacities and rules of clearing agencies that currently are registered temporarily with the Commission and of clearing agencies that may apply for registration . . . ." Regulation of Clearing Agencies, Exchange Act Release No. 16900 (Jun. 17. 1980), 45 FR 41920 (June 23, 1980) (emphasis added). See also the Clearing Agency Standards Proposing Release, supra note 30.

dealer's operational, financial, and compliance capabilities.[35]

At this time, although we provide guidance above regarding the factors a senior officer would use to serve as a foundation for the Senior Officer Certification,[36] we are not proposing a specific definition of the term "operational, financial and compliance capabilities." Instead, we request comment regarding whether and how that phrase should be further defined or interpreted. The Commission recognizes that whether an SBS Entity has the operational, financial and compliance capabilities to act as an SBS Entity likely will depend on its particular facts and circumstances, including, among other things: the scope and nature of its security-based swap business; its other related financial and business activities; the extent to which it is subject to other registration and regulatory requirements or other supervisory oversight with respect to its activities; its relationships with, and reliance on, affiliates, service providers, and other parties; and the extent and nature of its historical involvement in security-based swap transactions. Moreover, it may be appropriate to consider the capabilities required for this certification by reference to regulatory standards. For example, attesting to capabilities might include a self-assessment of whether the SBS Entity is capable of communicating in a manner that is based on principles of fair dealing and

---

35 See, e.g., NASD Rules 1013 and 1014 (membership application review requires a new broker-dealer to, among other things, file a detailed business plan, explain its sources of funding, describe the educational background and experience of its personnel, and undergo a membership interview). Existing FINRA members that wish to enter into a materially new business, such as dealing in security-based swaps, must also file an application to do so, and those applications are similarly reviewed to determine whether the broker-dealer has the requisite capabilities to conduct the new business. NASD Rule 1017. Exchange Act Rule 15b2-2 requires that a new broker-dealer be examined within six months to evaluate whether the broker-dealer is operating in conformity with applicable financial responsibility rules and again within twelve months to evaluate whether it is also operating in conformity with all other applicable provisions of the Exchange Act and rules thereunder. 17 CFR 240.15b2-2(b) &(c).

36 See supra notes 26 - 28.

good faith;[37] whether the SBS Entity has established all contractual or other arrangements and business relationships necessary to conduct its security-based swap business;[38] whether the SBS Entity has or has adequate plans to obtain facilities that are sufficient for its operations;[39] and whether the SBS Entity is capable of maintaining a level of capital that is adequate to support the SBS Entity's intended business operations on a continuing basis.[40]

The proposed rules would require that a senior officer of an SBS Entity certify that he or she has reasonably determined that, after "due inquiry," the security-based swap dealer or major security-based swap participant has the operational, financial, and compliance capabilities to act as an SBS Entity.[41] We believe it is important to make explicit that the senior officer is obligated under the rule to conduct some inquiry to form his or her reasonable determination. However, the Commission does not propose to prescribe any single method a senior officer must use to gain an appropriate level of comfort and information before signing the Senior Officer Certification. In other words, different SBS Entities may utilize different processes to provide a basis for a senior officer's reasonable determination that the SBS Entity has the requisite capabilities.[42]

---

37 See Section 15F(h)(3)(C) (providing that business conduct requirements adopted by the Commission shall establish a duty to communicate in a manner "based on principles of fair dealing and good faith").

38 See NASD Rule 1014(a)(4).

39 See NASD Rule 1014(a)(5).

40 See NASD Rule 1014(a)(7).

41 This certification must be accurate as of the date the certification is filed with the Commission. An SBS Entity would not be required to have a senior officer update the certification after the SBS Entity has been approved for ongoing registration.

42 For example, in satisfying other certification requirements some SBS Entities may use a sub-certification process whereby the senior officer will not certify a firm-wide statement unless and until other persons responsible for certain activities in turn certify to the senior officer that the standard has been met, while other SBS Entities may use an internal or external audit-type process whereby a senior officer may choose to employ a third party to review an area subject to a firm-wide certification before submitting the certification.

As described in Part I above, the proposed registration process would include conditional and ongoing registration. Pursuant to subparagraph (b)(1)(i) and (ii), respectively, of proposed Rule 15Fb2-1, SBS Entities that register conditionally during the transitional period would need to submit the Senior Officer Certification on or before the Last Compliance Date and major security-based swap participants that file an application after the Last Compliance Date would need to submit the certification within four months after filing an application. The Commission preliminarily believes that these timeframes would provide senior officers of conditionally registered SBS Entities sufficient time to determine that they are able to provide the relevant certification. Pursuant to subparagraph (b)(2), an SBS Dealer that files an application after the Last Compliance Date would need to submit the Senior Officer Certification with its application.

The Commission requests comment on all aspects of the proposed requirement for SBS Entities to provide the Commission with a Senior Officer Certification on Form SBSE-C as specified in proposed Rule 15Fb2-1(b), and on the registration process generally. With respect to this certification, the Commission is interested in commenters responses to the following questions, and also to questions Q-54. through Q-61. relating to Additional Registration Considerations.

Q-16. Would the Senior Officer Certification requirement provide sufficient assurance that each SBS Entity has the necessary capabilities to act as a registered SBS Entity? Why or why not? Would it provide sufficient assurance that SBS Entities have established controls to ensure compliance with all applicable securities law requirements? Why or why not?

Q-17. Would the Senior Officer Certification provide sufficient assurance to customers of and counterparties to SBS Entities, investors, eligible contract participants and other market participants that new SBS Entities have the requisite capabilities to act as SBS Entities? Why or why not?

Q-18. Should the Commission only require SBS Dealers, and not major security-based swap participants, to provide a Senior Officer Certification? Why or why not? What would be the comparative advantages, disadvantages, costs and/or benefits of such an approach?

Q-19. Alternatively, should the form of Senior Officer Certification an SBS Entity must file be driven by whether the entity is an SBS Dealer or major security-based swap participant? For instance, should an SBS Dealer be required to certify to its capabilities and a major security-based swap participant be required to certify to its policies and procedures? If so, what form of Senior Officer Certification should SBS Dealers be required to file and which form of Senior Officer Certification should major security-based swap participants be required to file? What would be the comparative advantages, disadvantages, costs and/or benefits of requiring dealers and participants to certify using different certification language?

Q-20. What alternative forms of Senior Officer Certification should be considered, if any? For example, should the proposed Senior Officer Certification use the language that the Commission proposed with respect to the certification to be made by municipal advisors?[43] Why or why not? What would be the comparative advantages, disadvantages, costs and/or benefits of using the same certification language the Commission has proposed for use by municipal advisors as opposed to the language proposed?

Q-21. The concept of developing and implementing written policies and procedures has often been used by the Commission to further its regulatory objectives. Should the Senior Officer Certification instead require that a senior officer certify that "to the best of his or her knowledge, after due inquiry, the security-based swap dealer or major security-based swap participant has developed and implemented written policies and procedures reasonably

[43] See supra note 31, regarding the certification the Commission proposed for use by municipal advisors in the Registration of Municipal Advisors Proposing Release.

designed to prevent violation of federal securities laws, the rules thereunder, and applicable self-regulatory organization rules?"[44] Why or why not? What would be the impact of the Senior Officer Certification if it did not specifically address operational capability? What would be the comparative advantages, disadvantages, costs and/or benefits of using this language as opposed to the language proposed?

Q-22. Should the Commission more specifically define the term "operational, financial, and compliance capabilities"? If so, how should this term be defined to, among other things, provide greater certainty to market participants about the basis for providing the Senior Officer Certification?

Q-23. Should the Commission specifically define the term "capability?" Should the Commission, for example, define the term "capability," as it relates to the financial, operational, and compliance functions of an SBS Entity, as "having the necessary ability or qualities"? Why or why not? Should the Commission define the term capability in some other way? If so, how and why?

Q-24. Alternatively, should the Commission simply adopt the Webster's New World Dictionary definition which defines the term "capability" to mean "the quality of being capable; practical ability," and defines the term "capable" to mean, among other things, "having ability; able; skilled; competent –capable of; having the ability or qualities necessary for; able or ready to?"[45] Why or why not? Should the Commission instead adopt some other

---

44 See, e.g., Section 15(g) of the Exchange Act (requiring that broker-dealers establish, maintain and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information). 15 U.S.C. 78o(g). See also Rule 206(4)-7 of the Investment Advisers Act of 1940 (the "Advisers Act") (requiring that investment advisers must adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder). 17 CFR 275.206(4)-7.

45 Websters New World Dictionary 110 (2nd concise ed. 1975).

dictionary definition? If so, what other dictionary definition should be used and why? Alternatively, should the Commission define the term capability in some other way? If so, how and why?

Q-25. Should the Commission determine that a firm may rely on the establishment, maintenance and enforcement of written policies and procedures by an SBS Entity that are reasonably designed to prevent violation of federal securities laws, the rules thereunder, and applicable self-regulatory organization rules as a basis for a senior officer to certify that an SBS Entity has the appropriate "compliance capability?" Why or why not?

Q-26. Should the Commission determine that a firm may rely on the establishment, maintenance and enforcement of written policies and procedures by an SBS Entity that are reasonably designed to assure that the SBS Entity complies with applicable capital and margin requirements as a basis for a senior officer to certify that an SBS Entity has the appropriate "financial capability?" Why or why not?

Q-27. If the Commission does not specifically define what would constitute operational, financial, and compliance capabilities, will there still be a sufficient basis for SBS Entities and/or their senior officers to provide the Commission with a Senior Officer Certification? Why or why not? Would any potential uncertainty arising from the decision not to define at this time the terms "operational, financial, and compliance capabilities" and "capabilities" cause difficulties for SBS Entities seeking to register on an ongoing basis? If so, please describe.

Q-28. Should SBS Entities be required to provide a Senior Officer Certification as to any capabilities in addition to the three specified? If so, what other capabilities and why? Alternatively, should any of the capabilities be eliminated from the Senior Officer Certification? If so, which one(s) and why? For example, should the certification relating to

an SBS Entity's capabilities be confined to operational capability given the regulatory imperative to comply with applicable regulations (including capital rules)? What would be the comparative advantages, disadvantages, costs and/or benefits of adding or eliminating such capabilities?

Q-29. In addition to, or in lieu of the Senior Officer Certification requirement, should the Commission utilize an approach to demonstration of capabilities similar to the one we use to register national securities exchanges under Exchange Act Section 6(b)(1)[46] (which requires that an exchange have the "capacity to be able to carry out the purposes of [the Exchange Act…], the rules and regulations thereunder")? Would such a standard provide additional clarity as to the capabilities to be required of registrants? What would be the advantages and disadvantages and the costs and benefits of such an alternative process?

Q-30. Should the Commission instead utilize an approach to demonstration of capabilities similar to the one we use to register clearing agencies under Exchange Act Section 17A(b)(3)(A)[47] (which requires that an exchange have the "capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and derivative agreements, contracts and transactions for which it is responsible, to safeguard securities and funds in its custody or control or for which it is responsible, to comply with the provisions of [the Exchange Act] and the rules and regulations thereunder, [and] to enforce […] compliance by its participants with the rules of the clearing agency, and to carry out the purposes of this section")? Would such a standard provide additional clarity as to the capabilities to be required of registrants? What would be the advantages and disadvantages and the costs and benefits of such an alternative process?

---

46 See supra note 32.

47 See supra note 33.

Q-31. Should the form of Senior Officer Certification an SBS Entity must file be driven by whether the entity is, or is not, already registered with the Commission as a broker-dealer or with the CFTC as a swap dealer or major swap participant? Why or why not? If so, what forms of certification would be appropriate for use by SBS Entities that are already registered with one of the Commission or the CFTC? What would be the comparative advantages, disadvantages, costs and/or benefits of this approach?

Q-32. Should SBS Entities already registered with the Commission as a broker-dealer or with the CFTC as a swap dealer or major swap participant be excepted from the requirement to file a Senior Officer Certification? Why or why not? What would be the comparative advantages, disadvantages, costs and/or benefits of this approach?

Q-33. If an SBS Entity were also registered with the Commission as a broker-dealer and an SRO were to conduct a "material change in business review" of the SBS Entity's security-based swap business, should the SBS Entity be permitted to rely on the SRO's review and approval of that new business as a basis for its Senior Officer Certification? Would the form of Senior Officer Certification affect the SBS Entity's ability to rely on such a review and approval? If so, how and why? Given that SBS Entities that are also registered as broker-dealers would be required by existing SRO rules to undergo a material change in business review, are there any advantages and disadvantages or costs and benefits associated with reliance on an SRO "material change in business review" and approval as a basis for its Senior Officer Certification?

Q-34. Similarly, if an SBS Entity were also involved in swap activity, could that entity use any CFTC, NFA or prudential regulatory agency's review of its swap business to inform its Senior Officer Certification to the Commission? Would the form of Senior Officer

Certification affect the SBS Entity's ability to rely on such a review and approval? If so, how and why? Are there any advantages and disadvantages or costs and benefits associated with reliance on a CFTC, NFA or prudential regulatory agency's review of its swap business as a basis for its Senior Officer Certification?

Q-35. Would the Senior Officer Certification requirement effectively require an SBS Entity to employ a third party's services to examine or confirm conclusions required for the certification? Why or why not? If third party services were effectively required, what would be the advantages and disadvantages and costs and benefits of such third party services?

Q-36. Should we include the due inquiry requirement in the rule? Should we instead specify particular steps a senior officer must take to determine whether the SBS Entity has the requisite capabilities?

Q-37. Should the senior officer of an SBS Entity be required to disclose on Form SBSE-C or elsewhere, the nature of the "due inquiry" he or she performed before signing Form SBSE-C and his or her resulting findings and conclusions? Why or why not?

Q-38. Should the Commission define its expectations with respect to the "due inquiry" a senior officer should perform before signing Form SBSE-C? If so, what should be included as part of a senior officer's "due inquiry?" Should "due inquiry" differ depending on whether the SBS Entity is an SBS Dealer or a major security-based swap participant? Please explain.

Q-39. Is the timeframe within which the proposed Senior Officer Certification would need to be filed appropriate? If not, should the timeframe be shorter or longer and why?

Q-40. Should the Commission eliminate the requirement that a senior officer certify that he or she has documented the process by which he or she reached his or her determination regarding

the SBS Entity's capacity? Why or why not? Should the Commission instead simply require that a senior officer document this process and require that the SBS Entity maintain those documents as part of its books and records? Would a senior officer believe that he or she may be second-guessed if, among other circumstances, the senior officer certifies as to an SBS Entity's capabilities but does not retain documentation demonstrating how he or she reached this determination?

iii. Electronic Filing

Paragraph (c) of proposed Rule 15Fb2-1 would address the manner in which the application, certification, and any additional registration documents would be filed with the Commission. Proposed paragraph (c)(1) would require applications, certifications, and any additional documents to be filed electronically. The Commission anticipates that the EDGAR system will be expanded to facilitate registration of SBS Entities because it likely would provide the most cost-effective solution.[48]

Proposed paragraph (c)(2) of proposed Rule 15Fb2-1 would specify the effective date of filing of applications and certifications submitted pursuant to the paragraphs (a) and (b). Subparagraph (c)(2)(i) would provide that an SBS Entity's application submitted pursuant to paragraph (a) would be considered filed only when a complete Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, and all required additional documents are filed with the Commission or its designee. Subparagraph (c)(2)(ii) would provide that an SBS Entity's certification submitted

[48] To the extent the Commission utilizes the EDGAR system to facilitate registration of SBS Entities, applicants would need to utilize the EDGAR Filer Manual (as defined in 17 CFR 232. 11) to facilitate their filing of applications electronically. The EDGAR Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Generally, entities filing documents in electronic format through the EDGAR system must comply with the applicable provisions of the EDGAR Filer Manual in order to assure the timely acceptance and processing of those filings.

pursuant to paragraph (b) would be considered filed when a complete Form SBSE-C is filed electronically with the Commission or its designee.

If a technological means to facilitate receipt and retention of applications is not functional by the time final rules are adopted, proposed temporary Rule 15Fb2-2T, described more fully below, would require SBS Entities to file applications and additional documents in paper form.

The Commission requests comment on the proposed method for receiving applications.

Q-41. Should the Commission not require electronic submission of applications? If not, why?

Q-42. Instead of expanding the EDGAR system to receive SBS Entity applications for registration, should the Commission utilize some other system? Please explain. What would be the comparative advantages and disadvantages and costs and benefits of utilizing a system other than EDGAR?

Q-43. What would be the advantages and disadvantages and costs and benefits to prospective applicants of expansion of the EDGAR system to receive SBS Entity applications for registration, especially with respect to the varying levels of familiarity that they may have with this system?

Q-44. Should the Commission designate another entity to facilitate the electronic receipt of applications? Why or why not? If so, what types of entities should we consider?

Q-45. What other issues, if any, should the Commission consider in connection with electronic filing?

iv. Standards for Granting or Denying Applications

Paragraph (d) of proposed Rule 15Fb2-1 would provide that the Commission may grant or deny an application for registration, and would set forth the standards the Commission would use to make that determination. The grant or denial of a conditional registration would depend principally

on the completeness of an application, whether the applicant is subject to a statutory disqualification, and whether the Commission is aware of inaccurate statements in the application. The grant or denial of an ongoing registration would also require that the Commission find that the requirements of Exchange Act Section 15F(b) are satisfied. As noted in Part I above, conditionally registered SBS Entities would need to obtain ongoing registration to continue doing a security-based swap business once their conditional registration expires.[49]

When considering an application for conditional registration, proposed paragraph 15Fb2-1(d)(1) provides that the Commission would grant such registration if it finds that the firm's application is complete, except that the Commission may institute proceedings to determine whether to deny conditional registration if it finds that the applicant is subject to a statutory disqualification or the Commission is aware of inaccurate statements in the application. Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing. At the conclusion of such proceedings, the Commission would grant or deny such registration.

Paragraph (d)(2) would allow the Commission to grant ongoing registration to an SBS Entity. It is contemplated that ongoing registration would be sought by firms that have been conditionally registered with the Commission, as well as by new firms entering the marketplace that have not been conditionally registered (e.g., an SBS Dealer seeking registration after the Last

---

[49] Proposed Rule 15Fb3-1(b)(1) would provide that conditional registrations granted pursuant to paragraph (d)(1) of Proposed Rule 15Fb2-1 would expire on the Last Compliance Date for SBS Entities that filed a complete application before the Last Compliance Date, unless the SBS Entity files with the Commission a certification on Form SBSE-C or the Commission extends conditional registration for good cause. Proposed Rule 15Fb3-1(b)(2) would provide that conditional registrations granted pursuant to paragraph (d)(1) of Proposed Rule 15Fb2-1 would expire four months after a major security-based swap participant files a complete application, if it filed such application after the Last Compliance Date, unless the major security-based swap participant files with the Commission a certification on Form SBSE-C. In both cases, if the Senior Officer Certification is filed within the given timeframe, conditional registration is extended by 30 days to allow the Commission time to determine whether to grant or deny ongoing registration.

Compliance Date). Paragraph (d)(2) would specify that the Commission would grant ongoing registration based on a firm's application and certification. Proposed paragraph (d)(2) would provide that if the Commission granted conditional registration to an SBS Entity, the Commission could grant or deny ongoing registration based on the original application submitted by the SBS Entity, as amended,[50] and the certification submitted to the Commission by the SBS Entity pursuant to paragraph (b). When considering any application for ongoing registration, Rule 15Fb2-1(d)(2) would provide that the Commission would grant registration if it finds that the requirements of Exchange Act Section 15F(b) are satisfied, except that the Commission may institute proceedings to determine whether ongoing registration should be denied if it does not make such finding or if it finds that the applicant is subject to a statutory disqualification or the Commission is aware of inaccurate statements in the application or certification. Such proceedings would include notice of the grounds for denial under consideration and opportunity for hearing, and that at the conclusion of such proceedings, the Commission would grant or deny such registration.

As discussed above, the Commission would notify the entity electronically when conditional or ongoing registration is granted, and would make information regarding registration status publicly available.

The Commission requests comment on these proposed standards of review for granting or denying registration in proposed Rule 15Fb2-1(d).

Q-46. Should the Commission consider using different standards of review to grant conditional registration to SBS Entities who apply before the Last Compliance Date than it uses for

[50] The SBS Entity may have amended its application to address changes that may have occurred in the intervening period between the date the application was originally filed and the date the Commission evaluates whether ongoing registration should be granted.

major security-based swap participants that apply for conditional registration after the Last Compliance Date?

Q-47. Would the standard requiring denial of an application if the applicant is subject to statutory disqualification cause undue hardship for any possible applicants? If so, how many applicants are likely to be affected? Should this standard be refined or eliminated? If applicants subject to statutory disqualification should be allowed to register, should they be subject to any additional requirements? Please explain.

Q-48. Should the Commission consider broader or more limited standards for granting or denying conditional registration? If so, please describe the standard that should be used and the reasons why it would be more appropriate than the standard proposed.

Q-49. Should the Commission consider using a different standard of review to grant ongoing registration?

Q-50. Should the Commission consider broader or more limited standards for granting or denying ongoing registration? If so, please describe the standard that should be used for granting or denying ongoing registration and the reasons why it would be more appropriate than the standard proposed.

Q-51. Should the Commission staff base its decision only on a review of a firm's application (including any additional documents) and certification or should an on-site examination or some other type of review be considered? If so, what would be the appropriate scope and timing of such a review?

Q-52. Is there a need to lengthen or shorten the proposed timeframes provided for the effectiveness of conditional registration in paragraph (d)(1)? If so, how long should they be?

Q-53. Should the Commission provide additional guidance regarding the process for institution of proceedings? For instance, should the Commission include timeframes within which proceedings would be instituted and/or a decision to grant or deny registration based on those proceedings should be provided (e.g., Exchange Act Section 15(b)(1))? If so, what timeframes or other guidance and why?

v. Request for Comment on Additional Registration Considerations

The Commission requests comment on what, if any, alternative approaches should be considered to meet the Commission's regulatory objectives in the registration process for SBS Entities and how any such alternative approaches would compare to the current proposal.[51] Any such comparison should describe the relative advantages and disadvantages of each alternative, as well as their relative costs and benefits.

Q-54. Should the Commission not adopt a Senior Officer Certification requirement, and instead seek to satisfy itself during the registration process, based on documents the SBS Entity may be able to provide to the Commission, that the SBS Entity has the operational, financial, and/or compliance capabilities to act as an SBS Dealer or major security-based swap participant, as applicable? What would be the advantages and disadvantages and the costs and benefits of such an alternative process?

Q-55. If the Commission determines to satisfy itself during the registration process, based on documents the SBS Entity may be able to provide to the Commission, that the SBS Entity has the operational, financial, and/or compliance capabilities to act as an SBS Dealer or major security-based swap participant, as applicable, should the Commission identify which

[51] As described in footnote 12 above, the Commission is presently reviewing the various standards and processes it uses to facilitate registration, and we would expect that any alternative processes suggested by commenters here would inform that review.

documents or categories of documents should be submitted in order to facilitate its review and/or decision? If so, what types of documents (e.g., business plan, written procedures, or annual audit statements) should the Commission identify to facilitate this review and what would be the costs of obtaining or providing such documents?

Q-56. Should the Commission not adopt a Senior Officer Certification requirement, and instead require that an SBS Entity obtain and submit to the Commission an independent third-party review of its operational, financial, and compliance capabilities or its written policies and procedures before granting ongoing registration? What practical considerations – e.g., identifying an appropriate independent third party, measuring the time, cost, and reliability of any such review, addressing the types of information to be shared with a third party and the factors to be considered in its review – would inform whether such a review would be appropriate? What would be the advantages and disadvantages and costs and benefits of requiring a third-party review instead of the Senior Officer Certification?

Q-57. Should the Commission adopt a Senior Officer Certification requirement, and also require that an SBS Entity employ a third party to independently review its capabilities to provide a basis for that Senior Officer Certification? What would be the advantages and disadvantages and costs and benefits of having an SBS Entity's capabilities independently reviewed? If such a review were required, who could perform such a review, what would such review entail, and should the review be submitted to the Commission along with the certification? What would be the comparative advantages, disadvantages, costs and/or benefits of requiring dealers and participants to have their capabilities independently reviewed?

Q-58. If the Commission required that SBS Entities obtain and submit an independent third-party review, what types of entities could perform such a review (e.g., accountants, law firms, consulting firms) and what independence standards should apply for purposes of conducting the review? Could a review or examination by another governmental agency (e.g., the Federal Reserve Board, the CFTC, the Office of the Comptroller of the Currency) or an SRO constitute an independent third party review for these purposes? If not, why? Are there any practical or legal impediments to obtaining or providing to the Commission a review from a third party or a governmental agency or an SRO? If so, could these be addressed by contract or otherwise?

Q-59. Are there any other forms of oversight that could or should reinforce or replace the proposed Senior Officer Certification? What would be the comparative advantages, disadvantages, costs and/or benefits of such an approach?

Q-60. Are there other approaches to registration the Commission should consider that, in a cost-effective manner, would both fulfill the statutory mandate to protect investors, maintain fair, orderly, and efficient markets, facilitate capital formation, and ensure that the security-based swap market smoothly transitions from a generally unregulated marketplace to one that is regulated and subject to appropriate oversight? If so, please explain which ones and why.

Q-61. If the Commission were to consider an approach to registration that required something other than a Senior Officer Certification, would SBS Entities need more time to gather, obtain, or submit any documents, third party review, or other items than we have proposed for submission of the Senior Officer Certification (i.e., on or before the Last Compliance Date or, for participants that apply after the Last Compliance Date, within four months after it files its completed application)? If so why or why not?

In the Intermediary Definitions Release,[52] the Commission acknowledged that the statutory definitions include a provision stating that a person may be designated as a dealer for one or more types, classes or categories of security-based swaps, or activities. Further, that release indicated that one commenter stated that the Commissions should allow a person to register as a swap dealer or SBS Dealer for only a limited set of types, classes or categories of swaps or security-based swaps.

Q-62. Should the registration process be expanded in any way to allow firms to choose whether they register in a "full" or "limited" capacity? If so, how?

Q-63. What additional information should be elicited by the proposed forms to provide the Commission with sufficient information to determine whether limited (as opposed to full) registration is appropriate? Should there be separate forms for firms to apply for limited, as opposed to full, registration? Should there instead be a separate schedule to the forms as proposed? Should the timing differ and, if so, how and why?

Q-64. Should an applicant for limited registration be required to provide the Commission with a different senior officer or other certification? If so, how should the certification differ?

Q-65. Should the Commission apply a different standard of review when considering whether to grant or deny limited registration to an applicant? If so, which one and why?

Q-66. If the Commission were to grant an SBS Entity's application for limited registration and the SBS Entity later determined that it would prefer to be fully registered, how should this transition be effected?

Please provide as much detail as possible in commenting on which of the above referenced courses of action should be pursued. Please also provide information regarding possible costs or benefits of each of these alternatives.

---

[52] Intermediary Definitions Release, supra note 5, at 80182.

2. Amendments to Application Forms: Proposed Rule 15Fb2-3

Proposed Rule 15Fb2-3 would require an SBS Entity to promptly[53] amend its Form SBSE, Form SBSE-A, Form SBSE-BD, as applicable, to correct any information it determines is, or has become, inaccurate for any reason.[54] The Commission preliminarily believes this proposed Rule is necessary in order for it to have access to accurate information as part of its ongoing oversight of SBS Entities.

The Commission requests comment on all aspects of proposed Rule 15Fb2-3.

Q-67. Should the Commission only require SBS Entities to promptly update their Forms SBSE, SBSE-A, and SBSE-BD when they become "materially" inaccurate?

Q-68. Should SBS Entities instead be required to periodically update these forms and, if so, what would be an appropriate timeframe for updating (e.g., monthly, quarterly, annually)? What may be the comparative costs and benefits of periodic updating vs. "prompt" updating?

Q-69. If the Commission requires SBS Entities to promptly update their Forms SBSE, SBSE-A, and SBSE-BD when they become materially inaccurate, should it also require that all information on the forms be updated periodically?

Q-70. Would it be appropriate for the Commission to require that certain information be updated more frequently than other information? If so, please describe what information should be

---

[53] For purposes of Rule 15b3-1, the Commission has interpreted the term "promptly" to mean within 30 days. (In the Matter of First Guarantor Securities, Inc., Exchange Act Release No. 32725, 51 S.E.C. 612 (Aug. 6, 1993), which states, "Absent extraordinary circumstances, an amendment to Form BD filed beyond thirty days from the change in information cannot be considered 'promptly' filed in accordance with Rule 15b3-1.") We preliminarily believe this standard is also appropriate with respect to the use of this term in proposed Rule 15Fb2-3.

[54] This proposed rule is based on Exchange Act Rule 15b3-1, which is applicable to registered brokers and dealers and has worked well to assure that broker-dealers promptly amend their applications.

subject to more frequent updates and why, and the frequency with which each such item should be updated.

B. Associated Persons

1. Certification

Paragraph (b)(6) of Exchange Act Section 15F generally prohibits SBS Entities from permitting any of their associated persons[55] who are subject to a "statutory disqualification" (as defined in Exchange Act Section 3(a)(39)) to effect or be involved in effecting[56] 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. To provide SBS Entities with a mechanism to assess their compliance with this provision, paragraph (a) of proposed Rule 15Fb6-1 would require that an SBS Entity certify, on Schedule G of Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, that no person associated with it who effects or is involved in effecting security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Exchange Act.[57] If an associated person later becomes statutorily disqualified, the SBS Entity

---

55 15 U.S.C. 78c(a)(70) generally defines the term "person associated with" an SBS Entity to include: (i) any partner, officer, director, or branch manager of an SBS Entity (or any person occupying a similar status or performing similar functions); (ii) any person directly or indirectly controlling, controlled by, or under common control with an SBS Entity; or (iii) any employee of an SBS Entity. However, it generally excludes persons whose functions are solely clerical or ministerial.

56 The Commission believes that associated persons "involved in effecting" security-based swaps would include, but not be limited to, persons involved in drafting and negotiating master agreements and confirmations, persons recommending security-based swap transactions to counterparties, persons on a trading desk actively involved in effecting security-based swap transactions, persons pricing security-based swap positions and managing collateral for the SBS Entity, and persons assuring that the SBS Entity's security-based swap business operates in compliance with applicable regulations. In short, the term would encompass persons engaged in functions necessary to facilitate the SBS Entity's security-based swap business.

57 Proposed Rule 15Fb1-1(b), described below, would require each SBS Entity to maintain a manually signed copy of this certification as part of its books and records until at least three

would need to ensure that the associated person does not continue to effect or be involved in effecting security-based swaps on the SBS Entity's behalf and/or promptly amend its Schedule G in accordance with proposed Rule 15Fb2-3.

To support this certification requirement, paragraph (b) of proposed Rule 15Fb6-1 would require SBS Entities to obtain a questionnaire or application for employment executed by each of its associated persons that effect or are involved in effecting security-based swaps on its behalf; such questionnaire or application would serve as a basis for a background check of the associated person to determine whether the associated person is statutorily disqualified. The questionnaires or applications would be required to contain, at a minimum, the following information: (1) the associated person's name, address, social security number, Central Registration Depository ("CRD") number (if any), Investment Adviser Registration Depository ("IARD") number (if any), and the starting date of the associated person's employment or other association with the SBS Entity; (2) the associated person's date of birth; (3) a complete, consecutive statement of all the associated person's business connections for at least the preceding ten years, including whether the employment was part-time or full-time; (4) a record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, by any national securities exchange or national securities association, or by a foreign financial regulatory authority including any finding that the associated person was a cause of any disciplinary action or had violated any law; (5) a record of any denial, suspension, expulsion or revocation of membership or registration of any broker, dealer, SBS Dealer, or major security-based swap participant with which the associated person was associated in any capacity when such action was taken; (6) a record of any permanent or temporary injunction entered against the

---

years after the certification has been replaced or is no longer effective.

associated person or any broker, dealer, SBS Dealer, or major security-based swap participant with which the associated person was associated in any capacity at the time such injunction was entered; (7) a record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities (including security-based swaps), futures or commodities (including swaps), banking, insurance or real estate (including, but not limited to, acting or being associated with a broker-dealer, investment company, investment adviser, futures sponsor, bank, or savings and loan association), fraud, false statements or omissions, wrongful taking of property or bribery, forgery, counterfeiting or extortion, and the disposition of the foregoing; and (8) a record of any other name or names by which the associated person has been known or which the associated person has used.

The Commission believes that it is standard in the financial services industry for firms to request this information on employment questionnaires. This information is similar to the information identified in Exchange Act Rule 17a-3(a)(12)(i) and required to be collected by broker-dealers with respect to their associated persons. Additionally, Form U-4 contains all the information needed pursuant to Exchange Act Rule 17a-3(a)(12)(i) and would fulfill the requirement to obtain a questionnaire or application specified in Rule 15Fb6-1(b). Rule 17a-3(a)(12)(i) and Form U-4 provide broker-dealers with information through which they can perform background checks on associated persons necessary to assure that those associated persons are not subject to statutory disqualification. Moreover, the NFA collects similar data on associated persons of its members through the Form 8-R. Consequently, we preliminarily believe it would be appropriate for SBS Entities to collect this information on associated persons to allow them to conduct background checks so that they can comply with the prohibition in Section 15F(b)(6) of the Exchange Act from allowing statutorily disqualified individuals to effect or be involved in effecting SBS transactions on their behalf.

In addition, paragraph (b) of proposed Rule 15Fb6-1 would require that the SBS Entity's chief compliance officer ("CCO") (appointed in accordance with Exchange Act Section 15F(k)), or his or her designee, review and sign each questionnaire or application.[58] This provision is designed to help ensure that due regard is being paid to this requirement to collect information on employees and to help ensure that none of the SBS Entity's employees who effect or are involved in effecting security-based swaps on the SBS Entity's behalf is subject to statutory disqualification. Moreover, to the extent the SBS Entity's CCO, or his or her designee, must sign the certification, this requirement helps ensure that the CCO is aware of this statutory prohibition and is familiar with the SBS Entity's procedures to comply with it.

Finally, paragraph (c) of proposed paragraph 15Fb6-1 would require that each SBS Entity maintain the questionnaires and applications for employment obtained pursuant to paragraph (b) as part of its books and records for at least three years after the associated person has terminated his or her association with the SBS Entity. It is likely that SBS Entities would retain these records for business purposes; however, this requirement will assure that the questionnaires and applications are available to the Commission during inspections and examinations.

The Commission requests comment on proposed Rule 15Fb6-1.

Q-71. Would the information regarding associated persons in paragraph (b) of the proposed rule be sufficient for a CCO to make the required certification? Why or why not?

Q-72. Should the information requirements in paragraph (b) be modified in any way?

58 Applicants may already have this information on their employees, but may not have a CCO, as required pursuant to new Section 15F(k) of the Act, until the effective date of rules the Commission may promulgate under Section 15F(k). Security-based swap dealers and major security-based swap participants could be conditionally registered even if a CCO has not signed each associated person's questionnaire or application.

Q-73. Should applicants be required to obtain any additional information not specified in proposed paragraph (b)?

Q-74. Should the Commission require that SBS Entities perform background checks on their employees (e.g., to confirm that their associated persons do not have a criminal history) in addition to obtaining questionnaires or applications? Why or why not?

Q-75. If not, what other process could the Commission use to help ensure that an applicant is not violating Exchange Act Section 15F(b)(6)?

Q-76. Should the Commission require applicants to require credit checks on associated persons? Why or why not?

Q-77. What, if any, practical or legal limitations or barriers exist that would hinder an applicant from obtaining background or credit checks?

Q-78. Should the Commission require applicants to obtain and process fingerprints of their associated persons that will be effecting or involved in effecting security-based swaps on the applicant's behalf? Why or why not?

Q-79. What, if any, practical or legal limitations or barriers exist that would hinder an applicant from obtaining or running fingerprints of associated persons?

Q-80. Should the Commission instead treat the provisions of Section 15F(b)(6) as essentially self-executing and permit SBS Entities to determine how best to screen associated persons to ensure they are not subject to a statutory disqualification (provided that they exercise reasonable care in so doing) and require that an SBS Entity create and maintain reasonable policies and procedures for determining whether an associated person is subject to a statutory disqualification? Why or why not?

Q-81. What would be the benefits and risks of this approach?

Q-82. Would this approach be more or less burdensome for SBS Entities to administer?

Q-83. Would SBS Entities nevertheless implement an approach similar to that required under the proposed rule?

Q-84. How might an SBS Entity comply with Section 15F(b)(6) in ways that differ from what is set forth in the proposed rule?

Q-85. Would this alternative policies and procedures approach provide SBS Entities sufficient legal certainty about whether they have properly complied with Section 15F(b)(6)?

Q-86. Should the Commission require that associated persons of SBS Entities that effect or are involved in effecting security-based swaps on behalf of the SBS Entity register directly with it? What would be the costs or benefits involved with registration of such SBS Entity associated persons? What, if any, practical or legal limitations or barriers exist to this approach?

Q-87. Are there other approaches to implementing Section 15F(b)(6) that the Commission should consider? Please explain.

Q-88. Should the Commission take a different view regarding which associated persons should be considered to be "involved in effecting" security-based swaps on behalf of the SBS Entity (see footnote 34)? If so, should additional categories of associated persons be included or should certain identified categories of associated persons be excluded? For what reason(s)?

2. Alternative Process

Section 15F(b)(6) expressly authorizes the Commission to establish exceptions to this prohibition by rule, regulation, or order.[59] This authority is similar to authority provided to the Commission with respect to the "traditional" securities industry, i.e., the industry regulated under

[59] 15 U.S.C. 78o-10(b)(6).

the Exchange Act prior to the Dodd-Frank Act amendments. This existing Exchange Act authority permits SROs, subject to Commission review, to allow, among other things, a person subject to a statutory disqualification to associate with a broker-dealer.[60]

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., employees of an investment adviser, an investment company, or a transfer agent) can seek to reenter the traditional securities industry despite previously being barred by the Commission.[61]

The Commission requests comment on whether it should develop an alternative process to allow associated persons of SBS Entities who are subject to a statutory disqualification to effect or be involved in effecting security-based swaps on their behalf.

Q-89. How many SBS Entities and associated persons thereof are likely to be affected if the Commission does not provide an exemptive process?

Q-90. 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?

---

[60] 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).

[61] 17 CFR 201.193.

Q-91. Should the Commission except such persons globally (e.g., by a blanket rule) or on an individual basis (e.g., via a Rule 193-type process)? What would be the possible costs or benefits of each?

Q-92. Are there certain statutorily disqualified persons who should not be permitted to remain associated with an SBS Dealer or major security-based swap participant based upon the nature of the disqualification?

Q-93. Should there be any differentiation in relief based upon the nature of the person, e.g. a natural person or an entity? If so, what type of differentiation and why?

C. Termination of Registration

1. Expiration: Proposed Rule 15Fb3-1

Exchange Act Section 15F(b)(3) provides that "each registration under this section shall expire at such time as the Commission may prescribe by rule or regulation." Although there is no Exchange Act parallel, this provision is similar to Commodity Exchange Act Section 6f(a)(1), which provides that "each registration shall expire on December 31 of the year for which issued or at such other time, not less than one year from the date of issuance, as the Commission may by rule, regulation, or order prescribe…." CFTC Rule 3.10(b) provides, among other things, that persons registered with the CFTC pursuant to CFTC Rule 3.10 "will continue to be so registered until the effective date of any revocation or withdrawal of such registration." Paragraph (a) of proposed Rule 15Fb3-1 would establish the same continuous registration as is set forth in CFTC Rule 3.10(b), and would provide that registered SBS Entities would "continue to be so registered until the effective date of any cancellation, revocation or withdrawal of such registration or any other event the Commission determines should trigger expiration."

Q-94. Does CFTC Rule 3.10(b) provide an appropriate model to implement Exchange Act Section 15F(b)(3)? Why or why not?

Q-95. Should the Commission instead allow initial SBS Entity registrations to expire and require SBS Entities to re-register to become an ongoing registrant (while providing a grace period for this re-registration to occur)? If so, what would be an appropriate amount of time before expiration (e.g., one year, two years, five years, or some other time period)?

Q-96. Alternatively, should the Commission allow SBS Entity registrations to expire periodically and require SBS Entities to re-register periodically (i.e., requiring registrants to "re-up" indefinitely on a regular basis)? If so, what would be an appropriate amount of time before expiration (e.g., annually, every two years, every five years, or some other time period)? What would be the advantages, disadvantages, costs and benefits of such an approach?

Q-97. Via what mechanism should any such re-registration be facilitated? For instance, should an SBS Entity be required to re-apply by filing a new application? Alternatively, should an SBS Entity be required to re-certify by filing a new Senior Officer Certification? Would some other mechanism be more appropriate? How should any such mechanism take into account the initial application and registration of an SBS Entity? How should any such mechanism take into account the SBS Entity's compliance with applicable rules during the period prior to the re-registration? Would any type of non-compliance during such period justify denial of re-registration, or should the nature of the non-compliance and any remedial actions be taken into account?

Q-98. If re-registration is facilitated by re-certification, would the proposed form of Senior Officer Certification on Form SBSE-C be the appropriate or would some other form or language be more appropriate? For instance, should any re-certification for SBS Entities be drafted to

more closely follow the certification requirement proposed for municipal advisors (wherein each municipal advisor certifies annually that it has met its regulatory obligations over the prior period)?

Q-99. If periodic re-registration were required, should re-registration be based on an SBS Entity's original registration date or should it be triggered by a calendar date (e.g., on December 31)?

Q-100. Should the same standard of review that applies to ongoing registration apply in the context of re-registration (see proposed rule 15Fb2-1(d)(2))? If not, what alternative standard of review would be more appropriate and why?

Q-101. Would any such expiration and re-registration requirement provide the Commission with a greater ability to enforce compliance with applicable regulations? Why or why not?

As discussed in Part I above, under paragraph (b)(1) of proposed Rule 15Fb3-1, conditional registrations granted by the Commission to an SBS Entity that applies for registration during the transitional period in accordance with Rule 15Fb2-1(b) would expire on the Last Compliance Date, unless the SBS Entity files a Senior Officer Certification with the Commission or its designee on or before the Last Compliance Date; in which case its conditional registration would be extended for an additional thirty days (which should allow the Commission staff sufficient time to review the SBS Entity's application and certification and determine whether to grant or deny ongoing registration). Paragraph (b)(2) of proposed Rule 15Fb3-1 would provide that conditional registrations granted by the Commission to major security-based swap participants that file applications for registration after the Last Compliance Date would expire four months after the major security-based swap participant files its completed application with the Commission unless the major security-based swap participant files a Senior Officer Certification with the Commission or its designee within that four month period; in which case its conditional registration would be

extended for an additional thirty days. Pursuant to paragraph (c) of proposed Rule 15Fb3-1, the Commission could extend conditional registration for good cause.

Q-102. Would these timeframes be sufficient to allow conditional registrants to complete – and the Commission to grant or deny – ongoing registration? Why or why not?

Q-103. What circumstances should the Commission consider in determining whether good cause exists to extend an SBS Entity's conditional registration? Why? Should these circumstances include situations in which the Commission may need additional time to review an SBS Entity's application and certification? Why or why not?

Q-104. Should the Commission require that an SBS Entity follow a particular process to request an extension of the SBS Entity's conditional registration? For instance, should an SBS Entity be required to submit a letter requesting an extension and setting forth the reasons why an extension is necessary? If so, what process would be appropriate and why?

2. Withdrawal: Proposed Rule 15Fb3-2

Proposed Rule 15Fb3-2 would provide a process by which an SBS Entity could withdraw from registration with the Commission.[62] The proposed rule would require an SBS Entity to file a notice of withdrawal from registration electronically on Form SBSE-W (described in more detail below) in accordance with the instructions to the Form. It also would require that an SBS Entity amend its Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, in accordance with proposed Rule 15Fb2-3 to update any inaccurate information prior to filing its notice of withdrawal from registration.

Paragraph (b) of proposed Rule 15Fb3-2 would provide that a notice of withdrawal from registration filed by an SBS Entity would generally become effective on the 60th day after the SBS

[62] This provision is similar to Exchange Act Rule 15b6-1, which has historically worked well to facilitate broker-dealer withdrawals.

Entity files Form SBSE-W. However, based on its experience with registered broker-dealers, the Commission recognizes that there may be circumstances in which it would be advisable to provide flexibility in scheduling the termination of business operations to registered entities seeking to withdraw from registration. Further, the Commission may determine that it would be appropriate for a registered entity that is under investigation by the Commission to maintain its registered status in order to allow the Commission to conclude a pending investigation without prematurely instituting a proceeding to impose conditions on the registered entity's withdrawal. In such instances, it may better serve the interests of all parties to have the registered entity consent to an extension of the effective date of the registered entity's withdrawal from registration beyond the general 60-day period provided for in the proposed rule. It also may be appropriate to permit the Commission to extend the effective date for a period if it determines, by order, that it is necessary or appropriate in the public interest or for the protection of investors.

Thus, paragraph (b) of proposed Rule 15Fb3-2 would identify specific situations in which notices of withdrawal from registration will not become effective on the 60th day. These would include situations where (1) the Commission determines that a shorter period is appropriate, (2) the SBS Entity consents to a longer period, (3) the Commission, by order, determines that a longer period is necessary or appropriate in the public interest or for the protection of investors, and (4) the Form SBSE-W is filed subsequent to the date of the issuance of a Commission order instituting proceedings to censure, place limitations on the activities, functions or operations of, or suspend or revoke the registration of the SBS Entity. Finally, paragraph (b) of proposed Rule 15Fb3-2 would provide that if the Commission institutes proceedings prior to the effective date of Form SBSE-W (1) to censure, place limitations on the activities, functions or operations of, or suspend or revoke the registration of the SBS Entity, or (2) to impose terms or conditions upon the SBS Entity's

withdrawal, the notice of withdrawal 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.

The Commission requests comment on all aspects of proposed Rule 15Fb3-2.

Q-105. Would the proposed withdrawal process be workable for SBS Entities? Are the proposed timeframes reasonable for these entities? Why or why not?

Q-106. Under what other circumstances, if any, should the Commission shorten or lengthen the timeframe for withdrawal?

3. Cancellation and Revocation: Proposed Rule 15Fb3-3

Proposed Rule 15Fb3-3 would provide the Commission with the ability to either cancel or revoke a registered SBS Entity's registration. More specifically, paragraph (a) of proposed Rule 15Fb3-3 would allow the Commission to cancel an SBS Entity's registration if the Commission finds that it is no longer in existence or has ceased to do business as an SBS Entity.[63] The cancellation process outlined in paragraph (a) is intended to be ministerial in nature, and not a means to revoke without due process the registration of an SBS Entity that may have violated federal securities laws. This provision is designed to help the Commission allocate its examination and other resources to entities that are actively engaged in business regulated by the Commission.

Paragraph (b) of proposed Rule 15Fb3-3 cross-references the Exchange Act to clarify that the Commission shall censure, place limitations on the activities, functions, or operations of, or revoke (on a permanent or temporary basis) the registration of any SBS Dealer or major security-

---

63 This provision is similar to Exchange Act Section 15(b)(5).

based swap participant that has registered with the Commission if it makes a finding as specified in Section 15F(l)(2) of the Exchange Act.[64]

Q-107. Is the proposed provision for cancellation of registration appropriate in the context of SBS Entities? Why or why not?

Q-108. Would there be occasion for SBS Entities to have an extended pause in their businesses such that they might appear to have ceased to do business? If so, should the Commission provide that such entities could notify the Commission of their intent to stay in business, notwithstanding their lack of current activities? Should such entities later inform the Commission when they become active?

Q-109. Should there be a time limit on how long such an SBS Entity could retain its registration with the Commission while it is in a "dormant" state?

Q-110. Does the proposed provision for revocation in paragraph (b) provide sufficient procedural safeguards for registered SBS Entities? If not, what procedures could be added to provide additional safeguards?

D. Special Requirements for Nonresident SBS Entities

Proposed Rule 15Fb2-4 would require, among other things, that nonresident SBS Entities that are required to register with the Commission[65] (1) appoint an agent for service of process in the

---

64 15 U.S.C. 78o-10(l).

65 The Commission has received questions as to how the registration requirements for SBS Entities would apply to non-U.S. persons. The Commission is continuing to consider the application of Title VII of the Dodd-Frank Act to non-U.S. persons and intends to address these issues in a separate release, and notes that the proposals described herein with respect to nonresident SBS Entities will be informed by the considerations and comments raised in connection with that release. See, e.g., Letter from Barclays Bank PLC, BNP Paribas S.A., Deutsche Bank AG, Royal Bank of Canada, The Royal Bank of Scotland Group PLC, Société Générale, and UBS AG to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Jan. 11, 2011); Letter from Sarah A. Miller, Chief Executive

United States (other than the Commission or a Commission member, official or employee) upon whom may be served any process, pleadings, or other papers in any action brought against the nonresident SBS Entity, (2) furnish the Commission with the identity and address of its agent for services of process, (3) certify that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission, and (4) provide the Commission with an opinion of counsel concurring that the firm can, as a matter of law, provide the Commission with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission.

Paragraph (a) of proposed Rule 15Fb2-4 would define the term "nonresident security-based swap dealer" and "nonresident major security-based swap participant," for purposes of Rule 15Fb2-4. Under this definition, an SBS Entity that is incorporated any place that is not in the United States would be considered to be a nonresident. In addition, an SBS Entity that has its principal place of business in any place not in the United States would be considered to be a nonresident.

Officer, Institute of International Bankers, to Elizabeth M. Murphy, Secretary, SEC, and David A. Stawick, Secretary, CFTC (Jan. 10, 2011); Letter from Barclays Bank PLC, BNP Paribas S.A., Credit Suisse AG, Deutsche Bank AG, HSBC, Nomura Securities International, Inc., Rabobank Nederland, Royal Bank of Canada, The Royal Bank of Scotland Group PLC, Société Générale, The Toronto-Dominion Bank, and UBS AG to David A. Stawick, Secretary, CFTC, Elizabeth M. Murphy, Secretary, SEC, and Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System (Feb. 17, 2011); and Letter from Laura J. Schisgall, Managing Director and Senior Counsel, Société Générale, to Elizabeth M. Murphy, Secretary, SEC, and David A. Stawick, Secretary, CFTC (Feb. 18, 2011). The Commission is also considering the approach outlined in the letter from Katsunori Mikuniya, Commissioner & Chief Executive, Financial Services Agency, Government of Japan, to Gary Gensler, Chairman, U.S. Commodity Futures Trading Commission (Apr. 1, 2011).

Q-111. Should the terms "nonresident security-based swap dealer" and "nonresident major security-based swap participant" be defined differently and, if so, how should the definitions be amended and why?

1. United States Agent for Service of Process

Paragraphs (b)(1) and (2) of proposed Rule 15Fb2-4 would require that each nonresident SBS Entity registered or registering with the Commission obtain a written irrevocable consent and power of attorney appointing an agent for service of process in the United States (other than the Commission or a Commission member, official or employee) upon whom may be served any process, pleadings, or other papers in any action brought against the nonresident SBS Entity and furnish the Commission with the identity and address of its agent for services of process on Schedule F[66] to Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable.[67] These requirements are important to facilitate the Commission and others (for example, the U.S. Department of Justice and any other agency with the power to enforce the Exchange Act) to serve process on a nonresident SBS Entity to enforce the Exchange Act. Paragraph (b)(4) of the proposed rule also would require that registered nonresident SBS Entities must promptly appoint a successor agent if it discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on its behalf.[68] Further, proposed paragraph (b)(3) would require that registered SBS Entities promptly inform the Commission, through an amendment of the Schedule F of Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, of any change to either its agent for service of process or the name or address of its existing agent for service of process. Finally, paragraph (b)(5) of proposed Rule 15Fb2-4 would require that the registered

---

66 The Schedule F is discussed more fully below as part of the discussion of the Forms.

67 Paragraphs (b)(1) and (b)(2) of proposed Rule 15Fb2-4, respectively.

68 Paragraph (b)(3) of proposed Rule 15Fb2-4.

nonresident SBS Entity maintain, as part of its books and records, the agreement identified in paragraph (b)(1) for at least three years after the agreement is terminated.

The Commission requests comment on all aspects of the requirement for nonresident SBS Entities to appoint an agent in the United States to receive service of process, pleadings or papers in any action brought against the nonresident SBS Entity.

Q-112. Should only certain types of entities (such as law firms) be allowed to act as U.S. agent for service of process?

Q-113. Should these requirements be expanded to require nonresident SBS Entities to appoint a U.S. agent for purposes of all potential legal proceedings, including those from non-governmental entities, or is this already adequately addressed by contract?

Q-114. Should the Commission require nonresident SBS Entities to provide the Commission with additional information not required of U.S. SBS Entities, such as verification of any non-U.S. registrations?

Q-115. Is the three year time frame for which an SBS Entity would be required to maintain, as part of its books and records, the agreement appointing its agent for service of process appropriate? Would a longer or shorter time period be more appropriate?

2. Access to Books and Records of Nonresident SBS Entity

Proposed Rule 15Fb2-4(c)(1), regarding access to books and records, would require that each nonresident SBS Entity registering with the Commission[69] provide an opinion of counsel and certify on Schedule F of Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, that it can, as a matter of law, provide the Commission with prompt access to its books and records and can, as

[69] See supra note 65.

a matter of law, submit to onsite inspection and examination by the Commission.[70] The Commission preliminarily believes that the nonresident SBS Entity certification and supporting opinion of counsel is important to confirm that each nonresident SBS Entity located overseas has taken the necessary steps to be in the position to provide the Commission with prompt access to its books and records and to be subject to inspection and examination by the Commission. To effectively fulfill its regulatory oversight responsibilities with respect to nonresident SBS Entities registered with it, the Commission must have access to those entities' records and the ability to examine them; however, certain foreign jurisdictions may have laws that complicate the ability of financial institutions such as nonresident SBS Entities located in their jurisdictions from sharing and/or transferring certain information including personal financial data of individuals that the financial institutions come to possess from third persons (e.g., personal data relating to the identity of market participants or their customers). The required certification and opinion of counsel regarding the nonresident SBS Entity's ability to provide prompt access to books and records and to be subject to inspection and examination will allow the Commission to better evaluate a nonresident SBS Entity's ability to meet the requirements of registration and ongoing supervision. Failure to make this certification or provide an opinion of counsel may be a basis for the Commission to deny an application for registration.

Paragraph (c)(2) of proposed Rule 15Fb2-4 would require that registered nonresident SBS Entities re-certify, on Schedule F to Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, within 90 days after any changes in the legal or regulatory framework that would impact the nonresident SBS Entity's ability to provide, or the manner in which it provides, the Commission

---

70 In accordance with Proposed Rule 15Fb1-1(b), the SBS Entity will need to maintain a manually signed copy of this certification as part of its books and records until at least three years after the certification has been replaced or is no longer effective.

prompt access to its books and records or impacts the Commission's ability to inspect and examine the nonresident SBS Entity. The re-certification would be required to include a revised opinion of counsel describing how, as a matter of law, the entity will continue to meet its obligations to provide the Commission with prompt access to its books and records and to be subject to Commission inspection and examination under the new regulatory regime. If a registered nonresident SBS Entity becomes unable to comply with this certification because of such changes, or otherwise, then this may be a basis for the Commission to revoke the nonresident SBS Entity's registration.

The Commission requests comment on all aspects of the certification and opinion of counsel requirements contained in paragraph (c) of proposed Rule 15Fb2-4.

Q-116. Will this certification requirement provide the Commission with adequate assurance that nonresident SBS Entities will be able to provide the Commission with access to records?

Q-117. Should the Commission specify that the opinion of counsel contain any additional information? For instance, should the requirement clarify that the opinion of counsel reference the applicable local law or, in the case of an amendment, the manner in which the local law was amended?

Q-118. As described above, certain foreign jurisdictions may have laws that complicate the ability of financial institutions such as nonresident SBS Entities located in their jurisdictions from sharing and/or transferring certain information. What impact may the requirement that a nonresident SBS Entity obtain and submit the described opinion of counsel have on a nonresident SBS Entity's ability to register in the United States in such circumstances or otherwise? Are there circumstances where it would be impossible or impractical for the nonresident SBS Entity to obtain the opinion of counsel? Would a nonresident SBS Entity

need to cease doing business in the United States or with U.S. persons solely because of this requirement? Why or why not?

Q-119. If the described opinion of counsel were not required, what alternatives would the Commission have to assure that it is able to access a registered nonresident SBS Entity's books and records and examine the registered nonresident SBS Entity in order to effectively fulfill its oversight responsibilities? What are the relative advantages or disadvantages of any such alternatives?

Q-120. Should the requirement that an SBS Entity obtain an amended opinion of counsel and re-certify its ability to provide the Commission with access to records be limited in any way?

Q-121. The Commission has received three comment letters containing alternative suggestions as to how the Commission should accommodate a foreign bank with a U.S. affiliate that organizes its business so that it could engage in security-based swap transactions with U.S. investors while being subject to a more limited regulatory regime under the Exchange Act in recognition that it is subject to regulation in its home country.[71] The Commission requests comment regarding whether the requirement that an applicant provide an opinion of counsel should be amended to recognize or facilitate such arrangements. If so, why and in what way

[71] See letter to Mr. David A. Stawick, Secretary, CFTC, Ms. Elizabeth M. Murphy, Secretary, Commission, and Ms. Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System from Davis Polk & Wardwell LLP, on behalf of Barclays Bank PLC, BNP Paribas S.A., Deutsche Bank AG, Royal Bank of Canada, The Royal Bank of Scotland Group plc, Société Générale and UBS AG, dated January 11, 2011 (http://www.sec.gov/comments/s7-39-10/s73910-9.pdf); letter to Elizabeth M. Murphy, Secretary, Commission, and David A. Stawick, Secretary, CFTC, dated January 10, 2011 (http://www.sec.gov/comments/s7-39-10/s73910-8.pdf); and letter to Ananda Radhakrishnan, Director, Division of Clearing and Intermediary Oversight, CFTC, John M. Ramsay, Deputy Director, Division of Trading and Markets, Commission, and Mark E. Van Der Weide, Senior Associate Director, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System, dated November 23, 2010 (http://www.sec.gov/comments/s7-34-10/s73410-3.pdf).

should the requirement be modified? If not, why? Would an amended requirement provide the Commission with adequate assurance that nonresident SBS Entities will be able to provide the Commission with sufficient access to records?

E. Special Situations

1. Succession: Proposed Rule 15Fb2-5

Proposed Rule 15Fb2-5 would provide a process through which an SBS Entity could succeed to the business of another SBS Entity.[72] Consistent with the use of the term in connection with broker-dealer registration, we propose to consider a "succession" to mean that a successor firm acquires or assumes substantially all of the assets and liabilities of the predecessor firm.[73]

Proposed Rule 15Fb2-5 would provide that, if an SBS Entity succeeds to and continues the business of another SBS Entity, the registration of the predecessor SBS Entity will remain effective as the registration of the successor if the successor files an application for registration in accordance with Rule 15Fb2-1 within 30 days after such succession, and the predecessor files a notice of withdrawal from registration on Form SBSE-W.

Paragraph (b) of Proposed Rule 15Fb2-5 would allow a successor firm that succeeds to the business of another for minor reasons, where the ownership or control of the SBS Entity does not change (e.g., solely because it is changing its date or state of incorporation, form of organization, or the composition of a partnership), to simply amend the registration of the predecessor SBS Entity on Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, within 30 days after the change.

Q-122. Are these proposed successor rules appropriate for SBS Entities?

---

72 This proposed rule is based on Exchange Act Rule 15b1-3, which is applicable to registered brokers and dealers and has worked well to facilitate succession of registrants.

73 Registration of Successors to Broker-Dealers and Investment Advisers, Exchange Act Release No. 31661 (Dec. 28, 1992) (58 FR 7 (Jan. 4, 1993)).

Q-123. Should the concept of succession be the same as used in the context of broker-dealer registration? Commenters should explain why any differences would be appropriate.

Q-124. Are the timeframes provided, which seem to work well in the broker-dealer context, appropriate with respect to SBS Entity succession?

2. Insolvency: Proposed Rule 15Fb2-6

Proposed Rule 15Fb2-6 would provide a process through which an executor, administrator, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy or other fiduciary appointed or qualified by order, judgment or decree of a court of competent jurisdiction could continue the business of an SBS Entity.[74] This is important to allow a fiduciary time to close-out positions and/or wind down an SBS Entity's business. Under the proposed rule, the fiduciary would be required to file with the Commission, within 30 days after entering upon the performance of his or her duties, an amended Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, indicating the fiduciary's position with respect to management of the SBS Entity, along with a copy of the order, judgment, decree, or other document appointing the fiduciary.

Q-125. Is proposed Rule 15Fb2-6 appropriate for SBS Entities? If another process would be more appropriate, please describe it.

Q-126. Should fiduciaries be able to continue the business of an SBS Entity to facilitate an orderly liquidation? If not, why?

74 The proposed rule is based on Exchange Act Rule 15b1-4, which applies to broker-dealer registrations. We believe this rule has worked well to allow fiduciaries to wind-up broker-dealer businesses without the need to separately register as a broker-dealer.

Q-127. Is the proposed 30-day timeframe, which is consistent with the Rule 15b1-4 requirement for broker-dealer fiduciaries, sufficient for an SBS Entity fiduciary to make the required filing with the Commission?

Q-128. Do the close-out provisions in the agreements between the parties provide sufficient ability for counterparties to close-out open positions in the event of an SBS Entity default so that a fiduciary would not be needed? Please explain.

F. Technical Rules

1. Electronic Signatures

Proposed Rule 15Fb1-1 would specify the format required for signatures to, or within, electronic submissions (including signatories within the forms and certifications required by §§ 240.15Fb2-1, 240.15Fb2-4 and 240.15Fb6-1, discussed below). In addition, paragraph (b) of proposed Rule 15Fb1-1 would require that each signatory to such an electronic filing manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing either before or at the time the electronic filing is made. Paragraph (b) would also require that the SBS Entity create the manually signed document when the electronic form is submitted, and furnish a copy of such document to the Commission upon request. Paragraph (c) of proposed Rule 15Fb1-1 would prohibit a person required to provide a signature on an electronic submission from having another person sign the form or certification on his or her behalf pursuant to a power of attorney or other form of confirming authority. Finally, paragraph (d) would require that the SBS Entity retain the manually signed document associated with Schedules F and G of Forms SBSE, SBSE-A, or SBSE-BD, as appropriate, until at least three years after the form or certification has been replaced or is no longer

effective, and the manually signed document associated with Form SBSE-C until at least three years after the Form was submitted to the Commission.

This proposed rule is based on Section 302 of Regulation S-T,[75] and is designed to require standard formatting of electronic signatures and provide the Commission with the ability to obtain additional documents to verify those signatures. In addition, paragraph (c) of proposed Rule 15Fb1-1 is based on paragraph (d) of Exchange Act Rule 15d-14. The Commission believes that this paragraph is necessary to assure that persons signing certifications can be held responsible for their statements.

The Commission requests comment on all aspects of Rule 15b1-1.

Q-129. Is it adequate to require an SBS Entity to maintain a signed copy of each certification as part of its books and records so that it is available for examiners to review?

Q-130. Should the Commission require SBS Entities to file the original certifications with the Commission?

Q-131. Are the timeframes for retention of manually signed documents appropriate? Why or why not? If not, what timeframe or timeframes may be more appropriate and why?

2. Temporary Rule to Facilitate Paper Filing of Forms

If a technological means to facilitate receipt and retention of applications required to be filed in accordance with Rule 15Fb2-1 is not functional by the time final rules are adopted, proposed temporary Rule 15Fb2-2T would require an SBS Entity to file its application on Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, and all additional documents in paper form by sending it to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, notwithstanding paragraph (c)(1) of Rule 15Fb2-1. In addition, if proposed temporary Rule 15Fb2-

[75] 17 CFR 232.302.

2T is adopted, paragraph (b) would require that each applicant must resubmit its Form SBSE, Form SBSE-A, and Form SBSE-BD, as applicable and all additional documents to the Commission electronically within three months of the date such technological means to facilitate receipt and retention of applications becomes functional. Depending on the timing, SBS Entities may also need to file their Forms SBSE-C in paper format and later resubmit those Forms electronically.

Proposed temporary Rule 15Fb2-2T would provide a process for the Commission to receive applications in paper format if a technological means to facilitate receipt and retention of applications cannot be completed before final SBS Entity registration rules are adopted. Further, Proposed temporary Rule 15Fb2-2T would facilitate the transition of data to an electronic format once such a system becomes functional. The benefits of an electronic system outweigh additional costs relating to the need for SBS Entities to file their applications in both paper and electronic form. In addition, requiring that each SBS Entity file its application electronically would assure that each firm can confirm that the data entered into the electronic system is accurate and complete.

The Commission requests comment on proposed temporary rule 15Fb2-2T.

Q-132. Is this paper process practicable?

Q-133. Should the Commission instead allow applicants to submit their applications in PDF form via email?

Q-134. Instead of the process contemplated by paragraph (b) of proposed Rule 15Fb2-2T, should the Commission reduce the paper filings to electronic form instead of the applicants?

G. Forms

1. Form SBSE

Proposed Form SBSE is generally based on Form BD - the consolidated Form used by broker-dealers to register with the Commission, states and SROs. Form BD has been used to gather and organize certain information concerning applicants' business operations to facilitate

Commission, state and SRO initial registration decisions, as well as ongoing examination and monitoring of registrations. Because SBS Entities will be subject to many requirements similar to those that affect broker-dealers (e.g., minimum capital, leverage, and business conduct rules and statutory disqualification prohibitions), the Commission believes using Form BD as a template for the registration of SBS Entities is logical and efficient. Key differences from Form BD are outlined below:

- The phrase "broker or dealer" was changed to "security-based swap dealer or major security-based swap participant" because Form SBSE will be used by firms to register as SBS Entities and not as broker-dealers;
- References to SROs and jurisdictions were removed except where they arose in the context of a contractual relationship or disciplinary proceeding because SBS Entities will generally not be required to register with SROs or states;
- References to branch offices were removed because the SBS business is generally conducted on a more centralized basis and is not effected through branch offices;
- The General Instructions eliminate the instructions for filing the form in paper format because we intend to require that the forms be filed electronically;[76]
- The Explanation of Terms section is substantially the same;[77] however the term "jurisdiction" was replaced with the term "state" to eliminate potential confusion regarding questions in Item 11 that relate to actions brought in either domestic or foreign jurisdictions

76 If a technological means to facilitate the receipt and retention of applications is not finalized by the time final rules are adopted and the Commission must adopt proposed Rule 15Fb2-2T, instructions regarding paper filing would be re-inserted.

77 The Explanation of Terms section includes definitions of the terms applicant, control, state, person, self-regulatory organization, successor, charged, control affiliate, enjoined, felony, found, investment or investment-related, involved, minor rule violation, misdemeanor, order, and proceeding.

and the term "foreign financial regulatory authority" was removed because it is now defined in Exchange Act Section 3(a)(52);

- Item 1-J of Form SBSE would elicit the name and contact information for the Chief Compliance Officer designated by the applicant in accordance with Exchange Act Section 15F(k) (broker-dealers are not now required to provide this information on Form BD);
- Item 2b of Form SBSE would elicit information, if a firm is registering as a major security-based swap participant, regarding whether the firm is registering because it maintains a substantial position, has substantial counterparty exposure, or is highly leveraged relative to its capital position, which will assist the staff in evaluating its application;
- Item 3 of Form SBSE would elicit whether the SBS Entity intends to use mathematical models to calculate any applicable capital or margin or to price customer or proprietary positions (whether or not for regulatory purposes), which will assist the staff in considering what types of examinations may be required;
- Item 4 of Form SBSE would elicit whether the applicant is subject to regulation by a prudential regulator[78] because the extent of the Commission's regulatory responsibilities for entities subject to regulation by a prudential regulator differ;
- In addition to eliciting information regarding recordkeeping arrangements, Item 8 would also query whether the applicant has any arrangement under which any other person, firm or organization executes, trades, custodies, clears or settles on behalf of the applicant (including any SRO or swap execution facility in which the applicant is a member). This information is designed to provide the Commission with an understanding of the SBS Entity's business relationships.

---

[78] The term "prudential regulator" is now defined at 15 U.S.C. 78c(a)(74).

- References to the Securities Investor Protection Corporation in the "Execution" section have been eliminated because SBS Entities are not required to become members of SIPC[79] and references to surety bonding and service of process in each state has also been eliminated because Form SBSE does not facilitate registration with states (as the Form BD does);
- Form SBSE would require disclosure of whether the applicant is registering as an SBS dealer or major security-based swap participant, the applicant's legal status, whether the applicant is succeeding to the business of another SBS Entity, and the applicant's control relationships;[80] and
- Form SBSE would elicit a description of the applicant's business in a text box rather than through the use of a list of possible types of business.

Proposed Form SBSE, like Form BD, would elicit information regarding criminal disclosures, regulatory action disclosures, civil judicial disclosures, and financial disclosures. As with Form BD, "yes" answers to these questions would require that the applicant file additional information on disclosure reporting pages (or "DRPs") as a supplement to the Form. As with Form BD, Form SBSE would also elicit information on whether the applicant is registered with the Commission as an investment adviser, registered with the CFTC as an FCM, or whether it is engaged in any other investment-related, non-securities business.

Schedules A and B, which elicit information regarding direct and indirect owners and executive officers, would be largely unchanged (with the exception of the header, the elimination of a request for social security numbers in the tables): however, the table in Schedule A has been expanded to elicit information regarding prior investment-related experience of individual owners

---

79 Only SBS Entities that are also registered as a broker-dealer would be SIPC members. SBS Entities that are also registered as a broker-dealer will be required to file Form SBSE-BD and not Form SBSE.

80 These questions are similar to questions that appear on pages 2 and 3 of the Form BD.

who are not otherwise registered through CRD or IARD to provide the Commission an understanding of each owner's background and qualifications in light of the fact that they will not be individually registered as is the case with owners of broker-dealers. Schedule C would be eliminated because electronic filing of the forms would make it unnecessary. Schedule D would be amended slightly to address differences between the security-based swap business and the broker-dealer business (e.g., there are no "introducing and clearing arrangements"). In addition, Section IV in Item D has been expanded to elicit additional information regarding the nature of the execution, trading, custody, clearing or settlement arrangement, as well as information regarding any prior investment-related experience of individual control persons who are not otherwise registered through CRD or IARD. This information is designed to provide the Commission with an understanding of the SBS Entity's business relationships and each control person's respective background and qualifications in light of the fact that they will not be individually registered as is the case with owners of broker-dealers. The staff understands that SBS Entities may conduct security-based swap business from multiple locations; however, those that would register with the Commission using Form SBSE likely would not refer to those locations as "branches." Consequently, Schedule E of Form SBSE[81] would solicit information regarding locations rather than branches.

---

81 Schedule E of Form BD has been replaced by Form BR, which is designed to enable broker-dealers to register their branch office locations electronically with SROs and states. See, Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to the Proposed Uniform Branch Office Registration Form ("Form BR"), Exchange Act Release No. 52543 (Sep. 30, 2005), 70 FR 58771 (Oct. 7, 2005); and Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 to the Proposed Rule Change Relating to the Proposed Uniform Branch Office Registration Form (''Form BR'') and Amendments to the Uniform Application for Securities Industry Registration or Transfer (''Form U4'') and the Uniform Termination Notice for Securities Industry Registration (''Form U5''), Exchange Act Release No. 52544 (Sep. 30, 2005), 70 FR 58764 (Oct. 7,

The proposed form would also include two additional schedules to be used by SBS Entities – Schedules F and G. Schedule F must be submitted by nonresident SBS Entities pursuant to proposed Rule 15Fb2-4 to provide the Commission with information regarding its appointed U.S. agent for service of process and to certify that it is able to provide the Commission with prompt access to its books and records.[82]

Schedule G would be required to be submitted by all SBS Entities pursuant to proposed Rule 15Fb6-1(a). Schedule G would provide each SBS Entity with a method to certify that none of its associated persons that are effecting or involved in effecting security-based swaps on its behalf is subject to statutory disqualification. This Schedule is designed to provide the Commission with assurance that the SBS Entity is compliant with Section 15F(b)(6) of the Exchange Act. The Form would require that the firm's Chief Compliance Officer sign Schedule G.

The Commission intends to use the information disclosed by applicants in Form SBSE (including the Schedules and DRPs) to determine whether the applicant meets the standards for registration, and to fulfill its oversight responsibilities.

The Commission requests comment on all aspects of Form SBSE.

Q-135. Should the registration form for SBS Entities be based on Form BD, CFTC Form 7-R, or some other form? Please describe the reasons for choosing a particular form over another.

Q-136. How many firms may apply for registration as SBS Entities?

Q-137. Should any of the instructions or questions on Form SBSE be amended to recognize particular characteristics of the business of SBS Entities?

Q-138. Are any of the proposed questions on Form SBSE inapplicable to the SBS business?

2005).

82 Nonresident broker-dealers must presently file one of four similar forms (Form 7-M, Form 8-M, Form 9-M or Form 10-M, depending on the broker-dealer's form or organization) to appoint an agent for service of process.

Q-139. Should any questions be added to Form SBSE to elicit information that is unique to the SBS business or to the SBS Entities that engage in that business?

Q-140. Is proposed new Schedule F the best method to collect information regarding a nonresident SBS Entity's agent for service of process? If not, what other method could the Commission utilize?

Q-141. Is the requirement that an SBS Entity certify on new Schedule F that it can, as a matter of law, provide the Commission with access to its books and records and allow the Commission to conduct onsite inspections the best method to assure the Commission is able to have such access? If not, what other method could the Commission utilize?

Q-142. Is it appropriate to require a nonresident SBS Entities to also submit an opinion of counsel opining on this issue?

Q-143. Is proposed new Schedule G the best method to assure that an SBS Entity is complying with Section 15F(b)(6) of the Exchange Act? If not, what other method could the Commission utilize?

Q-144. Would the Form SBSE disclosure requirements present any unique issues for financial institutions not previously subject to similar disclosure requirements? If so, please describe.

Q-145. Should Form SBSE include additional Schedules in which the applicant could provide more detailed information regarding its business (e.g., a business plan, descriptions of the types of products the applicant will offer, the types of counterparties it will have, information regarding the applicant's operational, supervisory and compliance infrastructure, its major vendors, its clearing arrangements), similar to what the Commission typically requires of other types of applicants (e.g., clearing agencies and national securities exchanges)? If so, what specific types of information should be required?

Q-146. If there are changes in this type of information over time, how frequently should the registrant be required to update the relevant schedules?

2. Form SBSE-A

CEA Section 4s(c) and Exchange Act Section 15F(c) require that persons that engage in both swap business and security-based swap business must separately register with each agency. However, the staff is proposing that applicants that are not registered with the Commission as broker-dealers, but that are registered or registering with the CFTC as either a swap dealer or major swap participant, file their application for registration on an alternative to Form SBSE, or Form SBSE-A. Form SBSE-A is a shorter form and is intended to make it easier for dual applicants to file with both agencies. As part of its application, a firm filing with the Commission on Form SBSE-A would need to provide the Commission with a copy of the form it files with the CFTC to register as a swap dealer or major swap participant. Form SBSE-A is designed to provide the Commission with data, not included on the form the applicant must file with the CFTC, that the Commission believes it will need to adequately review an application for registration.[83] While some information elicited via Form SBSE-A also may be elicited by the CFTC's form, it will be helpful for the Commission to receive this information directly to allow the Commission to match the Form SBSE-A with the CFTC Form and to coordinate the information elicited through Form SBSE-A with other information the Commission may have on the applicant. The Commission

[83] The CFTC has proposed that swap dealers and major swap participants file their applications on Form 7-R and accompanying Form 8-R. Also, see supra note 10. Consequently, the Commission's assessment of what information applicants should be required to provide on Form SBSE-A was based on Form 7-R. If the CFTC's application form for swap dealers or major swap participants deviates substantially from Form 7-R, the Commission will need to re-assess the information it would need to collect through Form SBSE-A. Form 8-R is the Form used for registration of individuals.

believes that requiring that these applicants use Form SBSE-A would reduce the costs and burdens associated with filing distinctly different forms to register with both the Commission and CFTC.

Proposed Form SBSE-A is loosely based on Form SBSE, which, as described above is based on Form BD (the Form used by broker-dealers to register with the Commission). As discussed more fully above, the Commission has used Form BD to gather information necessary for it and the SROs to determine whether to grant broker-dealer registration to an applicant. Key differences from Form SBSE are outlined below:

- The General Instructions have been modified to identify the Form and Schedules to be used to register as an SBS Entity and to eliminate the instructions for filing in paper format because we intend to require that the forms be filed electronically;[84] and
- To reduce potential confusion regarding the use of two forms,[85] the initial instruction in the Explanation of Terms section states that terms used in Form SBSE-A that are defined in CFTC Form 7-R shall have the same meaning as set forth in that form, and terms not otherwise defined in CFTC Form 7-R have the same meaning as in Form SBSE.

Item 1.C. on Form SBSE-A would elicit the firm's NFA number. Items 2 through 13 of proposed Form SBSE-A would require that the applicant identify the capacity in which it is seeking to register with the Commission, the capacity in which it is registered with or seeking to register with the CFTC, certain control and business relationships, succession and other basic information regarding the firm's business. These questions are similar to information elicited via Form SBSE, which elicit information not otherwise elicited through Form 7-R but which the Commission believes is useful to facilitate its oversight of regulated entities.

[84] See paragraph (c) of proposed Rule 15Fb2-1.

[85] One to register with the CFTC as a swap dealer or major swap participant and one to register with the Commission as an SBS Entity.

Item 2b of Form SBSE-A would elicit information, if a firm is requesting registration as a major security-based swap participant, regarding whether the firm is registering because it maintains a substantial position, has substantial counterparty exposure, or is highly leveraged relative to its capital position, which will assist the staff in evaluating its application. Item 3 of Form SBSE-A would elicit whether the SBS Entity intended to use mathematical models to calculate capital or margin or to price customer or proprietary positions because this would highlight for staff the need for a more extensive review. Item 5 of Form SBSE would elicit whether the applicant is subject to regulation by a prudential regulator because the extent of the Commission's regulatory responsibilities for entities subject to regulation by a prudential regulator differ.[86]

Items fourteen and fifteen on Form SBSE-A would elicit information regarding "principals." The definition of "principal" in CFTC Form 7-R is similar to the definition of control affiliate in Form BD. Form BD requires that an applicant file substantial information on its control affiliates. We understand that the CFTC presently requires that individual principals of entities registered with the CFTC file separate registrations with the CFTC. Consequently, the CFTC would have information on those individuals regarding any situations that would cause those individuals to be statutorily disqualified without requiring that the applicant include that information in its application. In recognition of this method and to decrease duplication, item thirteen would require that an applicant identify how many individual principals it has. Further, the applicant would need to list those principals on proposed new Schedule A to Form SBSE-A and provide information regarding those individual principals similar to the information provided on Schedule A of Form SBSE. Item fifteen asks whether any principals of the applicant that are entities effect or are

86 See, e.g., 15 U.S.C. 78o-10(e).

involved in effecting security-based swaps on behalf of the applicant. If the question is answered in the affirmative, the applicant would need to provide additional information on Schedule B with respect to those entities. This information is designed help the Commission better understand the relationship between the applicant and its principals in order to assure compliance with Section 15F(b)(6) of the Exchange Act and to police for manipulation and fraud.

As discussed above, Schedule A of Form SBSE-A would require that an applicant list all principals that are individuals and provide some basic information regarding each (e.g., the person's title, NFA number, and prior investment-related experience). Much of this information is provided to the Commission via Form BD for broker-dealers, and the CFTC would already have this information on control persons but, without new Schedule A to Form SBSE-A, the Commission would not otherwise have this information. This information is designed to help the Commission better understand the relationship between the applicant and its principals and a basic background of those principals in order to assure compliance with Section 15F(b)(6) of the Exchange Act and to police for manipulation and fraud.

Schedule B would elicit information regarding other business in which the applicant is engaged, business arrangements, successions, and principals that are not identified in Schedule A, and is based loosely on Schedule D to Form BD. Schedule C would elicit information regarding principals that are identified in Schedule B that would cause those persons to be statutorily disqualified, and is based on Item 11 in Form BD.[87] The applicant would need to file a DRP for

[87] Any differences between Schedule B to Form SBSE-A and Schedule D to Form SBSE and between Schedule C of Form SBSE-A and Item 11 in Form SBSE recognize the fact that Form SBSE-A has been tailored to collect information not otherwise elicited via Form 7-R which the Commission has found to be helpful to facilitate its oversight of the entities it regulates.

every "yes" answer in Schedule C. The Schedules F and G to Form SBSE-A are the same Schedules as described above in the section regarding Form SBSE.

The Commission intends to use the information disclosed in Form SBSE-A to determine whether applicants meet the standards for registration and to fulfill its oversight responsibilities.

Q-147. Is Form SBSE-A properly tailored to decrease costs for dual registration while still providing the Commission with information necessary on which to base its decision to grant or deny registration?

Q-148. What are the comparative costs or benefits with respect to filing Form SBSE versus filing Form SBSE-A for entities filing as both swap entities with the CFTC and SBS Entities with the Commission?

Q-149. How many firms expect to apply for registration as SBS Entities and what is the likelihood that those entities will also register with the CFTC as swap dealers or major swap participants?

Q-150. Will the benefit of being able to file the same form with the Commission as filed with the CFTC be outweighed by the requirement to file those forms, as well as additional schedules and documents, with more than one agency or entity or through more than one electronic system?

Q-151. Should FCMs registered with the CFTC that are not registered or registering with the CFTC as either a swap dealer or a major swap participant be allowed to register with the Commission using Form SBSE-A?

Q-152. Are any such FCMs likely to register with the Commission as an SBS Entity?

Q-153. Would it be more cost effective for the Commission to obtain the data applicants file with the CFTC electronically from the CFTC or its designee rather than having the applicant file a copy of that form with the Commission?

Q-154. Should any of the instructions or questions on Form SBSE-A be amended to recognize particular characteristics of the business of SBS Entities?

Q-155. Are any of the proposed questions inapplicable to the SBS business?

Q-156. Should any questions be added to elicit information that is unique to the SBS business or to the SBS Entities that engage in that business?

3. Form SBSE-BD

Similar to the Form SBSE-A, the staff is proposing that applicants that are also registered or registering with the Commission as broker-dealers file their application for registration on an alternative to Form SBSE, or Form SBSE-BD.[88] In addition, any entity that is registered or registering with the Commission as a broker-dealer and that is also registered or registering with the CFTC as a swap dealer or major swap participant would be required to use the Form SBSE-BD. Form SBSE-BD is based on Form BD, but is designed to provide the Commission with data not included on the Form BD (to which the Commission has access). The Commission believes that requiring that these applicants use Form SBSE-BD would reduce the costs and burdens on applicants that are already registered or registering with the Commission as broker-dealers.

The proposed Form SBSE-BD would consist of a single page that would elicit information not included on Form BD, such as the capacity in which the applicant is registering, whether the entity also is registering with the CFTC and, if so, in what capacity the firm is registering with the CFTC, if a firm is requesting registration as a major security-based swap participant - whether the

[88] Over-the-counter derivatives dealers, a limited form of broker-dealer established by the Commission in 1998, could also file on Form SBSE-BD.

firm is registering because it maintains a substantial position, has substantial counterparty exposure, or is highly leveraged relative to its capital position, whether the SBS Entity intends to use mathematical models to calculate capital or margin or to price customer or proprietary positions, whether the firm is subject to oversight by a prudential regulator and information regarding the applicant's chief compliance officer. Form SBSE-BD would also require that applicants submit Schedules F and G, described more fully above.

The Commission intends to use the information disclosed in Form SBSE-BD to determine whether applicants meet the standards for registration, and to fulfill its oversight responsibilities.

Q-157. What will the comparative costs or benefits be with respect to filing Form SBSE versus filing Form SBSE-BD for registered broker-dealers filing as SBS Entities with the Commission?

Q-158. How many firms expect to apply for registration as SBS Entities and whether those entities are already registered with the Commission as broker-dealers?

Q-159. Should any of the instructions or questions be amended to recognize particular characteristics of the business of SBS Entities?

Q-160. Are any of the proposed questions inapplicable to the SBS business?

Q-161. Should any questions be added to elicit information that is unique to the SBS business or to the SBS Entities that engage in that business?

4. Form SBSE-C

Proposed Form SBSE-C is designed to provide SBS Entities with a standard format and process through which to file the Senior Officer Certification required pursuant to proposed Rule 15Fb2-1(b). Form SBSE-C would need to be filed by all SBS Entities. As described above, SBS Entities that submitted their applications during the transitional period would need to file this certification either before the Last Compliance Date or their conditional registration would expire.

Major securities-based swap participants that submitted their applications after the Last Compliance Date would need to file this certification within four months after filing a completed application or their conditional registration would expire. SBS Dealers that file applications after the Last Compliance Date would need to file both an application and a certification simultaneously to be considered for ongoing registration.

Form SBSE-C includes instructions both requiring electronic submission and explaining how the form should be filed electronically.

Form SBSE-C would elicit the applicant's name, date, and SEC number, along with the signature, name and title of the senior officer signing the certification. The Commission intends to use the certification provided by Form SBSE-C in determining whether applicants meet the standards for ongoing registration.

The Commission requests comment on the Form SBSE-C.

Q-162. Should Form SBSE-C require that SBS Entities provide any additional information? If so, how should the form be amended?

Q-163. Should the instructions to Form SBSE-C be amended?

5. Form SBSE-W

Proposed Form SBSE-W is loosely based on Form BDW (the Form used by broker-dealers to withdraw from registration with the Commission). The Commission has found Form BDW to be an effective vehicle for gathering information necessary for it and the SROs to determine whether it is appropriate to allow a registered broker-dealer to withdraw from registration. Because SBS Entities will be subject to many requirements similar to those that affect broker-dealers (e.g., minimum capital, leverage, and business conduct rules and statutory disqualification prohibitions), the Commission believes using Form BDW as a template for the request for withdrawal from

registration of SBS Entities is logical and efficient. Key differences from Form BDW are outlined below:

- The distinction regarding full and partial withdrawal was eliminated from the Form SBSE-W as it is not relevant to the SBS business; and
- Item 4 was added to elicit information regarding the entity's reason for withdrawal from registration because we believe this information would be useful when considering a registered SBS Entity's request to withdraw from registration.

The purpose of proposed Form SBSE-W is to allow the Commission to determine whether it is in the public interest to permit a registered SBS Entity to withdraw from registration.

The Commission requests comment on the Form SBSE-W.

Q-164. Given that the Commission has proposed to use different forms for registration of certain types of applicants, should different types of forms also be provided for withdrawals from registration? If so, how should the form or forms be amended?

Q-165. Should the instructions to Form SBSE-W be amended? If so, how?

6. Tagged Data Formats

As part of the Commission's longstanding efforts to 1) improve the accuracy of financial and other filed information, 2) increase the transparency and usefulness of information, and 3) facilitate analysis of information provided to the Commission via reports, we have begun requiring that entities data-tag information contained in electronic filings.[89] Data becomes machine readable

[89] See Regulation S-T, 17 CFR 232. See also Electronic Filing and Revision of Form D, Securities Act Release No. 8891 (Feb. 6, 2008)(73 FR 10592 (Feb. 27, 2008)); Interactive Data To Improve Financial Reporting, Securities Act Release No. 9002 (Jan. 30, 2009)(74 FR 6776 (Feb 10, 2009)); and Interactive Data for Mutual Fund Risk/Return Summary, Securities Act Release No. 9006 (Feb. 11, 2009)(74 FR 7748 (Feb 19, 2009)); Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 61050 (Nov. 23, 2009)(74 FR 63832 (Dec. 4, 2009)); and Money Market Fund Reform, Investment Company Release No. 29132 (Feb. 23, 2010 (75 FR 10060 (Mar. 4, 2010)).

when it is labeled, or "tagged," using a computer markup language that can be processed by software programs for analysis. Such computer markup languages (such as eXtensible Markup Language (XML) and eXtensible Business Reporting Language (XBRL)) use standard sets of definitions, or "taxonomies," that translate text-based information in Commission filings into structured data that can be retrieved, searched, and analyzed through automated means.

In addition to using the data provided via proposed Forms SBSE, SBSE-A, and SBSE-BD to determine whether to grant or deny registration, the Commission will make this data public. The fact that counterparties of SBS Entities would have access to additional, standardized information could improve competition amongst SBS Entities and would enable counterparties and the marketplace to expend less time and money to independently obtain and compile information on SBS Entities to use in making such choices. Thus, the Commission intends to tag the information in a machine readable format using a data standard that is freely available, and that is consistent and compatible with the tagged data formats already in use for SEC filings, to enable users of that data to retrieve, search, and analyze the data through automated means.

Q-166. What tagged data language (e.g., XML, XBRL) would be most appropriate to be used for the required data to be provided via proposed Forms SBSE, SBSE-A, SBSE-BD, SBSE-C, and SBSE-W?

H. Alternative Approaches Considered

The Commission considered alternative approaches to registration of SBS Entities. One possibility would be to adopt joint registration forms with the CFTC, so that SBS Entities could register with both agencies using the same forms. While there could be benefits to this approach, we believe that the Commission's streamlined approach will achieve many of the same benefits.

Another possibility would be for the CFTC to require swap dealers and major swap participants to register using the Commission's forms, or for the Commission to require SBS

Entities to register using the CFTC's forms. While this approach might streamline the registration process for regulated entities, particularly those that intend to engage in both swaps and SBS business, it would be more difficult for the agencies to implement given the Commissions' finite resources. Further, differences between the Commodity Exchange Act and the Exchange Act and the means to facilitate registration may justify differences in the forms.

III. Request for Comment

In addition to the questions described above, we are requesting comments on all aspects of proposed rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W, including with respect to the following questions:

Q-167. Should the Commissions continue to consider whether to develop a joint registration form?

In addition, Title VII of the Dodd-Frank Act requires that the SEC consult and coordinate to the extent possible with the CFTC for the purposes of assuring regulatory consistency and comparability, to the extent possible, and states that in adopting rules, the CFTC and SEC shall treat functionally or economically similar products or entities in a similar manner.

The CFTC is adopting rules related to registration of swap dealers and major swap participants as required under Section 731 of the Dodd-Frank Act. Understanding that the Commission and the CFTC regulate different products and markets, and as such, appropriately may be proposing alternative regulatory requirements, we request comments on the impact of any differences between the Commission's approach to the registration process for SBS Entities and CFTC's approach to the registration of swap dealers and major swap participants. Specifically:

Q-168. 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 efforts on the part of

market participants subject to both regulatory regimes or result in gaps between those regimes?

Q-169. If so, in what ways do commenters believe that such duplication, inconsistencies, or gaps should be minimized?

Q-170. Do commenters believe the approaches proposed by the Commission and the CFTC to register SBS Entities and swap dealers and major swap participants are comparable? If not, why?

Q-171. Do commenters believe there are approaches that would make the registration of SBS Entities and swap dealers and major swap participants more comparable? If so, what?

Q-172. Do commenters believe that it would be appropriate for the Commission to adopt an approach proposed by the CFTC that differs from our proposal? Is so, which one and why?

We request commenters to provide data, to the extent possible, supporting any such suggested approaches.

The Commission is cognizant that the proposed rules discussed herein, as well as other proposals that the Commission may consider in the coming months to implement the Dodd-Frank Act, if adopted, could significantly affect — and be significantly affected by — the nature and scope of the security-based swaps market in a number of ways. For example, the Commission recognizes that if the measures proposed in this release are adopted and are too onerous for new entrants, they could hinder the further development of a market for security-based swaps by unduly discouraging competition and the formation of new SBS Dealers and major security-based swap participants. On the other hand, if the Commission adopts rules that are too permissive, the Commission may grant registration to firms that may have insufficient capacity, policies, procedures, or risk management systems. The Commission is also mindful that the further

development of the security-based swaps market may alter the calculus for future regulation of SBS Dealers and major security-based swap participants. As commenters review this release, they are urged to consider generally the role that regulation may play in fostering or limiting the development of the market for security-based swaps (or, vice versa, the role that market developments may play in changing the nature and implications of regulation) and specifically to focus on this issue with respect to the proposals to register SBS Dealers and major security-based swap participants.

IV. Paperwork Reduction Act

Certain provisions of proposed Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. 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 of this collection is "Registration Rules for Security-Based Swap Entities." We are applying for a new OMB Control Number for this collection in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13.

A. Summary of Collection of Information

As required by Exchange Act Section 15F, the Commission is proposing Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W to facilitate registration of, certification by, and withdrawal of SBS Entities.

Pursuant to paragraph (a) of proposed Rule 15Fb2-1, each SBS Entity would be required to file an application to register with the Commission. The Commission has sought to reduce burdens

and costs associated with the application process by providing alternate registration forms for SBS Entities that are registered or registering either with the CFTC as swap dealers or major swap participants or with the Commission as broker-dealers. The alternative forms (Form SBSE-A, and Form SBSE-BD) are both shorter and should require that an SBS Entity expend less effort to research, complete, and file. It is anticipated that each SBS Entity would only need to research, complete, and file one of the proposed Forms.

Proposed Rule 15Fb2-3 would require that SBS Entities promptly amend their applications if they find that the information contained therein has become inaccurate. While SBS Entities may need to update their Forms periodically, each firm will only need to amend that aspect of the Form that has become inaccurate.

Paragraph (b) of proposed Rule 15Fb2-1 would require that each SBS Entity have a knowledgeable senior officer, after due inquiry, make an attestation on Form SBSE-C. As discussed more fully above, the Commission is proposing to require that a senior officer certify that, after due inquiry, he or she has reasonably determined that the SBS Entity has the operational, financial, and compliance capabilities to act as an SBS Dealer or major security-based swap participant, as applicable, and has documented the process by which he or she reached such determination. This certification process is designed to allow SBS Entities to register with the Commission quickly so that they are not required to suspend their security-based swap business, while providing the Commission with a basis to take final action on SBS Entity registration.

Proposed Rule 15Fb6-1 would require that SBS Entities obtain a questionnaire or application for employment executed by each of its associated persons who is involved in effecting security-based swaps on behalf of the SBS Entity that contains certain, specified information.[90] The

[90] See supra notes 55 and 56.

proposed rule further would provide that the questionnaire or application shall serve as a basis for a background check of the associated person and be signed by the SBS Dealer's or major security-based swap participant's Chief Compliance Officer (or his or her designee). Proposed Rule 15Fb6-1 would require that each SBS Entity retain these employment questionnaires or applications until at least three years after the associated person has terminated his or her association with the SBS Entity. Finally, the CCO would need to certify (on Schedule G to Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable) that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification. SBS Entities would only need to fulfill these obligations for associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity.

Proposed Rule 15Fb2-4 would require that each nonresident SBS Entity must have in place at all times an agreement with a United States person appointing that person as the firm's U.S. agent for service of process. In addition, Proposed Rule 15Fb2-4 would require that each nonresident SBS Entity obtain an opinion of counsel stating that it can, as a matter of law, provide the Commission with access to records and the ability to conduct onsite examinations. These entities also must file an additional schedule (Schedule F) with their Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, to identify the firm's U.S. agent for service of process and to certify that the firm can, as a matter of law, provide the Commission with access to its books and records. In addition, each nonresident SBS Entity would be required to maintain its written agreement appointing a U.S. agent for service of process until at least three years after the agreement is terminated.

Pursuant to proposed Rule 15Fb1-1, each signatory to an electronic filing would be required to, when the electronic filing is made, manually sign a signature page or other document adopting

his or her signature that appears in typed form within the electronic filing. The SBS Entity would need to retain the manually-signed page until at least three years after the form or certification has been replaced or is no longer effective.

Proposed Rule 15Fb3-2 would require that an SBS Entity seeking to withdraw from Commission registration must file Form SBSE-W. Given that the cost and effort to register as an SBS Entity likely will be significant, the Commission believes that entities will not enter and exit this business regularly. Further, the Commission believes it is unlikely that any SBS Entity will seek to withdraw from registration within the first year.

Proposed temporary Rule 15Fb2-2T would only be adopted if a technological means to facilitate receipt and retention of applications is not functional by the time final rules are adopted. Pursuant to proposed temporary Rule 15Fb2-2T, each SBS Entity would need to file its application and certification in paper form. Proposed temporary Rule 15Fb2-2T also would require that each SBS Entity resubmit its application and certification in electronic form once a technological means to receive such documents becomes functional.

B. Proposed Use of Information

Information collected pursuant to proposed Rules 15Fb1-1 through 15Fb6-1 and through Forms SBSE, SBSE-A, SBSE-BD, and SBSE-C would allow the Commission to determine whether applicants meet the standards for registration, and to fulfill its oversight responsibilities. Further, Rule 15Fb3-2 and Form SBSE-W would allow the Commission to determine whether it is appropriate to allow an SBS Entity to withdraw from registration and to facilitate that withdrawal.

In addition, information collected pursuant to proposed Forms SBSE, SBSE-A, SBSE-BD, and SBSE-C would be made publicly available.

C. Respondents

Proposed Rule 15Fb1-1 through 15Fb6-1 would set forth rules to facilitate registration with the Commission of entities that fit the definition of SBS Dealer or major security-based swap participant.[91] Forms SBSE, SBSE-A, and SBSE-BD, as applicable, are applications through which SBS Entities would register with the Commission.

The Commission preliminarily believes, based on data obtained from DTCC and conversations with market participants, that approximately fifty entities may fit within the definition of SBS Dealer and up to five entities may fit within the definition of major security-based swap participant.[92] Further, the staff estimates, based on its experience and understanding of the unregulated swaps and security-based swaps markets, that the majority of firms that may register as SBS Entities (thirty-five) also will be engaged in the swaps business and will register with the

---

[91] See supra notes 5 - 7.

[92] In the Intermediary Definitions Release, the Commission and the CFTC proposed rules to define a number of terms used in Title VII, including, among others, "security-based swap dealer" and "major security-based swap participant." See supra note 5. As part of that proposal, the Commission preliminarily estimated that approximately 50 entities may be required to register as security-based swap dealers under the proposed rules. See Intermediary Definitions Release, n. 188 (75 FR 80174, at 80209 (Dec. 10, 2010)). We further estimated that no more than ten entities would have security-based swap positions large enough that they would have to monitor whether they meet the thresholds defining a major security-based swap participant. See Intermediary Definitions Release, (75 FR 80174, at 80207-8 (Dec. 10, 2010)). For purposes of these proposed rules, we conservatively estimate that, of the ten entities that would need to monitor their positions to determine whether they cross any of the definitional thresholds, five may actually meet the definition of "major security-based swap participant." 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 Trade Acknowledgment and Verification of Security-Based Swap Transactions, Exchange Act Release No. 63727 (Jan. 14, 2011), 76 FR 3859, at 3868 (Jan. 21, 2011); and Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (Jun. 29, 2011), 76 FR 42396, (Jul. 18, 2011), as corrected by Exchange Act Release No. 64766, 76 FR 46668 (Aug. 3, 2011).

CFTC as swap dealers or major swap participants.[93] In addition, persons holding securities positions may find it beneficial to hedge those positions with security-based swaps, so it may be beneficial for a broker-dealer to become an SBS Entity so that it can provide this option to its customers. Thus, Commission staff estimates that approximately sixteen broker-dealers will seek to register as SBS Entities.[94] Finally, given the costs of being a registered entity it may be less likely for an entity that is not otherwise registered with the CFTC or the Commission to register as an SBS Entity. Consequently, the Commission staff estimates that only four firms not otherwise registered with the CFTC or the Commission will seek to become an SBS Entity.

The Commission seeks comment on the reasonableness and accuracy of its estimates as to the number of participants in the security-based swap market that will be required to register with the Commission pursuant to proposed Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, and SBSE-BD, as applicable.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

1. Burden Associated with Filing Application Forms

Proposed Rule 15Fb2-1 would require that each SBS Entity register with the Commission by filing an application. The Commission has attempted to reduce the burden associated with the application process by providing multiple forms for SBS Entities to use to register (Form SBSE, Form SBSE-A, or Form SBSE-BD). It is anticipated that each SBS Entity will only need to research, complete, and file one form.

93 See Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 64766 (Jun. 29, 2011), 76 FR 42396, (Jul. 18, 2011), as corrected by Exchange Act Release No. 64766, 76 FR 46668 (Aug. 3, 2011).

94 Id.

While it is likely that the time necessary to complete these forms would vary depending on the nature and complexity of the entity's business, the Commission staff estimates (based on its experience relative to Form BD) that the average time necessary for an SBS Entity to research the questions, and complete and file a Form SBSE (including the Schedules[95] and DRPs) would be approximately one work week or forty hours.[96] As discussed above, the Commission estimates that approximately four firms would need to register using Form SBSE. Consequently, the total burden associated with filing Forms SBSE would be approximately 160 hours.[97]

The Commission staff believes that, as Form SBSE-A is shorter than the Form SBSE, it should take an SBS Entity approximately 80% of the time that it would take to research, complete, and file a Form SBSE (including the Schedules[98] and DRPs), or thirty two hours. As discussed above, the Commission estimates that approximately thirty-five firms would also be registered with the CFTC and therefore would need to register using Form SBSE-A. Consequently, the total burden associated with filing Forms SBSE would be approximately 1,120 hours.

The Commission staff believes that, as Form SBSE-BD is shorter than either Form SBSE or Form SBSE-A and broker-dealers who would be filing Form SBSE-BD are familiar with Commission terminology and forms, researching, completing, and filing a Form SBSE-BD should take an SBS Entity approximately 25% of the time that it would take to research, complete, and file

95 Except Schedules F and G, which are dealt with separately below.

96 The staff has previously estimated that the average time necessary for a broker-dealer to complete and file Form BD, the Form upon which Form SBSE was based, would be approximately three hours (and that estimate was been subject to notice and comment. Broker-Dealer Registration and Reporting, Exchange Act Release No. 41594 (July 2, 1999), 64 FR 37586.) However, some SBS Entities may not previously have been subject to regulation and thus may need more time to research the answers to complete Form SBSE and its schedules and DRPs.

97 (40 hours x 4 SBS Entities) = 160 hours total.

98 See supra note 95.

a Form SBSE (including the Schedules[99]), or ten hours. As discussed above, the Commission estimates that approximately sixteen SBS Entities would need to register using Form SBSE-BD. Consequently, the total burden associated with filing Forms SBSE-BD would be approximately 160 hours.[100]

2. Burden Associated with Amending Application Forms

Proposed Rule 15Fb2-3 would require that SBS Entities amend their applications if they find that the information contained therein has become inaccurate. While SBS Entities may need to update their Forms periodically, each firm will only need to amend that aspect of the Form that has become inaccurate. Further, it likely will not cost a significant amount to make such changes because each firm will have already completed Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, and will only need to amend that aspect of the Form that has become inaccurate. Based on the number of amendments the Commission receives annually on Form BD,[101] the Commission estimates that each SBS Entity will file approximately three amendments annually. While it is likely that the time necessary to file an amendment to Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, may vary depending on the nature and complexity of the information to be amended, the staff estimates, based on experience relative to Form BD, that it likely would take an SBS Entity, on average, approximately one hour to amend its application each time it files an

99 Id.

100 (10 hours x 16 SBS Entities) = 160 hours total.

101 On March 1, 2010 there were 5,163 broker-dealers registered with the Commission (based on Form BD data). The Commission received 20,666, 17,839, 16,702, 16,365, and 17,247 amended Forms BD during the fiscal years ending 9/30/2005, 9/30/2006, 9/30/2007, 9/30/2008 and 9/30/2009, respectively. ((20,666 + 17,839 + 16,702 + 16,365 + 17,247) / 5 years) / 5,163 broker-dealers = 3.44 amendments per broker-dealer per year.

amendment. Consequently, the total burden associated with amending Forms SBSE, SBSE-A, and SBSE-BD, as applicable, would be approximately 165 hours.[102]

3. Burden Associated with Certification

Paragraph (b) of proposed Rule 15Fb2-1 would require that each SBS Entity have a knowledgeable senior officer certify that, after due inquiry, he or she has reasonably determined that the SBS Entity has the operational, financial, and compliance capabilities to act as an SBS Dealer or major security-based swap participant, as applicable, and has documented the process by which he or she has reached such determination. Each SBS Entity would need to provide this certification on Form SBSE-C only once. The Commission believes that the majority of the cost associated with this certification would arise from the review the senior officer conducts, or has others conduct, prior to certifying that the SBS Entity has the requisite operational, financial, and compliance capabilities. The senior officer would also need to certify that he or she has documented this process.

The Commission understands (based on the staff's experience with broker-dealers and other regulated entities) that, in satisfying other certification requirements, SBS Entities may use different processes, depending on the facts and circumstances of their business. Some SBS Entities may develop more or less robust process than others and, as a result, may incur higher or lower than average costs. Some SBS Entities may use a sub-certification process whereby the senior officer will not certify a firm-wide statement unless and until other persons responsible for certain activities in turn certify to the senior officer that the standard has been met, while other firms may use an internal or external audit-type process whereby a senior officer may choose to employ a third party to review an area subject to a firm-wide certification before submitting the certification. There may

---

[102] 1 hour x three per year x 55 SBS Entities = 165 hours.

be other processes an SBS Entity could use to provide a basis for a senior officer's reasonable determination that the SBS Entity has the requisite capabilities that we have not specifically identified here. Many factors outside of the Commission's control[103] may determine whether an SBS Entity might choose to utilize an internal process, as opposed to an external process, to serve as a basis for the Senior Officer Certification. For purposes of this PRA, we will estimate that approximately half, or twenty-eight of the SBS Entities, may use an internal process and the other half, or twenty-seven of the SBS Entities, will use an external process.

The Commission believes that, regardless of whether an SBS Entity may choose to utilize an internal process, as opposed to an external process, to serve as a basis for the Senior Officer Certification, the burden associated with having a senior officer sign a certification likely would be approximately five hours,[104] The Commission has previously estimated that it would take a senior officer approximately twenty hours to review, document, and update compliance procedures,[105] which the staff believes would be analogous to reviewing documents provided either by subordinates or a third party to gain comfort necessary to sign the Senior Officer Certification.

Commission staff estimates, based on its experience relative to the securities and over-the-counter derivatives industries, that if a senior officer opted to conduct an internal review of the SBS Entity's operational, financial, and compliance capabilities, it would take approximately one hundred and seventy five additional hours for other SBS Entity employees to assess the SBS Entity's operational, financial, and compliance capabilities and provide the senior officer with sub-

---

[103] For instance, such factors could include: costs; how comfortable the senior officer may be with his or her subordinates within the SBS Entity's control structure; and how knowledgeable a senior officer may be regarding the SBS Entity's capabilities.

[104] See, e.g., Risk Management Controls for Brokers or Dealers With Market Access, Exchange Act Release No. 63241 (Nov. 3, 2010), 75 FR 69792, at 69816 (Nov. 15, 2010).

[105] Id.

certifications or other documents he or she may request to obtain the necessary comfort before signing the Senior Officer Certification. Consequently, the Commission estimates that the one-time burden for the twenty-eight SBS Entities that utilize an internal review process would be approximately 5,600 hours for other SBS Entity employees to assess the SBS Entity's operational, financial, and compliance capabilities and provide the senior officer with documents, and for the senior officer to review those documents and sign the Senior Officer Certification.[106]

The Commission has previously estimated that the burden associated with obtaining an internal control report from a third party would cost, on average, approximately $250,000.[107] The staff believes that an internal control report would be roughly analogous to a third party review of each SBS Entity capability included in the Senior Officer Certification; however, the staff believes the cost of a third party review of an SBS Entity's capabilities likely would be less than the cost of three separate internal control reviews because the third party review of capabilities would not require an accountant's opinion and because some economies of scale likely could be achieved when a third party reviews three capabilities for a single SBS Entity. Consequently, the staff estimates that the cost for an SBS Entity to obtain a third party review to provide its senior officer with the necessary comfort to sign the Senior Officer Certification would be approximately $600,000. Thus, the Commission estimates that the one-time burden for the twenty-seven SBS Entities that utilize an external review process would be approximately 675 hours[108] for the senior

---

106 (5 hours + 20 hours + 175 hours) x 28 SBS Entities = 5,600 hours.

107 See, e.g., Custody of Funds or Securities of Clients by Investment Advisers, Advisers Act Release No. 2968 (Dec. 30, 2009), 75 FR 1456, at 1473 (Jan. 11, 2010). Depending on the facts and circumstances relating to an SBS Entity's business, third party service providers may use different methods to assess each of an SBS Entity's capabilities and report their findings to the SBS Entity, which may affect the cost of the review and the amount a third party charges an SBS Entity for this review.

108 (5 hours + 20 hours) x 27 SBS Entities = 675 hours.

officer to review documents provided by the third party to gain the necessary comfort and to sign the Senior Officer Certification, and $16,200,000 to have a third party review the SBS Entity's operational, financial, and compliance capabilities and provide the SBS Entity with evidence sufficient to make the senior officer sufficiently comfortable to sign the Senior Officer Certification.

Thus, the total burden for all SBS Entities associated with the Senior Officer Certification would be approximately 6,275 hours and $16,200,000.

4. Burdens Relating to Associated Persons

Proposed Rule 15Fb6-1 would require an SBS Entity to obtain a questionnaire or application for employment executed by each of its associated persons who is involved in effecting security-based swaps on behalf of the SBS Entity that contains certain, specified information. The proposed rule further would provide that the questionnaire or application must be reviewed and signed by the SBS Dealer's or major security-based swap participant's Chief Compliance Officer. Finally, the CCO would need to certify (on Schedule G of its Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable) that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification. SBS Entities would only need to fulfill these obligations for associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity.[109] The Commission estimates (based on the staff's experience relative to the securities and OTC derivatives industries) that SBS Entities each have, on average, twenty-five associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity. The Commission believes that the information SBS Entities would need to obtain through these questionnaires is standard in the financial services industry, and is already collected by firms registered with the CFTC and the SEC. In addition, SBS Entities that are

---

[109] See supra notes 55 and 56.

registered with the Commission or the CFTC must already perform background checks on their employees because of the prohibitions from employment of statutorily disqualified persons in the CEA and the Exchange Act.

The Commission staff estimates, based on its experience relative to the securities industry, that the average time necessary for an SBS Entity to review its employment questionnaire or application to verify that it contains all of the required information and to update the questionnaire would be approximately three hours. As SBS Entities that are already registered with the Commission or the CFTC already collect this information, the Commission estimates that the cost to all SBS Entities to review employment questionnaires or applications, verify that they contain all of the required information and update the questionnaires or applications, as necessary, would be approximately 12 hours.[110]

As discussed above, the Commission staff believes that most financial services firms already collect all or most of the information proposed Rule 15Fb6-1 would require that they collect. Consequently, the Commission estimates that the burden to require an SBS Entity's existing associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity to provide those few categories of information that they did not originally provide on their employment questionnaires or applications would be approximately one hour each.[111] As SBS

---

110 3 hours x 4 SBS Entities that are not registered with the Commission or CFTC = 12 hours.

111 Commission staff believes that, as most firms already collect all or most of the information already, it likely would not take employees more than an hour each, on average, to provide any additional information. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar. As the categories of employees that could be required to provide additional information is diverse (see supra notes 55 and 56) the weighted-average cost of 46 of the positions included in Securities Industry and Financial Markets Association's ("SIFMA") publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of an Attorney is approximately $260/hour. 1 hour x 25 associated

Entities that are already registered with the Commission and the CFTC already collect this information from employees, the Commission estimates that the burden to all SBS Entities to obtain additional information from relevant associated persons, would be approximately 100 hours.[112]

The Commission staff estimates, based on the staff's experience relative to the securities industry, that it would take a CCO approximately one hour to review and sign a relevant employee's employment record. Consequently, the Commission estimates that the total burden to all SBS Entities to have their CCOs review and sign each associated person's employment record would be approximately 1,375 hours.[113]

On an ongoing basis, if employee turnover at an SBS Entity averages 12%,[114] each SBS Entity would need to perform background checks and have their CCO review and approve in writing three new associated persons' employment records per year. As stated above, the Commission estimates that the burden to have an SBS Entity's CCO review and sign each associated person's employment record would be approximately one hour. Thus, the ongoing annual burden to each SBS Entity would be approximately three hours[115] and the total cost to all

---

persons x $260 = $6,500.

[112] One hour x 4 SBS Entities that are not registered with the Commission or CFTC x 25 associated persons effecting or involved in effecting security-based swaps on behalf of the SBS Entity = 100 hours.

[113] One hour x 25 associated persons x 55 SBS Entities = 1,375 hours.

[114] The staff notes that the Bureau of Labor Statistics Labor Turnover Survey indicates that turnover is presently in the range of 3.2%, however the staff believes that the present economic situation has likely driven turnover to a historically low level and that this broad statistic likely does not adequately represent actual turnover in the financial services sector. Consequently, the staff believes, based on its experience, that a higher number may be more appropriate.

[115] One hour x three associated persons = three hours.

SBS Entities to comply with Rule 15Fb6-1 on an ongoing basis would be approximately 165 hours annually.[116]

The Commission believes that as the CCO would already have reviewed and signed each employee's employment record, signing the required certification will not take a significant amount of time. Thus, Commission staff estimates, based on its experience relative to the securities industry, that it would take a CCO approximately one hour to certify on Schedule G that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification. Consequently, the Commission staff estimates that the total burden to all SBS Entities to complete this certification on Schedule G would be approximately 55 hours.[117]

5. Burdens on Nonresident SBS Entities

The Commission estimates, based on conversations with industry participants, that approximately 40 percent or 22 SBS Entities will be nonresident SBS Entities. Proposed Rule 15Fb2-4 would require that each nonresident SBS Entity file an additional schedule (Schedule F) with their Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, to identify its U.S. agent for service of process and to certify that the firm can, as a matter of law, provide the Commission with access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission.

Commission staff conservatively estimates, based on its experience relative to the securities industry and Form BD, that the average time necessary for a nonresident SBS Entity to complete and file Schedule F would be approximately one hour. Thus, the Commission estimates that the

---

116 Three hours x 55 SBS Entities = 165 hours.

117 One hour x 55 SBS Entities = 55 hours.

total burden for all nonresident SBS Entities approximately to complete and file Schedule F would be approximately 22 hours.[118]

In addition, nonresident SBS Entities would incur outside legal costs associated with obtaining an opinion of counsel. In previous releases, the Commission estimated that firms with a similar requirement would incur, on average, approximately $900 in outside legal costs to obtain an opinion of counsel.[119] This estimate originally related to the cost a foreign bank issuer would incur to obtain a legal opinion to provide to the Commission when seeking an exemption from the requirement to make certain additional disclosures.[120] Although the legal opinion for foreign bank issuers also would address privacy laws in the issuer's home jurisdiction that may preclude certain disclosures, upon further reflection, we believe that the legal opinion required for nonresident SBS Entities pursuant to the proposed rule would likely require additional research and analysis to prepare. Based on staff experience, the Commission estimates that each nonresident SBS Entity would incur, on average, approximately $25,000 in outside legal costs to obtain the necessary opinion of counsel, and that the total cost for all nonresident SBS Entities to obtain this opinion of counsel would be approximately $550,000.[121]

118 1 hour x 22 nonresident SBS Entities = 22 hours.

119 Registration and Regulation of Security-Based Swap Execution Facilities, Exchange Act Release No. 63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011); Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010), 75 FR 77306 (Dec. 10, 2010); Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act Section 13(k), Exchange Act Release No. 49616 (Apr. 26, 2004), 69 FR 24016 (Apr. 30, 2004). The $900 figure is based on an estimate of $400 an hour for legal services.

120 Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act Section 13(k), Exchange Act Release No. 49616 (Apr. 26, 2004); 69 FR 24016 (Apr. 30, 2004).

121 $25,000 x 22 SBS Entities = $550,000.

6. Burden Related to Retention of Manually Signed Signature Pages

Pursuant to proposed Rule 15Fb1-1, each signatory to an electronic filing must, when the electronic filing is made, manually sign a signature page or other document adopting his or her signature that appears in typed form within the electronic filing. This manually signed page must be retained by the SBS Entity until at least three years after the form or certification has been replaced or is no longer effective. It is likely that each SBS Entity would need to maintain at least three pages with manually signed signatures (the execution page of Form SBSE, SBSE-A, or SBSE-BD, as applicable, Schedule G, and the Form SBSE-C certification). In addition, nonresident SBS Entities also would need to retain a manually signed copy of Schedule F. As so few pages would need to be retained, the staff believes the burden associated with retaining them would not be significant. Thus, the Commission estimates that it would take each SBS Entity approximately 10 minutes annually to assure that these pages are retained, or a total of approximately 9 hours annually for all SBS Entities.[122]

7. Burden Associated with Filing Withdrawal Form

Given that the cost and effort to register as an SBS Entity will be significant, the Commission believes that entities will not enter and exit this business regularly. As the Form SBSE-W is only one page and consists of information readily available to SBS Entities, the staff estimates (based on experience relative to Form BD-W) that it likely would take an SBS Entity, on average, approximately one hour to complete and file a Form SBSE-W. While the Commission believes it is unlikely that any SBS Entity will withdraw from registration often or within the first year, solely for purposes of this PRA the Commission estimates that one SBS Entity may file Form

[122] (10 minutes x 55 SBS Entities) / 60 minutes = 9.17 hours.

SBSE-W to withdraw from registration annually and the total burden associated with completing and filing Form SBSE-W would be approximately one hour each year.

8. Burden Associated with Proposed Temporary Rule 15Fb2-2T

Proposed temporary Rule 15Fb2-2T would only be adopted if a technological means to facilitate receipt and retention of applications is not functional by the time final rules are adopted. Pursuant to proposed temporary Rule 15Fb2-2T, each SBS Entity would need to file its application and certification in paper form, and then resubmit its application and certification in electronic form once a technological means to receive such documents becomes functional.

The burden associated with completing and filing the forms once are discussed above. Thus, the additional burden associated with proposed temporary Rule 15Fb2-2T relate to electronic resubmission of the form.

The staff estimates that the costs associated with resubmitting each of the forms would be minimal, but would be contingent on the length of the form. Further, the additional time to file the certification (which consists of a single page) would not vary relative to the form required to be filed, and would not add significantly to the times required to file the registration forms. The Commission staff preliminarily estimates, based on the staff's experience relative to the securities industry and Form BD, that the average time necessary for an SBS Entity to resubmit a Form SBSE would be approximately four hours. As Forms SBSE-A and SBSE-BD are shorter than Form SBSE, the Commission staff preliminarily estimates that resubmitting Form SBSE-A would take approximately two hours, and that resubmitting Form SBSE-BD would take approximately one hour. Thus, the Commission estimates that the total burden to all SBS Entities to resubmit their Forms SBSE, SBSE-A, or SBSE-BD, as applicable, would be approximately 102 hours.[123]

---

[123] (2 hours x 35 SBS Entities already registered with the CFTC) + (1 hour x 16 SBS Entities already registered with the Commission) + (4 hours x 4 SBS Entities not otherwise

9. Request for Comment on Burden Estimates

The Commission seeks comment on the recordkeeping and reporting collection of information burdens associated with proposed Rule 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, and SBSE-BD, as applicable.

Q-173. What burdens, if any, would respondents incur with respect to system design, programming, expanding systems capacity, and establishing compliance programs to comply with proposed Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W, as applicable?

Q-174. Is it likely that SBS Entities will complete Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W, as applicable, themselves or is it more likely that they would obtain assistance in completing these forms from some outside entity (e.g., outside counsel)? If an SBS Entity obtains assistance in completing the forms from an outside entity, what type of entity may be utilized and what may the relative costs to employ such an entity for this purpose be?

Q-175. Would there be different or additional burdens associated with the collection of information under Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W, as applicable, that a respondent does not currently undertake in the ordinary course of business that the Commission has failed to identify? If so, please both describe and quantify any additional burden(s).

Q-176. Are the burden and cost estimates regarding the review necessary to support the Senior Officer Certification appropriate? Are there other processes a senior officer may utilize to gain the necessary comfort to sign the Senior Officer Certification? If so, what other processes might be used and what are the advantages, burdens and/or costs of those other

---

registered with either the Commission or the CFTC) = 102 hours.

processes? Also, is the Commission's estimate accurate regarding how many SBS Entities may utilize an external, as opposed to an internal, review process?

Q-177. Would nonresident SBS Entities incur greater or lesser costs for the opinion of counsel? Would the cost more likely be closer to $900, as previously estimated? Are the costs likely to exceed $25,000?

E. Retention Period of Recordkeeping Requirements

Proposed Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W would require that each respondent retain certain records and information for three years.

F. Collection of Information is Mandatory

Any collections of information required pursuant to proposed Rules 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C would be mandatory to permit the Commission to determine whether applicants meet the standards for registration, and to fulfill its oversight responsibilities.

The collections of information required pursuant to proposed Rule 15Fb3-2 and Form SBSE-W would be mandatory to allow the Commission to determine whether it is in the public interest to allow an SBS Entity to withdraw from registration.

The collections of information required pursuant to proposed Rule 15Fb2-2T would be mandatory to provide a process for the Commission to facilitate registration of SBS Entities if an electronic system to facilitate registration is not functional by the time final registration rules are adopted.

G. Confidentiality

The Commission intends to make the information collected pursuant to proposed Rule 15Fb1-1 through 15Fb6-1 and Forms SBSE, SBSE-A, SBSE-BD, SBSE-C and SBSE-W public.

H. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the proper performance of our functions, including whether the information shall have practical utility;

2. Evaluate the accuracy of our estimate of the burden of the proposed collection of information;

3. Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and

4. Evaluate whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-40-11. 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. S7-40-11, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549-1090. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Economic Analysis

In response to the recent financial crisis, Congress passed the Dodd-Frank Act in July of 2010. Among other things, the Dodd-Frank Act is designed to strengthen oversight, improve consumer protections, and reduce systemic risks throughout the financial system. Title VII of the Dodd-Frank Act specifically addresses the OTC derivatives markets, including the market for security-based swaps, and requires the Commission to undertake a number of rulemakings to establish a regulatory framework for SBS Entities.

In promulgating the provisions of Section 764 of the Dodd-Frank Act, Congress established a mandatory registration regime for SBS Entities but left the form and manner of such registration within the discretion of the Commission. In determining the form and manner of such registration, the Commission may require "such information, as the Commission considers necessary concerning the business in which the applicant is or will be engaged."[124] The Dodd-Frank Act also requires that SBS Entities "continue to submit to the Commission reports that contain such information pertaining to the business of the person as the Commission may require."[125] Section 764 also provides that registrations "shall expire at such time as the Commission may prescribe by rule,"[126] and prohibit SBS Entities from allowing persons associated with it that are "subject to a statutory disqualification to effect or be involved in effecting security-based swaps on behalf of the [SBS Entity if the entity] knew, or in the exercise of reasonable care should have known, of the statutory

---

124 15 U.S.C. 78o-10(b)(2)(A).

125 15 U.S.C. 78o-10(b)(2)(B).

126 15 U.S.C. 78o-10(b)(3).

disqualification."[127] Finally, the Dodd-Frank Act provides the Commission with additional broad authority to effect registration and regulation of SBS Entities.[128]

Today, the Commission is proposing new rules and forms that provide a process for registration of SBS Entities. This process would require that SBS Entities apply for registration by submitting a Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable. Further, this process would allow SBS Entities to register conditionally or on an ongoing basis, as necessary. In addition, each SBS Entity seeking ongoing registration would need to submit to the Commission a certification on Form SBSE-C, signed by a knowledgeable senior officer.

In drafting these rules the Commission sought to design a registration process that is similar to other registration processes administered by the Commission. To the extent market participants are familiar with these existing registration processes, we believe that using similar processes to register SBS Entities would create efficiencies for market participants. Many of the proposed rules were drafted based on rules applicable to broker-dealers. Similarly, the draft forms were based on Forms BD and BDW. However, the Commission also has sought to assure that the staff has information sufficient to make a determination as to whether registration should be granted or denied. Thus, the Form SBSE differs from Form BD in that it requests information specific to the SBS business and does not request information specific to the broker-dealer business. The Commission also sought to assure that the proposed rules, the forms, and the process generally are as clear as possible so as to minimize confusion. The Commission has sought to minimize, to the extent possible, duplication and costs that the rules may impose on firms. Finally, burdens and costs that have been estimated for PRA purposes are included in the broader costs and benefits discussion that follows because we believe, as the registration process would largely be forms-

---

[127] 15 U.S.C. 78o-10(b)(6).

[128] 15 U.S.C. 78o-10(b)(4) and (d).

based, it is appropriate to include them. The Commission is sensitive to the costs and benefits imposed by its rules.

A. Benefits

The proposed rules and forms described in this section would be issued pursuant to a specific grant of rulemaking authority in the Dodd-Frank Act. As indicated above, the forms were based on Forms BD and BDW, which broker-dealers are familiar with and which are similar to the Form 7-R that futures and commodities firms use to register with the CFTC. Significantly, the Commission is proposing the use of multiple registration forms to limit the amount of duplication and costs imposed on firms already registered with the Commission as a broker-dealer or with the CFTC as a swap dealer or major swap participant. The Commission considered using only one form to facilitate registration, but we believe using multiple forms would provide a benefit to firms because it would reduce the costs to register.

In addition the proposed use of multiple forms is designed to allow firms already registered with the SEC as broker-dealers or registered or registering with the CFTC as swap dealers or swap participants to submit or utilize forms they have already completed to facilitate registration with the Commission. This use of existing forms would allow the Commission to obtain the information it needs to determine whether to grant registration without requiring the applicant to duplicate substantially the same information that they have already provided to regulators for another purpose.

The proposed rules and forms would require that SBS Entities provide certain standardized data (including disciplinary information) to the Commission. The Commission would then make this information public. This would provide SBS counterparties and the marketplace with additional, comparable information on all SBS Entities (for instance, by highlighting previously unrecognized comparative strengths and weaknesses) which would allow them to make more informed choices with respect to counterparties and collateral. The Commission also believes that

this may promote competition by leveling the playing field for market participants who may have disparate access to information regarding each SBS Entity. In addition, making such standardized information on SBS Entities public would enable counterparties and the marketplace to expend less time and money to independently obtain and compile information on SBS Entities to use in making such choices.

Requiring the reporting of standardized information through these forms also will allow the Commission to identify the risk characteristics of each SBS Entity, which should help the Commission focus examinations and other oversight resources more efficiently and effectively.

Once SBS Entities are registered, they will be subject to standardized requirements that set a baseline level of, among other things, internal controls, capital and margin levels for all SBS Entities. The registration and regulation of SBS Entities also may promote capital formation by providing market participants with certain, uniform information regarding registered SBS Entities (as described above) and assuring market participants that registered SBS Entities meet established standards. By facilitating oversight of SBS Entities, registration and regulation of these entities also could increase counterparty trust, and may encourage more counterparties and eligible contract participants to enter the SBS marketplace. It also may be beneficial if SBS entities that are not capable of meeting, or are unwilling to meet, their regulatory obligations exit the market.

B. Costs

Although the Commission believes that registration and regulation of SBS Entities would result in significant benefits to customers of and counterparties to SBS Entities, investors, eligible contract participants and the market for SBS, the Commission recognizes that the proposed registration rules and forms would also entail costs.

The Commission preliminarily estimates that SBS Entities would incur costs associated with: i) researching, completing, and filing the forms, ii) reviewing, completing and submitting the required certification, and documenting the review process, iii) obtaining or compiling the required questionnaires or employment applications, having the CCO review the questionnaires and certify that no relevant associated person is subject to statutory disqualification, iv) the requirements that nonresident SBS Entities obtain an agreement for U.S. service of process and an opinion of counsel stating that they can provide the Commission with access to records, v) the requirement to retain manually signed signature pages, and vi) the requirements associated with filing forms in paper format and resubmitting those forms electronically if the Commission does not have a technological means to receive applications electronically by the time final registration rules are adopted.

The Commission preliminarily believes that the proposed amendments may impose a burden on competition for smaller SBS Entities to the extent that they impose relatively fixed costs, which could represent a higher percentage of net income for smaller SBS Entities. Registration costs may also impact those SBS Entities that are not already registered under another area of their business model to a greater degree than they would impact SBS Entities that have previously registered under another regulatory regime. The SBS Entity registration requirement may cause some market participants that are not capable of meeting their operational, financial and/or regulatory obligations to exit the market. However, the Commission believes that any reduction in competition resulting from an exit from the market by SBS Entities that are not capable of meeting, or that are unwilling to meet, their regulatory obligations is a necessary and appropriate burden on competition.

1. Costs Attributable to Filing the Forms

Proposed Rule 15Fb2-1 would require that each SBS Entity register with the Commission by filing Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable. Firms must file these forms

electronically, which also should reduce the associated costs because SBS Entities will not incur costs associated with copying or postage. The Commission preliminarily believes that it would cost each SBS Entity approximately $11,800 to complete and file the Form SBSE (including the Schedules[129] and DRPs).[130] As stated previously, the Commission has attempted to reduce costs associated with the application process by providing multiple forms for SBS Entities to use to register. The alternative forms (Form SBSE-A, and Form SBSE-BD) are both shorter and should require that an SBS Entity expend less effort to research, complete, and file. Consequently, the Commission preliminarily believes that it would cost each firm approximately $9,440 to complete Form SBSE-A[131] (including the Schedules[132] and DRPs) and approximately $2,950 to complete

---

129 See supra note 95.

130 The staff has previously estimated that the average time necessary for a broker-dealer to complete and file Form BD, the Form upon which Form SBSE was based, would be approximately three hours (and that estimate was been subject to notice and comment. Broker-Dealer Registration and Reporting, Exchange Act Release No. 41594 (July 2, 1999), 64 FR 37586.) However, SBS Entities have not previously been subject to regulation and may need significantly more time to research the answers to complete Form SBSE and its schedules and DRPs. Thus, while it is likely that the time necessary to complete Form SBSE would vary depending on the nature and complexity of the entity's business, Commission staff estimates that the average time necessary for an SBS Entity to research the questions, and complete and file a Form SBSE would be approximately one work week or forty hours. The staff believes that an SBS Entity would have a Compliance Manager complete and file the form's application on Form SBSE, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 40 hours x $295 = $11,800.

131 The Commission staff believes that, as Form SBSE-A is shorter than the Form SBSE, it should take an SBS Entity less time to research the questions, and complete and file a Form SBSE-A. Thus, while it is likely that the time necessary to complete Form SBSE-A would vary depending on the nature and complexity of the entity's business, the staff estimates that researching, completing, and filing Form SBSE-A would take approximately 80% of the time that it would take to research, complete, and file a Form SBSE, or thirty two hours. The staff believes that an SBS Entity would have a Compliance Manager complete and file the form's application on Form SBSE-A, and that the pay scales for broker-dealers and SBS Entities would likely be similar. See supra note 130. 32 hours x $295 = $9,440.

Form SBSE-BD (including the Schedules).[133] It is anticipated that each SBS Entity will only need to research, complete, and file one Form, and that it will update that Form, as necessary, as described below.

The Commission preliminarily believes, based on its understanding of the security-based swap market and conversations with industry participants, that approximately fifty firms will fit the definition of SBS dealer and approximately five firms will fit the definition of major security-based swap participant. Further, based on its understanding of the securities-based swap market, the Commission believes that the majority of firms that may register as SBS Entities also will be engaged in the swaps business and will register with the CFTC as swap dealers or major swap participants. In addition, persons holding securities positions may find it beneficial to hedge those positions with security-based swaps, so it may be beneficial for a broker-dealer to become an SBS Entity so that it can provide this option to its customers. However, given the costs of being a registered entity, it may be less likely for an entity that is not otherwise registered to register as an SBS Entity. Consequently, the Commission believes that thirty-five SBS Entities will register with the Commission using Form SBSE-A, twelve SBS Entities will register with the Commission using Form SBSE-BD, and eight SBS Entities will register with the Commission using Form SBSE.

---

132 See supra note 95.

133 See supra note 95. The Commission staff believes that, as Form SBSE-BD is shorter than either Form SBSE or Form SBSE-A, it should take an SBS Entity less time to research the questions, and complete and file a Form SBSE-BD. In addition, broker-dealers who would be filing Form SBSE-BD are familiar with Commission terminology and Forms. Thus, while it is likely that the time necessary to complete Form SBSE-BD would vary depending on the nature and complexity of the entity's business, the staff estimates that researching, completing, and filing Form SBSE-BD would take approximately 25% of the time that it would take to research, complete, and file a Form SBSE, or ten hours. The staff believes that an SBS Entity would have a Compliance Manager complete and file the form's application on Form SBSE-BD. See supra note 130. 10 hours x $295 = $2,950.

Thus, the total estimated cost to all entities to research, complete, and file Forms to register as SBS Entities would be approximately $424,800.[134]

Proposed Rule 15Fb2-3 would require that SBS Entities amend their applications if they find that the information contained therein has become inaccurate. While SBS Entities may need to update their Forms periodically, it likely would not cost a significant amount to make such changes because each firm will have already completed Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, and would only need to amend that aspect of the Form that has become inaccurate. Based on the number of amendments the Commission receives annually on Form BD,[135] the Commission estimates that each SBS Entity would file approximately three amendments annually. Consequently, the Commission estimates that the cost for each SBS Entity to complete and file amendments to its forms is approximately $885.[136] Thus, the Commission estimates that it would cost all SBS Entities approximately $48,675 annually to complete and file these amendments.[137]

---

134 $424,800= (35 x $9,440) + (16 x $2,950) + (4 x $11,800).

135 On March 1, 2010 there were 5,163 broker-dealers registered with the Commission (based on Form BD data). The Commission received 20,666, 17,839, 16,702, 16,365, and 17,247 amended Forms BD during the fiscal years ending 9/30/2005, 9/30/2006, 9/30/2007, 9/30/2008 and 9/30/2009, respectively. ((20,666 + 17,839 + 16,702 + 16,365 + 17,247) / 5 years) / 5,163 broker-dealers = 3.44 amendments per broker-dealer per year.

136 While it is likely that the time necessary to file an amendment to Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable may vary depending on the nature and complexity of the information to be amended, the staff estimates, based on experience, that it likely would take an SBS Entity, on average, approximately one hour to amend its application each time it files an amendment. The staff believes that an SBS Entity would have a Compliance Manager complete and file amendments to the SBS Entity's forms, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 1 hours x $295 x three per year = $885.

137 $885 x 55 SBS Entities = $48,675.

Proposed Rule 15Fb3-1 would require an SBS Entity seeking to withdraw from Commission registration to file Form SBSE-W. Given that the cost and effort to register as an SBS Entity will be significant, the Commission believes that entities will not enter and exit this business regularly. Further, the Commission believes it is unlikely that any SBS Entity will withdraw from registration within the first year. However, there will be a cost associated with withdrawing from registration as an SBS Entity must file a Form SBSE-W to do so. As the Form SBSE-W is only one page and consists of information readily available to SBS Entities, the Commission estimates that the cost for an SBS Entity to complete and file a Form SBSE-W would be approximately $295.[138]

The Dodd-Frank Act clearly requires registration of SBS Entities. All other entities that register with the Commission do so by filing some type of application, which may be a standardized form (e.g., Form TA-1, Form ADV and Form BD). The Commission generally requires that registered entities amend these forms to correct inaccurate information either as necessary or periodically. Further, all other entities that with to withdraw from Commission registration must file some type of notice with the Commission, which may be a standardized form (see, e.g., Form TA-W, Form ADVW, and Form BDW). Thus, it is likely that Congress contemplated or intended that the Commission establish this type of registration regime. The Commission believes the use of conditional registration and the certification process using Form SBSE-C is a reasonable and relatively low cost method to assure that firms have operational, financial and compliance capabilities to act as SBS Entities and implement adequate procedures to comply with federal

[138] The staff estimates, based on experience, that it likely would take an SBS Entity, on average, approximately one hour to complete and file a Form SBSE-W. The staff believes that an SBS Entity would have a Compliance Manager complete and file Form SBSE-W, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 1 hour x $295 = $295.

securities laws and provide the Commission with a basis to take final action on SBS Entity registration.

2. Costs of Certification

Paragraph (b) of proposed Rule 15Fb2-1 would require that each SBS Entity have a knowledgeable senior officer certify that, after due inquiry, he or she has reasonably determined that the SBS Entity has the operational, financial, and compliance capabilities to act as an SBS Dealer or major security-based swap participant, as applicable, and has documented the process by which he or she has reached such determination. Each SBS Entity would need to provide this certification on Form SBSE-C only once. The Commission believes that the majority of the cost associated with this certification would arise from the review the senior officer conducts, or has others conduct, prior to certifying that the SBS Entity has the requisite operational, financial, and compliance capabilities.[139] The senior officer would also need to certify that he or she has documented this process.

The Commission understands (based on the staff's experience with broker-dealers and other regulated entities) that, in satisfying other certification requirements, SBS Entities may use different processes, depending on the facts and circumstances of their business. Some SBS Entities may develop more or less robust process than others and, as a result, may incur higher or lower than average costs. Some SBS Entities may use a sub-certification process whereby the senior officer will not certify a firm-wide statement unless and until other persons responsible for certain activities in turn certify to the senior officer that the standard has been met, while other firms may use an internal or external audit-type process whereby a senior officer may choose to employ a third party to review an area subject to a firm-wide certification before submitting the certification. There may

---

[139] See supra note 42.

be other processes an SBS Entity could use to provide a basis for a senior officer's reasonable determination that the SBS Entity has the requisite capabilities that we have not specifically identified here. Many factors outside of the Commission's control[140] may determine whether an SBS Entity might choose to utilize an internal process, as opposed to an external process, to serve as a basis for the Senior Officer Certification. For purposes of this economic analysis, we will estimate that approximately half, or twenty-eight of the SBS Entities, may use an internal process and the other half, or twenty-seven of the SBS Entities, will use an external process.

The Commission believes that, regardless of whether an SBS Entity may choose to utilize an internal process, as opposed to an external process, to serve as a basis for the Senior Officer Certification, it will cost approximately $10,450 on average for a senior officer to review documents provided either by subordinates or by a third party to gain the comfort necessary to sign and to sign the Senior Officer Certification.[141] The Commission estimates that, if an SBS Entity opted to conduct an internal review of the SBS Entity's operational, financial and compliance capabilities, it will cost each SBS Entity approximately an additional $73,150[142] for other SBS

---

140 See supra note 103.

141 The Commission has previously estimated that the burden associated with having a senior officer sign a certification likely would be approximately five hours. See supra note 104. The Commission has also estimated that it would take a senior officer approximately twenty hours to review, document, and update compliance procedures, (Id.) which the staff believes would be analogous to reviewing documents provided either by subordinates or a third party to gain comfort necessary to sign the Senior Officer Certification, and to document this review. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar, and that the pay of a Chief Compliance Officer likely would be similar to the amount paid to other senior officers. According to the SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Chief Compliance Officer is approximately $418/hour. 25 hours x $418 = $10,450.

142 Commission staff estimates, based on its experience relative to the securities and OTC derivatives industries, that if a senior officer opted to conduct an internal review of the SBS Entity's operational, financial, and compliance capabilities, it would take approximately one

Entity employees to assess the SBS Entity's operational, financial, and compliance capabilities and provide the senior officer with whatever sub-certifications or other documents he or she may request to obtain the necessary comfort before signing the Senior Officer Certification. Alternatively, if an SBS Entity opted to conduct an external review of the SBS Entity's operational, financial and compliance capabilities, the Commission estimates that it will cost each SBS Entity approximately an additional $600,000.[143] Thus, the Commission estimates that this certification requirement will cost all SBS Entities a total of approximately $18,822,950.[144]

---

hundred and seventy five additional hours for other SBS Entity employees to assess the SBS Entity's operational, financial, and compliance capabilities and provide the senior officer with whatever sub-certifications or other documents he or she may request to obtain the necessary comfort before signing the Senior Officer Certification. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar, and that the pay of a Chief Compliance Officer likely would be similar to the amount paid to other senior officers. According to the SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Chief Compliance Officer is approximately $418/hour. For purposes of this estimate, we will assume that those a senior officer may consult with are paid at approximately the same level. 175 hours x $418 = $73,150.

143 The Commission has previously estimated that the burden associated with obtaining an internal control report from a third party would cost approximately $250,000. See supra note 107. The staff believes that an internal control report would be roughly analogous to a third party review of each SBS Entity capability included in the Senior Officer Certification; however, the staff believes the cost of a third party review of an SBS Entity's capabilities likely would be less than the cost of three separate internal control reviews because the third party review of capabilities would not require an accountant's opinion and because some economies of scale likely could be achieved when a third party reviews three capabilities for a single SBS Entity. Depending on the facts and circumstances of an SBS Entity's business, third party service providers may use different methods to assess each of an SBS Entity's capabilities and report their findings to the SBS Entity, which may affect the cost of the review and the amount a third party charges an SBS Entity for this review. Consequently, the staff estimates that the cost for an SBS Entity to obtain a third party review to provide its senior officer with the necessary comfort to sign the Senior Officer Certification would be approximately $600,000 to have a third party review the SBS Entity's operational, financial, and compliance capabilities and provide the SBS Entity with evidence sufficient to make the senior officer sufficiently comfortable to sign the Senior Officer Certification.

144 ($10,450 x 55 SBS Entities) + ($73,150 x 28 SBS Entities) + ($600,000 x 27 SBS Entities) = $574,750 + $2,048,200 + $16,200,000 = $18,822,950.

In addition to these costs, there may be additional costs and benefits relating to certification that are more difficult to quantify. For instance, the requirement to certify as to capabilities may impose costs on SBS Entities relating to the legal uncertainty and potential liability that arises from the possibility that a regulator may find that the certification was inaccurate or false. However, a potential benefit would be to focus senior officers' attention to assuring that an SBS Entity conducts its business in accordance with the certification language. In addition, the more robust the process and meaningful the review of an SBS Entity's capabilities, the more likely that review will fulfill the Commission's goals in proposing the Senior Officer Certification requirement, and the more likely the process will help the SBS Entity to strengthen its capabilities, processes and controls which could serve to decrease operational, financial, and compliance risks.

In addition, the Senior Officer Certification is designed to help assure the Commission, potential investors in, customers of, and counterparties to an SBS Entity that the SBS Entity has the requisite capabilities to act in that capacity. By providing this assurance after a senior officer has performed due inquiry, the Senior Officer Certification requirement also could prevent entities who may be more likely to fail because they do not have the requisite capabilities from registering with the Commission, which could help prevent disorderly and unstable markets. Further, the Senior Officer Certification may enhance market participants' ability to assess the counterparty credit risk associated with a particular SBS Entity counterparty. In this way, the Senior Officer Certification should help to protect market participants from SBS Entities that are not competent to engage in that business, lack the financial resources to do so, or are unable or unwilling to comply with applicable law.

3. Costs Relating to Associated Persons

The Dodd-Frank Act makes it unlawful for SBS Entities to permit any associated person subject to a statutory disqualification to effect or be involved in effecting security-based swaps on its behalf if it knew or, in the exercise of reasonable care should have known, of the statutory disqualification. Proposed Rule 15Fb6-1 would require that SBS Entities obtain a questionnaire or application for employment executed by each of its associated persons who is involved in effecting security based swaps on behalf of the SBS Entity that contains certain, specified information. The proposed rule further would provide that the questionnaire or application must be reviewed and signed by the SBS Dealer's or major security-based swap participant's Chief Compliance Officer. Finally, the CCO would need to certify that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification. SBS Entities would only need to fulfill these obligations for associated persons that effect or are involved in effecting security based swaps on behalf of the SBS Entity.[145] The Commission estimates, based on the staff's experience in dealing with entities that likely will need to register as SBS Entities, that SBS Entities each have, on average, 25 associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity. The Commission believes that the information SBS Entities would need to obtain through these questionnaires is fairly standard in the financial services industry, and is already collected by firms registered with the CFTC and the SEC. In addition, SBS Entities that are registered with the Commission or the CFTC must already perform background checks on their employees because of the prohibitions from employment of statutorily disqualified persons in the CEA and the Exchange Act.

---

[145] See supra notes 55 and 56.

The Commission estimates that the cost for each SBS Entity to review its employment questionnaire or application to verify that it contains all of the required information and to update the questionnaire, as necessary, to obtain any information not presently included on that questionnaire would be approximately $950.[146] As SBS Entities that are already registered with the Commission and the CFTC already collect this information, the Commission estimates that the cost to all SBS Entities to review employment questionnaire or application forms, verify that they contain all of the required information and update the questionnaire or application forms, as necessary, would be approximately $3,800.[147]

The Commission estimates that the cost to require an SBS Entity's existing associated persons that effect or are involved in effecting security-based swaps on behalf of the SBS Entity to provide those few categories of information that they did not originally provide on their employment questionnaires or applications would be approximately $6,500.[148] As SBS Entities that

146 Commission staff estimates, based on its experience, that the average time necessary for an SBS Entity to review its employment questionnaire or application to verify that it contains all of the required information and to update the questionnaire would be approximately three hours. The staff believes that an SBS Entity would have an Attorney perform this review and update, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of an Attorney is approximately $316/hour. 3 hours x $316 = $948.

147 $950 x 4 SBS Entities that are not registered with the Commission or CFTC = $3,800.

148 Commission staff believes that, as most firms already collect all or most of the information already, it likely would not take employees more than an hour each, on average, to provide any additional information. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar. As the categories of employees that could be required to provide additional information is diverse (see supra notes 55 and 56) the weighted-average cost of 46 of the positions included in SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of an Attorney is approximately $260/hour. 1 hour x 25 associated persons x $260 = $6,500.

are already registered with the Commission and the CFTC already collect this information from employees, the Commission estimates that the cost to all SBS Entities to obtain additional information from relevant associated persons, would be approximately $52,000.[149]

The Commission estimates that the cost to have an SBS Entity's CCO review and sign each associated person's employment record would be approximately $418.[150] The Commission estimates that the cost to all SBS Entities to have their CCOs review and sign each associated person's employment record would be approximately $574,750.[151]

On an ongoing basis, if employee turnover at an SBS Entity averages 12%, each SBS Entity would need to perform background checks and have its CCO review and sign three new associated persons' employment records per year. As stated above, the Commission estimates that the cost to have an SBS Entity's CCO review and sign each associated person's employment record would be approximately $418. Thus, the cost of each new associated person would be approximately $418, the ongoing annual cost to each SBS Entity would be approximately $1,254[152] and the total cost to all SBS Entities to comply with Rule 15Fb6-1 on an ongoing basis would be approximately $68,970.[153]

---

149 $6,500 x 4 SBS Entities that are not registered with the Commission or CFTC = $26,000.

150 Commission staff estimates, based on staff experience, that it would take a CCO approximately one hour to review and approve a relevant employee's employment record. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Chief Compliance Officer is approximately $418/hour. 1 hour x $418 = $418.

151 $418 x 25 associated persons x 55 SBS Entities = $574,750.

152 $418 x 3 associated persons = $1,254.

153 $1,254 x 55 SBS Entities = $68,970.

The Commission believes that as the CCO would already have reviewed and signed each employee's employment record, signing the certification on Schedule G will not take a significant amount of time. Thus, the Commission estimates that the cost for each SBS Entity to have its CCO certify on Schedule G that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification would be approximately $418.[154] Consequently, the total cost for all SBS Entities to have their CCO sign this certification on Schedule G would be approximately $22,990.[155]

The Commission believes that, in order to comply with the prohibition in the Dodd-Frank Act from having statutorily disqualified associated persons that effect or are involved in effecting security-based swaps, SBS Entities would need to at least obtain the information required by proposed Rule 15Fb6-1 and perform a background check. Having the CCO approve the employment applications and provide the Commission with a certification would provide the Commission with a degree of comfort that the SBS Entity is complying with the prohibition in the Act and aid it in its oversight of SBS Entities.

4. Costs to Nonresident SBS Entities

The Commission estimates, based on conversations with industry participants, that approximately 40 percent or twenty-two SBS Entities will be nonresident SBS Entities. Proposed Rule 15Fb2-4 would require that each nonresident SBS Entity must obtain an agreement with a

---

154 Commission staff conservatively estimates that it would take a CCO approximately one hour to certify that no associated person that effects or is involved in effecting security-based swaps on behalf of the SBS Entity is subject to a statutory disqualification. The staff believes the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA's publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Chief Compliance Officer is approximately $418/hour. 1 hour x $418 = $418.

155 $418 x 55 SBS Entities = $22,990.

United States person appointing that person as the firm's U.S. agent for service of process. In addition, Proposed Rule 15Fb2-4 would require that each nonresident SBS Entity obtain an opinion of counsel stating that it can provide the Commission with access to records. These entities also must file an additional schedule (Schedule F) with their Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, to identify the firm's U.S. agent for service of process and to certify that the firm can, as a matter of law, provide the Commission with access to its books and records.

The Commission estimates, based on internet research,[156] that it would cost each nonresident SBS Entity approximately $125 annually to appoint and maintain a relationship with a U.S. agent for service of process. Consequently, the total cost for all nonresident SBS Entities to appoint and maintain relationships with U.S. agents for service of process is approximately $2,750 per year.[157]

In addition, nonresident SBS Entities would incur outside legal costs associated with obtaining an opinion of counsel. In previous releases, the Commission estimated that firms with a similar requirement would incur, on average, approximately $900 in outside legal costs to obtain an opinion of counsel.[158] This estimate originally related to the cost a foreign bank issuer would incur to obtain a legal opinion to provide to the Commission when seeking an exemption from the requirement to make certain additional disclosures.[159] Although the legal opinion for foreign bank issuers also would address privacy laws in the issuer's home jurisdiction that may preclude certain

---

156 See, e.g., http://www.incnow.com/registered_agent.shtml, and http://www.ailcorp.com/registeredagent.htm. The staff sought websites that provided pricing information and a comprehensive description of their registered agent services.

157 $125 per nonresident SBS Entity x 22 nonresident SBS Entities = $2,750.

158 Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 63347 (Nov. 19, 2010); 75 FR 77306 (Dec. 10, 2010); Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act Section 13(k), Exchange Act Release No. 49616 (Apr. 26, 2004); 69 FR 24016 (Apr. 30, 2004). The $900 figure is based on an estimate of $400 an hour for legal services.

159 Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act Section 13(k), Exchange Act Release No. 49616 (Apr. 26, 2004); 69 FR 24016 (Apr. 30, 2004).

disclosures, upon further reflection, we believe that the legal opinion required for nonresident SBS Entities pursuant to the proposed rule would likely require additional research and analysis to prepare. Based on staff experience, the Commission estimates that each nonresident SBS Entity would incur, on average, approximately $25,000 in outside legal costs to obtain the necessary opinion of counsel, and that the total cost for all nonresident SBS Entities to obtain this opinion of counsel would be approximately $550,000.[160]

The Commission estimates that it would cost each nonresident SBS Entity approximately $295 to complete Schedule F.[161] Thus, the Commission estimates that the total cost for all nonresident SBS Entities approximately $6,490.[162]

While the Dodd-Frank Act does not distinguish between resident and nonresident SBS Entities, it clearly contemplates Commission oversight of registered SBS Entities. The Commission's experience with other nonresident registrants has led the staff to believe that these requirements are necessary and appropriate to allow the Commission to adequately oversee nonresident SBS Entities.

---

160 $25,000 x 22 SBS Entities = $550,000.

161 Commission staff conservatively estimates, based on staff experience, that the average time necessary for an SBS Entity to complete and file Schedule F would be approximately one hour. The staff believes that an SBS Entity would have a Compliance Manager complete and file Schedule F with its Form SBSE, Form SBSE-A, or form SBSE-BD, as appropriate, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 1 hour x $295 = $295.

162 $295 per nonresident SBS Entity x 22 nonresident SBS Entities = $6,490.

5. Costs of Retaining Manually Signed Signature Pages

Pursuant to proposed Rule 15Fb1-1, each signatory to an electronic filing would be required to, when the electronic filing is made, manually sign a signature page or other document adopting his or her signature that appears in typed form within the electronic filing. Each SBS Entity must retain these manually signed pages until at least three years after the form or certification has been replaced or is no longer effective. It is likely that each SBS Entity would need to maintain at least three pages with manually signed signatures (the execution page of Form SBSE, SBSE-A, or SBSE-BD, as applicable, Schedule G, and the Form SBSE-C certification). In addition, nonresident SBS Entities also will need to retain a manually signed copy of Schedule F. As so few pages would need to be maintained pursuant to proposed Rule 15Fb1-1, Commission staff does not believe the costs associated with retaining them would be significant. Thus, the Commission estimates that it would cost each SBS Entity approximately $49.17 annually assure that it is complying with the requirement to retain these manually signed signature pages,[163] or a total of approximately $2,704 annually for all SBS Entities.[164]

6. Costs Associated with Proposed Temporary Rule 15Fb2-2T

Proposed temporary Rule 15Fb2-2T would only be adopted if a technological means to facilitate receipt and retention of applications is not functional by the time final rules are adopted.

---

163 Commission staff conservatively estimates, based on staff experience, that the average time necessary for an SBS Entity to assure that it is complying with the requirement to retain these pages would be approximately ten minutes. The staff believes that an SBS Entity would have a Compliance Manager to assure that it is complying with the requirement to retain these pages, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 10 minutes x $295 = $49.17.

164 $49.17 per SBS Entity x 55 SBS Entities = $2,704.17.

Pursuant to proposed temporary Rule 15Fb2-2T, each SBS Entity would need to file its application and certification in paper form. Proposed temporary Rule 15Fb2-2T also would require that each SBS Entity resubmit its application and certification in electronic form once a technological means to receive such documents becomes functional.

The costs associated with completing the forms are discussed above. Thus, the additional costs associated with proposed temporary Rule 15Fb2-2T would include the postage cost to send a paper form and the personnel costs associated with later resubmitting the form electronically.

The postage costs likely would be driven by the number of pages each SBS Entity would need to send, which could vary significantly depending on the number of DRPs each firm must include with its Form. The staff conservatively estimates that each SBS Entity may incur, on average, approximately $5 to send its form to the Commission. As the certification consists of a one page Form SBSE-C, the staff estimates that it likely would cost an SBS Entity approximately $.50 to send its certification to the Commission. The Commission hopes that it will have a technological means to receive these forms functional relatively quickly; however each SBS Entity may also need to file an amendment before that occurs. As any amendment would likely include few pages because the SBS Entity only would need to provide updates to those items which become inaccurate, the staff estimates that it would cost each SBS Entity approximately $.50 to send an amendment to the Commission. Consequently, the total postage cost to each SBS Entity associated with proposed temporary Rule 15Fb2-2T would be approximately $6, and the total postage costs associated with proposed temporary Rule 15Fb2-2T would be approximately $330.

The staff estimates that the costs associated with filing each of the forms would be minimal, but would be contingent on the length of the form. The Commission preliminarily believes that it

would cost each SBS Entity approximately $1,180 to resubmit the Form SBSE.[165] As Forms SBSE-A and SBSE-BD are shorter than Form SBSE, the Commission preliminarily believes that it would cost each SBS Entity approximately $590 to resubmit the Form SBSE-A,[166] and $295 to resubmit the Form SBSE-BD.[167] Thus, the Commission estimates that the total cost to all SBS Entities to resubmit their Form SBSE, SBSE-A, or SBSE-BD, as applicable, would be approximately $33,630.[168]

C. Request for Comment

The Commission requests data to quantify and estimates of the costs and the value of the benefits of the proposed rules described above. The Commission specifically requests the following data or estimates with respect to the number of persons that act as SBS Dealers and major security-based swap participants. The Commission specifically requests comment on the following:

Q-178. Are the estimates of the number of registrants that would be required to submit each form and the estimates of the costs associated with completing the forms and amendments are reasonable? If not, why not?

---

165 Commission staff estimates, based on staff experience, that the average time necessary for an SBS Entity to file a Form SBSE would be approximately four hours. The staff believes that an SBS Entity would have a Compliance Manager file the firm's application on Form SBSE, and that the pay scales for broker-dealers and SBS Entities would likely be similar. According to the SIFMA publication titled Management & Professional Earnings in the Securities Industry 2009, as modified by Commission staff to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, the hourly cost of a Compliance Manager is approximately $295/hour. 4 hours x $295 = $1,180.

166 Commission staff estimates that filing Form SBSE-A would take approximately two hours. The staff believes that an SBS Entity would have a Compliance Manager file the form's application on Form SBSE-A, and that the pay scales for broker-dealers and SBS Entities would likely be similar. 2 hours x $295 = $590.

167 Commission staff estimates that filing Form SBSE-BD would take approximately one hour. The staff believes that an SBS Entity would have a Compliance Manager complete and file the form's application on Form SBSE-BD. 1 hour x $295 = $295.

168 ($590 x 35) + ($295 x 16) + ($1,180 x 4) = $30,090.

Q-179. Should the Commission require different and/or additional information to be provided on the proposed forms?

Q-180. Would additional benefits accrue if the Commission required different or additional information and, if so, what would these requirements entail?

Q-181. What other processes might an SBS Entity use to provide a basis for a senior officer's reasonable determination that the SBS Entity has the requisite capabilities that we may not have considered, and what would be the advantages, disadvantages, costs and benefits of those other processes?

Q-182. Are there additional costs or benefits related to registration information that the Commission should consider?

The Commission solicits comments on the costs and benefits related to the limited recordkeeping requirements of these proposed registration rules. The Commission specifically requests comment on the following:

Q-183. Should the Commission require different and/or additional information to be maintained by SBS Entities?

Q-184. Would additional benefits accrue if the Commission imposed different or additional recordkeeping requirements and, if so, what would these requirements entail?

Q-185. Are there additional costs or benefits related to recordkeeping that the Commission should consider?

We request comment on all aspects of the costs and benefits of the proposed rules and forms, particularly any effect our proposed rules may have on efficiency, competition, and capital formation. Commentators should provide analysis and empirical data to support their views on the costs and benefits associated with the proposed rule.

Q-186. What would be the competitive or anticompetitive effects of the proposed rules and forms on any market participants if the proposals are adopted as proposed?

Q-187. Would proposed Rules 15Fb1-1 through 15Fb6-1 and the proposed forms place a burden on competition?

Q-188. What may be the effect of the proposal on efficiency, competition, and capital formation?

VI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA")[169] the Commission must advise the Office of Management and Budget as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effect on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

Q-189. What may be the potential impact of these proposed registration rules and forms for SBS Entities? Please include empirical data on (a) the potential annual effect of the proposed registration rules and forms on the economy; (b) any increase in costs or prices for consumers or individual industries associated with the proposed registration rules and forms; and (c) any potential effect the proposed registration rules and forms may have on competition, investment or innovation.

[169] Pub. L. No. 104-121, Tit. II, 110 Stat. 857 (1996).

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")[170] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[171] of the Administrative Procedure Act,[172] 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."[173] 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.[174]

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;[175] or (ii) a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act,[176] 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

---

170 5 U.S.C. 601 et seq.

171 5 U.S.C. 603(a).

172 5 U.S.C. 551 et seq.

173 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 Statement of Management on Internal Control, Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982).

174 See 5 U.S.C. 605(b).

175 See 17 CFR 240.0-10(a).

176 See 17 CFR 240.17a-5(d).

business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[177] Under the standards adopted by the Small Business Administration, small entities in the finance and insurance industry include the following: (i) for entities in credit intermediation and related activities,[178] entities with $175 million or less in assets or, (ii) for non-depository credit intermediation and certain other activities,[179] $7 million or less in annual receipts; (iii) for entities in financial investments and related activities,[180] entities with $7 million or less in annual receipts; (iv) for insurance carriers and entities in related activities,[181] entities with $7 million or less in annual receipts; and (v) for funds, trusts, and other financial vehicles,[182] entities with $7 million or less in annual receipts.[183]

Based on the Commission's existing information about the security-based swap market, the Commission preliminarily believes that the market, while broad in scope, is largely dominated by

---

177 See 17 CFR 240.0-10(c).

178 Including commercial banks, savings institutions, credit unions, firms involved in other depository credit intermediation, credit card issuing, sales financing, consumer lending, real estate credit, and international trade financing. Subsector 522.

179 Including firms involved in secondary market financing, all other non-depository credit intermediation, mortgage and nonmortgage loan brokers, financial transactions processing, reserve, and clearing house activities, and other activities related to credit intermediation. Subsector 522.

180 Including firms involved in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, providing investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities. Subsector 523.

181 Including direct life insurance carriers, direct health and medical insurance carriers, direct property and casualty insurance carriers, direct title insurance carriers, other direct insurance (except life, health and medical) carriers, reinsurance carriers, insurance agencies and brokerages, claims adjusting, third party administration of insurance and pension funds, and all other insurance related activities. Subsector 524.

182 Including pension funds, health and welfare funds, other insurance funds, open-end investment funds, trusts, estates, and agency accounts, real estate investment trusts and other financial vehicles. Subsector 525.

183 See 13 CFR 121.201 (Jan. 1, 2010).

entities such as those that would be covered by the "security-based swap dealer" and "major security-based swap market participant" definitions. Subject to certain exceptions, Exchange Act Section 3(a)(71)(A) defines "security-based swap dealer" to mean any person who: (i) holds itself out as a dealer in security-based swaps; (ii) makes a market in security-based swaps; (iii) regularly enters into security-based swaps with counterparties as an ordinary course of business for its own account; or (iv) engages in any activity causing it to be commonly known in the trade as a dealer or market maker in security-based swaps.[184] Exchange Act Section 3(a)(67)(A) defines "major security-based swap participant" to be as any person: (i) who is not an SBS 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.[185]

Based on feedback from industry participants about the security-based swap markets, the Commission preliminarily believes that entities that will qualify as SBS Dealers and major security-

---

[184] See supra note 6.

[185] See supra note 7.

based swap market participants, whether registered broker-dealers or not, exceed the thresholds defining "small entities" set out above. Thus, the Commission believes it is unlikely that the proposed SBS Entity registration rules and forms would have a significant economic impact any small entity.

For the foregoing reasons, the Commission certifies that the proposed SBS Entity registration rules and forms would not have a significant economic impact on any small entity 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 the extent of the impact.

VIII. Statutory Basis and Text of Proposed Rules

The Commission is proposing Rule 15Fb1-1 through 15Fb6-1 pursuant to Sections 15F(a) through (d), 17(a), 23(a) and 30 of the Securities Exchange Act of 1934, as amended.

List of Subjects in 17 CFR Parts 240 and 249

Registration, Reporting and recordkeeping requirements, Securities, Security-based swaps, Security-based Swap Dealers, Security-based Swap Participants, Forms.

In accordance with the foregoing, the Securities and Exchange Commission is proposing to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

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

1. The general authority citation for Part 240 is revised to read as follows:

Authority: 12 U.S.C. 5221(e)(3); 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, 78o-10, 78p, 78q, 78s, 78u-5, 78w, 78x, 78dd, 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 Pub. L. 111-203, §939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

2. Add an undesignated center heading and §§ 240.15Fb1-1 through 240.15Fb6-1 to read as follows:

Registration of Security-based Swap Dealers and Major Security-based Swap Participants

Sec.

240.15Fb1-1 Signatures.

240.15Fb2-1 Registration of security-based swap dealers and major security-based swap participants.

240.15Fb2-2T Temporary filing requirement.

240.15Fb2-3 Amendments to application for registration.

240.15Fb2-4 Nonresident security-based swap dealers and major security-based swap participants.

240.15Fb2-5 Registration of successor to registered security-based swap dealer or major security-based swap participant.

240.15Fb2-6 Registration of fiduciaries.

240.15Fb3-1 Duration of registration.

240.15Fb3-2 Withdrawal from registration.

240.15Fb3-3 Cancellation or revocation from registration.

240.15Fb6-1 Reports regarding associated persons.

* * * * *

§ 240.15Fb1-1. Signatures.

(a) Required signatures to, or within, any electronic submission (including, without limitation, signatories within the forms and certifications required by §§ 240.15Fb2-1, 240.15Fb2-4

and 240.15Fb6-1) must be in typed form rather than manual format. Signatures in an HTML, XML or XBRL document that are not required may, but are not required to, be presented in a graphic or image file within the electronic filing. When used in connection with an electronic filing, the term "signature" means an electronic entry in the form of a magnetic impulse or other form of computer data compilation of any letters or series of letters of characters comprising a name, executed, adopted or authorized as a signature.

(b) Each signatory to an electronic filing (including, without limitation, each signatory to the forms and certifications required by §§ 240.15Fb2-1, 240.15Fb2-4 and 240.15Fb6-1) shall manually sign a signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing. Such document shall be executed before or at the time the electronic filing is made. Upon request, the security-based swap dealer or major security-based swap participant shall furnish to the Commission or its staff a copy of any or all documents retained pursuant to this paragraph (b).

(c) A person required to provide a signature on an electronic submission (including, without limitation, each signatory to the forms and certifications required by §§ 240.15Fb2-1, 240.15Fb2-4 and 240.15Fb6-1) may not have the form or certification signed on his or her behalf pursuant to a power of attorney or other form of confirming authority.

(d) Each manually signed signature page or other document authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing -

(1) on Schedules F and G to Form SBSE (§249.1600 of this chapter), SBSE-A (§249.1600a of this chapter), or SBSE-BD (§249.1600b of this chapter), as appropriate, shall be retained by the filer until at least three years after the form or certification has been replaced or is no longer effective

(2) on Form SBSE-C (§249.1600c of this chapter) shall be retained by the filer until at least three years after the Form was filed with the Commission.

§ 240.15Fb2-1 Registration of security-based swap dealers and major security-based swap participants.

(a) Application. An application for registration of a security-based swap dealer or a major security-based swap participant that is filed pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) shall be filed on Form SBSE (§249.1600 of this chapter) or Form SBSE-A (§249.1600a of this chapter) or Form SBSE-BD (§249.1600b of this chapter), as appropriate, in accordance with this section and the instructions to the forms.

(b) Certification.

(1) Form of certification. A knowledgeable senior officer shall certify on Form SBSE-C (§249.1600c of this chapter) that, after due inquiry, he or she has reasonably determined that the security-based swap dealer or major security-based swap participant has the operational, financial, and compliance capabilities to act as a security-based swap dealer or major security-based swap participant, as applicable, and has documented the process by which he or she reached such determination.

(2) Timing of filing of certification.

(i) Conditional registration.

(A) Prior to the last compliance date. Each security-based swap dealer or major security-based swap participant that files a completed application in accordance with paragraph (a) of this section before the last compliance date (as defined in paragraph (e) of this section) must file the certification described in paragraph (b)(1) of this section on or before such last compliance date.

(B) Major security-based swap participants. Each major security-based swap participant that files a completed application in accordance with paragraph (a) of this section after the last

compliance date must file the certification described in paragraph (b)(1) of this section within four months after it files its completed application.

(ii) Ongoing registration. Each security-based swap dealer that files a completed application in accordance with paragraph (a) of this section after the last compliance date must file the certification described in paragraph (b)(1) of this section at the time it files its application.

(c) Filing.

(1) Electronic filing. Every application for registration and certification of a security-based swap dealer or major security-based swap participant and any additional registration documents shall be filed electronically with the Commission or its designee.

(2) Effective date of filing.

(i) Application. An application of a security-based swap dealer or a major security-based swap participant submitted pursuant to paragraph (a) of this section shall be considered filed when a complete Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, and all required additional documents are submitted electronically with the Commission or its designee;

(ii) Certification. A certification of a security-based swap dealer or a major security-based swap participant submitted pursuant to paragraph (b) of this section shall be considered filed when a complete Form SBSE-C (§249.1600c of this chapter) is submitted electronically with the Commission or its designee.

(d) Commission decision.

(1) Conditional registration. The Commission may deny or grant registration to a security-based swap dealer or major security-based swap participant on a conditional basis. The Commission will grant conditional registration if it finds that the security-based swap dealer's or

major security-based swap participant's application is complete; Except that, the Commission may institute proceedings to determine whether conditional registration should be denied if the applicant is subject to a statutory disqualification (as defined in 15 U.S.C. 78c(a)(39)) or if the Commission is aware of inaccurate statements in the application. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing. At the conclusion of such proceedings, the Commission shall grant or deny such registration.

(2) Ongoing registration. The Commission may grant or deny ongoing registration based on a security-based swap dealer's or major security-based swap participant's application (filed pursuant to paragraph (a) of this section) and certification (filed pursuant to paragraph (b) of this section). A conditionally registered security-based swap dealer or major security-based swap participant need not submit a new application to apply for ongoing registration, but must amend its application, as required pursuant to §240.15Fb2-3. The Commission will grant ongoing registration if it finds that the requirements of Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) are satisfied; Except that, the Commission may institute proceedings to determine whether ongoing registration should be denied if it does not make such finding or if the applicant is subject to a statutory disqualification (as defined in 15 U.S.C. 78c(a)(39)) or the Commission is aware of inaccurate statements in the application or certification. Such proceedings shall include notice of the grounds for denial under consideration and opportunity for hearing. At the conclusion of such proceedings, the Commission shall grant or deny such registration.

(e) Definition. For purposes of this section, the term last compliance date shall mean the latest date, designated by the Commission, by which security-based swap dealers and major security-based swap participant must comply with any of the initial rules promulgated under Section 15F of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10).

§ 240.15Fb2-2T **Temporary Filing Requirement.**

(a) Paper filing. If a technological means to facilitate receipt and retention of applications required to be filed in accordance with §240.15Fb2-1 is not functional on or before [date to be determined], each applicant for registration as a security-based swap dealer or major security-based swap participant must, notwithstanding §240.15Fb2-1(c)(1), file its application on Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as applicable, any additional documents, and Form SBSE-C (§249.1600c of this chapter) in paper form by sending it to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

(b) Transitional resubmission requirement. Each applicant must resubmit its Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), and Form SBSE-BD (§249.1600b of this chapter), as applicable, any additional documents, and Form SBSE-C (§249.1600c of this chapter) to the Commission electronically within three months of the date such technological means to facilitate receipt and retention of applications becomes functional.

§ 240.15Fb2-3 Amendments to application for registration. If a security-based swap dealer or a major security-based swap participant finds that the information contained in its application for registration (as described in §240.15Fb2-1(a)), or in any amendment thereto, is or has become inaccurate for any reason, the security-based swap dealer or a major security-based swap participant shall promptly file an amendment electronically with the Commission/its designee on Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, to correct such information.

§ 240.15Fb2-4 Nonresident security-based swap dealers and major security-based swap participants.

(a) Definition. For purposes of this section, the terms nonresident security-based swap dealer and nonresident major security-based swap participant shall mean:

(1) In the case of an individual, one who resides, or has his or her principal place of business, in any place not in the United States;

(2) In the case of a corporation, one incorporated in or having its principal place of business in any place not in the United States; or

(3) In the case of a partnership or other unincorporated organization or association, one having its principal place of business outside the United States.

(b) Power of attorney.

(1) Each nonresident security-based swap dealer and nonresident major security-based swap participant registered or applying for registration pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) shall obtain a written irrevocable consent and power of attorney appointing an agent in the United States, other than the Commission or a Commission member, official or employee, upon whom may be served any process, pleadings, or other papers in any action brought against the nonresident security-based swap dealer or nonresident major

security-based swap participant to enforce the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.). This consent and power of attorney must be signed by the nonresident security-based swap dealer or nonresident major security-based swap participant and the named agent(s) for service of process.

(2) Each nonresident security-based swap dealer and nonresident major security-based swap participant registered or applying for registration pursuant to section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) shall, at the time of filing its application on Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, furnish to the Commission the name and address of its United States agent for service of process on Schedule F to the appropriate form.

(3) Any change of a nonresident security-based swap dealer's and nonresident major security-based swap participant's agent for service of process and any change of name or address of a nonresident security-based swap dealer's and nonresident major security-based swap participant's existing agent for service of process shall be communicated promptly to the Commission through amendment of the Schedule F of Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate.

(4) Each nonresident security-based swap dealer and nonresident major security-based swap participant must promptly appoint a successor agent for service of process if the nonresident security-based swap dealer and nonresident major security-based swap participant discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on behalf of the nonresident security-based swap dealer or nonresident major security-based swap participant.

(5) Each nonresident security-based swap dealer and nonresident major security-based swap participant must maintain, as part of its books and records, the agreement identified in paragraph (b)(1) of this section for at least three years after the agreement is terminated.

(c) Access to books and records.

(1) Certification and opinion of counsel. Any nonresident security-based swap dealer and nonresident major security-based swap participant applying for registration pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b) shall certify on Schedule F of Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, and provide an opinion of counsel that the nonresident security-based swap dealer and nonresident major security-based swap participant can, as a matter of law, provide the Commission with prompt access to the books and records of such nonresident security-based swap dealer and nonresident major security-based swap participant, and can, as a matter of law, submit to onsite inspection and examination by the Commission.

(2) Amendments. The nonresident security-based swap dealer and nonresident major security-based swap participant shall re-certify, on Schedule F to Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as applicable, within 90 days after any changes in the legal or regulatory framework that would impact the nonresident security-based swap dealer's or nonresident major security-based swap participant's ability to, or the manner in which it provides the Commission with prompt access to its books and records, or impacts the Commission's ability to inspect and examine the nonresident security-based swap dealer or nonresident major security-based swap participant. The re-certification shall be accompanied by a revised opinion of counsel describing how, as a matter of law, the nonresident security-based swap dealer or nonresident major security-based swap

participant will continue to meet its obligations to provide the Commission with prompt access to its books and records and to be subject to Commission inspection and examination under the new regulatory regime.

§ 240.15Fb2-5 Registration of successor to registered security-based swap dealer or a major security-based swap participant.

(a) In the event that a security-based swap dealer or major security-based swap participant succeeds to and continues the business of a security-based swap dealer or major security-based swap participant registered pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)), the registration of the predecessor shall be deemed to remain effective as the registration of the successor if the successor, within 30 days after such succession, files an application for registration in accordance with §240.15Fb2-1, and the predecessor files a notice of withdrawal from registration on Form SBSE-W (§249.1601 of this chapter).

(b) Notwithstanding paragraph (a) of this section, if a security-based swap dealer or major security-based swap participant succeeds to and continues the business of a registered predecessor security-based swap dealer or major security-based swap participant, and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor security-based swap dealer or major security-based swap participant on Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, to reflect these changes. This amendment shall be deemed an application for registration filed by the predecessor and adopted by the successor.

§ 240.15Fb2-6 Registration of fiduciaries.

The registration of a security-based swap dealer or a major security-based swap participant shall be deemed to be the registration of any executor, administrator, guardian, conservator, assignee for the benefit of creditors, receiver, trustee in insolvency or bankruptcy, or other fiduciary, appointed or qualified by order, judgment, or decree of a court of competent jurisdiction to continue the business of such registered security-based swap dealer or a major security-based swap participant; Provided, that such fiduciary files with the Commission, within 30 days after entering upon the performance of his or her duties, an amended Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, indicating the fiduciary's position with respect to management of the firm and, as an additional document, a copy of the order, judgment, decree, or other document appointing the fiduciary.

§ 240.15Fb3-1 Duration of registration.

(a) General. A person registered as a security-based swap dealer or major security-based swap participant in accordance with §240.15Fb2-1 will continue to be so registered until the effective date of any cancellation, revocation or withdrawal of such registration or any other event the Commission determines should trigger expiration.

(b) Conditional registration. Notwithstanding paragraph (a) of this section, conditional registration granted by the Commission in accordance with §240.15Fb2-1(d)(1) shall expire:

(1) During the transitional period - on the last compliance date (as that term is defined in §240.15Fb2-1(e)) for security-based swap dealers and major security-based swap participants that filed a completed application before the last compliance date, unless the security-based swap dealer or major security-based swap participant files with the Commission a certification in accordance

with §240.15Fb2-1(b)(1)(i), in which case conditional registration shall extend an additional thirty days;

(2) Major security-based swap participants – four months after the major security-based swap participant files its completed application, unless the major security-based swap participant files with the Commission a certification in accordance with §240.15Fb2-1(b)(1)(ii); in which case the conditional registration shall extend an additional thirty days.

(c) Extensions. The Commission may extend conditional registration for good cause.

§ 240.15Fb3-2 Withdrawal from registration.

(a) Notice of withdrawal from registration as a security-based swap dealer or major security-based swap participant pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) shall be filed on Form SBSE-W (§249.1601 of this chapter) in accordance with the instructions contained therein. Every notice of withdrawal from registration as a security-based swap dealer or major security-based swap participant shall be filed electronically with the Commission or its designee in accordance with applicable filing requirements. Prior to filing a notice of withdrawal from registration on Form SBSE-W, a security-based swap dealer or major security-based swap participant shall amend its Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter) or Form SBSE-BD (§249.1600b of this chapter), as appropriate, in accordance with §240.15Fb2-3(a) to update any inaccurate information.

(b) A notice of withdrawal from registration filed by a security-based swap dealer or major security-based swap participant pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) shall become effective for all matters (except as provided in this paragraph (b)) on the 60th day after the filing thereof with the Commission or its designee, within such longer period of time as to which such security-based swap dealer or major security-based swap participant

consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors, or within such shorter period of time as the Commission may determine. If a notice of withdrawal from registration is filed with the Commission at any time subsequent to the date of the issuance of a Commission order instituting proceedings to censure, place limitations on the activities, functions or operations of, or suspend or revoke the registration of, such security-based swap dealer or major security-based swap participant, or if prior to the effective date of the notice of withdrawal pursuant to this paragraph (b), the Commission institutes such a proceeding or a proceeding to impose terms or conditions upon such withdrawal, the notice of withdrawal shall not become effective pursuant to this paragraph (b) 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.

§ 240.15Fb3-3 Cancellation and revocation of registration.

(a) Cancellation. If the Commission finds that any person registered pursuant to §240.15Fb2-1 is no longer in existence or has ceased to do business as a security-based swap dealer or major security-based swap participant, the Commission shall by order cancel the registration of such person.

(b) Revocation. The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, or revoke the registration of any security-based swap dealer or major security-based swap participant that has registered with the Commission if it makes a finding as specified in Section 15F(l)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(l)(2)).

§ 240.15Fb6-1 Reports regarding associated persons.

(a) Certification. No registered security-based swap dealer or major security-based swap participant shall act as a security-based swap dealer or major security-based swap participant unless

it has certified electronically on Schedule G of Form SBSE (§249.1600 of this chapter), Form SBSE-A (§249.1600a of this chapter), or Form SBSE-BD (§249.1600b of this chapter), as appropriate, that no person associated with such security-based swap dealer or major security-based swap participant who is effecting or involved in effecting security-based swaps on behalf of the security-based swap dealer or major security-based swap participant is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(39)).

(b) To support the certification required by paragraph (a) of this section, each registered security-based swap dealer and registered major security-based swap participant shall obtain a questionnaire or application for employment executed by each of its associated persons who effects or is involved in effecting security based swaps on behalf of the security-based swap dealer or major security-based swap participant which questionnaire or application shall serve as a basis for a background check of the associated person and be reviewed and signed by the security-based swap dealer's or major security-based swap participant's Chief Compliance Officer (designated as required by Section 15F(k) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(k)) or his or her designee and shall contain at least the following information with respect to the associated person:

(1) The associated person's name, address, social security number, and the starting date of the associated person's employment or other association with the security-based swap dealer and major security-based swap participant;

(2) The associated person's date of birth;

(3) A complete, consecutive statement of all the associated person's business connections for at least the preceding ten years, including whether the employment was part-time or full-time;

(4) A record of any denial of membership or registration, and of any disciplinary action taken, or sanction imposed, upon the associated person by any federal or state agency, by any national securities exchange or national securities association, or by any foreign financial regulatory authority including any finding that the associated person either aided or abetted or was a cause of any disciplinary action or had violated any law;

(5) A record of any denial, suspension, expulsion or revocation of membership or registration of any broker, dealer, security-based swap dealer, or major security-based swap participant with which the associated person was associated in any capacity when such action was taken;

(6) A record of any permanent or temporary injunction entered against the associated person or any broker, dealer, security-based swap dealer, or major security-based swap participant with which the associated person was associated in any capacity at the time such injunction was entered;

(7) A record of any arrest or indictment for any felony, or any misdemeanor pertaining to securities (including security-based swaps), futures or commodities (including swaps), banking, insurance or real estate (including, but not limited to, acting or being associated with a broker-dealer, investment company, investment adviser, futures sponsor, bank, or savings and loan association), fraud, false statements or omissions, wrongful taking of property or bribery, forgery, counterfeiting or extortion, and the disposition of the foregoing; and

(8) A record of any other name or names by which the associated person has been known or which the associated person has used.

(c) Each registered security-based swap dealer and registered major security-based swap participant shall maintain all questionnaires and applications for employment obtained pursuant to paragraph (b) of this section as part of its books and records for at least three years after the

associated person has terminated his or her association with the registered security-based swap dealer or registered major security-based swap participant.

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

4. Add subpart Q to read as follows:

Subpart Q - Registration of Security-based Swap Dealers and Major Security-based Swap Participants

Sec.

249.1600 Form SBSE, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.

249.1600a Form SBSE-A, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant that are not also registered or registering with the Commission as a broker or dealer.

249.1600b Form SBSE-BD, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commission as a broker or dealer.

249.1600c Form SBSE-C, for certification by security-based swap dealers and major security-based swap participants.

249.1601 Form SBSE-W, for withdrawal from registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.

§ 249.1600 Form SBSE, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.

This form shall be used for application for registration as a security-based swap dealer or major security-based swap participant by firms that are not registered with the Commission as a broker or dealer and that are not registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) and to amend such an application for registration.

§ 249.1600a Form SBSE-A, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant that are not also registered or registering with the Commission as a broker or dealer.

This form shall be used instead of Form SBSE (§249.1600) to apply for registration as a security-based swap dealer or major security-based swap participant by firms that are not registered or registering with the Commission as a broker or dealer but that are registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) and to amend such an application for registration. An entity that is registered or registering with the Commission as a

broker or dealer and is also registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant shall apply for registration as a security-based swap dealer or major security-based swap participant on Form SBSE-BD (§249.1600b) and not on this Form SBSE-A.

§ 249.1600b Form SBSE-BD, for application for registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration by firms registered or registering with the Commission as a broker or dealer.

This form shall be used instead of either Form SBSE (§249.1600) or SBSE-A (§249.1600a) to apply for registration as a security-based swap dealer or major security-based swap participant solely by firms registered or registering with the Commission as a broker or dealer, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)) and to amend such an application for registration. An entity that is registered or registering with the Commission as a broker or dealer and is also registered or registering with the Commodity Futures Trading Commission as a swap dealer or major swap participant, the entity shall apply for registration as a security-based swap dealer or major security-based swap participant on this Form SBSE-BD and not on Form SBSE-A.

§ 249.1600c Form SBSE-C, for certification by security-based swap dealers and major security-based swap participants.

This form shall be used to file the certification required pursuant to §240.15Fb2-1(b) of this chapter.

§ 249.1601 Form SBSE-W, for withdrawal from registration as a security-based swap dealer or major security-based swap participant or to amend such an application for registration.

This form shall be used to withdraw from registration as a security-based swap dealer or major security-based swap participant, pursuant to Section 15F(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78o-10(b)).

Note: The following Forms will not appear in the Code of Federal Regulations.

By the Commission

Elizabeth M. Murphy

Secretary

Dated: October 12, 2011

Form SBSE

OMB Approval
OMB Number: .....3235-___
Expires:...... ..Month __, 2014
Estimated average burden hours
per response: . . . . ____.
per amendment: . . . . . ____.

Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants

FORM SBSE INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. **FORM** - Form SBSE is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, "SBS Entities"). SBS Entities that are not registered with the Commission as broker-dealers nor registered or registering with the Commodity Futures Trading Commission ("CFTC") as a swap dealer or major swap participant must file this form to register with the Securities and Exchange Commission. An applicant must also file Schedules A, B, D, E, F, and G as appropriate. There is no Schedule C.
2. **ELECTRONIC FILING –** The applicant must file Form SBSE through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232. 11) to file and amend Form SBSE electronically to assure the timely acceptance and processing of those filings.[186]
3. **UPDATING** - By law, the *applicant* must promptly update Form SBSE information by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason [17 CFR 240.15Fb2-2]. In addition, the *applicant* must update any incomplete or inaccurate information contained on Form SBSE prior to filing a notice of withdrawal from registration on Form SBSE-W [17 CFR 15Fb3-2(a)].
4. **CONTACT EMPLOYEE** - The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant's* organization.
5. **FEDERAL INFORMATION LAW AND REQUIREMENTS** - An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§78o-10, 78q and 78w. Filing of this form is mandatory; however, the social security number information, which aids in identifying the applicant, is voluntary. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirements to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form, 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 information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

B. FILING INSTRUCTIONS

1. **FORMAT**
   a. Sections 1-14 must be answered and all fields requiring a response must be completed before the filing will be accepted.
   b. *Applicant* must complete the execution screen certifying that Form SBSE and amendments thereto have been executed properly and that the information contained therein is accurate and complete.
   c. To amend information, the *applicant* must update the appropriate Form SBSE screens.
   d. A paper copy, with original signatures, of the initial Form SBSE filing and amendments to Disclosure Reporting Pages (DRPs) must be retained by the *applicant* and be made available for inspection upon a regulatory request.
2. **DISCLOSURE REPORTING PAGE (DRP) –** Information concerning the *applicant* or *control affiliate* that relates to the occurrence of an event reportable under Item 12 must be provided on the *applicant's* appropriate DRP.
3. **DIRECT AND INDIRECT OWNERS** - Amend the Direct Owners and Executive Officers screen and the Indirect Owners screen when changes in ownership occur.

The mailing address for questions and correspondence is:

186 As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

EXPLANATION OF TERMS
(The following terms are italicized throughout this form.)

1. GENERAL

APPLICANT - The security-based swap dealer or major security-based swap participant applying on or amending this form.

CONTROL - The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any *person* that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% 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 (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to *control* that company.

STATE – Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, any other territory of the United States, or any subdivision or regulatory body thereof.

PERSON - An individual, partnership, corporation, trust, or other organization.

SELF-REGULATORY ORGANIZATION (SRO) - Any national securities or futures exchange, registered securities or futures association, registered clearing agency, or derivatives clearing organization.

SUCCESSOR – The term "successor" is defined to be an unregistered entity that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a predecessor security-based swap dealer or major security-based swap participant that ceases its security-based swap activities. [See Exchange Act Rule 15Fb2-5 (17 CFR 240.15Fb2-5]

2. FOR THE PURPOSE OF ITEM 12 AND THE CORRESPONDING DISCLOSURE REPORTING PAGES (DRPs)

CHARGED - Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge).

CONTROL AFFILIATE – A person named in Items 10 or 11 as a control person or any other individual or organization that directly or indirectly controls, is under common control with, or is controlled by, the *applicant*, including any current employee of the applicant except one performing only clerical, administrative, support or similar functions, or who, regardless of title, performs no executive duties or has no senior policy making authority.

ENJOINED – Includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining order.

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.

FOUND – 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.

INVESTMENT OR INVESTMENT-RELATED – Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).

INVOLVED – Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

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 or CFTC. 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).

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.

ORDER – A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an *order*.

PROCEEDING – Includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or a *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal charge); or a *misdemeanor* criminal information (or equivalent formal charge). 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).

FORM SBSE Page 1 (Execution Page)	**Uniform Application for Security-based Swap Dealer and Major Security-based Swap Participant Registration** Date:________ , SEC Filer No: ________	**Official Use**	Official Use Only

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

[ ] APPLICATION **[ ] AMENDMENT**

1. Exact name, principal business address, mailing address, if different, and telephone number of the *applicant:*

A. Full name of the *applicant*:

B. Tax Identification No.: Applicant's CIK # (if any):

C. (1) The *business name* under which the *applicant* primarily conducts business, if different from 1A.

(2) List on Schedule D, Page 1, Section I any other name by which the *applicant* conducts business and where it is used.

D. If this filing makes a name change on behalf of an *applicant*, enter the new name and specify whether the change is to the [ ] *applicant's name* (1A) or [ ] business name (1C): *above.*

Please check

E. *Applicant's* Main Address: (Do not use a P.O. Box)

Number and Street 1: Number and Street 2:

City: State: Country: Zip/Postal Code:

Other business locations must be reported on Schedule E. Security-based swap dealers and major security-based swap participants that do not reside in the United States of America shall designate a U.S. agent for service of process on Schedule F.

F. Mailing Address, if different:

Number and Street 1: Number and Street 2:

City: State: Country: Zip/Postal Code:

G. Business Telephone Number:

H Website/URL:

I. Contact Employee:

Name: Title:

Telephone Number: Email Address:

J. Chief Compliance Officer designated by the *applicant* in accordance with Exchange Act Section 15F(k):

Name: Title:

Telephone Number: Email Address:

EXECUTION:

The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity , may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.

The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.

Date (MM/DD/YYYY) Name of Applicant

By: Signature Name and Title of Person Signing on *Applicant's* behalf

This page must always be completed in full.

DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY

FORM SBSE Page 2	*Applicant* Name: ____________ Date:________ SEC Filer No: ________	**Official Use**	Official Use Only

2\. A. The applicant is registering as a security-based swap dealer: [ ] Yes [ ] No

B. The applicant is registering as a major security-based swap participant: [ ] Yes [ ] No
Because it: (check all that apply)
[ ] maintains a substantial security-based swap position
[ ] has substantial counterparty exposure [ ] is highly leveraged relative to its capital position

3\. Does the applicant intend to compute capital or margin, or price customer or proprietary positions, using mathematical models? [ ] Yes [ ] No

4\. Is the *applicant* subject to regulation by a prudential regulator, as defined in Section 1a(39) of the Commodity Exchange Act. [ ] Yes [ ] No
If "*yes*," identify the prudential regulator: ____________.

5\. Briefly describe the *applicant's* business: ____________

6\. A. Indicate legal status of the *applicant*:
[ ] Corporation [ ] Limited Liability Company [ ] Other (specify)
[ ] Partnership

B. Month *applicant's* fiscal year ends:

C. Indicate date and place *applicant* obtained its legal status (i.e., state or country where incorporated, where partnership agreement was filed, or where *applicant* entity was formed):

State of formation: Country of formation: Date of formation: MM/DD/YYYY

Schedule A and, if applicable, Schedule B must be completed as part of all initial applications.

Item		Question	YES	NO
7.		Is the *applicant* at the time of this filing *succeeding* to the business of a currently registered SBS Entity? *If "Yes," complete appropriate items on Schedule D, Page 1, Section III.*	[ ]	[ ]
8.		Does the *applicant* hold or maintain any funds or securities to collateralize counterparty transactions?	[ ]	[ ]
9.		Does the *applicant* have any arrangement:		
	A.	With any other *person*, firm, or organization under which any books or records of the *applicant* are kept, maintained, or audited by such other *person*, firm or organization?	[ ]	[ ]
	B.	Under which any other person, firm or organization executes, trades, custodies, clears or settles on behalf of the applicant (including any *SRO* or swap execution facility in which the applicant is a member)?	[ ]	[ ]
		If "Yes" to any part of Item 9, complete appropriate items on Schedule D, Page 1, Section IV.		
10.		Does any *person* directly or indirectly:		
	A.	*Control* the management or policies of the *applicant* through agreement or otherwise?	[ ]	[ ]
	B.	Wholly or partially finance the business of the *applicant*?	[ ]	[ ]
		Do not answer "Yes" to 9B if the person finances the business of the applicant through: 1) a public offering of securities made pursuant to the Securities Act of 1933; or 2) credit extended in the ordinary course of business by suppliers, banks, and others.		
		If "Yes" to any part of Item 10, complete appropriate items on Schedule D, Page 1, Section IV.		
11.	A.	Directly or indirectly, does the *applicant control*, is the *applicant controlled* by, or is the *applicant* under common *control* with, any partnership, corporation, or other organization that is engaged in the securities or investment advisory business?	[ ]	[ ]
		If "Yes" to item 11A, complete appropriate items on Schedule D, Page 2, Section V.		
	B.	Directly or indirectly, is applicant controlled by any bank holding company or does applicant control, is applicant controlled by, or is applicant under common control with any bank (as defined in 15 U.S.C. 78c(a)(6)) or any foreign bank?	[ ]	[ ]
		If "Yes" to item 11B, complete appropriate items on Schedule D, Page 3, Section VI.		

FORM SBSE Page 3	*Applicant* Name: ____________ Date: ________ SEC Filer No: ________	Official Use	Official Use Only

12. Use the appropriate DRP for providing details to "yes" answers to the questions in Item 12. Refer to the Explanation of Terms section of Form SBSE Instructions for explanations of italicized terms.

CRIMINAL DISCLOSURE

A. In the past ten years has the *applicant* or a *control affiliate*:

	YES	NO
(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 a *felony*	[ ]	[ ]

B. In the past ten years has the *applicant* or a *control affiliate*:

	YES	NO
(1) Been convicted of or pled guilty or 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* specified in 12B(1)?	[ ]	[ ]

REGULATORY ACTION DISCLOSURE

C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:

	YES	NO
(1) *Found* the *applicant* or a *control affiliate* to have made a false statement or omission?	[ ]	[ ]
(2) *Found* the *applicant* or a *control affiliate* to have been involved in a violation of its regulations or statutes?	[ ]	[ ]
(3) *Found* the *applicant* or a *control affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, revoked, or restricted?	[ ]	[ ]
(4) Entered an *order* against the *applicant* or a *control affiliate* in connection with *investment-related* activity?	[ ]	[ ]
(5) Imposed a civil money penalty on the *applicant* or a *control affiliate*, or ordered the *applicant* or a *control affiliate* to cease and desist from any activity?	[ ]	[ ]

D. Has any other federal regulatory agency, state regulatory agency, or *foreign financial regulatory authority*:

	YES	NO
(1) Ever found the *applicant* or a *control affiliate* to have made a false statement or omission or been dishonest, unfair, or unethical?	[ ]	[ ]
(2) Ever found the *applicant* or a *control affiliate* to have been involved in a violation of *investment-related* regulations or statutes?	[ ]	[ ]
(3) Ever found the *applicant* or a *control 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 the *applicant* or a *control affiliate* in connection with an *investment-related* activity?	[ ]	[ ]
(5) Ever denied, suspended, or revoked the *applicant's* or a *control affiliate's* registration or license or otherwise, by order, prevented it from associating with an *investment-related* business or restricted its activities?	[ ]	[ ]

E. Has any *self-regulatory organization*:

	YES	NO
(1) *found* the *applicant* or a *control affiliate* to have made a false statement or omission?	[ ]	[ ]
(2) *found* the *applicant* or a *control 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 U.S. Securities and exchange Commission)?	[ ]	[ ]
(3) *found* the *applicant* or a *control affiliate* to have been the cause of an *investment-related* business having its authorization to do business denied, suspended, revoked or restricted?	[ ]	[ ]
(4) Disciplined the *applicant* or a *control affiliate* by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?	[ ]	[ ]

	YES	NO
F. Has the *applicant's* or a *control affiliate's* authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?	[ ]	[ ]
G. Is the *applicant* or a *control affiliate* now the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of 12C, D, or E?	[ ]	[ ]

Applicant Name: ______________________

Date: __________ SEC Filer No: __________

Official Use	Official Use Only

CIVIL JUDICIAL DISCLOSURE

		YES	NO
H.	(1) Has any domestic or foreign civil judicial court:		
	(a) In the past ten years, enjoined the *applicant* or a *control affiliate* in connection with any investment-related activity?	[ ]	[ ]
	(b) Ever *found* that the *applicant* or a *control affiliate* was involved in a violation of *investment-related* statutes or regulations?	[ ]	[ ]
	(c) Ever dismissed, pursuant to a settlement agreement, an *investment-related* civil judicial action brought against the *applicant* or *control affiliate* by a state or *foreign financial regulatory authority*?	[ ]	[ ]
	(2) Is the *applicant* or a *control affiliate* now the subject of any civil judicial *proceeding* that could result in a "yes" answer to any part of 12H(1)?	[ ]	[ ]

FINANCIAL DISCLOSURE

		YES	NO
I.	In the past ten years has the *applicant* or a *control affiliate* ever been a securities firm or a futures firm, or a control affiliate of a securities firm or a futures firm that:		
	(1) Has been the subject of a bankruptcy petition?	[ ]	[ ]
	(2) Has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?	[ ]	[ ]

		YES	NO
13.	Is the *applicant* registered with the Commission as an investment adviser or municipal securities advisor or with the CFTC as a commodity trading adviser? If "yes," provide all unique identification numbers assigned to the firm relating to this business on Schedule D, Page 1, Section II.	[ ]	[ ]
14. A.	Does *applicant* effect transactions in commodity futures, commodities or commodity options as a broker for others or as a dealer for its own account? If "yes," provide all unique identification numbers assigned to the firm relating to this business on Schedule D, Page 1, Section II.	[ ]	[ ]
B.	Does *applicant* engage in any other investment-related, non-securities business? If "yes," provide all unique identification numbers assigned to the firm relating to this business and describe each other business briefly on Schedule D, Page 1, Section II.	[ ]	[ ]

Schedule A of FORM SBSE **DIRECT OWNERS AND EXECUTIVE OFFICERS** (Answer for Form SBSE Item 3)	*Applicant* Name: ____________________ Date:________ SEC Filer No: ________	**Official Use**

1. Use Schedule A to provide information on the **direct** owners and executive officers of the applicant. Use Schedule B to provide information on **indirect** owners. **Complete each column.**

2. List below the names of:

   (a) Each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, Director, and individuals with similar status or function;

   (b) In the case of an *applicant* that is a corporation, each shareholder that directly owns 5% or more of a class of a voting security of the *applicant*, unless the *applicant* is a public reporting company (a company subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934).

   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 a voting security of the *applicant*. 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) In the case of an *applicant* that is a partnership, all general partners, and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the partnership's capital; and

   (d) In the case of a trust that directly owns 5% or more of a class of a voting security of the *applicant*, or that has the right to receive upon dissolution, or has contributed, 5% or more of the *applicant*'s capital, the trust and each trustee.

   (e) In the case of an *applicant* that is a Limited Liability Company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

3. Are there any indirect owners of the applicant required to be reported on Schedule B? [ ] Yes [ ] No

4. In the "DE/FE/I" column, enter "DE" if the owner is a domestic entity, or enter "FE" if owner is an entity incorporated or domiciled in a foreign country, or enter "I" if the owner is an individual.

5. Complete the "Title or Status" column by entering board/management titles; status as partner, trustee, sole proprietor, or shareholder; and for shareholders, 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 *person* has *control* as defined in the instructions to this form, and enter "No" if the *person* does not have *control*. Note that under this definition most executive officers and all 25% owners, general partners, and trustees would be "*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 Securities Exchange Act of 1934.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Title or Status	Date Title or Status Acquired		Ownership Code	Control Person		CRD and/or IARD No. If None, IRS Tax No.	Official Use Only
			MM	YYYY			PR		
	For individuals not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
	For individuals not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
	For individuals not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service)								
	For individuals not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								

Schedule B of FORM SBSE **INDIRECT OWNERS** (Answer for Form SBSE Item 3)	*Applicant* Name: ____________ Date:________ SEC Filer No: ________	**Official Use**

1. Use Schedule B to provide information on the **indirect** owners of the *applicant*. Use Schedule A to provide information on **direct** owners. **Complete each column.**

2. With respect to each owner listed on Schedule A, (except individual owners), list below:

   (a) In the case of an owner that is a corporation, each of its shareholders that beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 25% or more of a class of a voting security of that corporation. For purposes of this Schedule, a *person* beneficially owns any securities (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence, or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant or right to purchase the security.

   (b) In the case of an owner that is a partnership, **all** general partners, and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital; and

   (c) In the case of an owner that is a trust, the trust and each trustee.

   (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 company (a company subject to Sections 12 or 15(d) of the Securities Exchange Act of 1934) is reached, no ownership information further up the chain of ownership need be given.

4. In the "DE/FE/I" column, enter "DE" if the owner is a domestic entity, or enter "FE" if owner is an entity incorporated or domiciled in a foreign country, or enter "I" if the owner is an individual.

5. Complete the "Status" column by status as partner, trustee, shareholder, etc., and if shareholder, 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 Partners

7. (a) In the "Control Person" column, enter "Yes" if *person* has *control* as defined in the instructions to this form, and enter "No" if the *person* does not have *control*. Note that under this definition most executive officers and all 25% owners, general partners, and trustees would be "*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 Securities Exchange Act of 1934.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired		Ownership Code	Control Person		CRD and/or IARD No. If None, IRS Tax No.	Official Use Only
				MM	YYYY			PR		

Schedule D of FORM SBSE
Page 1

Applicant Name: ____________________

Date: __________ SEC Filer No: __________

Official Use

Official Use Only

Use Schedule D Page 1 to report details for items listed below.
This is an [ ] INITIAL [ ] AMENDED detail filing for the Form SBSE items checked below:

Section I *Other Business Names*

(Check if applicable) [ ] Item 1C(2)
List each of the "other" names and the *state(s) or country(ies)* in which they are used.

1. Name	State/Country	2. Name	State/Country
3. Name	State/Country	4. Name	State/Country

Section II *Other Business*

(Check if applicable) [ ] Item 13 [ ] Item 14A [ ] Item 14B
Applicant must complete a separate Schedule D Page 1 for each affirmative response in this section.

Unique Identification Number(s):	*Assigning Regulator(s)/Entity(s):*

Briefly describe any other investment-related, non-securities business. Use reverse side of this sheet for additional comments if necessary.

Section III *Successions*

(Check if applicable) [ ] Item 7

Date of Succession MM DD YYYY / /	*Name of Predecessor*
IRS Employer Number (if any)	SEC File Number (if any)

Briefly describe details of the succession including any assets or liabilities not assumed by the successor. Use reverse side of this sheet for additional comments if necessary.

Section IV *Record Maintenance Arrangements / Business Arrangements / Control Persons / Financings*

(Check one) [ ] Item 9A [ ] Item 9B [ ] Item 10A [ ] Item 10B
Applicant must complete a separate Schedule D Page 1 for each affirmative response in this section including any multiple responses to any item. Complete the "Effective Date" box with the Month, Day and Year that the arrangement or agreement became effective. When reporting a change or termination of an arrangement, enter the effective date of the change.

Firm or Organization Name	SEC File, CRD, NFA, IARD, and/or CIK Number (if any)	
Business Address *(Street, City, State/Country, Zip + 4 Postal Code)*	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Individual Name	CRD, NFA, and/or IARD Number (if any)	
Business Address (if applicable) *(Street, City, State/Country, Zip + 4 Postal Code)*	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /

Briefly describe the nature of the arrangement with respect to books or records (ITEM 9A); the nature of the execution, trading, custody, clearing or settlement arrangement (ITEM 9B);the nature of the control or agreement (ITEM 10A); or the method and amount of financing (ITEM 10B). Use reverse side of this sheet for additional comments if necessary.

For ITEM 10A ONLY - If the control person is an individual not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service).

Schedule D of FORM SBSE Page 2	*Applicant* Name: ____ Date:____ SEC Filer No: ____	**Official Use**	Official Use Only

Use this Schedule D Page 2 to report details for Item 11A. Supply details for all partnerships, corporations, organizations, institutions and individuals necessary to answer each item completely. Use additional copies of Schedule D Page 2 if necessary.

Use the "Effective Date" box to enter the Month, Day, and Year that the affiliation was effective or the date of the most recent change in the affiliation.

This is an [ ] INITIAL [ ] AMENDED detail filing for Form SBSE Item 11A

[ ] 11A. Directly or indirectly, does *applicant control*, is *applicant controlled* by, or is *applicant* under common *control* with, any partnership, corporation, or other organization that is engaged in the securities or investment advisory business?

Section V *Complete this section for control issues relating to ITEM 11A only.*

The details supplied relate to:

1. Partnership, Corporation, or Organization Name | CRD Number (if any)

(check only one)
This Partnership, Corporation, or Organization [ ] *controls applicant* [ ] is *controlled* by *applicant* [ ] is under common *control* with *applicant*

Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /

Is Partnership, Corporation or Organization a foreign entity* [ ] Yes [ ] No	If Yes, provide country of domicile or incorporation*	Check "Yes" or "No" for activities of this partnership Corporation, or organization: ▶ Securities [ ] Yes [ ] No Activities:	Investment Advisory [ ] Yes [ ] No Activities:

Briefly describe the *control* relationship. Use reverse side of this sheet for additional comments if necessary.

2. Partnership, Corporation, or Organization Name | CRD Number (if any)

(check only one)
This Partnership, Corporation, or Organization [ ] *controls applicant* [ ] is *controlled* by *applicant* [ ] is under common *control* with *applicant*

Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /

Is Partnership, Corporation or Organization a foreign entity* [ ] Yes [ ] No	If Yes, provide country of domicile or incorporation*	Check "Yes" or "No" for activities of this partnership Corporation, or organization: ▶ Securities [ ] Yes [ ] No Activities:	Investment Advisory [ ] Yes [ ] No Activities:

Briefly describe the *control* relationship. Use reverse side of this sheet for additional comments if necessary.

3. Partnership, Corporation, or Organization Name | CRD Number (if any)

(check only one)
This Partnership, Corporation, or Organization [ ] *controls applicant* [ ] is *controlled* by *applicant* [ ] is under common *control* with *applicant*

Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /

Is Partnership, Corporation or Organization a foreign entity* [ ] Yes [ ] No	If Yes, provide country of domicile or incorporation*	Check "Yes" or "No" for activities of this partnership Corporation, or organization: ▶ Securities [ ] Yes [ ] No Activities:	Investment Advisory [ ] Yes [ ] No Activities:

Briefly describe the control relationship. Use reverse side of this sheet for additional comments if necessary.

If applicant has more than 3 organizations to report, complete additional schedule D Page 2s.

Schedule D of FORM SBSE Page 3	Applicant Name: ______________ Date:________ SEC Filer No: ________	**Official Use**	Official Use Only

Use Schedule D Page 3 to report details for Item 11B. Report only new information or changes/updates to previously submitted details. Do not report previously submitted information. Supply details for all partnerships, corporations, organizations, institutions and individuals necessary to answer each item completely. Use additional copies of Schedule D Page 3 if necessary.

Use the "Effective Date" box to enter the Month, Day, and Year that the affiliation was effective or the date of the most recent change in the affiliation.

This is an [ ] INITIAL [ ] AMENDED detail filing for Form SBSE Item 11B

[ ] 11B. Directly or indirectly, is applicant controlled by any bank holding company or does applicant control, is applicant controlled by, or is applicant under common control with any bank (as defined in 15 U.S.C. 78c(a)(6)) or any foreign bank?

Section VI *Complete this section for control issues relating to ITEM 10B only.*

Provide the details for each organization or institution that *controls* the *applicant*, including each organization or institution in the *applicant's* chain of ownership. The details supplied relate to:

1. Financial Institution Name	CRD Number (if applicable)
Institution Type (*e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.*)	Effective Date MM DD YYYY / / Termination Date MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code	If foreign, country of domicile or incorporation
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.	

2. Financial Institution Name	CRD Number (if applicable)
Institution Type (*e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.*)	Effective Date MM DD YYYY / / Termination Date MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code	If foreign, country of domicile or incorporation
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.	

3. Financial Institution Name	CRD Number (if applicable)
Institution Type (*e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.*)	Effective Date MM DD YYYY / / Termination Date MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code	If foreign, country of domicile or incorporation
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.	

4. Financial Institution Name	CRD Number (if applicable)
Institution Type (*e.g., bank holding company, national bank, state member bank of the Federal Reserve System, state non-member bank, savings bank or association, credit union, foreign bank.*)	Effective Date MM DD YYYY / / Termination Date MM DD YYYY / /
Business Address (Street, City, State/Country, Zip + 4/Postal Code	If foreign, country of domicile or incorporation
Briefly describe the control relationship. Use reverse side of this sheet for additional comments, if necessary.	

If applicant has more than 4 organizations/institutions to report, complete additional Schedule D page 3s.

Schedule E of FORM SBSE Page 1	*Applicant* Name: ____________ Date:________ SEC Filer No: ________	Official Use

INSTRUCTIONS

General: Use this schedule to identify other business locations of the *applicant*. Repeat Items 1-6 for each other business location. Each item must be completed unless otherwise noted. Use additional copies of this schedule as necessary.

Specific:

Item 1. Specify only one box. Check "Add" when the applicant is filing the initial notice to inform the Commission that it has opened another business location, "Delete" when the applicant closes another business location, and "Amendment" to indicate any other change to previously filed information.

Item 2. Complete this item for all entries. Provide the date that the other business location was opened (ADD), closed (DELETE), or the effective date of the change (AMENDMENT).

Item 3. Complete this item for all entries. A physical location must be included; post office box designations alone are not sufficient.

Item 4. Complete this item only when the *applicant* changes the address of an existing other business location.

Item 5. If the other business location occupies or shares space on premises within a bank, or other financial institution, enter the name of the institution in the space provided.

Item 6. Complete this item for all entries. Enter the name of the associated person who is responsible for the operations of, and is physically at, this location.

1. Check only one box: [ ] Add [ ] Delete [ ] Amendment
2. Effective Date: ____________
3. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
4. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
5. Institution Name: ____________
6. Responsible Associated Person: ____________

1. Check only one box: [ ] Add [ ] Delete [ ] Amendment
2. Effective Date: ____________
3. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
4. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
5. Institution Name: ____________
6. Responsible Associated Person: ____________

1. Check only one box: [ ] Add [ ] Delete [ ] Amendment
2. Effective Date: ____________
3. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
4. Street: ____________
   P.O. Box (if applicable), Suite, Floor: ____________
   City, State/Country, Zip Code +4/Postal Code: ____________
5. Institution Name: ____________
6. Responsible Associated Person: ____________

Schedule F of FORM SBSE **NONRESIDENT SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS**	*Applicant* Name: __________ Date:______ SEC Filer No: ______	**Official Use**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Schedule F to identify its United States agent for service of process and the certify that it can

(1) provide the Commission with prompt access to its books and records, and
(2) submit to onsite inspection and examination by the Commission.

1. Service of Process:

A. Name of United States person *applicant* designates and appoints as agent for service of process

B. Address of United States person *applicant* designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

(a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and

(b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:

Applicant can as a matter of law;

(1) provide the Commission with prompt access to its books and records, and
(2) submit to onsite inspection and examination by the Commission.

Applicant must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4.

Signature: __________

Name and Title: __________

Date: __________

Schedule G of FORM SBSE CERTIFICATION ON STATUTORY DISQUALIFICATION	*Applicant* Name: ____________ Date:________ SEC Filer No: ________	Official Use

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)].

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.
For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a: [ ] CERTIFICATION [ ] RE-CERTIFICATION

The *applicant* certifies that it has

(a) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and

(b) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

CRIMINAL DISCLOSURE REPORTING PAGE (SBSE)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Items 12A and 12B*** of Form SBSE;

Check [√] item(s) being responded to:

12A. In the past ten years has the applicant or a control 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 a felony?

12B. In the past ten years has the applicant or a control 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 specified in 12B(1)?

Use a separate DRP for each event or *proceeding*. An 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 above items.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

Applicants must attach a copy of each applicable court document (*i.e.*, criminal complaint, information or indictment as well as judgment of conviction or sentencing documents) if not previously submitted through CRD (as they could be in the case of a *control affiliate* registered through CRD). Documents will not be accepted as disclosure in lieu of answering the questions on this DRP.

PART I

A. The *person(s)* or entity(ies) for whom this DRP (SBSE) is being filed is (are):

[ ] The *Applicant*

[ ] *Applicant* and one or more *control affiliate(s)*

[ ] One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

SBSE DRP – CONTROL AFFILIATE

CRD NUMBER

This *Control Affiliate* is [ ] Firm [ ] Individual

Registered: [ ] Yes [ ] No

NAME (For individuals, Last, First, Middle)

[ ] This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

CRIMINAL DISCLOSURE REPORTING PAGE (SBSE)

(continuation)

PART II

1. If charge(s) were brought against an organization over which the applicant or control affiliate exercise(d) control: Enter organization name, whether or not the organization was an investment-related business and the applicant's or control 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 <u>and</u> 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: <u>1.</u> number of counts, <u>2.</u> *felony* or *misdemeanor*, <u>3.</u> plea for each charge, and <u>4.</u> product type if charge is *investment-related*):

   ____
   ____
   ____

   C. Current status of the Event? [ ] Pending [ ] On Appeal [ ] Final

   D. 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, <u>A.</u> Disposition Type [e.g., convicted, acquitted, dismissed, pretrial.], <u>B.</u> Date, <u>C.</u> Sentence/Penalty, <u>D.</u> Duration [if sentence-suspension, probation, etc.], <u>E.</u> Start Date of Penalty, <u>F.</u> Penalty/Fine Amount and <u>G.</u> Date Paid.

   ____
   ____
   ____
   ____
   ____
   ____

5. Provide a brief summary of the circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the char(s) occurred. (The information must fit within the space provided.)

   ____
   ____
   ____
   ____
   ____
   ____
   ____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Items 12C, 12D, 12E, 12F, or 12G*** of Form SBSE;

Check [√] item(s) being responded to:

12C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:
- [ ] (1) Found the applicant or a control affiliate to have made a false statement or omission?
- [ ] (2) Found the applicant or a control affiliate to have been involved in a violation of its regulations or statutes?
- [ ] (3) the applicant or a control affiliate to have been a cause of an investment-related business having its authorization to do business denied, revoked, or restricted?
- [ ] (4) Entered an order against the applicant or a control affiliate in connection with investment-related activity?
- [ ] (5) Imposed a civil money penalty on the applicant or a control affiliate, or ordered the applicant or a control affiliate to cease and desist from any activity?

12D. Has any other federal regulatory agency, state regulatory agency, or foreign financial regulatory authority:
- [ ] (1) Ever found the applicant or a control affiliate to have made a false statement or omission or been dishonest, unfair, or unethical?
- [ ] (2) Ever found the applicant or a control affiliate to have been involved in a violation of investment-related regulations or statutes?
- [ ] (3) Ever found the applicant or a control 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 the applicant or a control affiliate in connection with an investment-related activity?
- [ ] (5) Ever denied, suspended, or revoked the applicant's or a control affiliate's registration or license or otherwise, by order, prevented it from associating with an investment-related business or restricted its activities?

12E. Has any self-regulatory organization or commodities exchange ever:
- [ ] (1) found the applicant or a control affiliate to have made a false statement or omission?
- [ ] (2) found the applicant or a control 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 U.S. Securities and exchange Commission)?
- [ ] (3) found the applicant or a control affiliate to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
- [ ] (4) Disciplined the applicant or a control affiliate by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?

12F. [ ] Has the applicant's or a control affiliate's authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?

12G. [ ] Is the applicant or a control affiliate now the subject of any regulatory proceeding that could result in a "yes" answer to any part of 11C, D, or E?

Use a separate DRP for each event or *proceeding*. An 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 12C, 12D, 12E, 12F or 12G. 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.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):

[ ] The *Applicant*

[ ] Applicant and one or more *control affiliate(s)*

[ ] One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

SBSE DRP – CONTROL AFFILIATE

CRD NUMBER

This *Control Affiliate* is [ ] Firm [ ] Individual

Registered: [ ] Yes [ ] No

NAME (For individuals, Last, First, Middle)

[ ] This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE)

(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. Control 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
   [ ] Banking Products (other than CD(s))
   [ ] 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 Type:

7. Describe the allegations related to this regulatory action. (The information 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:

   ____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE)

(continuation)

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)
[ ] Decision & Order of Offer of Settlement
[ ] Decision
[ ] Consent
[ ] Dismissed
[ ] Order
[ ] Settled
[ ] Stipulation and Consent
[ ] Vacated

11. Resolution Date (MM/DD/YYYY) ____________ [ ] Exact [ ] Explanation

If not exact, provide explanation:

12. A. Were any of the following Sanctions Ordered? (Check all appropriate items):

[ ] Monetary/Fine Amount $________
[ ] Revocation/Expulsion/Denial
[ ] Censure
[ ] Cease and Desist/Injunction
[ ] Disgorgement/Restitution
[ ] Bar
[ ] Suspension

B. Other Sanctions Ordered:

C. Sanction Detail: If suspended, enjoined or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification, by exam/retraining was a condition of the sanction, provide length of time given to re-qualify/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 applicant or control affiliate, date paid and if any portion of penalty was waived.

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates. (The information must fit within the space provided.)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (BD)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Items 12H*** of Form BD;

Check [√] item(s) being responded to:

12H(1) Has any domestic or foreign civil judicial court:

[ ] (a) in the past ten years, enjoined the applicant or a control affiliate in connection with any investment-related activity?

[ ] (b) ever found that the applicant or a control affiliate was involved in a violation of investment-related statutes or regulations?

[ ] (c) ever dismissed, pursuant to a settlement agreement, an investment-related civil judicial action brought against the applicant or a control affiliate by a state or foreign financial regulatory authority?

12H(2) [ ] Is the applicant or a control affiliate now the subject of any civil judicial proceeding that could result in a "yes" answer to any part of 12H(1)?

Use a separate DRP for each event or *proceeding*. An 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 11H. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):

[ ] The *Applicant*

[ ] Applicant and one or more *control affiliate(s)*

[ ] One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

DRP SBSE – CONTROL AFFILIATE

CRD NUMBER

This *Control Affiliate* is [ ] Firm [ ] Individual

Registered: [ ] Yes [ ] No

NAME (For individuals, Last, First, Middle)

[ ] This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or BD DRP to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE)

(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
   [ ] Banking Products (other than CD(s))
   [ ] 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 Type:

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court – City or County <u>and</u> State or Country, Docket/Case Number):

6. Control Affiliate Employing Firm when activity occurred which led to the civil judicial action (if applicable):

7. Describe the allegations related to this civil judicial action. (The information must fit within the space provided.):

8. Current Status? [ ] Pending [ ] On Appeal [ ] Final

9. If on appeal, action appealed to (provide name of court): Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY) [ ] Exact [ ] Explanation

    If not exact, provide explanation:

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE)

(continuation)

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 [ ] Judgement 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 all appropriate items):

[ ] Monetary/Fine [ ] Revocation/Expulsion/Denial [ ] Disgorgement/Restitution
Amount $________ [ ] Censure [ ] Cease and Desist/Injunction [ ] Bar [ ] Suspension

B. Other Sanctions:

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 re-qualify/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 applicant or control affiliate, date paid and if any portion of penalty was waived.

14. Provide a brief summary of details related to action(s), allegation(s), disposition(s), and/or finding(s) disclosed above. (The information must fit within the space provided.)

BANKRUPTCY / SIPC DISCLOSURE REPORTING PAGE (SBSE)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Questions 12l*** on Form SBSE;

Check [√] item(s) being responded to:

12l In the past ten years has the *applicant* or a *control affiliate* of the *applicant* ever been a securities firm or a *control affiliate* of a securities firm that:

[ ] (1) has been the subject of a bankruptcy petition?

[ ] (2) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

It is not a requirement that documents be provided for each event or *proceeding*. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *control affiliate* is an individual or organization registered through CRD, such *control affiliate* need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *control affiliate's* appropriate DRP (BD) or DRP (U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *control affiliate* of its obligation to update its CRD records.

PART I

A. The *person* or entity for whom this DRP (SBSE) is being filed is:

[ ] The *Applicant*

[ ] Applicant and one or more *control affiliate(s)*

[ ] One or more *control affiliate(s)*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Applicant*

BD DRP – CONTROL AFFILIATE

CRD NUMBER

This *Control Affiliate* is [ ] Firm [ ] Individual

Registered: [ ] Yes [ ] No

NAME (For individuals, Last, First, Middle)

[ ] This DRP should be removed from the SBS Entity's record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

PART II

1. Action Type: (check appropriate item)

[ ] Bankruptcy [ ] Declaration [ ] Receivership

[ ] Compromise [ ] Liquidated [ ] Other ____________

2. Action Date (MM/DD/YYYY) ____________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ____________

(continued)

3. If the financial action relates to an organization over which the *applicant* or the *control affiliate* exercise(d) *control*, enter organization name and the applicant's or control affiliate's position, title or relationship:

Was the Organization investment-related? [ ] Yes [ ] No

4. Court action brought in (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country), Docket/Case Number and Bankruptcy Chapter Number (if Federal Bankruptcy Filing):

5. Is action currently pending? [ ] Yes [ ] No

6. If not pending, provide Disposition Type: (check appropriate item)

[ ] Direct Payment Procedure [ ] Dismissed [ ] Satisfied/Released

[ ] Discharged [ ] Dissolved [ ] SIPA Trustee Appointed [ ] Other ____________

7. Disposition Date (MM/DD/YYYY): ____________________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ____________________

8. Provide a brief summary of events leading to the action and if not discharged, explain. (The information must fit within the space provided.):

9. If a SIPA trustee was appointed or a direct payment procedure was begun, enter the amount paid or agreed to be paid by you; or the name of the trustee:

Currently open? [ ] Yes [ ] No

Date Direct Payment Initiated/Filed or Trustee Appointed (MM/DD/YYYY): __________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ____________________

10. Provide details of any status/disposition. Include details of creditors, terms, conditions, amounts due and settlement schedule (if applicable). (The information must fit within the space provided.)

Form SBSE-A

OMB Approval
OMB Number: .....3235-____
Expires:...... ..Month __, 2014
Estimated average burden hours per response: . . . . _____.
per amendment: . . . . . _____.

Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants that are Registered or Registering with the Commodity Futures Trading Commission as a Swap Dealer or Major Swap Participant

FORM SBSE-A INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. **FORM** - Form SBSE-A is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, "SBS Entities") by an entity that is not registered or registering with the Commission as a broker-dealer but is registered or registering with the Commodity Futures Trading Commission ("CFTC") as a swap dealer or major swap participant. **These SBS Entities must file this form and a copy of the Form 7-R they file with the CFTC (or its designee) to register with the Securities and Exchange Commission.** An applicant must also file Schedules A, B, C, F, and G, as appropriate. There are no Schedules D, or E. An entity that is registered with the Commission as a broker-dealer and also is registered or registering with the Commodity Futures Trading Commission ("CFTC") as a swap dealer or major swap participant should file Form SBSE-BD to register with the Commission as an SBS Entity.
2. **ELECTRONIC FILING** - This Form SBSE-A must be filed electronically with the Commission through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232. 11) to file and amend Form SBSE-A electronically to assure the timely acceptance and processing of those filings.[187] Additional documents shall be attached to this electronic application.
3. **UPDATING** - By law, the *applicant* must promptly update Form SBSE-A information by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason [17 CFR 240.15Fb2-2]. In addition, the applicant must update any incomplete or inaccurate information contained on Form SBSE-A prior to filing a notice of withdrawal from registration on Form SBSE-W [17 CFR 15Fb3-2(a)].
4. **CONTACT EMPLOYEE** - The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant's* organization.
4. **FEDERAL INFORMATION LAW AND REQUIREMENTS** - An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§78o-10, 78q and 78w. Filing of this form is mandatory; however, the social security number information, which aids in identifying the applicant, is voluntary. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirement to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form, 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 information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

C. FILING INSTRUCTIONS

1. FORMAT

a. Items 1-16 and the accompanying Schedules and DRP pages must be answered and all fields requiring a response must be completed before the filing will be accepted.
b. *Applicant* must complete the execution screen certifying that Form SBSE-A and amendments thereto have been executed properly and that the information contained therein is accurate and complete.
c. To amend information, the *applicant* must update the appropriate Form SBSE-A screens.
d. A paper copy, with original signatures, of the initial Form SBSE-A filing [and amendments to Disclosure Reporting Pages (DRPs)] must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. **DISCLOSURE REPORTING PAGE (DRP)** – Information concerning a *principal* that relates to the occurrence of an event reportable in Schedule C must be provided on the appropriate DRP.

The mailing address for questions and correspondence is:

---

187 As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

EXPLANATION OF TERMS
(The following terms are italicized throughout this form.)

GENERAL

Terms used in this Form SBSE-A that are defined in the form the CFTC requires that swap dealers and major swap participants use to apply for registration with the CFTC shall have the same meaning as set forth in that form.

APPLICANT - The security-based swap dealer or major security-based swap participant applying on or amending this form.

CONTROL - The power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise. Any *person* that (i) is a director, general partner or officer exercising executive responsibility (or having similar status or functions); (ii) directly or indirectly has the right to vote 25% 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 (iii) in the case of a partnership, has the right to receive upon dissolution, or has contributed, 25% or more of the capital, is presumed to *control* that company.

JURISDICTION - A state, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, or any subdivision or regulatory body thereof.

SUCCESSOR –The term "successor" is defined to be an unregistered entity that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a predecessor security-based swap dealer or major security-based swap participants that ceases its security-based swap activities. [See Exchange Act Rule 15b2-5 (17 CFR 240.15Fb2-5)]

3. FOR THE PURPOSE OF SCHEDULE C AND THE CORRESPONDING DISCLOSURE REPORTING PAGES (DRPs)

FOREIGN FINANCIAL REGULATORY AUTHORITY - Includes (1) a foreign securities authority; (2) other governmental body or foreign equivalent of a *self-regulatory organization* empowered by a foreign government to administer or enforce its laws relating to the regulation of *financial services industry-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.

FINANCIAL SERVICES INDUSTRY-RELATED – Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency). (This definition is used solely for the purpose of Form SBSE-A.)

INVOLVED - Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

ORDER - A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an *order*.

PROCEEDING - Includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or a *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal charge); or a *misdemeanor* criminal information (or equivalent formal charge). 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).

FORM SBSE-A Page 1 (Execution Page)	Application for Registration as a Security-based Swap Dealer and Major Security-based Swap Participant that is Registered or Registering with the CFTC as a Swap Dealer or Major Swap Participant Date:________ *Applicant* NFA Number: ________	Official Use	Official Use Only

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and the laws of the *jurisdictions* and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

[ ] APPLICATION **[ ] AMENDMENT**

1. Exact name, principal business address, mailing address, if different, and telephone number of the *applicant:*

A. Full name of the *applicant*:

B. IRS Empl. Ident. No.:

C. Applicant's NFA ID #: Applicant's CIK # (if any):

D. *Applicant's* Main Address: (Do not use a P.O. Box)

Number and Street 1: Number and Street 2:

City: State: Country: Zip/Postal Code:

E. Mailing Address, if different:

Number and Street 1: Number and Street 2:

City: State: Country: Zip/Postal Code:

F. Business Telephone Number:

G Website/URL:

H. Contact Employee:

Name: Title:

Telephone Number: Email Address:

I. Chief Compliance Officer designated by the *applicant* in accordance with Exchange Act Section 15F(k):

Name: Title:

Telephone Number: Email Address:

EXECUTION:

The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity, may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.

The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.

Date (MM/DD/YYYY) Name of Applicant

By:

Signature Name and Title of Person Signing on *Applicant's* behalf

This page must always be completed in full.

DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY

FORM SBSE-A Page 2	*Applicant* Name: ______ Date:______ *Applicant* NFA No.: ______	**Official Use**	Official Use Only

2. A. The *applicant* is registering as a security-based swap dealer: [ ] Yes [ ] No

   B. The *applicant* is registering as a major security-based swap participant: [ ] Yes [ ] No
   Because it: (check all that apply)
   [ ] maintains a substantial security-based swap position
   [ ] has substantial counterparty exposure [ ] is highly leveraged relative to its capital position

3. Does the *applicant* intend to compute capital or margin, or price customer or proprietary positions, using mathematical models? [ ] Yes [ ] No

4. A. The *applicant* is currently registered with the Commodity Futures Trading Commission as a:
   [ ] Swap Dealer [ ] Major Swap Participant

   B. The *applicant* is registering with the Commodity Futures Trading Commission as a:
   [ ] Swap Dealer [ ] Major Swap Participant

5. Briefly describe the *applicant's* business: ______

		YES	NO
6.	Is the *applicant* subject to regulation by a prudential regulator, as defined in Section 1a(39) of the Commodity Exchange Act. If "*yes*," identify the prudential regulator: ______.	[ ]	[ ]
7.	Is the *applicant* registered with the Commission as an investment adviser? Applicant's IARD #: ______	[ ]	[ ]
8. A.	Is the *applicant* registered with the Commodity Futures Trading Commission in any capacity other than as a swap dealer or major swap participant?	[ ]	[ ]
B.	If "yes," as a: [ ] Futures Commission Merchant [ ] Introducing Broker [ ] Commodity Pool Operator [ ] Other: ______		
9.	Does *applicant* engage in any other non-securities, *financial services industry-related* business? *If "yes," describe each other business briefly on Schedule B, Section I.*	[ ]	[ ]
10.	Does the *applicant* hold or maintain any funds or securities to collateralize counterparty transactions?	[ ]	[ ]
11.	Does the *applicant* have any arrangement:		
A.	With any other *person*, firm, or organization under which any books or records of the *applicant* are kept, maintained, or audited by such other *person*, firm or organization?	[ ]	[ ]
B.	Under which such other person, firm or organization executes, trades, custodies, clears or settles on behalf of the applicant (including any *SRO* in which the applicant is a member)? *If "yes" to any part of Item 11, complete appropriate items on Schedule B, Section II.*	[ ]	[ ]
12.	Does any *person* directly or indirectly *control* the management or policies of the *applicant* through agreement or otherwise? *If "yes," complete appropriate item on Schedule B, Section II.*	[ ]	[ ]
13.	Does any *person* directly or indirectly finance (wholly or partially) the business of the *applicant*? *Do not answer "Yes" to Item 13 if the person finances the business of the applicant through: 1) a public offering of securities made pursuant to the Securities Act of 1933; or 2) credit extended in the ordinary course of business by suppliers, banks, and others.* *If "yes," complete appropriate item on Schedule B, Section II.*	[ ]	[ ]
14.	Is the *applicant* at the time of this filing *succeeding* to the business of a currently registered SBS Entity? *If "yes," complete appropriate items on Schedule B, Section III.*	[ ]	[ ]

15. The applicant has ______ principals who are individuals.
   Please list all principals who are individuals on Schedule A.

16. Does any principal not identified in Item 15 and Schedule A effect, or is any principal not identified in Item 15 and Schedule A involved in effecting security-based swaps on behalf of the applicant, or will such principals effect or be involved in effecting such business on the applicant's behalf?
   If "yes," complete appropriate item on Schedule B, Section IV.

Schedule A of FORM SBSE **PRINCIPALS THAT ARE INDIVIDUALS** (Answer for Form SBSE-A Item 15)	*Applicant* Name: ____________________ Date:__________ *Applicant* NFA No.: __________	**Official Use**

Use Schedule A to identify all principals of the applicant who are individuals.

Complete the "Title or Status" column by entering board/management titles; status as partner, trustee, sole proprietor, or shareholder; and for shareholders, the class of securities owned (if more than one is issued).

Ownership Codes are:

NA -	less than 5%	B -	10% but less than 25%	D -	50% but less than 75%
A -	5% but less than 10%	C -	25% but less than 50%	E -	75% or more

	FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	Title or Status	Date Title or Status Acquired		Date Individual began working for applicant		Does person have an ownership interest in the applicant	If yes, include ownership code	NFA Identification No., CRD No. and/or IARD No.	Official Use Only
			MM	YYYY	MM	YYYY				
1.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
2.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
3.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
4.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
5.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
6.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
7.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
8.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
9.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								
10.							Y / N			
		For individuals not presently registered through NFA, CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service):								

Schedule B of FORM SBSE-A
Page 1

Applicant Name: ____________________

Date: ________ *Applicant* NFA No.: ________

Official Use | Official Use Only

Use this Schedule B to report details for items listed below. Report only new information or changes/updates to previously submitted details. Do not repeat previously submitted information.
This is an [ ] INITIAL [ ] AMENDED detail filing for the Form SBSE-A items checked below:

Section I *Other Business*

Item 9: Does *applicant* engage in any other non-securities, *financial services industry-related* business?

Unique Identification Number(s):	*Assigning Regulator(s)/Entity(s):*

Briefly describe any other *financial services industry-related*, non-securities business in which the applicant is engaged:

Section II *Record Maintenance Arrangements / Business Arrangements / Control Persons / Financings*

(Check one) [ ] Item 11A [ ] Item 11B [ ] Item 12 [ ] Item 13

Applicant must complete a separate Schedule B Page 1 for each affirmative response in this section including any multiple responses to any item. Complete the "Effective Date" box with the Month, Day and Year that the arrangement or agreement became effective. When reporting a change or termination of an arrangement, enter the effective date of the change.

Firm or Organization Name	SEC File, CRD, NFA, IARD, and/or CIK Number (if any)	
Business Address *(Street, City, State/Country, Zip + 4 Postal Code)*	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /
Individual Name	CRD, NFA, and/or IARD Number (if any)	
Business Address (if applicable) *(Street, City, State/Country, Zip + 4 Postal Code)*	Effective Date MM DD YYYY / /	Termination Date MM DD YYYY / /

Briefly describe the nature of the arrangement with respect to books or records (ITEM 11A); the nature of the execution, trading, custody, clearing or settlement arrangement (ITEM 11B); the nature of the control or agreement (ITEM 12); or the method and amount of financing (ITEM 13). Use reverse side of this sheet for additional comments if necessary.

For ITEM 12 ONLY - If the control person is an individual not presently registered through CRD or IARD, describe prior *investment-related* experience (e.g., for each prior position - employer, job title, and dates of service).

Section III *Successions*

Item 14: Is the *applicant* at the time of this filing *succeeding* to the business of a currently registered SBS Entity?

Date of Succession MM DD YYYY / /	*Name of Predecessor*
SEC File, CRD, NFA, IARD, and/or CIK Number (if any)	IRS Employer Number (if any)

Briefly describe details of the succession including any assets or liabilities not assumed by the successor. Use reverse side of this sheet for additional comments if necessary.

Section IV *Principals Effecting or Involved in Effecting SBS Business*

Item 16: Does any principal not identified in Item 15 and Schedule A effect, or is any principal not identified in Item 15 and Schedule A involved in effecting security-based swaps on behalf of the applicant, or will such principals effect or be involved in effecting such business on the applicant's behalf?

For each Principal identified in Section IV, complete Schedule C of the Form SBSE-A and the relevant DRP pages.

1.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address *(Street, City, State/Country, Zip + 4/Postal Code)*		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

Schedule B of FORM SBSE-A Page 2	Applicant Name: ______ Date: ______ Applicant NFA No.: ______	**Official Use**	Official Use Only

Section IV, Continued — ***Principals Effecting or Involved in Effecting SBS Business***

For each Principal identified in Section IV, complete Schedule C of the Form SBSE-A and the relevant DRP pages.

2.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

3.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

4.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

5.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

6.	Name of Principal	Type of Entity (Corp, Partnership, LLC, etc.)	SEC File No., CRD, NFA, IARD, CIK Number, and/or Tax Identification Number
	Business Address (*Street, City, State/Country, Zip + 4/Postal Code*)		
	This entity [ ] effects [ ] is involved in effecting security based swaps on behalf of the applicant. *(check only one)*		

Briefly describe the details of the principal's activities relating to its effecting or involvement in effecting security-based swap transactions on behalf of the applicant:

Schedule C of FORM SBSE-A Page 1	*Applicant* Name: ______ *Principal* Name: ______ Date:______ *Applicant* NFA No.: ______	Official Use	Official Use Only

Use the appropriate DRP for providing details to "yes" answers to the questions in Schedule C. Refer to the Explanation of Terms section of Form SBSE-A Instructions for explanations of italicized terms.

CRIMINAL DISCLOSURE

A. In the past ten years has the *principal*:

	YES	NO
(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 a *felony*	[ ]	[ ]

B. In the past ten years has the *principal*:

	YES	NO
(1) Been convicted of or pled guilty or or nolo contendere ("no contest") in a domestic, foreign or military court to a *misdemeanor involving*: *financial services industry-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* specified in B(1)?	[ ]	[ ]

REGULATORY ACTION DISCLOSURE

C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:

	YES	NO
(1) *Found* the *principal* to have made a false statement or omission?	[ ]	[ ]
(2) *Found* the *principal* to have been involved in a violation of its regulations or statutes?	[ ]	[ ]
(3) *Found* the *principal* to have been a cause of a *financial services industry-related* business having its authorization to do business denied, revoked, or restricted?	[ ]	[ ]
(4) Entered an *order* against the *principal* in connection with *financial services industry-related* activity?	[ ]	[ ]
(5) Imposed a civil money penalty on the *principal*, or ordered the *principal* to cease and desist from any activity?	[ ]	[ ]

REGULATORY ACTION DISCLOSURE

D. Has any other federal regulatory agency, state regulatory agency, or *foreign financial regulatory authority*:

	YES	NO
(1) Ever found the *principal* to have made a false statement or omission or been dishonest, unfair, or unethical?	[ ]	[ ]
(2) Ever found the *principal* to have been involved in a violation of *financial services industry-related* regulations or statutes?	[ ]	[ ]
(3) Ever found the *principal* to have been a cause of a *financial services industry-related* business having its authorization to do business denied, suspended, revoked or restricted?	[ ]	[ ]
(4) In the past ten years, entered an order against the *principal* in connection with a *financial services industry-related* activity?	[ ]	[ ]
(5) Ever denied, suspended, or revoked the *principal's* registration or license or otherwise, by order, prevented it from associating with a *financial services industry-related* business or restricted its activities?	[ ]	[ ]

E. Has any *self-regulatory organization* or commodities exchange ever:

	YES	NO
(1) *found* the *principal* to have made a false statement or omission?	[ ]	[ ]
(2) *found* the *principal* to have been involved in a violation of its rules (other than a violation designated as a "*minor rule violation*" under a plan approved by the U.S. Securities and exchange Commission)?	[ ]	[ ]
(3) *found* the *principal* to have been the cause of a *financial services industry-related* business having its authorization to do business denied, suspended, revoked or restricted?	[ ]	[ ]
(4) Disciplined the *principal* by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?	[ ]	[ ]

	YES	NO
F. Has the *principal's* authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?	[ ]	[ ]
G. Is the *principal* now the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of C, D, or E?	[ ]	[ ]

Schedule C of FORM SBSE-A Page 2	*Applicant* Name: ____ *Principal* Name: ____ Date: ____ *Applicant* NFA No.: ____	Official Use	Official Use Only

CIVIL JUDICIAL DISCLOSURE

H. (1) Has any domestic or foreign civil judicial court:

	YES	NO
(a) In the past ten years, enjoined the *principal* in connection with any *financial services industry-related* activity?	[ ]	[ ]
(b) Ever *found* that the *principal* was involved in a violation of *financial services industry-related* statutes or regulations?	[ ]	[ ]
(c) Ever dismissed, pursuant to a settlement agreement, a *financial services industry-related* civil judicial action brought against the *principal* by a state or *foreign financial regulatory authority*?	[ ]	[ ]
(2) Is the *principal* now the subject of any civil judicial *proceeding* that could result in a "yes" answer to any part of H(1)?	[ ]	[ ]

FINANCIAL DISCLOSURE

I. In the past ten years has the *principal* ever been a securities firm or a *principal* of a securities firm that:

	YES	NO
(1) Has been the subject of a bankruptcy petition?	[ ]	[ ]
(2) Has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?	[ ]	[ ]

Schedule F of FORM SBSE-A **NONRESIDENT SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS**	*Applicant* Name: ______________________ Date:__________ *Applicant* NFA No.: __________	**Official Use**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Schedule F to identify its United States agent for service of process and the certify that it can

(3) provide the Commission with prompt access to its books and records, and

(4) submit to onsite inspection and examination by the Commission.

1. Service of Process:

A. Name of United States person *applicant* designates and appoints as agent for service of process

B. Address of United States person *applicant* designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

(a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and

(b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:

Applicant can as a matter of law;

(3) provide the Commission with prompt access to its books and records, and

(4) submit to onsite inspection and examination by the Commission.

Applicant must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4].

Signature: ______________________

Name and Title: ______________________

Date: ______________________

Schedule G of FORM SBSE-A CERTIFICATION ON STATUTORY DISQUALIFICATION	*Applicant* Name: ____________ Date:________ *Applicant* NFA No.: ________	Official Use

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)].

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.
For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a: [ ] CERTIFICATION [ ] RE-CERTIFICATION

The *applicant* certifies that it has

(c) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and
(d) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

CRIMINAL DISCLOSURE REPORTING PAGE (SBSE-A)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Items A and B*** of Schedule C of Form SBSE-A;

Check [√] item(s) being responded to:

A. In the past ten years has the principal:

[ ] (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 a felony?

B. In the past ten years has the principal:

[ ] (1) Been convicted of or pled guilty or 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 specified in B(1)?

Use a separate DRP for each event or *proceeding*. An 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 above items.

If a *principal* is an organization registered through the CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an individual or organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-A). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

Applicants must attach a copy of each applicable court document (*i.e.*, criminal complaint, information or indictment as well as judgment of conviction or sentencing documents) if not previously submitted through CRD (as they could be in the case of a *control affiliate* registered through CRD). Documents will not be accepted as disclosure in lieu of answering the questions on this DRP.

PART I

A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*
CRD NUMBER

Registered: [ ] Yes [ ] No

[ ] This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

CRIMINAL DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

PART II

1. If charge(s) were brought against an organization over which the principal exercise(d) control: Enter organization name, whether or not the organization was an investment-related business and the principal'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 <u>and</u> 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: <u>1.</u> number of counts, <u>2.</u> *felony* or *misdemeanor*, <u>3.</u> plea for each charge, and <u>4.</u> product type if charge is *investment-related*):

   ____

   ____

   ____

   C. Current status of the Event? [ ] Pending [ ] On Appeal [ ] Final

   D. 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, <u>A.</u> Disposition Type [e.g., convicted, acquitted, dismissed, pretrial.], <u>B.</u> Date, <u>C.</u> Sentence/Penalty, <u>D.</u> Duration [if sentence-suspension, probation, etc.], <u>E.</u> Start Date of Penalty, <u>F.</u> Penalty/Fine Amount and <u>G.</u> Date Paid.

   ____

   ____

   ____

   ____

   ____

   ____

5. Provide a brief summary of the circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the char(s) occurred. (The information must fit within the space provided.)

   ____

   ____

   ____

   ____

   ____

   ____

   ____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Items C, D, E, F, or G*** of Schedule C of Form SBSE-A;

Check [√] item(s) being responded to:

C. Has the U.S. Securities and Exchange Commission or the Commodity Futures Trading Commission ever:
- [ ] (1) Found the principal to have made a false statement or omission?
- [ ] (2) Found the principal to have been involved in a violation of its regulations or statutes?
- [ ] (3) the principal to have been a cause of an investment-related business having its authorization to do business denied, revoked, or restricted?
- [ ] (4) Entered an order against the principal in connection with investment-related activity?
- [ ] (5) Imposed a civil money penalty on the principal, or ordered the principal to cease and desist from any activity?

D. Has any other federal regulatory agency, state regulatory agency, or foreign financial regulatory authority:
- [ ] (1) Ever found the principal to have made a false statement or omission or been dishonest, unfair, or unethical?
- [ ] (2) Ever found the principal to have been involved in a violation of investment-related regulations or statutes?
- [ ] (3) Ever found the principal 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 the principal in connection with an investment-related activity?
- [ ] (5) Ever denied, suspended, or revoked the principal's registration or license or otherwise, by order, prevented it from associating with an investment-related business or restricted its activities?

E. Has any self-regulatory organization or commodities exchange ever:
- [ ] (1) found the principal to have made a false statement or omission?
- [ ] (2) found the principal to have been involved in a violation of its rules (other than a violation designated as a "minor rule violation" under a plan approved by the U.S. Securities and exchange Commission)?
- [ ] (3) found the principal to have been the cause of an investment-related business having its authorization to do business denied, suspended, revoked or restricted?
- [ ] (4) Disciplined the principal by expelling or suspending it from membership, barring or suspending its association with other members, or otherwise restricting its activities?

F. [ ] Has the principal's authorization to act as an attorney, accountant, or federal contractor ever been revoked or suspended?

G. [ ] Is the principal now the subject of any regulatory proceeding that could result in a "yes" answer to any part of C, D, or E?

Use a separate DRP for each event or *proceeding*. An 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 C, D, E, F or 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.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If the principal is an organization registered through the CRD, such principal need only complete Part I of the *applicant's* appropriate DRP (SBSE). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

PART I

A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*	*Principal's* CRD Number

Registered: [ ] Yes [ ] No

[ ] This DRP should be removed from the SBS Entity record because the control affiliate(s) are no longer associated with the SBS Entity.

B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

(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. Principal 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
[ ] Banking Products (other than CD(s))
[ ] 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 Type:

7. Describe the allegations related to this regulatory action. (The information 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:

REGULATORY ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

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	[ ] Settled
[ ] Decision & Order of Offer of Settlement	[ ] Dismissed	[ ] Stipulation and Consent
[ ] Decision	[ ] Order	[ ] Vacated

11. Resolution Date (MM/DD/YYYY) ____________ [ ] Exact [ ] Explanation

If not exact, provide explanation:

12. A. Were any of the following Sanctions Ordered? (Check all appropriate items):

[ ] Monetary/Fine Amount $________ [ ] Revocation/Expulsion/Denial [ ] Disgorgement/Restitution [ ] Censure [ ] Cease and Desist/Injunction [ ] Bar [ ] Suspension

B. Other Sanctions Ordered:

C. Sanction Detail: If suspended, enjoined or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification, by exam/retraining was a condition of the sanction, provide length of time given to re-qualify/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 principal, date paid and if any portion of penalty was waived.

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates. (The information must fit within the space provided.)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (BD)] is an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Item H*** of Schedule C of Form BD;

Check [√] item(s) being responded to:

H(1) Has any domestic or foreign civil judicial court:

[ ] (a) in the past ten years, enjoined the principal in connection with any investment-related activity?

[ ] (b) ever found that the principal was involved in a violation of investment-related statutes or regulations?

[ ] (c) ever dismissed, pursuant to a settlement agreement, an investment-related civil judicial action brought against the principal by a state or foreign financial regulatory authority?

H(2) [ ] Is the principal now the subject of any civil judicial proceeding that could result in a "yes" answer to any part of H?

Use a separate DRP for each event or *proceeding*. An 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 H. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

It is not a requirement that documents be provided for each event or proceeding. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *principal* is an individual or organization registered through the CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-A). The completion of this DRP does not relieve the *principal* of its obligation to update its CRD records.

PART I

A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*
CRD NUMBER

Registered: [ ] Yes [ ] No

[ ] This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

(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 [ ] Disgorgement [ ] Money Damages (Private/Civil Complaint) [ ] Restraining Order
[ ] Civil Penalty(ies)/Fine(s) [ ] Injunction [ ] Restitution [ ] Other ________

Other Relief Sought:

3. Filing Date of Court Action (MM/DD/YYYY) [ ] Exact [ ] Explanation

If not exact, provide explanation: ________

4. Principal Product Type: (check appropriate item)

[ ] Annuity(ies) - Fixed
[ ] Annuity(ies) - Variable
[ ] Banking Products (other than CD(s))
[ ] 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 Type:

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. Control Affiliate Employing Firm when activity occurred which led to the civil judicial action (if applicable):

7. Describe the allegations related to this civil action. (The information must fit within the space provided.):

8. Current Status? [ ] Pending [ ] On Appeal [ ] Final

9. If on appeal, action action appealed to (provide name of court): Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY) [ ] Exact [ ] Explanation

If not exact, provide explanation:

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

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 [ ] Judgement 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 all appropriate items):

[ ] Monetary/Fine [ ] Revocation/Expulsion/Denial [ ] Disgorgement/Restitution
Amount $________ [ ] Censure [ ] Cease and Desist/Injunction [ ] Bar [ ] Suspension

B. Other Sanctions:

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 re-qualify/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 prinicpal, date paid and if any portion of penalty was waived.

14. Provide a brief summary of details related to action(s), allegation(s), disposition(s), and/or finding(s) disclosed above. (The information must fit within the space provided.)

BANKRUPTCY / SIPC DISCLOSURE REPORTING PAGE (SBSE-A)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page [DRP (SBSE)] is an an [ ] INITIAL ***OR*** [ ] AMENDED response to report details for affirmative responses to ***Questions I*** on Schedule C of Form SBSE;

Check [√] item(s) being responded to:

I In the past ten years has the *principal* ever been a securities firm or a *control affiliate* of a securities firm that:

[ ] (1) has been the subject of a bankruptcy petition?

[ ] (2) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one person or entity using one DRP. File with a completed Execution Page.

It is not a requirement that documents be provided for each event or *proceeding*. Should they be provided, they will not be accepted as disclosure in lieu of answering the questions on this DRP.

If a *principal* is an individual or organization registered through CRD, such *principal* need only complete Part I of the *applicant's* appropriate DRP (SBSE-A). Details of the event must be submitted on the *principal's* appropriate DRP (BD) or DRP (U-4). If a *principal* is an organization not registered through the CRD, provide complete answers to all the items on the *applicant's* appropriate DRP (SBSE-a). The completion of this DRP does not relieve the *prinicpal* of its obligation to update its CRD records.

PART I

A. If the *principal* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

Name of *Principal*
CRD NUMBER

Registered: [ ] Yes [ ] No

[ ] This DRP should be removed from the SBS Entity's record because the principal is no longer associated with the SBS Entity.

B. If the *principal* is registered through the CRD, has the *principal* submitted a DRP (with Form U-4) or DRP (BD) to the CRD System for the event?

If the answer is "Yes," no other information on this DRP must be provided: If "No," complete Part II.

[ ] Yes [ ] No

Note: The completion of this Form does not relieve the *principal* of its obligation to update its CRD records.

PART II

1. Action Type: (check appropriate item)

[ ] Bankruptcy [ ] Declaration [ ] Receivership

[ ] Compromise [ ] Liquidated [ ] Other ____________________

2. Action Date (MM/DD/YYYY) ____________________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ________________________________

BANKRUPTCY / SIPC DISCLOSURE REPORTING PAGE (SBSE-A)

(continuation)

3. If the financial action relates to an organization over which the *applicant* or the *control affiliate* exercise(d) *control*, enter organization name and the applicant's or control affiliate's position, title or relationship:

____

Was the Organization investment-related? [ ] Yes [ ] No

4. Court action brought in (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country), Docket/Case Number and Bankruptcy Chapter Number (if Federal Bankruptcy Filing):

____

5. Is action currently pending? [ ] Yes [ ] No

6. If not pending, provide Disposition Type: (check appropriate item)

[ ] Direct Payment Procedure [ ] Dismissed [ ] Satisfied/Released

[ ] Discharged [ ] Dissolved [ ] SIPA Trustee Appointed [ ] Other ____________

7. Disposition Date (MM/DD/YYYY): ____________________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ______________________________

8. Provide a brief summary of events leading to the action and if not discharged, explain. (The information must fit within the space provided.):

____

____

____

____

____

9. If a SIPA trustee was appointed or a direct payment procedure was begun, enter the amount paid or agreed to be paid by you; or the name of the trustee:

____

Currently open? [ ] Yes [ ] No

Date Direct Payment Initiated/Filed or Trustee Appointed (MM/DD/YYYY): __________ [ ] Exact [ ] Explanation

If not exact, provide explanation: ______________________________

10. Provide details of any status/disposition. Include details of creditors, terms, conditions, amounts due and settlement schedule (if applicable). (The information must fit within the space provided.)

____

____

____

____

____

____

____

____

____

____

____

____

____

Form SBSE-BD

OMB Approval
OMB Number: .....3235-____
Expires:...... ..Month __, 2014
Estimated average burden hours per response: . . . . _____.
per amendment: . . . . . _____.

Application for Registration of Security-based Swap Dealers and Major Security-based Swap Participants that are Registered Broker-dealers

FORM SBSE-BD INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. **FORM** - Form SBSE-BD is the Application for Registration as either a Security-based Swap Dealer or Major Security-based Swap Participant (collectively, "SBS Entities") by an entity that is registered or registering with the Commission as a broker or dealer. These SBS Entities must file this form to register with the Securities and Exchange Commission. An applicant must also file Schedules F and G, as appropriate. There are no Schedules A, B, C, D, or E.
2. **DEFINITIONS –** Form SBSE-BD uses the same definitions as in Form BD.
3. **ELECTRONIC FILING** - This Form SBSE-BD must be filed electronically with the Commission through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232. 11) to file and amend Form SBSE-BD electronically to assure the timely acceptance and processing of those filings.[188] Additional documents shall be attached to this electronic application.
4. **UPDATING** - By law, the *applicant* must promptly update Form SBSE-BD information by submitting amendments whenever the information on file becomes inaccurate or incomplete for any reason [17 CFR 240.15Fb2-2]. In addition, the applicant must update any incomplete or inaccurate information contained on Form SBSE-BD prior to filing a notice of withdrawal from registration on Form SBSE-W [17 CFR 15Fb3-2(a)].
4. **FEDERAL INFORMATION LAW AND REQUIREMENTS -** An agency may not conduct or sponsor, and a *person* is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§78o-10, 78q and 78w. Filing of this form is mandatory. The principal purpose of this Form is to permit the Commission to determine whether the *applicant* meets the statutory requirements to engage in the security-based swap business. The Commission maintain[s] a file of the information on this form and will make certain information collected via the form publicly available. Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form, 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 information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

D. FILING INSTRUCTIONS

1. FORMAT

a. Items 1-4 and the accompanying Schedules must be answered and all fields requiring a response must be completed before the filing will be accepted.

b. *Applicant* must complete the execution screen certifying that Form SBSE-BD and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

c. To amend information, the *applicant* must update the appropriate Form SBSE-BD screens.

d. A paper copy, with original signatures, of the initial Form SBSE-BD filing and Schedules must be retained by the *applicant* and be made available for inspection upon a regulatory request.

The mailing address for questions and correspondence is:

---

188 As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

FORM SBSE-BD	Application for Registration as a Security-based Swap Dealer and Major Security-based Swap Participant that is Registered as a Broker-Dealer	Official Use	Official Use Only

WARNING: Failure to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as an SBS Entity, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

[ ] APPLICATION **[ ] AMENDMENT**

1. Exact name and CRD number of the *applicant:*
   A. Full name of the *applicant*:
   B. CRDNo.:
   C Website/URL:
   D. Contact Employee:
   Name: Title:
   Telephone Number: Email Address:
   E. Chief Compliance Officer designated by the *applicant* in accordance with Exchange Act Section 15F(k):
   Name: Title:
   Telephone Number: Email Address:

2. A. The *applicant* is registering as a security-based swap dealer: [ ] Yes [ ] No
   B. The *applicant* is registering as a major security-based swap participant: [ ] Yes [ ] No
   Because it: (check all that apply)
   [ ] maintains a substantial security-based swap position
   [ ] has substantial counterparty exposure [ ] is highly leveraged relative to its capital position

3. A. The *applicant* is presently registered with the Commodity Futures Trading Commission as a:
   [ ] Swap Dealer [ ] Major Swap Participant
   B. The *applicant* is registering with the Commodity Futures Trading Commission as a:
   [ ] Swap Dealer [ ] Major Swap Participant

4. Is the *applicant* subject to regulation by a prudential regulator, as defined in Sec. 1a(39) of the Commodity Exchange Act.
   [ ] Yes [ ] No If "*yes*," identify the prudential regulator: ______________________.

Briefly describe the *applicant's* business: ______________________

EXECUTION:

The applicant consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission in connection with the applicant's security-based swap activities, unless the applicant is a nonresident SBS Entity , may be given by registered or certified mail or confirmed telegram to the applicant's contact employee at the main address, or mailing address if different, given in Items 1E and 1F. If the applicant is a nonresident SBS Entity, it must complete Schedule F to designate a U.S. agent for service of process.

The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, said applicant. The undersigned and applicant represent that the information and statements contained herein, including schedules attached hereto, and other information filed herewith are current, true and complete. The undersigned and applicant further represent that to the extent any information previously submitted is not amended such information is currently accurate and complete.

Date (MM/DD/YYYY) Name of Applicant

By: Signature Name and Title of Person Signing on *Applicant's* behalf

This page must always be completed in full.

DO NOT WRITE BELOW THIS LINE – FOR OFFICIAL USE ONLY

Schedule F of FORM SBSE **NONRESIDENT SECURITY-BASED SWAP DEALERS AND MAJOR SECURITY-BASED SWAP PARTICIPANTS**	*Applicant* Name: ______________________ Date:__________ Firm SEC No.: __________	**Official Use**

Each nonresident security-based swap dealer and non-resident security-based swap participant shall use Schedule F to identify its United States agent for service of process and the certify that it can

(5) provide the Commission with prompt access to its books and records, and

(6) submit to onsite inspection and examination by the Commission.

1. Service of Process:

   A. Name of United States person *applicant* designates and appoints as agent for service of process

   B. Address of United States person *applicant* designates and appoints as agent for service of process

   The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

   (a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and

   (b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2. Certification regarding access to records:

   Applicant can as a matter of law;

   (5) provide the Commission with prompt access to its books and records, and

   (6) submit to onsite inspection and examination by the Commission.

Applicant must attach to this Form SBSE a copy of the opinion of counsel it is required to obtain in accordance with paragraph (c)(2) or (c)(3) of Exchange Act Rule 15Fb2-4, as appropriate [paragraphs (c)(2) or (c)(3) of 17 CFR 240.15Fb2-4].

Signature: ______________________

Name and Title: ______________________

Date: ______________________

Schedule G of FORM SBSE-BD CERTIFICATION ON STATUTORY DISQUALIFICATION	*Applicant* Name: ____________ Date:________ Firm SEC No.: ________	**Official Use**

Use Schedule G to certify that none of the *applicant's* associated persons is subject to statutory disqualification (as that term is defined in Section 3(a)(39) of the Exchange Act [15 U.S.C. 78c(a)(39)].

Instructions: This certification must be signed by the *applicant's* Chief Compliance Officer designated pursuant to Exchange Act Section 15F(k) or by his or her designee.
For purposes of this Form, the term *associated person* shall have the meaning as specified in Section 3(a)(70) of the Exchange Act [15 U.S.C. 78c(a)(70)].

This is a: [ ] CERTIFICATION [ ] RE-CERTIFICATION

The *applicant* certifies that it has

(e) performed background checks on all of its *associated persons* who effect or are involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf, and

(f) determined that no *associated person* who effects or is involved in effecting, or who will effect or be involved in effecting, security-based swaps on its behalf is subject to statutory disqualification, as defined in Section 3(a)(39) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(39)].

Applicant Name:	Date:
Signature of Chief Compliance Officer or Designee:	
Name of Chief Compliance Officer or Designee:	If Designee, Title of Designee:

Form SBSE-C

OMB Approval
OMB Number: .....3235-____
Expires:...... ..Month __, 2014
Estimated average burden hours
per response: . . . . _____.
per amendment: . . . . . _____.

Certification for Registration of Security-based Swap Dealers and Major Security-based Swap Participants

FORM SBSE-C INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. Each security-based swap dealer and major security-based swap participant must file Form SBSE-C to apply for ongoing registration.
2. **ELECTRONIC FILING** – The applicant must file Form SBSE-C through the EDGAR system, and must utilize the EDGAR Filer Manual (as defined in 17 CFR 232. 11) to file and amend Form SBSE-C electronically to assure the timely acceptance and processing of those filings.[189]
3. All fields requiring a response must be complete before the filing is accepted.

The mailing address for questions and correspondence is:

FEDERAL INFORMATION LAW AND REQUIREMENTS – 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 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§78o, 78o-4, 78o-5, 78q and 78w. Filing of this Form is mandatory. The principal purpose of this Form is to permit the Commission to determine whether it is in the public interest to approve or disapprove the application for ongoing registration by the security-based swap dealer or major security-based swap participant. The Commission maintains a file of the information on this Form 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 this Form, 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 information contained in this Form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

FORM SBSE-C	*Applicant* Name: ______________________ Date:__________ SEC Filer No: _________	Official Use

Instructions: This certification must be signed by a knowledgeable senior officer of the *applicant*.

I certify that, after due inquiry, I have reasonably determined that the applicant -

(1) has the operational, financial, and compliance capabilities to act as a security-based swap dealer or major security-based swap participant, as applicable, and

(2) I have documented the process by which I reached such determination.

Applicant Name:	Date:
Signature of Knowledgeable Senior Officer:	Name of Knowledgeable Senior Officer:
	Title of Knowledgeable Senior Officer

Form SBSE-W

OMB Approval
OMB Number: .....3235-___
Expires:...... ..Month __, 2014
Estimated average burden hours
per response: . . . . ____.
per amendment: . . . . . ____.

Request for Withdrawal from Registration as a Security-based Swap Dealer or Major Security-based Swap Participant

FORM SBSE-W INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. Security-based swap dealers and major security-based swap participants (collectively "SBS Entities") must file Form SBSE-W to withdraw their registration from the Securities and Exchange Commission ("SEC").
2. All questions must be answered and all fields requiring a response must be complete before the filing is accepted.
3. File Form SBSE-W with the SEC electronically.[190] Prior to filing Form SBSE-W, amend Form SBSE, Form SBSE-A, or Form SBSE-BD, as applicable, to update any incomplete or inaccurate information.
4. A paper copy of this Form SBSE-W with the original manual signature(s) must be retained by the security-based swap dealer or major security-based swap participant filing the Form SBSE-W and be made available for inspection upon a regulatory request. A paper copy of the initial Form SBSE, Form SBSE-A, or Form SBSE-BD filing, as appropriate, and amendments to any Disclosure Reporting Pages (DRPs) also must be retained by the security-based swap dealer and major security-based swap participant filing the Form SBSE-W.

The mailing address for questions and correspondence is:

EXPLANATION OF TERMS

(The following terms are italicized throughout this form.)

The term **INVESTIGATION** includes: (a) grand jury investigations, (b) U.S. Securities and Exchange Commission investigations after the "Wells" notice has been given, (c) formal investigations by a self-regulatory organization or, (d) actions or procedures designated as investigations by jurisdictions. The term investigation does not include subpoenas, preliminary or routine regulatory inquiries or requests for information, deficiency letters, "blue sheet" requests or other trading questionnaires, or examinations.

The term **INVESTMENT-RELATED** pertains to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, savings association, credit union, insurance company, or insurance agency).

FEDERAL INFORMATION LAW AND REQUIREMENTS – 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 15F, 17(a) and 23(a) of the Exchange Act authorize the SEC to collect the information on this form from registrants. See 15 U.S.C. §§78o, 78o-4, 78o-5, 78q and 78w. Filing of this Form is mandatory. The principal purpose of this Form is to permit the Commission to determine whether whether it is in the public interest to permit the security-based swap dealer or major security-based swap participant to withdraw its registration. The Commission maintain a file of the information on this Form 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 this Form, 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 information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

---

190 As discussed in the release proposing this Form, the Commission is currently developing a system to facilitate receipt of applications electronically. More specific instructions on how to file this Form may be included in the final version of the Form.

FORM SBSE-W	Request for Withdrawal from Registration as a Security-based Swap Dealer or Major Security-based Swap Participant	Official Use

INTENTIONAL MISSTATEMENTS OR OMISSIONS OF FACTS MAY CONSTITUTE CRIMINAL VIOLATIONS.

NOTE: Prior to filing a notice of withdrawal from registration on Form SBSE-W, an entity must update any incomplete or inaccurate information contained on Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate [17 CFR 15Fb3-2(a)].

1.
- A. Full name of Security-based Swap Dealer or Major Security-based Swap Participant:
- B. IRS Emp. Ident. No.:
- C. Name under which business is conducted, if different:
- D. Firm SEC, NFA, and/or CRD No.:
- E. Firm main address: Number and Street | City | State/Country | Zip+4/Postal Code
- F. Mailing address, if different: Number and Street | City
- G. Area Code / Telephone No.:

2. Withdrawing from Registration as a: [ ] Security-based Swap Dealer [ ] Major Security-based Swap Participant

3. Date firm ceased business: MM / DD / YY

4. Reason security-based swap dealer or major security-based swap participant is seeking to withdraw from SEC registration:

[ ] Winding down all business
[ ] No longer doing security-based swap business in U.S.
[ ] Have effected less security-based swap business for previous four quarters and no longer fit definition of major security-based swap participant
[ ] Ceasing business as a security-based swap dealer
[ ] Ceasing business as a major security-based swap participant
[ ] Other (describe):

5. Does the security-based swap dealer or major security-based swap participant hold any segregated counterparty collateral? Yes [ ] No [ ]
- A. Number of counterparties whose collateral is held:
- B. Amount of money held as collateral: $
- C. Market value of securities held as collateral: $
- D. Describe arrangements made for return of collateral:

6. Is the security-based swap dealer or major security-based swap participant now the subject of or named in any investment-related:

	yes	no
- investigation	[ ]	[ ]
- customer-initiated complaint	[ ]	[ ]
- private civil litigation	[ ]	[ ]

7. Name and Address of the Person who will have Custody of Books and Records: | Area Code / Telephone No.:

Address where the Books and Records will be Located, if Different: Number and Street | City | State/Country | ZIP + 4/Postal Code

EXECUTION: The undersigned certifies that he/she has executed this form on behalf of, and with the authority of, the security-based swap dealer or security-based swap participant, and that all information herein, including any attachments hereto, is accurate, complete, and current. The undersigned and security-based swap dealer or major security-based swap participant further certify that all the information previously submitted on Form SBSE, Form SBSE-A, or Form SBSE-BD, as appropriate, is accurate and complete as of this date, and that the security-based swap dealer's or major security-based swap participant's books and records will be preserved and available for inspection as required by law.

Date (MM/DD/YYYY)

Name

By:

Signature

Print Name and Title

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65555 / October 13, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3328 / October 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14585

In the Matter of, **Watts Water Technologies, Inc. and Leesen Chang,** **Respondents.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING CEASE-AND-DESIST ORDERS AND CIVIL PENALTIES**

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 Watts Water Technologies, Inc. and Leesen Chang (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over themselves and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Cease-and-Desist Orders and Civil Penalties ("Order"), as set forth below.

III.

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

Summary

1. This matter concerns violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by Watts Water Technologies, Inc ("Watts") and Leesen Chang ("Chang"). The violations took place at Watts Valve Changsha Co., Ltd., ("CWV") a wholly-owned Chinese subsidiary that Watts established in November 2005 to purchase the assets and businesses of Changsha Valve Works ("Changsha Valve"). CWV acquired Changsha Valve in April 2006 and Watts sold CWV in January 2010. CWV produced and supplied large valve products for infrastructure projects in China. Infrastructure projects in China are mostly developed, constructed, and owned by state-owned entities ("Project SOEs"). Project SOEs routinely retain state-owned design institutes to assist in the design and construction of their projects. Employees of CWV made improper payments to employees of certain design institutes. The purpose and effect of those payments was to influence the design institutes to recommend CWV valve products to Project SOEs and to create design specifications that favored CWV valve products. CWV's improper payments generated profits for Watts of more than $2.7 million.

2. The payments were disguised as sales commissions in CWV's books and records, thereby causing Watts' books and records to be inaccurate. Watts failed to devise and maintain a system of internal accounting controls sufficient to prevent and detect the payments.

3. Respondent Chang, a U.S. citizen and the former interim general manager of CWV and vice president of sales for Watts' management subsidiary in China, approved many of the payments to the design institutes and knew or should have known that the payments were improperly recorded on Watts' books as commissions.

Respondents

4. **Watts Water Technologies, Inc.** is a Delaware corporation with its headquarters in North Andover, Massachusetts. Watts designs, manufactures, and sells water valves and related products through its wholly-owned subsidiary Watts Regulator Co., and maintains operations in North America, Europe, and China. Watts manages its Chinese subsidiaries through Watts (Shanghai) Management Co., Ltd. ("Watts China") headquartered in Shanghai. Watts' common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

---

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

5. **Leesen Chang**, age 51, is a U.S. citizen and was the vice president of sales at Watts China between November 2008 and June 2009. Chang also served as interim general manager of CWV from April to November 2008. Chang maintains a residence in Los Angeles, California but lives most of the year in China where he is currently employed.

Other Relevant Entities

6. **Watts Valve (Changsha) Co., Ltd.** (or as defined above, "CWV") was a wholly foreign owned enterprise limited liability company ("WFOE")[2] established by Watts in China for the purpose of purchasing Changsha Valve. CWV purchased Changsha Valve in April 2006 and operated as a valve manufacturing subsidiary of Watts until January 2010 when Watts sold the business to a privately-held Hong Kong company. Watts consolidated CWV's books and records into its financial statements and CWV's revenues accounted for approximately 1% of Watts' gross revenues.

7. **Watts (Shanghai) Management Co., Ltd.** (or as defined above "Watts China"), is a Watts' WFOE headquartered in Shanghai that manages the operations of Watts' manufacturing subsidiaries located in China, including CWV during the period of Watts' ownership. Watts China is solely a management subsidiary and had no ownership interest in CWV.

Facts

A. CWV's Acquisition of Changsha Valve

8. CWV completed its acquisition of Changsha Valve in April 2006. Although Watts had significant operations in China prior to CWV's purchase of Changsha Valve, CWV was Watts' first experience with a Chinese subsidiary that conducted business predominantly with SOEs. Watts' other Chinese subsidiaries are primarily engaged in the manufacture of products destined for sale or distribution to non-governmental entities in China, the U.S. and Europe.

9. Watts failed to implement adequate internal controls to address the potential FCPA problems posed by its ownership of CWV – a subsidiary that sold its products almost exclusively to SOEs. In addition, although Watts implemented an FCPA policy in October 2006, Watts failed to conduct adequate FCPA training for its employees in China until July 2009.

---

2 The WFOE corporate structure under Chinese law permits foreign investors to establish and operate business enterprises in China that are capitalized exclusively with foreign funds. In addition, foreign investors who establish a WFOE in China can exercise control over the management and day-to-day operations of their WFOE.

B. CWV Made Improper Payments to Design Institutes

10. During the period of Watts' ownership, CWV sales personnel made payments to employees of certain design institutes to influence the design institutes to recommend CWV products to Project SOEs and to include specifications in their design proposals that would increase the likelihood that Project SOEs would select CWV products.

11. The improper payments were facilitated by a sales incentive policy created by Changsha Valve prior to its acquisition by CWV, and adopted by CWV in December 2006 (the "CWV Sales Policy"). The CWV Sales Policy provided, among other things, that all sales-related expenses, including travel, meals, entertainment, and payment of "consulting fees" to design institutes, would be borne by the CWV sales employees out of their commissions, which were equal to 7% to 7.5% of the contract price, depending on the size of the contract. The CWV Sales Policy further provided that sales personnel at CWV could utilize their commissions to make payments to design institutes of up to 3% of the total contract amount. As a result, the payments to design institutes were improperly recorded in Watts' books and records as sales commissions. The CWV Sales Policy was never translated into English or submitted to Watts' management in the U.S.

C. Chang's Role in the Violations

12. As vice president of sales at Watts China and interim general manager of CWV, Chang was among those responsible for maintaining and enforcing Watts' policies and procedures, including the company's general prohibition against improper payments to SOEs. Nonetheless, Chang approved commission payments to CWV sales personnel that he knew included payments to design institutes. In fact, Chang signed commission payment approval requests that explicitly itemized payments of 3% to design institutes. Chang also knew that Watts' management in the U.S. was unaware of the CWV Sales Policy that facilitated the improper payments and he resisted at least one attempt by several of his colleagues at Watts China to have the policy translated and submitted to Watts' senior management for approval. In an email discussing this issue, Chang stated that "China sale policy should stay in control within China regional operation" because involving Watts' management in the U.S. might cause CWV to "lose many flexibility [sic] on working with sale, sale agent and end buyer." Accordingly, Chang knew or should have known that, pursuant to the CWV Sales Policy, payments to design institutes were recorded in Watts' books and records as sales commissions. In addition, Chang's resistance to efforts to have the Sales Policy translated and submitted to Watts' management in the U.S. was a cause of Watts' internal control violations, since it prevented the parent company from discovering the improper payments.

D. Discovery, Internal Investigation and Self Reporting

13. In March 2009, Watts' General Counsel learned of a Commission enforcement action against another company that involved unlawful payments to employees of Chinese design institutes. Because Watts' senior management in the U.S. knew that CWV's customers included Project SOEs, Watts implemented anti-corruption and FCPA training for its Chinese subsidiaries. This training took place starting in the Spring of 2009. In July 2009, following FCPA training sessions for certain management of Watts China, Watts China's in-house

corporate counsel became aware of potential FCPA violations at CWV through conversations with CWV sales personnel who were participating in the training. Shortly thereafter, the in-house lawyer notified Watts' management in the U.S. of the potential violations.

14. On July 21, 2009, Watts retained outside counsel to conduct an internal investigation of CWV's sales practices. Watts' outside counsel subsequently retained forensic accountants to assist with the investigation.

15. On August 6, 2009, Watts self-reported its internal investigation to the staff. As the internal investigation progressed, Watts shared the results of the investigation with its outside auditors and the staff through periodic reports, and undertook the remedial measures described below.

E. Watts' Remedial Measures

16. Since July 2009 when the conduct was discovered, Watts has taken the following remedial steps. At the start of its internal investigation, Watts directed all of its sales and finance employees at CWV and Watts China to stop all payments of any kind to SOEs. While the internal investigation was ongoing, Watts eliminated commission-based compensation at CWV to ensure that no further improper payments were made by CWV sales personnel and disclosed the internal investigation in its August 7, 2009 Form 10-Q. In addition, Watts retained additional outside counsel to draft and implement enhanced anti-corruption policies and procedures, including an enhanced Anti-Bribery Policy, a Business Courtesy Policy designed to ensure that any payments made to customers comply with the FCPA, an enhanced Travel and Entertainment Expense Reimbursement Policy for its Chinese subsidiaries, and enhanced intermediary due diligence procedures.

17. In conjunction with its internal investigation, Watts conducted a worldwide anti-corruption audit. As part of its anti-corruption audit, Watts conducted additional FCPA and anti-corruption training for Watts China and the company's locations in Europe, conducted a risk assessment and anti-corruption compliance review of Watts' international operations in Europe, China, and any U.S. location with international sales, and conducted anti-corruption testing at seven international Watts sites, including each of the manufacturing and sales locations in China. In an effort to ensure FCPA compliance and training going forward, Watts contracted with an online global training organization to provide regular anti-corruption training and hired a Director of Legal Compliance, a new position that reports to Watts' General Counsel regarding issues under the Code of Conduct and Anti-Bribery Policy.

Legal Standards and Violations

A. Standard for the Issuance of a Cease-and Desist Order

18. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder, and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.

B. The Requirements of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder

19. The FCPA, enacted in 1977, added Section 13(b)(2)(A) to the Exchange Act to require public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. 15 U.S.C. § 78m(b)(2)(A).

20. The FCPA also added Section 13(b)(2)(B) to the Exchange Act to require public companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions: (i) are executed in accordance with management's general or specific authorization; and (ii) are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. § 78m(b)(2)(B).

21. Rule 13b2-1 prohibits a person from, directly or indirectly, falsifying or causing to be falsified any book, record, or account subject to Section 13(b)(2)(A) of the Exchange Act. 17 CFR § 240.13b2-1.

C. Watts Violated Sections 13(b)(2)(A) and 13(b)(2)(B)

22. Watts' subsidiary, CWV, made improper payments to design institutes. The payments were improperly recorded in CWV's books and records as sales commissions. CWV's books and records were consolidated into Watts' books and records. Accordingly, as a result of the misconduct of its subsidiary, Watts failed to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect its transactions and the disposition of its assets as required by Section 13(b)(2)(A) of the Exchange Act.

23. As evidenced by the extent and duration of the improper payments and the fact that Watts management was unaware of the CWV Sales Policy that facilitated the improper payments, Watts failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that it maintained accountability for its assets, and that its transactions were executed in accordance with management's authorization and recorded as necessary to permit the preparation of financial statements in conformity with GAAP. Watts also failed to implement an FCPA compliance and training program commensurate with the extent of its international operations and its ownership of CWV, a subsidiary that sold its products almost exclusively to SOEs. Accordingly, Watts violated Section 13(b)(2)(B) of the Exchange Act.

D. Chang Violated Rule 13b2-1 and Was a Cause of Watts' Violations of Sections 13(b)(2)(A) and 13(b)(2)(B)

24. Chang knew that CWV sales personnel made payments to design institutes out of their sales commissions pursuant to the CWV Sales Policy and he signed commission payment approval requests that explicitly itemized payments of 3% to design institutes. Under these

circumstances, Chang knew or should have known that the sales commission payments he approved contained payments to design institutes that were improperly recorded in Watts' books and records as sales commissions. Accordingly, Chang was a cause of Watts' failure to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company as required by Section 13(b)(2)(A) of the Exchange Act. By this same conduct, Chang was a cause of Watts' failure to maintain accurate books and records and thereby violated Exchange Act Rule 13b2-1.

25. As described more fully above, Chang knew that Watts' senior management was unaware of the CWV Sales Policy that facilitated the falsifications of its books and records and he resisted attempts by his colleagues at Watts China to have the CWV Sales Policy translated and submitted to Watts' senior management for approval. By these actions and others described herein, Chang was a cause of Watts' failure to devise and maintain a sufficient system of internal accounting controls as required by Section 13(b)(2)(B) of the Exchange Act.

Commission Consideration of
Watts' Remedial Efforts and Cooperation

26. In determining to accept Watts' Offer of Settlement, the Commission considered remedial acts promptly undertaken by Watts and the cooperation afforded the staff.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act:

1. Respondents Watts and Chang cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act;

2. Respondent Chang cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13b2-1.

B. Within fourteen days of the entry of this Order:

1. Respondent Watts shall pay to the United States Treasury disgorgement of $2,755,815, prejudgment interest of $820,791 and a civil money penalty of $200,000; and

2. Respondent Chang shall pay to the United States Treasury a civil money penalty of $25,000.

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 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, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover of a letter that identifies the payer as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. Respondent Watts acknowledges that the Commission is not imposing a civil penalty in excess of $200,000 based upon its cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in the 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

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65556 / October 13, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14586

In the Matter of EDGX EXCHANGE, INC., EDGA EXCHANGE, INC., and DIRECT EDGE ECN LLC Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 19(h) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (the "Commission") deems it necessary and appropriate in the public interest and for the protection of investors that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against EDGX Exchange, Inc. ("EDGX"), EDGA Exchange, Inc. ("EDGA") (collectively, "Exchange" or the "Exchanges"), and Direct Edge ECN LLC ("DECN") doing business as DE Route ("DE Route") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted a joint Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 19(h) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. **Respondents**

1. EDGA is registered with the Commission as a national securities exchange pursuant to Section 6(a) of the Exchange Act and is a self-regulatory organization ("SRO"). Since July 2010, EDGA has operated as an all-electronic exchange. EDGA is located in Jersey City, New Jersey and currently trades U.S. equity securities.

2. EDGX is registered with the Commission as a national securities exchange pursuant to Section 6(a) of the Exchange Act and is an SRO. Since July 2010, EDGX has operated as an all-electronic exchange. EDGX is located in Jersey City, New Jersey and currently trades U.S. equity securities.

3. DE Route is a broker-dealer registered with the Commission pursuant to Section 15 of the Exchange Act. DE Route is both a facility of and the affiliated routing broker of EDGA and EDGX. DE Route is also a member of FINRA and the Exchanges. DE Route is located in Jersey City, New Jersey.

B. **Summary**

4. The National Market System is among the pillars of our economy and provides the foundation for investor confidence in the integrity and orderliness of our capital markets. National securities exchanges and the electronic quoting, routing, and execution platforms through which they operate are critical elements of the National Market System. To gain Commission approval to become registered as an exchange, an exchange operator must not only represent that it is able to meet its regulatory obligations but also demonstrate that it is organized to do so and has the capacity to carry out the purposes of the statutes, rules, and regulations upon which its registration is conditioned. Given the systemic risk that can result from the failure of an exchange to comply with these requirements, the operation of a national securities exchange carries with it among the most significant regulatory compliance obligations that are expected of any market participant.

5. National securities exchanges are obligated to ensure that their order quoting, routing, and execution systems, compliance infrastructures, and communications platforms are developed, maintained, and governed to avoid material failures, outages, and other significant contingencies that could pose material risk to the National Market System and to the public interest. While some system outages inevitably will occur and not every outage is a violation of the federal securities laws, such outages, particularly when combined with significant other deficiencies in an exchange's systems, processes, and controls, can present risks that, left unremediated, could cause harm to investors and other market participants. A national securities exchange must invest appropriate resources necessary to ensure the strength and integrity of its systems, processes, and controls, to comply with its own Commission-approved rules, to provide for adequate backup and failover systems, to prevent or react appropriately to significant system

outages and failures, and, ultimately, to ensure an adequate governance and oversight structure necessary for quality assurance, continuous improvement, and process measurement, monitoring, and control.

6. This matter concerns the failure by EDGX, EDGA, and DE Route to comply with certain provisions of the Exchange Act, the rules and regulations thereunder, and each Exchange's own rules. EDGA violated Sections 19(b) and 19(g) of the Exchange Act, EDGX violated Sections 19(b) and 19(g) of the Exchange Act and Rule 602(a)(3) thereunder, and DE Route caused violations of Section 19(g) of the Exchange Act and violated Rules 200(g) and 203(b) thereunder. These violations occurred against the backdrop of weaknesses in Respondents' systems, processes, and controls.

C. **Discussion**

Facts

7. On May 7, 2009, EDGA and EDGX submitted to the Commission Form 1 applications seeking registration as national securities exchanges under Section 6 of the Exchange Act. When the Exchanges applied for registration as national securities exchanges, each was operating as a separate trading platform of DECN,[1] an alternative trading system ("ATS").[2]

8. In an order dated March 12, 2010 (the "Approval Order"), the Commission granted the applications of EDGA and EDGX for registration as national securities exchanges.[3] The Approval Order that granted the Exchanges' applications for registration conditioned their operation upon the satisfaction of several requirements, including that the Exchanges have adequate procedures and programs in place to effectively regulate the Exchanges, and, as noted in Commission Automation Review Policy ("ARP") guidelines, to effectively process trades and maintain the confidentiality, integrity, and availability of the Exchanges' systems.[4]

9. As required by the Approval Order, the Exchanges sent letters to the Commission's Office of Compliance Inspections and Examinations ("OCIE") and the Division of Trading and Markets ("TM") on June 18 and 28, 2010, respectively, representing that each Exchange had adequate procedures and programs in place to effectively regulate the Exchange, and, as noted in Commission ARP guidelines, to process trades and maintain the confidentiality, integrity, and availability of the

[1] Direct Edge ECN, LLC was formed in the State of Delaware on April 19, 2005.

[2] Rules 300–303 under the Exchange Act, 17 C.F.R. §§ 242.300–303.

[3] *See* In the Matter of the Applications of EDGX Exchange, Inc., and EDGA Exchange, Inc. for Registration as National Securities Exchanges: Findings, Opinion, and Order of the Commission, Exchange Act Release No. 34-61698 (Mar. 12, 2010), 75 FR 13151 (Mar. 18, 2010) (File Nos. 10-194 and 10-196).

[4] *Id.* at 13167.

Exchange's systems. Each Exchange commenced operating as a national securities exchange in July 2010.

10. Following EDGA's and EDGX's commencement of operations as national securities exchanges, DECN ceased operations as an ATS and began to operate as a facility of the Exchanges doing business as DE Route. The Commission approved rules permitting DE Route to provide outbound order routing for the Exchanges and inbound order routing to EDGX from EDGA and to EDGA from EDGX, subject to certain conditions.[5] In particular, the rules stated that DE Route would not engage in any business other than (a) its outbound router function, (b) its inbound router function, and (c) any other activities it may engage in as approved by the Commission.[6] Until 2011, neither Exchange had sought Commission approval to expand the activities of DE Route, and the Commission had not approved any other DE Route activities.

<u>The November 8, 2010 Systems Incident</u>

11. Prior to November 8, 2010, EDGA and EDGX made certain code changes related to the processing of customer orders. The code changes addressed compliance with amendments to Regulation SHO (prior to the extension of the compliance date for those amendments) as well as several enhancements. While certain code changes were subjected to testing prior to being rolled out on November 8, 2010, the code changes at issue were not subjected to testing. When the markets opened on November 8, 2010, the untested code changes caused an operational error whereby EDGA and EDGX systems increased the number of shares in orders submitted by three members, which resulted in these orders being executed for more than their intended amount. The Exchanges instructed the affected members to trade out of the resulting overfilled positions and to submit a claim for any losses to the Exchanges. One member traded out of the overfilled executions and submitted a claim for a loss in the amount of $105,000. The other two members refused to assume the overfilled positions and, as a result, EDGA and EDGX decided that DE Route would assume and liquidate the overfilled positions of the two members through its error account. In addition to the positions assumed in response to the November 8, 2010 operational error, Respondents assumed positions in other securities to facilitate the resolution of overfilled or error positions that separately arose from July through November 2010.

12. The assumption of positions to facilitate the resolution of overfilled or error positions was not permitted under the rules of the Exchanges, and the Exchanges failed to file proposed rule amendments permitting them to assume member positions. The use of the DE Route error account to engage in trading activity was not permitted by the Exchanges' rules, and neither Exchange had sought Commission approval to expand the activities of DE Route beyond those listed in paragraph 10 above. Section 19(g)(1) of the Exchange Act requires every exchange to comply with the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules. Section 19(b)(1) of

---

[5] *Id.* at 13165.

[6] *EDGA* Rules 2.11–12 and EDGX Rules 2.11–12.

the Exchange Act requires an exchange to file proposed rule changes with the Commission, and Rule 19b-4 thereunder provides that any "stated policy, practice or interpretation" of an exchange shall be deemed a "proposed rule change" unless "it is reasonably and fairly implied by an existing rule" of the exchange.

13. From November 8 through November 10, 2010, DE Route traded through its error account to unwind the November 8, 2010 positions. In attempting to liquidate these positions as quickly as practicable, DE Route engaged in short selling activity. DE Route did not mark its short orders as short or marked them long and did not locate or document the availability of securities to borrow prior to effecting these short sales. Regulation SHO requires broker dealers to mark orders in all equity securities "long" or "short" in accordance with Rule 200(g) and also requires executing broker-dealers to meet the locate requirement under Rule 203(b) prior to effecting short sales. See 17 C.F.R. §§ 242.200(g), 203(b).

14. The November 8, 2010 operational error caused an estimated 27 million shares of excess trading for three members with a value of roughly $773 million across approximately one thousand symbols. The Exchanges realized a net loss of approximately $2.1 million in connection with the positions that were assumed and liquidated. Respondents did not discuss the operational error with Commission staff until after they were contacted by TM on November 10, 2010.

The April 13, 2011 Systems Incident

15. On April 13, 2011, at approximately 3:19 p.m., an EDGX database administrator inadvertently entered a command that effectively disabled all other connections to EDGX's production database, disrupting the Exchange's ability to process incoming orders, modifications, and cancellations. This incident occurred, in part, due to levels of employee access to production systems inconsistent with the principle of "least privilege," as well as a lack of visual differentiation between production and nonproduction environments.[7]

16. Immediately thereafter, Respondents' personnel began receiving internal system alerts. At 3:23 p.m., reports to EDGX's trade desk indicated that trades were not being reported to the Securities Information Processors ("SIP"), which publish market data to the public. Between 3:24 and 3:34 p.m., EDGX received at least eleven self-help declarations from other trading centers.[8] At 3:29 p.m., EDGX sent a notice to its members that it was "investigating a potential connectivity issue" and would return with an update shortly. By approximately 3:35 p.m., EDGX's help desk had received calls from several of its members requesting cancellations, and it advised those members that it was experiencing issues and that the members should route away from EDGX. EDGX

[7] Under the "least privilege" principle, each employee receives the least access necessary to perform his or her job responsibilities.

[8] Regulation NMS provides a "self-help" remedy that allows trading centers to bypass the quotations of a trading center that fails to provide immediate responses to incoming orders.

removed its quotations from the SIP at 3:43 p.m., approximately twenty-four minutes after the systems incident occurred. EDGX did not "immediately" identify its quotations as manual quotations when it had reason to believe that it was not capable of displaying automated quotations.

17. As a result of the April 13, 2011 systems incident, several members of EDGX submitted claims for a total of more than $668,000 in losses. Respondents promptly notified the Commission staff of the incident.

Systems Procedures and Programs

18. After the events discussed above, Respondents, with substantial assistance from external experts, engaged in an examination of their technological infrastructure in light of, among other things, Commission ARP guidelines, for purposes of ensuring that their procedures and programs are designed to prevent, and if not prevent, to appropriately address, systems errors in a manner consistent with their responsibilities as exchange operators. The Exchanges submitted to the Commission staff a Plan of Remediation, which they promptly began to implement. Among other things, the Exchanges retained multiple consultants and purchased new hardware, software licenses and related support systems to implement the Plan of Remediation. Remedial acts and other enhancements undertaken by Respondents include, but are not limited to, engaging outside counsel and consultants to conduct a review of Respondents' compliance and operational policies, augmenting the ranks of staff and management, and making improvements to their compliance functions, information technology control environments, and information systems.

D. Violations

Section 19(b)(1) of the Exchange Act

19. Section 19(b)(1) of the Exchange Act requires an exchange to file proposed rule changes with the Commission, and Rule 19b-4 provides that any "stated policy, practice, or interpretation" of an exchange shall be deemed a "proposed rule change" unless "it is reasonably and fairly implied by an existing rule" of the exchange. An exchange must file a proposed rule change with the Commission on Form 19b-4 and, in turn, the Commission publishes the proposed rule in the Federal Register to allow all interested parties to comment upon it. Pursuant to Section 19(b)(2), the Commission will approve the proposed rule change only upon a finding that it "is consistent with the requirements of [the Exchange Act] and the rules and regulations thereunder."

20. Each Exchange violated Section 19(b)(1) of the Exchange Act by not filing a proposed rule change concerning the use of the DE Route error account to assume overfilled or error positions, including those positions arising from the systems incident on November 8, 2010.

Section 19(g)(1) of the Exchange Act

21. Section 19(g)(1) of the Exchange Act requires every exchange to comply with the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules, and, absent reasonable justification or excuse, to enforce compliance by its members with such provisions.

22. Each Exchange violated Section 19(g)(1) of the Exchange Act by not complying with its own rules when it allowed DE Route to engage in activities not approved by the Commission. DE Route conducted trading beyond the outbound and inbound routing on behalf of the Exchanges that was filed in the Exchanges' rules and approved by the Commission and caused the Exchanges' violations of Section 19(g) of the Exchange Act.

17 C.F.R. §§ 242.200(g) and 203(b) (Regulation SHO)

23. Rule 200(g) of Regulation SHO requires that a broker or dealer must mark all sell orders of any equity security "long" or "short" or "short exempt."

24. Rule 203(b) of Regulation SHO provides that a broker or dealer may not effect a short sale in any equity security for its own account, unless the broker or dealer has borrowed the security, has entered into a bona fide agreement to borrow the security, or otherwise has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date it is due. Regulation SHO also requires that a broker or dealer document compliance with these requirements.

25. DE Route violated Rules 200(g) and 203(b) of Regulation SHO when, in liquidating the positions assumed in connection with the November 8, 2010 systems incident, DE Route failed to mark certain orders "short," mismarked other short sale orders "long," and did not locate the shorted stock prior to effecting these short sales.

17 C.F.R. § 242.602 (Regulation NMS)

26. The definition of an automated trading center contained in Rule 600(b)(4) of Regulation NMS requires that such a trading center immediately identify its quotations as manual quotations whenever it has reason to believe that it is not capable of displaying automated quotations.

27. Rule 602(a)(1)(i) of Regulation NMS provides that "[e]ach national securities exchange shall at all times such exchange is open for trading, collect, process, and make available to vendors the best bid, the best offer, and aggregate quotation sizes for each subject security listed or admitted to unlisted trading privileges which is communicated on any national securities exchange by any responsible broker or dealer."

28. Rule 602(a)(3)(i) of Regulation NMS provides that "[i]f, at any time a national securities exchange is open for trading, such exchange determines . . . that the level of trading activities or the existence of unusual market conditions is such that the exchange is incapable of collecting, processing, and making available to vendors the data

for a subject security required to be made available pursuant to paragraph (a)(1) of this section in a manner that accurately reflects the current state of the market on such exchange, such exchange shall immediately notify all specified persons of that determination."

29. EDGX, which displayed quotations representing that it was operating as an automated trading center, violated Rule 602(a)(3) of Regulation NMS on April 13, 2011, by not immediately notifying all specified persons when it determined that it was not capable of displaying quotations that accurately reflected the current state of the market on EDGX.

E. **Findings**

30. Based on the foregoing, the Commission finds that EDGA violated Sections 19(b) and 19(g) of the Exchange Act, EDGX violated Sections 19(b) and 19(g) of the Exchange Act and Rule 602(a)(3) thereunder, and DE Route caused violations of Section 19(g) of the Exchange Act and violated Rules 200(g) and 203(b) thereunder.

F. **Respondents' Remedial Efforts**

31. In determining to accept the Offer, the Commission considered remedial acts undertaken by Respondents and cooperation afforded the Commission staff.

G. **Undertakings**

Respondents have undertaken to:[9]

1. Implement the measures set forth in the Plan of Remediation ("the Plan"), substantially in accordance with the schedule set forth in the Plan. To the extent that a non-material variation from the Plan is necessary, Respondents shall consult with TM and OCIE. The measures encompassed by the Plan include:

(a) enhancing EDGA's and EDGX's policies and procedures with respect to systems development and maintenance that include automated testing; testing of new code and functions as they are introduced; testing of all software changes; end-user testing; audits of information systems; and controls over and oversight of systems changes;

(b) implementing the following programs:

(i) an enterprise risk management framework;

(ii) an information security program, including the hiring of an information security director and the appointment of dedicated program resources;

---

[9] Respondents have begun or completed many of the Undertakings.

(iii) enhancements to Respondents' information technology control framework and underlying controls, including:

(1) a policy designed to restrict employee access to production trading system components except to the extent necessary, including the principle of least privilege user access;

(2) measures to provide for greater differentiation of production and nonproduction environments; and

(3) enhancements to their systems development methodology and quality assurance practices.

(c) outsourcing the Exchanges' internal audit function regarding information systems;

(d) engaging outside counsel to conduct a retrospective review of the circumstances leading to the systems incidents at the Exchanges and the submission of the Plan; and

(e) hiring a Corporate Training Director to create and assure a sustainable and productive annual training program for all Direct Edge employees, which shall include, but not be limited to, training regarding the federal securities laws and regulations, including Regulation NMS and Regulation SHO; the rules of EDGA and EDGX; and Respondents' policies and procedures.

2. Hire a Chief Compliance Officer ("CCO") who reports directly to the Chief Executive Officer of the Exchanges, with dotted line reporting to the Exchanges' Regulatory Oversight Committees and Boards. The CCO's responsibilities include implementing policies and procedures reasonably designed to ensure that Respondents fulfill their regulatory and compliance obligations; coordinating with the Chief Information Officer to implement policies and procedures reasonably designed to ensure the quality, integrity, security, and stability of Respondents' information technology and information security control environments; and serving as the primary point of contact for the Commission staff regarding Respondents' regulatory obligations.

3. Develop procedures to compensate Exchange members for losses incurred as a result of Exchange activities only as permitted by Respondents' rules.

4. Submit a rule filing to the Commission that satisfies the requirements of Form 19b-4 to change the operational scope of DE Route's error account.

5. Engage outside counsel to conduct a comprehensive review of the Respondents' policies and procedures for compliance with the federal securities laws, rules and regulations thereunder, and the Respondents' rules and identify areas for enhancement.

6. With respect to each of the reviews identified in Paragraphs 1(d) and 5 of this Section III.G:

(a) The Respondents shall require Counsel to submit written recommendations for improvement to the Boards. The Boards shall adopt the recommendations made by Counsel, subject to Section III.G.6(b) below, and shall take steps necessary to commence implementation of such recommendations.

(b) If the Boards determine that any of the recommendations are unduly burdensome or impractical, they may propose an alternative reasonably designed to accomplish the same objectives, and they shall submit any such alternative to Counsel. If, upon evaluating the Boards' proposal, Counsel determines that the suggested alternative is reasonably designed to accomplish the same objectives as the recommendations in question, then Counsel shall approve the suggested alternative and amend his/her recommendations. If Counsel determines that the suggested alternative is not reasonably designed to accomplish the same objectives, Counsel shall reject the Boards' proposal. In the event that the Boards and the Counsel jointly determine that they are unable to agree on an alternative proposal, Respondents and Counsel shall jointly confer with TM and OCIE to resolve the matter.

7. Expend sufficient funds to permit Respondents' regulatory personnel to discharge the Undertakings referenced herein, including, but not limited to, providing adequate funds for the retention of outside counsel and/or professionals.

8. To the extent that any claims for loss associated with the November 8, 2010 and April 13, 2011 systems incidents have not yet been paid, ensure that they are paid consistent with the rules of EDGX and EDGA in effect at those times.

9. When each Exchange's Chief Executive Officer concludes that, to the best of his or her knowledge based on reasonable inquiry, EDGX, EDGA, and DE Route have achieved all of the Undertakings set forth in this Order, he or she shall certify, in writing, compliance with the Undertaking(s) set forth above. Such certifications shall be reviewed and accepted for filing by the Audit Committee of the Board of each Exchange. 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 Kathryn A. Pyszka, Assistant Director, Market Abuse Unit, Chicago Regional Office, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

Accordingly, pursuant to Sections 19(h)(1) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondents EDGA, EDGX, and DE Route be, and hereby are, censured pursuant to Section 19(h)(1) of the Exchange Act;

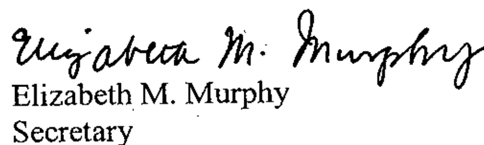
B. Respondent EDGA be, and hereby is, ordered pursuant to Section 21C of the Exchange Act to cease and desist from committing or causing any violations and any future violations of Sections 19(b) and 19(g) of the Exchange Act;

C. Respondent EDGX be, and hereby is, ordered pursuant to Section 21C of the Exchange Act to cease and desist from committing or causing any violations and any future violations of Sections 19(b) and 19(g) of the Exchange Act and Rule 602(a)(3) thereunder;

D. Respondent DE Route be, and hereby is, ordered pursuant to Section 21C of the Exchange Act to cease and desist from committing or causing any violations and any future violations of Section 19(g) of the Exchange Act and Rules 200(g) and 203(b) thereunder; and

E. Respondents EDGA, EDGX, and DE Route shall comply with the Undertakings enumerated in Section III.G above.

By the Commission.



Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65560 / October 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14587

In the Matter of Ablest Inc., Absolute Potential, Inc. (f/k/a Absolute Waste Services, Inc.), Alpha Petroleum Exploration Corp., AMCV Capital Trust I, American Health, Inc., Avid Sportswear & Golf Corp. (n/k/a Merger Co., Inc.), and The Bighub.com, Inc. (n/k/a Capital Consultants Funding, 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 Ablest Inc., Absolute Potential, Inc. (f/k/a Absolute Waste Services, Inc.), Alpha Petroleum Exploration Corp., AMCV Capital Trust I, American Health, Inc., Avid Sportswear & Golf Corp. (n/k/a Merger Co., Inc.), and The Bighub.com, Inc. (n/k/a Capital Consultants Funding, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Ablest Inc. (CIK No. 46653) is a Delaware corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange

Act Section 12(g). Ablest is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended April 1, 2007, which reported a net loss of $290,000 for the prior thirteen weeks.

2. Absolute Potential, Inc. (f/k/a Absolute Waste Services, Inc.) (CIK No. 1002360) is a Florida corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Absolute Potential is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2006, which reported a net loss of over $306,000 for the prior nine months.

3. Alpha Petroleum Exploration Corp. (CIK No. 90685) is an inactive New York corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alpha Petroleum Exploration 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 $18,000 for the prior nine months.

4. AMCV Capital Trust I (CIK No. 1103253) is a Delaware trust located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AMCV Capital Trust is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on February 16, 2000, which reported a net loss of over $1.7 million for the nine months ended September 30, 1999.

5. American Health, Inc. (CIK No. 824647) is a Pennsylvania corporation located in Conshohocken, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Health is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on April 15, 1992.

6. Avid Sportswear & Golf Corp. (n/k/a Merger Co., Inc.) (CIK No. 1100127) is a permanently revoked Nevada corporation located in Pittsburgh, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Avid Sportswear & Golf 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, 2003, which reported a net loss of over $40,000 for the prior three months. The company's stock is not publicly quoted or traded.

7. The Bighub.com, Inc. (n/k/a Capital Consultants Funding, Inc.) (CIK No. 1093192) is a dissolved Florida corporation located in Jensen Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Bighub.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 30, 2000, which reported a net loss of over $4.4 million for the prior nine months. As of October 12, 2011, the company's stock (symbol "BHUB") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires 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

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65561 / October 14, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14588

In the Matter of **ACS Acquisition Corp.,** **American Radio Empire, Inc.,** **American Resources & Development Co.,** **Aviation General, Inc.,** **The Bombay Company, Inc., and** **Brodie Exploration 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 ACS Acquisition Corp., American Radio Empire, Inc., American Resources & Development Co., Aviation General, Inc., The Bombay Company, Inc., and Brodie Exploration Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. ACS Acquisition Corp. (CIK No. 1112167) 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). ACS Acquisition is delinquent in its filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB/A registration statement on April 24, 2000, which reported a net loss of over $5,000 between its inception date on March 6, 2000 and March 31, 2000.

2. American Radio Empire, Inc. (CIK No. 1101922) is a Wyoming corporation located in Austin, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Radio Empire is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of over $269,000 for the prior nine months.

3. American Resources & Development Co. (CIK No. 812555) is a Utah corporation located in Murray, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Resources & Development Co. 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, 2009.

4. Aviation General, Inc. (CIK No. 1063703) is a void Delaware corporation located in Bethany, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aviation General is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2004, which reported a net loss of over $571,000 for the prior six months. As of October 12, 2011, the company's stock (symbol "AVGE") was traded on the over-the-counter markets.

5. The Bombay Company, Inc. (CIK No. 96287) is a void Delaware corporation located in Fort Worth, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Bombay Company is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 5, 2007, which reported a net loss of over $15.4 million for the prior three months. On September 20, 2007, The Bombay Company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Texas, and the case was still pending as of June 23, 2011.

6. Brodie Exploration Corp. (CIK No. 14423) is a Colorado corporation located in Houston, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Brodie Exploration 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, 2000, which reported a net loss of over $84,000 for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the

Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires 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

Commissioner Walter not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 9267 / October 14, 2011

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65571 / October 14, 2011

Admin. Proc. File No. 3-13871

In the Matter of RONALD S. BLOOMFIELD ROBERT GORGIA, and JOHN EARL MARTIN, SR.	ORDER GRANTING PARTIAL PROTECTIVE ORDER

On May 5, 2011, Robert Gorgia submitted a petition for review of an administrative law judge's initial decision, together with financial disclosure statements (later updated on May 17, 2011 and September 7, 2011), which contain personal financial information that he requests be protected from public disclosure ("Confidential Information"). The Division of Enforcement has not responded to Gorgia's request for a protective order.

Under Rule of Practice 322, any party "may file a motion requesting a protective order to limit from disclosure to other parties or to the public documents or testimony that contain confidential information."[1] That rule further provides that "[a] motion for a protective order shall be granted only upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure."[2]

The documents that Gorgia submitted contain sensitive information and, at this stage in the proceeding, the harm resulting from complete disclosure appears to outweigh the benefits. However, we have determined that disclosure of certain information included in the record will be necessary to the resolution of the issues before us.

---

[1] 17 C.F.R. § 201.322(a).

[2] *Id.* § 201.322(b).

Accordingly, IT IS ORDERED that:

1. Except as otherwise provided in this Order, the Confidential Information shall be disclosed only to the parties to this action, their counsel, the Commission, any staff advising the Commission in its deliberative processes with respect to this proceeding, and in the event of an appeal of the Commission's determination, any staff acting for the Commission in connection with that appeal.

2. All persons who receive access to the Confidential Information shall keep it confidential and, except as provided in this Order, shall not divulge the Confidential Information to any person.

3. No person to whom the Confidential Information is disclosed shall make any copies or otherwise use such Confidential Information, except in connection with this proceeding or any appeal thereof.

4. The Office of the Secretary shall place the Confidential Information in sealed envelopes or other sealed containers marked with the title of this action, identifying each document, and marked "CONFIDENTIAL."

5. The requirements of sealing and confidentiality shall not apply to any reference to the existence of the Confidential Information or to citation of particular information contained therein in testimony, oral argument, briefs, opinions, or in any other similar use directly connected with this action or any appeal thereof.

6. The Commission expressly reserves the authority to reach a different conclusion regarding the confidentiality of the Confidential Information covered by this Order at any time before it determines the issues raised in the proceeding.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65570 / October 14, 2011

Admin. File Proc. No. 3-14104

In the Matter of the Application of SHAREMASTER c/o Howard Feigenbaum 8747 Duval Lane Hemet, CA 92545 for Review of Disciplinary Action Taken by Financial Industry Regulatory Authority, Inc.	ORDER DISMISSING PROCEEDINGS

I.

Sharemaster (or the "Firm"), a Financial Industry Regulatory Authority, Inc. ("FINRA") member firm and a registered broker-dealer, seeks review of disciplinary action taken by FINRA. FINRA found that the Firm violated Rule 17a-5 of the Securities Exchange Act of 1934 by filing an annual report that was audited by an accounting firm that was not registered with the Public Company Accounting Oversight Board ("PCAOB").[1] FINRA suspended the Firm until it filed a compliant annual report. The Firm did not file a motion for a stay of FINRA's action pursuant to Rule 401(d) of the Commission's Rules of Practice.[2] On January 24, 2011, the suspension was lifted after Sharemaster filed an annual report that was audited by a PCAOB-registered accounting firm. We base our findings on an independent review of the record.

II.

A. **Background**

Exchange Act Section 17(e)(1)(A) and Rule 17a-5(d) thereunder generally require all registered broker-dealers to file annual reports that contain financial statements audited by a

---

[1] 17 C.F.R. § 240.17a-5.

[2] 17 C.F.R. § 201.401(d).

PCAOB-registered accounting firm.[3] Exchange Act Rule 17a-5(e)(1)(i)(A) provides that a broker or dealer's financial statements need not be audited if "[t]he 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."[4] At issue in the proceeding below was whether Sharemaster qualified for an exemption pursuant to Exchange Act Rule 17a-5(e)(1)(i)(A) from filing audited financial statements.

On February 17, 2010, Sharemaster submitted its annual report for the year ended December 31, 2009 ("2009 Annual Report"). A certified public accountant, who was not registered with the PCAOB, audited the financial statements. Howard Feigenbaum, the Firm's owner and chief compliance officer, submitted a letter ("Exemption Letter") with the 2009 Annual Report in which he asserted, without elaboration, that the Firm qualified for an exemption pursuant to Exchange Act Rule 17a-5(e)(1)(i)(A) from filing audited financial statements.[5] Feigenbaum stated that the exemption obviated the need for the accountant to be PCAOB registered.

B. FINRA Initiates a Disciplinary Proceeding.

On May 3, 2010, FINRA notified Sharemaster by letter that the 2009 Annual Report was incomplete because it was audited by an accounting firm that was not PCAOB registered. FINRA stated that it deemed the report not filed and that it would suspend Sharemaster's membership as of May 25, 2010 unless the Firm filed a compliant annual report. Among other things, FINRA advised Sharemaster of its right to a hearing pursuant to FINRA Rules 9552 and 9559.[6]

---

3 15 U.S.C. § 78q(e)(1)(A), as amended by the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 205(c)(2), 116 Stat. 745 (2002); 17 C.F.R. § 240.17a-5(d); *see generally Gremo Inv. Inc.*, Securities Exchange Act Rel. No. 64481 (May 12, 2011), _ SEC Docket _ (explaining regulatory background of Exchange Act and Sarbanes-Oxley Act provisions requiring, as of January 1, 2010, all broker-dealers to file annual reports that contain financial statements audited by a PCAOB-registered accounting firm).

4 17 C.F.R. § 240.17a-5(e)(1)(i)(A).

5 It is unclear why Sharemaster filed audited financial statements, given Feigenbaum's belief that the Firm was not required to do so.

6 FINRA Rule 9552(e) provides that a member may file with FINRA a "written request for a hearing pursuant to Rule 9559." FINRA Rule 9559 sets forth the hearing procedures for expedited proceedings under the Rule 9550 series, which is the kind of proceeding at issue here.

On May 17, 2010, Sharemaster timely requested a hearing to challenge the findings of violation and the sanction imposed. FINRA granted the request and on June 24, 2010, a FINRA Hearing Panel conducted an Expedited Proceeding telephonically. Feigenbaum testified that he knew that a broker-dealer is required generally to file an annual report that is audited by a PCAOB-registered accounting firm and that Sharemaster's accountant was not PCAOB registered. Feigenbaum also stated, however, that he believed that the Exchange Act Rule 17a-5(e)(1)(i)(A) exemption from filing audited financial statements applied to Sharemaster because the Firm does not hold customer funds or securities, acts as an agent for issuers, and promptly transmits money or securities of a customer to such issuers. FINRA contended that the "exemption is only applicable to firms whose business in a particular fiscal year is limited to doing business with one issuer" and that Sharemaster "has settlement agreements with more than one issuer" and "received income from more than one issuer in 2009." FINRA asserted that Sharemaster consequently did not qualify for the exemption.

In an October 6, 2010 decision, the Hearing Panel found that the Firm submitted an annual report that was audited by an accounting firm that was not PCAOB registered, that Sharemaster was not exempt from filing an annual report that included financial statements audited by a PCAOB-registered firm, that the report submitted was incomplete, that the incomplete report was deemed not filed pursuant to FINRA's By-Laws, and that the Firm violated Exchange Act Rule 17a-5. The Hearing Panel suspended Sharemaster "until it files the requisite annual report," with the suspension to convert to an expulsion at the end of six months if the report was not filed. The Hearing Panel also imposed costs of $1,785. On October 29, 2010, Sharemaster filed with the Commission an application for review of the Hearing Panel's decision. Sharemaster did not request a stay of the suspension pursuant to Rule 401(d) of the Commission's Rules of Practice pending the Commission's consideration of the application for review. In its brief filed on appeal, Sharemaster states that it filed a compliant annual report on November 1, 2010. On January 24, 2011, while this appeal was pending, the suspension was lifted.

III.

Sharemaster asks the Commission to set aside FINRA's decision and "deem filed" the 2009 Annual Report originally submitted. Sharemaster asserts that its subsequent compliance should have no impact on the Commission's authority to consider this appeal because "acquiescence through compliance was not an abandonment of a protected legal interest derived from statute but, rather, based solely on financial exigencies."

FINRA contends that "Sharemaster did not show that it qualified for an exemption" and that FINRA's "findings are correct." FINRA acknowledges that it has lifted the suspension and that "the sanction is no longer in effect." FINRA nonetheless states that "a Commission decision that leaves unresolved the issue of whether Sharemaster must pay the costs ordered by the Hearing Panel would fail to address a key component of Sharemaster's appeal."

Exchange Act Section 19 authorizes FINRA members or persons associated with such members to seek Commission review of action taken by FINRA. Under Exchange Act Section 19(d), certain FINRA action "shall be subject to review" by the Commission, namely

action that: (i) imposes a final disciplinary sanction on a FINRA member; (ii) denies membership or participation to an applicant; (iii) prohibits or limits any person with respect to access to services offered by FINRA or a FINRA member; or (iv) bars any person from becoming associated with a FINRA member.[7] Here, the question is whether the Commission has jurisdiction based on a "final disciplinary sanction;" neither party argues, and we do not find, that any of the other three bases for jurisdiction exists.

This is a case of first impression.[8] *Wedbush Morgan Securities, Inc.*[9] appears to be the closest Commission precedent. There, NASD found that the firm violated an NASD rule for failing to pay an arbitration award. NASD ordered the firm to pay the award by a certain date or be suspended. The suspension never took effect because the firm paid the arbitration award before the deadline. The firm filed an application for review after it had paid, and we dismissed the appeal for lack of jurisdiction. In that case, then, there never was a final disciplinary sanction, which distinguishes it from this case. Like in *Wedbush*, however, here there is no final sanction in place for the Commission to review. As we previously have held, "Section 19(d) does not . . . grant us jurisdiction to review disciplinary actions generally, but only over those in which a final disciplinary sanction is imposed."[10]

The parties argue that the Commission should resolve the case because, although the suspension has been lifted, a violation was found and costs were assessed. The best arguments for finding that we have jurisdiction appear to be that FINRA had imposed a suspension that had consequences for the applicant that would warrant Commission review, and that one can read the statute to permit review even where a sanction that once existed has been lifted. That approach, however, does not address the more straightforward reading of the statute – that the Commission reviews final disciplinary sanctions and that in this case, because Sharemaster filed a compliant annual report instead of not complying and seeking a stay pursuant to Rule 401(d) of the Commission's Rules of Practice, and because the sanction therefore has been lifted, there is nothing left to review.

---

[7] 15 U.S.C. § 78s(d).

[8] FINRA instituted this action as an expedited proceeding under the Rule 9550 series, which resulted in the imposition of a conditional suspension that could be lifted following the applicant's subsequent compliance. *See Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change Relating to Uniform Hearing Procedures For and Consolidation of Rules Applicable to Expedited Proceedings*, File No. SR-NASD-2003-110, Exchange Act Rel. No. 48887 (Dec. 5, 2003), 81 SEC Docket 3103, 2003 WL 22926826.

[9] Order Dismissing Proceedings, Exchange Act Rel. No. 57138 (Jan. 14, 2008), 92 SEC Docket 1306.

[10] *Russell A. Simpson*, 53 S.E.C. 1042, 1046 (1998). We have defined a disciplinary action as "an action that responds to an alleged violation of [a self-regulatory organization] rule or Commission statute or rule, or an action in which a punishment or sanction is sought or intended." *Id.*

On October 29, 2010, when Sharemaster filed with the Commission an application for review of FINRA's decision, the suspension that FINRA imposed earlier that month was still in effect. At that point, Sharemaster had the option to not file a compliant annual report (in which case the suspension would convert to an expulsion at the end of six months) and to seek a stay of the suspension pursuant to Rule 401(d) of the Commission's Rules of Practice pending the Commission's consideration of the appeal. Instead, on January 24, 2011, after Sharemaster filed a properly audited annual report in compliance with the Hearing Panel's order, the suspension was lifted. Because the suspension is no longer in effect, there is no final disciplinary sanction within the meaning of Exchange Act Section 19(d) that is subject to review by the Commission.[11]

Nor does the imposition of costs create jurisdiction. FINRA's rules distinguish between disciplinary sanctions and costs.[12] Our authority to review costs imposed by FINRA in a disciplinary action derives from, and is limited to, the jurisdiction granted to us by Exchange Act Section 19(d) to review a final disciplinary sanction.[13] Here, we are not authorized to review the costs of $1,785 imposed by FINRA because there is no final disciplinary sanction that is subject

---

[11] A conclusion that the Commission lacks jurisdiction under the circumstances is similar to how courts treat situations of contempt or compliance with injunctions. Specifically, the federal courts have jurisdiction over cases and controversies under Article III of the Constitution. Courts have held that: "'In the context of purely coercive civil contempt, a contemnor's compliance with the district court's underlying order moots the contemnor's ability to challenge his contempt adjudication.' *In re Grand Jury Subpoena Duces Tecum*, 955 F.2d 670, 672 (11th Cir. 1992). 'A long line of precedent holds that once a civil contempt order is purged, no live case or controversy remains for adjudication.' *Id.* (quoting *In re Campbell*, 628 F.2d 1260, 1261 (9th Cir. 1980)." *U.S. v. Zakharia*, 2011 WL 1283682 (6th Cir. 2011) (unpublished). Similarly, with respect to injunctive actions, courts have held that a case can become "moot not by happenstance or voluntary action of the appellee, but because the appellants, rather than seeking a stay, complied with the court order. *See U.S. Bancorp Mortg. Co. v. Bonner Mall P'ship*, 513 U.S. 18, 24, 115 S. Ct. 386, 130 L.Ed.2d 233 (1994)." *Clarke v. Office of Fed. Hous. Enter. Oversight*, 171 F. App'x 864, 865 (D.C. Cir. 2005) (unpublished).

[12] *Compare* FINRA Investigations and Sanctions Rule 8310 (Sanctions for Violations of Rules) with Rule 8330 (Costs of Proceedings).

[13] *See Maryland Sec. Co., Inc.*, 40 S.E.C. 443, 449 n.18 (1960) ("The scope of our review under the [Exchange] Act to determine whether a penalty imposed is excessive or oppressive includes the determination of whether an amount assessed as costs of the proceedings is proper."); *Ernest F. Boruski, Jr.*, 40 S.E.C. 258, 264 n.10 (1960) (same); *Boren & Co.*, 40 S.E.C. 217, 229 n.31 (1960) (same); *Managed Inv. Programs*, 37 S.E.C. 783, 791 (1957) (same); *see also, e.g., Rita H. Malm*, 52 S.E.C. 64, 76 n.41 (1994) (imposing sanctions but modifying costs).

to Commission review.[14] Sharemaster's appeal therefore must be dismissed for lack of jurisdiction.

Sharemaster also seeks to recover the late filing fee imposed by FINRA and costs other than those imposed by FINRA, such as $25.00 in commission checks cancelled by the customer, and PCAOB-registered accountant fees and mailing expenses. However, even if FINRA had not lifted the sanction and we had jurisdiction to review the FINRA-imposed costs, we would not have authority to order FINRA to pay these collateral costs.[15] Under the circumstances, we have determined to dismiss Sharemaster's application for review.[16]

Accordingly, it is ordered that Sharemaster's application for review be, and it hereby is, dismissed.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

---

[14] *See Wedbush*, 92 SEC Docket at 1310 (dismissing for lack of jurisdiction an appeal involving NASD disciplinary action where there was no final disciplinary sanction to review and although costs were imposed).

[15] *Cf. Robert M. Ryerson*, Exchange Act Rel. No. 57839 (May 20, 2008), 93 SEC Docket 6058, 6066 & n.20 (rejecting as a collateral attack, and finding no jurisdiction to grant, request for stay of NASD's collection efforts); *Marshall Fin., Inc.*, 57 S.E.C. 869, 877 n.21 (2004) (stating that Exchange Act Section 19 did not appear to authorize the setting aside or remission of NASD-imposed arbitration fees in connection with the Commission's review of associated disciplinary proceeding).

[16] Sharemaster submitted, pursuant to Commission Rule of Practice 452, three motions to adduce additional evidence, including, among other things, proof of payment of certain expenses, correspondence with regulators, and lost commissions. Rule 452 permits a party to adduce new evidence on appeal only if the moving party shows "with particularity" both (a) that the evidence is "material" and (b) that there were "reasonable grounds for failure to adduce such evidence previously." 17 C.F.R. § 201.452. Because we have determined to dismiss Sharemaster's appeal for lack of jurisdiction, Sharemaster's motions are moot, and we accordingly deny the motions.

Chairman Schapiro not participating

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65569 / October 14, 2011

Admin. Proc. File No. 3-14396

In the Matter of the Application of

MICHAEL PICOZZI III
c/o Timothy A. Valliere, Esq.
Smith Valliere PLLC
75 Rockefeller Plaza, 21st Floor
New York, New York 10019

For Review of Disciplinary Action by

PCX Equities, Inc.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE – REVIEW OF DISCIPLINARY PROCEEDINGS

Practice and Procedure

Alleged Failure to Cooperate with Request for Information

Former registered representative of former member firm of former national securities exchange was barred for failure to answer a notice of summary determination concerning alleged failure to cooperate with exchange's request for information. *Held*, exchange's findings of violations and sanctions it imposed are *set aside*, with exchange's successors' consent, where record contains limited evidence regarding the proceeding.

APPEARANCES:

Timothy A. Valliere, of Smith Valliere PLLC, for Michael Picozzi III.

Ivan Kline, of Friedman & Wittenstein, for NYSE Euronext and NYSE Regulation, Inc.

Appeal filed: May 17, 2011
Last brief received: September 9, 2011

I.

Michael Picozzi III, formerly associated with Andover Brokerage ("Andover"), a former PCX Equities, Inc. ("PCX") member firm, seeks review of PCX disciplinary action. The PCX found that Picozzi and Andover failed to respond to a Notice of Summary Determination (the "Notice of Summary Determination"), which the PCX entered against Picozzi and Andover after they failed to respond to a PCX complaint alleging that they had failed to respond to information requests in connection with an investigation.[1] The PCX censured and permanently barred Picozzi and Andover from association with any PCX member or member organization. Picozzi now petitions the Commission to vacate the PCX's summary determination. The PCX's successors in interest, NYSE Euronext and NYSE Regulation, Inc. (collectively, the "NYSE"), do not oppose Picozzi's petition, noting the limited evidentiary record and the time elapsed.[2] We base our findings on an independent review of the record.

II.

Picozzi was the founder and sole owner of Andover. On or about January 6, 2003, the PCX opened an investigation (the "Investigation") of possible market manipulation related to twenty-six transactions executed on November 1, 2002 involving shares of Tenet Healthcare Corp. ("THC"). The PCX mailed Picozzi and Andover, at Andover's address, a First Request for Information on January 14, 2003. Picozzi states in a declaration filed under penalty of perjury with the Commission that he "do[es] not recall ever seeing the initial PCX information request letter."[3]

---

1 As outlined in the Notice of Summary Determination, PCX Rule 10.4(b) states that respondents who fail to answer a complaint shall be considered to have admitted the complaint's charges, and PCX Rule 10.4(c) states that the PCX Business Conduct Committee may make a summary determination and may impose a penalty as to such charges that respondents failed to answer.

2 As result of mergers, the PCX no longer exists as a national securities exchange. An indirect subsidiary of NYSE Euronext is the successor in interest.

3 Picozzi filed a motion to introduce declarations by him and Daniel G. Viola, Andover's former general counsel, pursuant to Rule 452 of our Rules of Practice. 17 C.F.R. § 201.452. Rule 452 requires a movant to show reasonable grounds for failure to adduce such evidence previously and that the additional evidence is material. Picozzi asserts that, because he was unaware of the PCX's proceedings, he has not yet had an opportunity to respond to PCX's allegation or to introduce any evidence. NYSE does not oppose Picozzi's motion. We believe that Picozzi's motion satisfies the requirements of Rule 452 and therefore admit the declarations.

During this time, Picozzi was negotiating with SunGard Data Systems ("SunGard") for the sale of substantially all of Andover's assets, which sale was completed on March 3, 2003. Picozzi states that the PCX information request did not appear on any schedule of Andover's purchase agreement with SunGard and that he "had no basis to believe that Andover had any outstanding regulatory issues or requests for information that were not being addressed when I sold nearly all of Andover's assets to SunGard."

After the sale, SunGard controlled Andover's former office space, and a SunGard subsidiary (Assent LLC) operated Andover's former business. According to Picozzi, Assent's general securities principal would have handled any incoming mail to the address. In his declaration, Picozzi states that, although the PCX sent several additional request for information to Andover's address, "[n]o one at Assent informed me about any of the post-sale PCX mailings."

On October 23, 2003, the PCX filed a complaint against Andover and Picozzi (the "Complaint"), charging them with violating PCX Rule 10.2(d) for failing to furnish information and testimony requested by PCX, thereby obstructing a PCX regulatory investigation (the "Proceeding").[4] The PCX mailed the Complaint to Picozzi, care of Andover Securities, LLC, but Picozzi states that no one forwarded the Complaint to him and that he "never saw it until 2010." After Picozzi and Andover failed to respond, the PCX issued the Notice of Summary Determination on October 25, 2004, censuring and permanently barring Picozzi and Andover from association with any PCX member or member organization, with the provision that, if Picozzi and Andover "fully cooperated" with PCX within three months after issuance of the Notice of Summary Determination, "the permanent bar would be lifted and an appropriate sanction for obstructing the investigation be imposed." Neither Picozzi nor Andover ever responded to the Notice of Summary Determination, and Picozzi now states that "I never saw a single one of these [PCX] mailings until 2010."

As a result of the sale of Andover to SunGard, Picozzi was subject to a five-year non-competition agreement. After the agreement expired, Picozzi decided to re-enter the securities industry in early 2010, at which point he claims to have learned of the PCX bar. Picozzi now petitions the Commission to vacate the default summary determination. The NYSE does not oppose his petition.[5]

---

4 As outlined in the Notice of Summary Determination, PCX Rule 10.2(d) prohibited Equity Trading Permit Holders (of which Andover was one) from impeding or delaying a regulatory investigation regarding possible violations or refusing to furnish testimony, documentary materials, or other information requested by the PCX during one of its investigations. Failure to furnish such information or materials was considered to be obstructive of an inquiry or investigation.

5 Picozzi also asks us to "expunge" his CRD (Central Registration Depository) record, but we see no basis for doing so. We assume that FINRA will update Picozzi's CRD

(continued...)

III.

The record contains few details about what occurred during the PCX's investigation or the PCX's attempts to serve documents on Picozzi. The evidence essentially consists of Picozzi's uncontradicted declaration that he did not see the PCX's Notice of Summary Determination, the Complaint, or other PCX mailings until 2010. Picozzi also declares that, had he been aware of the PCX's Complaint and Notice of Summary Determination, he would have responded to them. He also asserts that the information PCX sought during the Investigation was readily available and would have shown that he had not engaged in improper conduct in connection with the THC transactions. Picozzi argues that it is now "utterly disproportionate" for him to be barred from the industry for failing to respond to a complaint he never saw.

The NYSE does not oppose Picozzi's petition. The NYSE explains that "there is uncertainty" about whether Picozzi received notice of the Complaint or Notice of Summary Determination before 2010. "Because of that uncertainty," the NYSE states that it has "reason to believe that Picozzi did not in fact deliberately obstruct or impede the Investigation, and did not have the opportunity to defend himself in the Proceeding." The NYSE adds that, "given the passage of time, the [NYSE] likely cannot now as a practical matter determine whether Picozzi, or even Andover for that matter, engaged in any improper conduct in connection with the trading that was the subject of the Investigation."

Given the unique facts of this case, including the lack of evidence surrounding the PCX's attempts to serve Picozzi with the Notice of Summary Determination and the NYSE's statement that it does not oppose Picozzi's petition, we believe it is appropriate to set aside the PCX's findings of violations and sanctions.[6] In reaching this conclusion, we emphasize that our decision regarding Picozzi's petition turns on the particular circumstances of this case and in no

---

[5] (...continued)
record to reflect our decision in this matter. We also note that Picozzi initially moved for oral argument in this matter, but withdrew that request when he learned that NYSE did not oppose his petition.

[6] *Cf. Roger B. Johnson*, 50 S.E.C. 1164, 1165-66 (1992) (declaring a default summary judgment issued by the PCX to be "null and void" where respondent asserted that he never received the complaint that the PCX had improperly served).

way diminishes established precedent that a respondent's lack of awareness of official regulatory correspondence is not a defense where evidence shows that the regulatory entity properly sent correspondence to the address that the respondent provided to the regulatory agency.[7] An appropriate order will issue.[8]

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

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

---

[7] *See, e.g., Dennis A. Pearson, Jr.*, Securities Exchange Act Rel. No. 54913 (Dec. 11, 2006), 89 SEC Docket 1627, 1638 (noting that "[i]t is the responsibility of NASD members and their associated persons to keep NASD apprised of any changes in their addresses, and a failure to respond to NASD in connection with an investigation . . . is not excused by that person's having temporarily moved from the address listed in the CRD"); *Warren B. Minton, Jr.*, 55 S.E.C. 1170, 1177 n.15 (noting that associated persons have "a continuing duty to notify the [NASD] ... of [their] current address, and to receive and read mail sent to [them] at that address" (quotation omitted)).

[8] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65569 / October 14, 2011

Admin. Proc. File No. 3-14396

In the Matter of the Application of

MICHAEL PICOZZI III
c/o Timothy A. Valliere, Esq.
Smith Valliere PLLC
75 Rockefeller Plaza, 21st Floor
New York, New York 10019

For Review of Disciplinary Action by

PCX Equities, Inc.

ORDER SETTING ASIDE DISCIPLINARY ACTION OF NATIONAL SECURITIES EXCHANGE

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

ORDERED that the disciplinary action taken by PCX Equities, Inc. against Michael Picozzi III be, and hereby is, set aside.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65582 / October 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14589

In the Matter of **Lisa C. Berry,** **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 Lisa C. Berry ("Respondent" or "Berry") 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 her and the subject matter of these proceedings, and the findings contained in Section III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e)

[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.

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. Berry, age 53, is and has been an attorney qualified to practice in California. From September 1996 to June 1999, Berry was Vice President and General Counsel for KLA-Tencor Corporation ("KLA"). From June 1999 to January 2004, Berry was General Counsel for Juniper Networks ("Juniper"). From June 1999 to December 2003 she was the Secretary of Juniper and from February 2000 until January 2004 she was a Vice President of Juniper.

2. At all relevant times, KLA was a Delaware corporation headquartered in San Jose, California, that made and sold systems for the semiconductor industry, and whose common stock was registered with the Commission pursuant to Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. § 78*l*].

3. At all relevant times, Juniper was a Delaware corporation headquartered in Sunnyvale, California, that made and sold internet-related networking products, and whose common stock was registered with the Commission pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78*l*].

4. On August 28, 2007, the Commission filed a civil injunctive action against Berry, captioned *Securities and Exchange Commission v. Berry*, Case No. C-07-4431-RMW (N.D. Cal.). On October 7, 2011, the court entered an order permanently enjoining Berry, by consent, from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. §§ 77q(a)(2) and (3)], Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)] and Rule 13b2-1 under the Exchange Act [17 C.F.R. § 240.13b2-1], and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) and 14(a) of the Exchange Act [15 U.S.C. §§ 78m(a), 78m(b)(2)(A), 78m(b)(2)(B) and 78n(a)] and Rules 12b-20, 13a-1, 13a-11, 13a-13 and 14a-9 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13 and 240.14a-9]. Berry was also ordered to pay disgorgement with interest totaling $77,120, and to pay a $350,000 civil money penalty.

5. In its Second Amended Complaint (filed September 18, 2008), the Commission alleged, among other things, that from 1997 through 2003 Berry caused KLA and Juniper to report false financial information to the investing public through her preparation of corporate records that concealed the pricing of employee stock option grants with the benefit of hindsight at both companies.

IV.

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

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

Respondent is suspended from appearing or practicing before the Commission as an attorney. After five (5) years from the date of this Order, Respondent may request that the Commission consider her reinstatement by submitting an affidavit to the Commission's Office of General Counsel truthfully stating, under penalty of perjury, that she has complied with the Order; that she is not the subject of any suspension or disbarment as an attorney by a court of the United States or of any state, territory, district, commonwealth, or possession; and that she has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3300 / October 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14590

In the Matter of

JOHN CLEMENT,

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 John Clement ("Clement" 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. Clement was the Chief Executive Officer and co-owner, with his spouse, of Edgefund Capital, LLC ("Edgefund"). Neither Clement nor Edgefund have ever been registered with the Commission in any capacity. Clement, 65 years old, is a resident of Encinitas, California.

2. On September 16, 2011, a judgment was entered by consent against Clement, 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, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. John Clement and Edgefund Capital, LLC, Case Number 11CV1034 LAB WVG, in the United States District Court for the Southern District of California.

3. The Commission's Complaint alleged that, beginning in approximately August 2008, Clement raised at least $2,161,000 from at least 22 investors to invest in purported hedge funds The Edge Fund Ltd., LP and The Edgefund LP (of which Edgefund was the general partner). The Complaint further alleged that to induce investors to invest, Clement represented that their monies would be invested in hedge funds which he day traded, that they would receive a monthly return of one to two percent, and that the losses were capped at a maximum of 5% of their principal investment. The Complaint alleged that, in fact, rather than investing the funds, Clement deposited investor monies into a bank account in the name of Edgefund, and that additionally, although he deposited $320,000 of the almost $2.2 million in investor funds raised into a brokerage account in the name of Edgefund, Clement in fact did not make a profit for investors from his trading in that account. The Complaint alleged that nevertheless, in Ponzi-like fashion, Clement distributed investor funds to investors as purported "returns." The Complaint also alleged that Clement used the Edgefund accounts as his personal accounts, misappropriating at least $295,300 for his personal use, and withdrawing at least another $293,417 in cashier's checks.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Clement 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.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of

factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3301 / October 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14591

In the Matter of **DONALD W. KLEIN,** **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 Donald W. Klein ("Respondent" or "Klein").

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 consent 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 Sactions ("Order"), as set forth below.

III.

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

1. From at least May 2009 through January 2010, Klein was the president and CEO of KCM Holdings Corporation, a Nevada corporation with a principle place of business in Frisco, Texas. From April 2008 until December 31, 2010, he was also associated with The KCM Trading Group, LLC, an investment adviser registered with the State of Texas.

2. On September 6, 2011, a permanent injunction was entered by consent against Klein, 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 Exchange Act Rule 10b-5, in the civil action entitled Securities and Exchange Commission v. Donald W. Klein, et al., Case Number 11-cv-61457, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged, among other things, that from at least May 2009 through January 2010, Klein engaged in a fraudulent stock scheme. Klein, through KCM, paid illegal kickbacks to a purported trustee of a pension fund to purchase restricted shares of company stock. Klein, through KCM, issued shares of stock to a middleman who made the introductions. A friend of the trustee helped arrange the deal. Unbeknownst to Klein, the corrupt fund trustee was a creation of the FBI, the friend was an undercover FBI agent, and the middleman was a cooperating witness. After completing the kickback scheme, Klein and the cooperating witness engaged in a market manipulation scheme. Klein made undisclosed payments to the cooperating witness' broker in exchange for his purchase of KCM stock on the open market. Unbeknownst to Klein, the broker was a creation of the FBI. Klein also issued strategically timed press releases to mask the fraud.

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 203(f) of the Advisers Act, that Respondent be, and hereby is barred from association from any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating 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

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. 65584 / October 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14592

In the Matter of **Sergey Rumyantsev,** **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 Sergey Rumyantsev ("Rumyantsev" 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. Rumyantsev was the CEO and head trader at NevWest Securities Corporation ("NevWest"), then a broker-dealer registered with the Commission, from at least January 1, 2002, until April 13, 2006. Rumyantsev was also one of four members of the Board of Directors of NevWest, which had policy-making authority. Rumyantsev holds Series 4 (registered options principal), 7 (general securities representative), 24 (securities principal), 27 (financial and operations principal), 53 (municipal securities principal), 55 (equities trader) and 63 (state securities) licenses. Rumyantsev, 41 years old, is a resident of Las Vegas, Nevada.

2. On August 1, 2011, after the Commission's motion for summary judgment against Respondent was granted, a final judgment was entered against Rumyantsev, permanently enjoining him from violating Section 5 of the Securities Act of 1933, 15 U.S.C. § 77e, and additionally permanently barring him from participating in an offering of penny stock, in the civil action entitled *SEC v. CMKM Diamonds, Inc. et al.*, Case No. 2:08-cv-00437-LRH-RJJ, in the United States District Court for the District of Nevada.

3. In granting the Commission summary judgment, the Court concluded, among other things, that the following facts were uncontroverted: (a) while CEO of NevWest, Rumyantsev allowed NevWest to acquire and distribute newly issued unregistered stock certificates representing billions of shares of stock of CMKM Diamonds, Inc., a Nevada corporation, from which the restrictive legends had been improperly removed by CMKM's transfer agent; (b) Rumyantsev allowed an individual associated with CMKM to open more than thirty different brokerage accounts at NevWest in more than thirty different names, while using the same social security number for most accounts, for the sole purpose of trading the unrestricted shares of CMKM stock, which were sold in several unregistered distributions between December 2002 and September 2004.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Rumyantsev 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; 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
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. 65589 / October 18, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14593

In the Matter of JEFFREY GREENEY, 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 Jeffrey Greeney ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2 and III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 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. **Greeney** was the CFO and 20% owner of Westcap Securities, Inc. ("Westcap") from February 2001 to December 2008. Greeney, age 40, is a resident of Laguna Niguel, California.

2. On October 3, 2011, a final judgment was entered by consent against Greeney, permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act"), in the civil action entitled Securities and Exchange Commission v. Jeffrey Greeney et al., Civil Action Number11-01467, in the United States District Court for the Central District of California.

3. The Commission's complaint alleged that, from approximately April 2007 through December 2007, Greeney and an entity he controlled violated Securities Act Sections 5(a) and 5(c) by selling shares of Bluefire Ethanol Fuels, Inc. and Advanced Growing Systems, Inc. through the use of means of interstate transportation or communication or the mails, while no applicable registration statement was in effect or on file for the offer or sale of those securities and without any available exemption from registration.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Greeney 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; with the right to apply for reentry after three (3) 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
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 ACT OF 1933
Release No. 9268 / October 19, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3302 / October 19, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14594

In the Matter of

CREDIT SUISSE ALTERNATIVE CAPITAL, LLC (f/k/a CREDIT SUISSE ALTERNATIVE CAPITAL, INC.), CREDIT SUISSE ASSET MANAGEMENT, LLC, and SAMIR H. BHATT

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND 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 Section 8A of the Securities Act of 1933 ("Securities Act") and Section 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Credit Suisse Alternative Capital, LLC (f/k/a Credit Suisse Alternative Capital, Inc.) ("CSAC") and Credit Suisse Asset Management, LLC ("CSAM") and Section 8A of the Securities Act and Sections 203(f) and 203(k) of the Advisers Act against Samir H. Bhatt ("Bhatt") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, CSAC has submitted an Offer of Settlement of Credit Suisse Alternative Capital, LLC (f/k/a Credit Suisse Alternative Capital, Inc.) ("CSAC Offer"), CSAM has submitted an Offer of Settlement of Credit Suisse Asset Management, LLC ("CSAM Offer"), and Bhatt has submitted an Offer of Settlement of Samir H. Bhatt ("Bhatt Offer"), all of 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 and Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act, 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[1] that

A. Summary

1. This matter involves violations of federal securities laws by CSAC, the predecessor of CSAM, and Bhatt, a former registered representative and portfolio manager at CSAC, in connection with the structuring and marketing of a largely synthetic collateralized debt obligation ("CDO") known as Class V Funding III ("Class V III"). The investment portfolio for Class V III consisted primarily of credit default swaps ("CDS") referencing other CDO securities with collateral consisting primarily of subprime residential mortgage-backed securities ("RMBS"). As a result, the value of Class V III and its underlying investment portfolio was tied to subprime mortgages and the United States residential housing market. CDO-squareds such as Class V III were designed to, and did, provide leveraged exposure to the housing market and therefore magnified the severity of losses suffered by investors when the United States housing market experienced a downturn.

2. Class V III was structured and marketed by Citigroup Global Markets Inc. ("Citigroup"). The marketing materials for Class V III – including a pitch book and an offering circular – represented that the investment portfolio was selected by CSAC, a registered investment adviser. CSAC promoted itself as having experience and expertise in analyzing credit risk in CDOs, using an extensive asset selection process. Undisclosed to either investors or the directors of the special purpose vehicles ("SPVs") that issued the securities to investors in Class V III, CSAC allowed Citigroup to exercise significant influence over the composition of Class V III's investment portfolio.

3. Bhatt was the portfolio manager at CSAC primarily responsible for the Class V III transaction. Bhatt was responsible for selecting the assets in accordance with CSAC's stated processes, as well as for negotiating and executing the purchase of those assets on behalf of Class V III. Bhatt and CSAC understood that Citigroup was seeking to short assets into Class V either for itself or for its customers (though did not necessarily know which), and thus that Citigroup was representing economic incentives potentially adverse to those of Class V III and its investors.

---

[1] The findings herein are made pursuant to the CSAC Offer, the CSAM Offer, and the Bhatt Offer and are not binding on any other person or entity in this or any other proceeding.

Rather than follow CSAC's stated asset selection process, Bhatt provided Citigroup with a list of potential assets with which he had some familiarity, and allowed Citigroup to select from the list the names on which it wanted to purchase protection. The CDO securities on which Citigroup bought protection had a notional value of approximately $500 million, representing half of the Class V III investment portfolio. Citigroup's selections were weighted towards assets that were regarded by the market as particularly risky.

4. CSAC and Bhatt also represented in the pitch book that CSAC performed extensive credit analysis on all of the assets that it selected for the portfolio. In actuality, CSAC and Bhatt performed little-to-no analysis on several of the assets in the portfolio. Specifically, CSAC and Bhatt purchased several cash bonds from deals underwritten by Citigroup without having done any credit work on those bonds. The final Class V III investment portfolio contained nine cash bonds with a total value of approximately $130 million (approximately 13% of Class V III's total investment portfolio). Of those nine bonds, six, with a face value of $92.25 million, were purchased from Citigroup. For five of the six bonds purchased from Citigroup, CSAC and Bhatt did not perform the credit analysis as represented in the marketing materials. Bhatt was responsible for purchasing these bonds.

5. The offering circular for Class V III represented that the assets in the portfolio were purchased at "fair market value." This statement was inaccurate. Rather than seeking market bids, CSAC and Bhatt purchased most of the synthetic assets (i.e. those referenced by the sale of protection via CDS) in two separate portfolio trades with Citigroup. After determining that Citigroup had paid prices well below what was available in the market for individual assets (i.e. Citigroup had purchased protection for lower premium payments than it would have had to pay for the individual assets in a market transaction as of that day) for the first portfolio trade, CSAC and Bhatt nevertheless proceeded with a second portfolio trade with Citigroup. The prices CSAC and Bhatt obtained in that second trade were higher than for the first trade, but well below what was available in the market for individual assets. CSAC and Bhatt did not take meaningful action to verify that CSAC was obtaining market prices in the transactions with Citigroup. CSAC and Bhatt did not disclose to its client or to investors in Class V III that the synthetic assets were not acquired at market value.

6. CSAC and Bhatt participated in drafting the marketing materials, including the pitch book and offering circular, and provided the original drafts of the sections concerning CSAC and its stated collateral selection process. The documents themselves attributed responsibility for the content of those sections to CSAC. CSAC and Bhatt also helped market Class V III in meetings and conference calls with actual and potential investors. CSAC and Bhatt, in the marketing materials and in conversations with investors, did not disclose material facts about both the asset selection process and the price of the assets purchased by Class V III.

7. Using the marketing materials which CSAC and Bhatt had helped draft, Citigroup sold approximately $847 million of notes across the capital structure of Class V III to approximately 15 different investors. Investors in Class V III focused on CSAC's role in selecting assets in making its investment decision. They also considered the representations about the asset purchase prices to be important.

8. CSAC collected approximately $1 million in fees for managing Class V III. An affiliate of CSAC also purchased equity in Class V III with a face value of $2 million for a payment of $1.3 million.

9. Class V III proved to be one of the worst-performing CDOs issued during the relevant period. As soon as it was issued, certain knowledgeable market participants noted the poor quality of the portfolio, and much of the underlying collateral declined precipitously in late 2007. By November 2007, collateral representing approximately 83% of the value of Class V III had been downgraded. As a result, an event of default was declared on November 19, 2007, making Class V III the second-fastest CDO-squared transaction to default. Investors in Class V III lost virtually their entire investments.

Respondents

10. **Credit Suisse Alternative Capital, LLC (f/k/a Credit Suisse Alternative Capital, Inc.) ("CSAC")**, an investment adviser registered with the Commission and based in New York, was an investment adviser to various managed investment vehicles, including CDOs, throughout the relevant period. CSAC assigned its investment management agreements to its affiliate CSAM in January 2011. CSAC has not been a registered entity since December 2010. CSAC currently serves as the general partner of and administrator for certain limited partnerships, and does not serve as an investment adviser. CSAC is a wholly owned subsidiary of Credit Suisse Securities (USA) LLC, the principal U.S. broker-dealer and investment adviser subsidiary of Credit Suisse Group, a global financial services firm based in Switzerland.

11. **Credit Suisse Asset Management, LLC ("CSAM")** is an investment adviser registered with the Commission and based in New York. As a result of acquiring CSAC's investment advisory business, CSAM is the successor in interest to CSAC. CSAM is a wholly-owned subsidiary of Credit Suisse Securities (USA) LLC.

12. **Samir H. Bhatt ("Bhatt")**, age 37, worked at CSAC and related entities from 1999 to 2008. In 2004, he was part of the team in an asset management unit of Credit Suisse Securities USA that became CSAC, and was with CSAC until his departure in 2008. During 2006 and 2007, Bhatt served as a Director in CSAC's Leveraged Investment Group ("LIG"), which was responsible for the management of CDOs and other structured finance vehicles. Bhatt was a registered representative during 2006 and 2007. Bhatt resides in New York, New York.

Other Relevant Entities

13. **Citigroup Global Markets Inc. ("CGMI,"** and along with certain affiliates, **"Citigroup")** is the principal U.S. broker-dealer subsidiary of Citigroup Inc. CGMI is a wholly owned subsidiary of Citigroup Inc. CGMI acted as the warehouse provider, arranger, initial purchaser, and placement agent for Class V III. An affiliate of CGMI served as the initial short counterparty to all the CDS assets in Class V III.

Background

14. CDOs are debt securities collateralized by fixed income obligations, such as RMBS. A CDO collateralized by bonds is known as a "cash CDO." A CDO collateralized by tranches of other CDOs is called a CDO-squared. Investors in a CDO-squared receive payments derived from the cash flows produced by the investment portfolio. The securities in the investment portfolio are packaged and held by a special purpose vehicle ("SPV"), an independent entity with its own board of directors, that issues the notes. Investors in a cash CDO-squared receive payments derived from the principal and interest paid by the underlying CDO tranches in the investment portfolio.

15. The cash flows from the CDO-squared are distributed to the notes in a waterfall fashion, based on seniority. The "super senior" tranche is at the top of the waterfall and thus has the first right to receive principal and interest. It is considered to have the lowest likelihood of being affected by negative performance of the underlying collateral. Next in priority are the senior tranches, which are typically rated AAA or AA by the rating agencies. Below the senior tranches are the "mezzanine" tranches, rated A and BBB, which are junior in priority and, therefore, carry more risk. Below the mezzanine tranches are the subordinated notes, or equity, which are the first to experience losses based on negative performance of the underlying collateral.

16. A CDO collateralized only by CDS is called a "synthetic CDO." A CDS is an over-the-counter derivative contract that functions like insurance on a so-called "reference asset" or "reference issuer." In a CDS transaction, a "protection buyer" makes periodic premium payments to a "protection seller." In exchange, the protection seller promises to pay the protection buyer if the reference asset experiences a "credit event," such as a default. Because the protection seller generally receives premium payments while the reference asset is performing but suffers a principal loss if the reference asset defaults, the protection seller is considered to have a long position on the reference asset. In contrast, because the protection buyer receives payments when the reference asset experiences a credit event, and thus declines in value, the protection buyer is considered to have a short position on the reference asset. Investors in a synthetic CDO-squared receive payments derived from the periodic premium payments that the SPV receives from the protection buyers on the CDS into which the SPV entered.

17. A hybrid CDO is a CDO collateralized by both cash assets (i.e. bonds) and synthetic assets (i.e. CDS). Class V III was a hybrid CDO-squared. Typically, in a CDO-squared with synthetic assets (such as Class V III), the arranging bank, i.e. the bank that structures and markets the transaction, plays the role of initial CDS asset counterparty. In its role as initial CDS asset counterparty, the arranging bank typically acts through its trading desks as an intermediary between the CDO-squared SPV and other market participants. If there is a collateral manager, the collateral manager identifies a counterparty for a CDS that it wants to include in the investment portfolio of the CDO-squared and the arranging bank intermediates that trade (that is, sells protection to that counterparty and simultaneously buys protection from the CDO-squared) in exchange for a small "intermediation fee." In addition, the arranging bank can itself negotiate with the manager to purchase protection from the CDO, either for an interested customer or the arranging bank's own account. When the arranging bank trades directly with the CDO-squared, there is no intermediation fee. If the arranging bank sells protection to one of its customers, it

seeks to capture as profit the difference between what it pays for protection and what it charges its customer – the spread between the two trades.

18. Prior to the closing date in a CDO-squared transaction, it is typical for the arranging bank to have acquired most of the collateral (whether cash or synthetic) on behalf of the CDO-squared. During the resulting "warehouse" period, the arranging bank typically finances the acquisition of collateral and places that collateral in a segregated account or "warehouse." If there is a collateral manager for the CDO-squared, it is the collateral manager that directs what assets will be acquired by the warehouse. In the case of a synthetic CDO-squared, the arranging bank, in its role as initial CDS asset counterparty, will buy protection from the warehouse. When the CDO-squared transaction closes, the assets are transferred to the SPV, and the SPV becomes the protection seller. The SPV uses the money from investors in the CDO-squared's notes to make any contingent payments due under the CDS if there are credit events on the assets in the reference portfolio. Thus, once the arranging bank sells the CDO-squared notes to outside investors, those investors have effectively taken the long side of the underlying CDS transactions.

CSAC Allows Citigroup to Influence the Selection of Assets for Class V III's Investment Portfolio

19. During late 2006 and early 2007, certain hedge funds and other market participants came to believe that CDOs whose assets consisted primarily of BBB-rated subprime RMBS (so-called "mezzanine" CDOs) would experience significant losses, leading even the A-rated tranches of "mezzanine" CDOs to potentially become worthless. These market participants sought to profit from a downturn in the United States housing market by buying protection through CDS on A-rated tranches of mezzanine CDOs originated in 2006. The increased demand for protection in the market led to the widening of spreads that market participants were willing to pay for protection on A-rated tranches of CDOs. CDS premiums are typically based on a spread over a risk free funding rate, such as LIBOR. All other things being equal, a wider spread on a CDS indicates a higher level of perceived riskiness in the reference asset underlying the CDS. With this widening of spreads, internal discussions began at Citigroup about the feasibility of structuring and marketing a CDO-squared collateralized by A-rated tranches.

20. On November 1, 2006, CSAC and Bhatt spoke with representatives of Citigroup to discuss the possibility of CSAC managing a CDO-squared to be underwritten by Citigroup. After the meeting, a Citigroup employee emailed Bhatt and Bhatt's supervisor, the head of LIG, with the subject line "CDO-squared Proposal – Portfolio," which read, "Thanks for taking the time to talk about the CDO-squared proposal earlier today... As discussed, I'm attaching herewith a list of about 30 CDOs that are contemplated to be in the portfolio. This is a first cut, but should be good enough to give both parties an idea of whether or not a trade is feasible." Attached was a list of 25 CDOs (the "Citigroup November 1 List").

21. Twenty-two of the 25 CDOs on the list provided by Citigroup were mezzanine CDOs. Mezzanine CDOs were perceived as risky investments (generally with higher spreads as a result). All 22 of the mezzanine CDOs on the Citigroup November 1 List were "2006 vintage," meaning they were structured and sold in 2006. 2006 vintage CDOs were perceived as being more risky than CDOs of earlier vintages, due to their exposure to mortgages originated in 2006. Many

of the CDOs on the Citigroup November 1 list were CDOs for which Bhatt knew there was a large amount of demand in the market to short. In other words, Bhatt should have known that Citigroup was proposing a portfolio weighted towards CDOs that many market participants believed would perform poorly.

22. In an internal email on November 2, the head of Citigroup's CDO Trading desk, who had supplied the list that was provided to CSAC on November 1, indicated that Bhatt was "amenable" to including in the prospective CDO-squared the assets that Citigroup suggested.

23. Between November 1 and December 21, Citigroup and CSAC held intermittent discussions regarding the potential agreement between the two firms for the CDO-squared, including extensive negotiations about the fee to be paid to CSAC. During that period, spreads continued to widen on A-rated tranches of mezzanine CDOs. In late December 2006, CDS spreads on single-A CDO tranches widened further, and Citigroup renewed its efforts to finalize the engagement with CSAC and move forward with the CDO squared. As a result of those efforts, CSAC and Citigroup agreed to proceed with the transaction.

24. On December 21, 2006, Bhatt held conversations with Citigroup personnel about moving forward with the CDO-squared. After those discussions, Bhatt sent Citigroup an email with a list of 127 CDO names for potential inclusion in the CDO-squared ("Bhatt December 21 List"). The 127 names, which Bhatt described as "[CDOs] that we own some part of in [other CDOs managed by CSAC] . . . [and] other deals I am familiar with," were diversified by deal type and vintage, with only a portion represented by recent-vintage, mezzanine CDOs. The list included approximately 19 of the original 25 names Citigroup provided CSAC on November 1, 2006.

25. Citigroup and CSAC executed an engagement letter on or about January 8, 2007, pursuant to which Citigroup agreed to arrange and place a CDO-squared with an investment portfolio of primarily cash and synthetic investments in CDOs, and CSAC agreed to select and manage that portfolio. The engagement letter provided that Citigroup would function as warehouse provider for the CDO-squared, and that CSAC, as manager, would "direct the purchase of securities" into the warehouse "for subsequent delivery by Citigroup to [the CDO SPV] on the Closing Date at the price such securities were purchased . . . ."

26. At approximately 9:58 AM on January 8, 2007, the Citigroup salesperson responsible for the CSAC account forwarded to Bhatt an email from a Citigroup CDO trader. The Citigroup CDO trader had written, "Here are the names where we would like to buy protection from CSAC," and had selected 25 names from the Bhatt December 21 List (the "Citigroup January 8 List"). All 25 of the names on the Citigroup January 8 List were mezzanine CDOs, and 24 of the 25 were from the 2006 vintage. Sixteen of the 25 names on the Citigroup January 8 List were also on the Citigroup November 1 List. Five of the nine names from the Citigroup November 1 List that were not on the Citigroup January 8 List were actually on the CSAC December 21 List, but Citigroup did not seek to short those names on January 8.

27. By approximately 10:57 AM, less than one hour later, CSAC had agreed to include all 25 of the names from the Citigroup January 8 List in the Class V III investment portfolio.

While CSAC had performed some due diligence on most of the 25 names on the Citigroup January 8 List at some point in the past, there is no evidence that CSAC undertook any additional action to analyze the collective properties of the particular set of 25 names on the Citigroup January 8 List to assess their propriety for use as collateral for Class V III. Instead, CSAC simply agreed to fill half of the portfolio with the names that Citigroup wanted to short.

28. By approximately 12:34 PM, Bhatt had agreed to sell protection to Citigroup for $10 million face value on each of the 25 names, for a total of $250 million, or half of the anticipated total dollar value of the Class V III portfolio.

29. On January 12, 2007, Citigroup and CSAC agreed to double the total size of Class V III to $1 billion. Bhatt agreed to allow Citigroup to short another $10 million each of the 25 names from the Citigroup January 8 List. Thus, following the additional $250 million trade on January 12 (the "January 12 Upsize Trade), the assets that Citigroup selected and shorted comprised $500 million of the anticipated $1 billion total Class V III portfolio. Notwithstanding all of the indications that there was significant demand in the market for protection on A-rated tranches of 2006 mezzanine CDOs, CSAC executed the January 12 Upsize Trade directly with Citigroup, without seeking competitive bids.

CSAC Purchases Certain Citigroup Bonds without Performing Credit Analysis

30. The majority of the final Class V III portfolio was comprised of synthetic assets. However, the portfolio also included nine actual bonds issued by other CDOs ("cash assets," and collectively, the "cash portfolio.") As with the synthetic portfolio, CSAC, as the manager, had the responsibility for identifying, evaluating, and selecting cash assets for the Class V III portfolio.

31. Bhatt directed the purchase of nine cash assets for the Class V III portfolio, with a face value of approximately $130 million. Of those nine bonds, six were purchased from Citigroup, with a total face value of approximately $92.25 million ("Citigroup Cash Assets"). The Citigroup Cash Assets were all tranches of CDOs structured and marketed by Citigroup.

32. CSAC's internal policies required that, in connection with CSAC's selection of CDO assets for portfolios that it managed, certain types of analysis must be performed in order to assess the asset prior to its purchase for the portfolio. The analysis that CSAC was supposed to perform or obtain for each CDO asset was listed on a document titled "Documentation Requirements for Deal files – ABS Transactions" ("CDO Documentation Requirements"). Bhatt was aware that the analysis required by the CDO Documentation Requirements should have been performed for every CDO asset purchased by CSAC.

33. Bhatt directed the purchase of four of the Citigroup Cash Assets without having performed or obtained the analysis called for by the CDO Documentation Requirements. Of the remaining two Citigroup Cash Assets, CSAC obtained the full analysis spreadsheet for only one, and obtained only partial results for another. By contrast, Bhatt did obtain or perform the analysis called for by the CDO Documentation requirements for all three of the cash assets that were not purchased from Citigroup.

CSAC Failed to Obtain Market Value in the Two Portfolio Trades with Citigroup

34. CDS assets are typically priced based on a spread over a risk free funding rate, such as LIBOR. For example, if a CDS trades at a spread of L+ 200 basis points, that means that the protection buyer will pay a total of LIBOR plus 2% per year of the insured amount to the protection seller. All other things being equal, a wider spread on a CDS indicates a higher level of perceived riskiness in the reference asset. Obtaining a fair market price for the assets in the investment portfolio is the responsibility of a CDO manager. With synthetic assets, that means the CDO manager should seek the widest spreads (i.e. the highest price) available for the assets in the CDO's investment portfolio. The wider the spread, the greater the amount of money available to the CDO to pay off the notes and the equity tranche.

35. When a manager wants to purchase synthetic assets for a CDO, the manager typically does so in one of two ways. The most common method is by conducting what is called a "BWIC," which stands for Bids Wanted in Competition. Simply put, a BWIC is a competitive bidding process in which the manager sends out, through various dealers, a list of reference assets on which it wishes to sell protection. Interested parties provide their bid (i.e. the widest spread they are willing to pay for protection), and, assuming the bids meet the manager's minimum requirements, the manager will then typically trade with the highest bidder. Conducting a BWIC helps ensure that the manager receives a fair market price for the assets.

36. Alternatively, the manager can source synthetic collateral by negotiating directly with a counterparty, such as a dealer who the manager knows has an "axe," or mandate to trade, on a specific name. The collateral manager uses its knowledge of the market and the specific reference asset to negotiate a price for the trade. If a manager decides to trade directly with a counterparty, the manager generally verifies that the price at which it is trading is fair and reasonable. Managers typically obtain such verification either by contacting other market participants to see where they would bid for assets, or by comparing the prices to contemporaneous trades in identical or similar assets.

37. CSAC and Bhatt agreed to prices on Citigroup's purchase of protection on $500 million of assets in the Class V III investment portfolio that were significantly lower than what was available in the market for those individual assets at the time of the trades. Rather than seeking market bids for the assets in the portfolio, CSAC purchased (i.e. sold protection on) most of the synthetic assets in the two separate portfolio trades with Citigroup, in order to allow Citigroup to source, or act as the protection buyer on, a significant portion of the collateral. Despite recognizing that Citigroup had paid prices (i.e. had agreed to pay ongoing premiums) significantly below those available in the market at the time of the first portfolio trade, CSAC and Bhatt nevertheless proceeded with a second portfolio trade with Citigroup at prices that, although higher than those for the first portfolio trade, it knew or should have known were below what was available in the market.

38. On the morning of January 8, 2007, within approximately two hours after CSAC agreed to allow Citigroup to short the names from the Citigroup January 8 List, Bhatt agreed to sell protection on $10 million of each name to Citigroup at an average spread of 200.8 basis points. Bhatt took no action to verify that the price he was accepting was a market price. Rather, Bhatt

based his position on prices at which he had seen similar assets trade in mid-December 2006. Internal Citigroup documents show that it was willing to pay up to 23% higher spreads for some of the names in the portfolio trade, and that Citigroup was willing to pay an average spread of 214.8 basis points for the portfolio trade as a whole – fully 14 basis points higher than CSAC obtained, which would translate to $350,000 per year in additional payments to Class V III.

39. Between the January 8 and January 12, 2007 trades with Citigroup, CSAC received sufficient information to put it on notice that significantly higher prices were available in the market than it had demanded from Citigroup. For example, on January 8, another collateral manager ("Third Party Manager") conducted a BWIC for 26 A-rated tranches of 2006 vintage mezzanine CDOs, seven of which were also part of the January 8 Portfolio Trade. As was customary in the market, after the BWIC was completed, the Third Party Manager distributed to various market participants a list showing the second-highest bid ("cover") that it received on each asset. For the seven assets that appeared in both the BWIC and the January 8 Portfolio Trade, the manager obtained a 21% higher spread, on average, than CSAC obtained from Citigroup in the January 8 Portfolio Trade. For the Third Party Manager's complete list of 25 names (one did not trade), the average cover (that is, *second* highest bid received) was 238.2 basis points, or an approximately 18.6% higher spread, on average, than CSAC obtained on a virtually identical asset pool in its portfolio trade with Citigroup. Several individuals at CSAC, including Bhatt, received the list of the Third Party Manager's BWIC covers on the afternoon of January 8.

40. In addition, between January 8 and January 12, Bhatt received at least three inquiries from other market participants seeking to buy protection from CSAC on assets which had been part of the January 8 Portfolio Trade. In each instance, the *bid* was higher than the price received by CSAC from Citigroup on January 8.

41. CSAC had even more direct evidence of how far below market the January 8 Portfolio Trade had been executed. On January 10, in order to fill out the rest of the Class V III synthetic portfolio, CSAC conducted a BWIC (the "January 10 BWIC") for additional A-rated, 2006 vintage mezzanine CDO tranches that it selected for the Class V III portfolio. Eighteen of the assets on the January 10 BWIC were placed into the Class V III portfolio. For the 18 assets on the January 10 BWIC, CSAC received an average spread of 252 basis points, a 25% higher spread than CSAC received from Citigroup in the January 8 Portfolio Trade. Bhatt conducted the January 10 BWIC for CSAC.

42. On January 12, 2007, Citigroup and CSAC executed the January 12 Upsize Trade. While CSAC did obtain more from Citigroup on January 12 than it did on January 8, CSAC knew or should have known that the price Citigroup paid on January 12 was in many cases still significantly lower than prices that were available in the market. For the three overlapping assets, the prices on the January 12 Upsize Trade were even lower than the bids on those assets that CSAC received from other market participants between January 8 and January 12. Indeed, the average spread that CSAC received for the 25 assets in the January 12 Upsize Trade was 230.8 basis points, significantly lower than the spreads that CSAC itself obtained for similar assets in the January 10 BWIC.

43. As of the time of the January 8 Portfolio Trade, CSAC and Citigroup had agreed to a "spread target" for the Class V III portfolio of 215 basis points, meaning the goal was for the weighted average spread of the assets in the portfolio to meet that target. Because the weighted average spread of the January 8 portfolio trade with Citigroup was only 200.8 basis points, CSAC was forced to add assets with wider spreads, and thus more risk, to achieve the target spread. This meant that even the portion of the portfolio selected without any influence by Citigroup was tilted towards higher risk assets than might otherwise have been the case. Had CSAC obtained market prices in the first portfolio trade, it could have sought less risky assets to complete the ramp, while still achieving the target spread. Essentially, by selling protection to Citigroup for below-market spreads, CSAC was assuming heightened risk for Class V and its investors without the necessary corresponding increase in premiums.

CSAC's and Bhatt's Roles in Drafting Misleading Marketing Materials

44. The primary marketing materials for Class V III were the offering circular (similar in content to a prospectus in a registered offering) and the pitch book (a PowerPoint presentation provided to potential investors). Both documents represented that CSAC selected the investment portfolio pursuant to a detailed asset selection process. The marketing materials failed to disclose Citigroup's influence over the asset selection process and CSAC's deviations from its advertised process. The marketing materials also falsely represented that the assets were acquired at "fair market value."

45. CSAC and Bhatt helped draft a 64-page pitch book for Class V III dated February 2007, which was finalized on or about February 5, 2007. The pitch book described CSAC as the "Collateral Manager," and stated that the collateral for Class V III had been "selected" by CSAC. Specifically, CSAC and Bhatt were responsible for the contents of a 25-page section of the pitch book, titled "The Manager." The first page of the "Manager" section included a disclaimer that read, "*Information related to CSAC, its personnel, organization, affiliates, processes and historical performance has been provided by CSAC. Citigroup is not responsible for the content of the following section and has not independently verified any such information.*"

46. The "Manager" section supplied by CSAC provided an overview of CSAC, and described its track record, investment philosophy, and most significantly, included a detailed, 9-page section titled "Portfolio Construction and Management," purporting to describe CSAC's rigorous approach to selecting each asset it put in the investment portfolio of its CDOs. In this section, CSAC claimed that it "utilizes a credit-intensive, relative value investment approach in managing structured finance assets," and that it "believes performance is driven by a strong credit culture and systematic investment process." In another sub-section, CSAC described its "CDO Investment Process," which it claimed included three steps: "Evaluation of Transaction Structure," "Evaluation of Collateral Manager," and "Evaluation of Underlying Collateral." Another page represented that a key element of CSAC's "process" was "bottom-up fundamental security selection." The "Portfolio Construction and Management" section also contained screenshots and descriptions of the detailed modeling and analysis that CSAC claimed to undertake in connection with its credit selection process.

47. Various CSAC personnel, including Bhatt, participated in the original drafting of the "Manager" section in connection with previous transactions. For Class V III, Bhatt reviewed and commented on multiple drafts of the pitch book, including the "Manager" section, in late January and early February 2007.

48. In addition to the pitch book, CSAC and Bhatt participated in drafting the 210-page offering circular for Class V III dated February 26, 2007. The offering circular states in at least six separate locations that the portfolio was "selected" by CSAC, and emphasizes the importance of CSAC's process for asset selection. A Risk Factor states that the performance of Class V III's investment portfolio "depends on the investment strategy and investment process of the Manager in analyzing, selecting and managing the [portfolio]."

49. Similar to the pitch book, CSAC and Bhatt were responsible for the contents of a section titled "The Manager," which included the following disclaimer: "*Information related to CSAC, its personnel, organization, affiliates, processes and historical performance has been provided by CSAC. Citigroup is not responsible for the content of the following section and has not independently verified any such information.*" (emphasis in original) In addition, the offering circular contains a disclaimer that

> TO THE BEST KNOWLEDGE AND BELIEF OF THE MANAGER, HAVING TAKEN ALL REASONABLE CARE THAT SUCH IS THE CASE, THE INFORMATION CONTAINED IN THE SECTIONS ENTITLED "THE MANAGER", "RISK FACTORS—POTENTIAL CONFLICTS OF INTEREST INVOLVING THE MANAGER" AND "RISK FACTORS—CDO OF CDO SECURITIES EXPERIENCE; DEPENDENCE ON MANAGER AND KEY PERSONNEL THEREOF; RELATIONSHIP TO PRIOR INVESTMENT RESULTS" IS IN ACCORDANCE WITH THE FACTS AND DOES NOT OMIT ANYTHING LIKELY TO AFFECT THE IMPORT OF SUCH INFORMATION.

50. The "Manager" section represented that "the Manager [CSAC] will select the portfolio of Eligible Collateral Debt Securities," and that "the Manager's selection of Eligible Collateral Debt Securities is based primarily on structural and credit analysis as well as technical factors which may influence trading levels and pricing." The "Manager" section also contains a description of CSAC, details on its track record, and biographies of its officers and employees.

51. The Class V III marketing materials also assured investors that CSAC's stated asset selection procedures would be followed even for assets purchased from Citigroup. For example, one of the Risk Factors in the offering circular stated that "The Issuer [the Class V III SPVs] will purchase Eligible Collateral Debt Securities from Citigroup or any affiliate thereof only to the extent the Manager determines that such purchases are consistent with the investment guidelines and objectives of the Issuer, the restrictions contained in the Indenture and applicable law," and continued, "all purchases of such Eligible Collateral Debt Securities from any third party (including . . . [CGMI] or any of its affiliates) will be . . . at fair market value (as determined by the Manager in its discretion at the time such Eligible Collateral Debt Security is originally acquired pursuant to the Warehousing Facility) and otherwise on an 'arm's length basis'. . . ."

52. Bhatt reviewed and provided edits to multiple versions of the offering circular in early February 2007.

53. As described above, neither the pitch book nor the offering circular contained a description of the actual process by which the assets in the Class V III investment portfolio were selected. There was no description in either document of either the significant role played by Citigroup in the selection process, or the fact that CSAC purchased several of the cash assets without following its internal procedures for evaluating those bonds.

54. On February 28, 2007, the closing date for the Class V III transaction, CSAC entered into a Management Agreement pursuant to which the Class V III SPV appointed CSAC as its investment adviser and CSAC agreed to select and manage the collateral. Bhatt signed the Management Agreement on behalf of CSAC. The Management Agreement executed by Bhatt on behalf of CSAC contained a certification to the SPV, CSAC's client, that the sections of the offering circular cited above "are true and correct in all material respects and do not omit to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading." On the basis of this certification, the Directors of the SPV authorized the issuance of the offering circular for use in marketing Class V III to potential investors.

Violations

55. Section 206(2) of the Advisers Act prohibits investment advisers from "engage[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." Section 206(2) of the Advisers Act imposes a fiduciary duty on investment advisers obligating them to disclose all material information to their client. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194-97 (1963). Proof of scienter is not required to establish a violation of Section 206(2), but rather may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *Capital Gains*, 375 U.S. at 194-95.) *See also SEC v. Wash. Inv. Network*, 475 F.2d 392, 396 (D.C. Cir. 2007). Negligence is sufficient to establish liability for causing a primary violation that does not require scienter. *In the Matter of KPMG Peat Marwick LLP*, Admin. Proc. No. 3-9500 (2001).

56. Section 17(a)(2) of the Securities Act prohibits any person "in the offer or sale of any securities or securities-based swap agreement . . . to obtain money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." Scienter is not required to establish violations of Section 17(a)(2). *See Aaron v. SEC*, 446 U.S. 680, 697 (1980). Instead, violations of this section may be established by showing negligent conduct. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

57. As a result of the negligent conduct described above, CSAC and CSAM willfully[2] violated Section 206(2) of the Advisers Act and Section 17(a)(2) of the Securities Act.

[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.

58. As a result of the negligent conduct described above, Bhatt willfully violated Section 17(a)(2) of the Advisers Act, and caused CSAC's violation of Section 206(2) of the Advisers Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 203(e), 203(f), and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents CSAC and CSAM shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Section 206(2) of the Advisers Act.

B. Respondent Bhatt shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Section 206(2) of the Advisers Act.

C. Respondent Bhatt be, and hereby is, suspended from association with any investment adviser for a period of six (6) months, effective on the second Monday following the entry of this Order.

D. Respondents CSAC and CSAM shall, jointly and severally, within ten (10) days of the entry of this Order, pay disgorgement of $1,000,000 and prejudgment interest of $250,000, and a civil money penalty of $1,250,000 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 Credit Suisse Alternative Capital, LLC and Credit Suisse Asset Management, LLC as Respondents in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Kenneth R. Lench, Chief of the Structured and New Products Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-6561.

E. Respondent Bhatt shall, within ten (10) days of the entry of this Order, pay a civil money penalty of $50,000 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

---

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)).

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 Samir H. Bhatt 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 Kenneth R. Lench, Chief of the Structured and New Products Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-6561.

F. 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 referenced in paragraphs IV.D. and IV.E., above. The foregoing payments may be combined in a single Fair Fund for distribution to injured investors. Additional monies paid by any defendant or respondent in a related proceeding arising from the underlying conduct also may be added to this Fair Fund for distribution. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, 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 Respondents' payments 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 they 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 CSAC, Respondent CSAM, or Respondent Bhatt 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
October 19, 2011

Securities Exchange Act of 1934
Release No. 65592

In the Matter of **NASDAQ OMX BX, Inc.** **File No. SR-BX-2011-046**	)	**Order Denying NASDAQ OMX BX, Inc.'s Petition for Review of Division of Trading and Markets Suspension of and Institution of Proceedings by Delegated Authority of SR-BX-2011-046; Lifting the Automatic Stay; and Notice of Designation of a Longer Comment Period for the Proceedings**

Pursuant to Rule 431(b)(2) of the Rules of Practice,[1] it is ORDERED that the petition[2] of Boston Options Exchange Group LLC, an options trading facility of NASDAQ OMX BX, Inc., ("BOX") for review of the temporary suspension and institution of proceedings by the Division of Trading and Markets (the "Division") by delegated authority of SR-BX-2011-046[3] is hereby denied. It is further ORDERED that the automatic stay of delegated action pursuant to Rule 431(e) of the Rules of Practice[4] is hereby lifted.

The Commission hereby is also extending the length of the period for market participants to submit comments related to SR-BX-2011-046 until November 17, 2011 and the length of the period for submission of rebuttal comments until December 14, 2011.

On July 15, 2011, NASDAQ OMX BX, Inc. filed, pursuant to Section 19(b)(1) of the Exchange Act[5] and Rule 19b-4 thereunder,[6] a proposed rule change that amended the BOX Fee

---

1 17 CFR 201.431(b)(2)

2 Petition for Review of Action by Delegated Authority from BOX, dated September 27, 2011 ("BOX Petition").

3 See Securities Exchange Act Release No. 65330 (September 13, 2011), 76 FR 58065 (September 19, 2011) ("Suspension Order").

4 17 CFR 201.431(e).

5 15 U.S.C. 78s(b)(1).

6 17 CFR 240.19b-4.

29 of 49

Schedule to increase the credits and fees for certain transactions in the BOX Price Improvement Period ("PIP").[7]

The Division, pursuant to delegated authority,[8] published BOX's proposed rule change for notice and comment on August 3, 2011.[9] The Commission received four comment letters on the proposal, three urging the Commission to suspend the proposal and institute proceedings, and one urging the Commission not to take such action.[10] BOX filed a response to comments.[11] As evidenced by these letters, market participants have differing views on the impact of the proposal and whether it is consistent with the Act. In recognition of the issues raised by commenters and in view of the significant legal and policy issues raised by the proposal, on September 13, 2011, the Division, pursuant to delegated authority,[12] temporarily suspended BOX's proposal and simultaneously instituted proceedings to determine whether to approve or disapprove the proposal.[13]

---

7 The PIP is a mechanism in which members submit an agency order on behalf of a customer for price improvement over the BOX BBO, paired with a contra-order guaranteeing execution of the agency order at or better than the NBBO. The contra-order could be for the account of the member, or an order solicited from someone else. The agency order is exposed for a 1-second auction in which members may submit competing interest at the same price or better. The initiating member is guaranteed 40% of the order (after public customers) at the final price for the PIP order, assuming it is at the best price. See Chapter V, Section 18 of the BOX Rules.

8 17 CFR 200.30-3(a)(12).

9 See Securities Exchange Act Release No. 64981 (July 28, 2011), 76 FR 46858 (August 3, 2011).

10 See letters to Elizabeth Murphy, Secretary, Commission, from John C. Nagel, Managing Director and General Counsel, Citadel Securities LLC ("Citadel"), dated August 12, 2011 ("Citadel Letter"); Andrew Stevens, Legal Counsel, IMC Financial Markets ("IMC"), dated August 15, 2011 ("IMC Letter"); Michael J. Simon, Secretary, International Securities Exchange ("ISE"), dated August 22, 2011 ("ISE Letter"), and Christopher Nagy, Managing Director Order Strategy, TD Ameritrade, Inc. ("TD Ameritrade"), dated September 12, 2011 ("TD Ameritrade Letter").

11 See letter to Elizabeth Murphy, Secretary, Commission, from Anthony D. McCormick, Chief Executive Officer, BOX, dated September 9, 2011 ("BOX Letter"). BOX filed its response to comments on Friday, September 9, 2011, two business days prior to the end of the 60 day period during which the Commission could act to suspend the filing and institute proceedings, and 16 days after the close of the original comment period for the filing.

12 17 CFR 200.30–3(a)(57) and (58).

13 See Suspension Order, supra note 3. Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C), provides the statutory standard by which the Commission may temporarily suspend an immediately effective proposed rule change. Specifically, Section

In the Suspension Order, the Division, pursuant to delegated authority, states its belief that it is appropriate to evaluate the effect of the proposed rule change on competition among different types of market participants and on market quality, and that it intends to assess whether the potential fee disparity between BOX Participants who initiate a PIP auction ("PIP Initiators") and BOX Participants who respond to a PIP auction ("PIP Responders") is consistent with the statutory requirements applicable to a national securities exchange under the Act,[14] in particular the standards requiring, among other things, that exchange rules provide for the equitable allocation of reasonable fees among members, issuers, and other persons using its facilities; not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers; and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[15] The Suspension Order finds that it is appropriate in the public interest, for the protection of investors, and otherwise in furtherance of the purposes of the Act to temporarily suspend the proposed rule change and that it is appropriate in the public interest to institute disapproval proceedings in view of the significant legal and policy issues raised by the proposal.[16]

On September 20, 2011, BOX filed a notice of intention to petition for review from BOX stating that, pursuant to the Commission Rule of Practice 430(b),[17] BOX appeals to the Commission the Division's action to institute proceedings by delegated authority. Pursuant to Rule of Practice 431(e), a notice of intention to petition for review results in an automatic stay of the action by delegated authority.[18] On September 27, 2011, BOX filed a petition to review the

---

19(b)(3)(C) provides that the Commission may take such action "if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Act]." 15 U.S.C. 78s(b)(3)(C). If the Commission temporarily suspends a rule change, it must institute proceedings under Section 19(b)(2)(B) of the Act. See 15 U.S.C. 78s(b)(3)(C).

14 See Suspension Order, supra note 3, at 58067. Under the proposed rule change, the Exchange would charge both the PIP Initiator and the PIP Responder the same fee for executing an order in the PIP. However, if the PIP Initiator also submits the agency order into the PIP, the PIP Initiator receives the rebate paid to the agency order that is auctioned in the PIP. As a result, if the fee the PIP Initiator pays is aggregated with the rebate the PIP Initiator receives for the agency order (i.e., a "net" fee), the PIP Initiator would pay a lower net fee compared to PIP Responders. The disparity between the net fees charged to a PIP Initiator and those charged to a PIP Responder could be as high at $0.90 per contract. See id. at 58066-58067.

15 See id. at 58067.

16 See id.

17 17 CFR 201.430(b).

18 17 CFR 201.431(e).

Division's action by delegated authority instituting proceedings to determine whether to approve or disapprove the filing.[19]

In considering whether to accept or reject the BOX Petition, Rule 411(b)(2) of the Rules of Practice[20] requires that the Commission determine whether:

(i) a prejudicial error was committed by the Division in the conduct of the proceeding; or

(ii) the Division's decision embodies:

(A) a finding or conclusion of material fact that is clearly erroneous; or

(B) a conclusion of law that is erroneous; or

(C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.

For the reasons discussed below, the Commission finds that BOX has not made a reasonable showing that the Division committed a prejudicial error or that the Division's delegated action involved an error of fact or law that would provide an appropriate basis for Commission review.

First, the BOX Petition does not allege that the Division committed any prejudicial error in the conduct of the proceedings, including the decision to temporarily suspend and institute proceedings to determine whether to approve or disapprove the proposal. The Commission recognizes the issues raised as to the impact of the fee change and the differing views of market participants outlined in the comments received. The Division's action through the Suspension Order provides an opportunity for the Commission to receive more focused comment and data on the issues raised, as well as an opportunity for the Commission to more fully assess the issues raised and whether the filing is consistent with the Act. Based on the proposed rule change as filed, the comments received, and BOX's response to comments, the Commission finds that the Division acted appropriately in finding that it is appropriate in the public interest, for the protection of investors, and otherwise in furtherance of the purposes of the Act to temporarily suspend the filing.[21] Accordingly, the Commission finds that the Division did not commit any prejudicial error in temporarily suspending and instituting proceedings with respect to BOX's proposed rule change.

Second, the Division's action to suspend the filing and institute proceedings is an interim step in the Commission's consideration of substantive issues raised by the filing, and one that did not embody a finding of material fact. The Suspension Order therefore is incapable of embodying a finding or conclusion of material fact that is erroneous. Although BOX notes that it

---

19 See BOX Petition, supra note 2.

20 17 CFR 201.411(b)(2).

21 Pursuant to the provisions of Section 19(b)(3)(C) of the Act, the Commission must institute proceedings to determine whether to approve or disapprove an immediately effective rule change if it suspends such rule change. See 15 U.S.C. 78s(b)(3)(C).

provided the Division with data relating to six weeks of trading in the BOX PIP that BOX believes supports a finding that its fees are consistent with the Act,[22] the Division also received data from a commenter purporting to show a decline in average price improvement and average percentage of contracts price improved in the PIP.[23] The Suspension Order states that the Commission has not reached any conclusions with respect to the issues involved.[24] To the contrary, the Suspension Order seeks additional comment and data with respect to the issues raised by the filing,[25] and the institution of proceedings will provide the Commission the opportunity to more fully assess the issues raised, including a further assessment of the facts underlying the issues.

Third, the Division's action pursuant to delegated authority to suspend the filing and institute proceedings is an interim step that does not involve a conclusion of law that is clearly erroneous. The Suspension Order states that the Commission has not reached any conclusions with respect to the issues involved,[26] and no finding as to whether the proposed rule change is consistent with the Act was made in the Suspension Order. To the contrary, the Suspension Order seeks additional comment and data with respect to the issues raised by the filing, which will help the Commission further assess the proposed rule change and inform its ultimate decision as to whether the proposed rule change is consistent with the Act. Based on the proposed rule change as filed, the comments received, and BOX's response to comments, the Commission finds that the Division acted appropriately in finding that it is appropriate in the public interest, for the protection of investors, and otherwise in furtherance of the purposes of the Act to temporarily suspend the filing.[27]

Fourth, the BOX Petition does not specifically allege that the Division's action pursuant to delegated authority was an exercise of discretion or decision of law or policy that is important and that the Commission should review pursuant to the standard of Rule 431(b)(2). For purposes of determining whether to grant de novo review of the Division's exercise of delegated authority with respect to the Suspension Order, the Commission does not believe that the act of suspending and instituting proceedings in this filing embodies an exercise of discretion or a decision of law or policy that is important and that the Commission should review. The Commission believes that the Division acted appropriately, based on the record, in determining that the underlying BOX proposed rule change does merit additional opportunity for comment and Commission

---

22 The Division noted this data in the Suspension Order. See Suspension Order, supra note 3, at 58067.

23 See Citadel Letter, supra note 10, at 3.

24 See Suspension Order, supra note 3, at 58067.

25 See id. at 58067-68.

26 See id. at 58067.

27 Pursuant to the provisions of Section 19(b)(3)(C) of the Act, the Commission must institute proceedings to determine whether to approve or disapprove an immediately effective rule change if it suspends such rule change. See 15 U.S.C. 78s(b)(3)(C).

consideration. .The Division's Suspension Order is the proper statutory mechanism to commence that process and conduct such review.

Finally, in its petition, BOX requests, if the Commission does determine to institute proceedings to determine whether to approve or disapprove the proposal, that the Commission not stay the effectiveness of the PIP fee during the course of the proceedings.[28] BOX notes its belief that the proposed fees allow it to compete with larger options exchanges that charge payment for order flow fees that, in BOX's view, are substantially similar to the proposed fees and that suspension of the fees would cause unfair harm to BOX.[29] However, under Section 19(b)(3)(C) of the Act,[30] the Commission cannot institute proceedings to determine whether to approve or disapprove an immediately effective rule change unless it first suspends the rule change. The Commission does not find a sufficient basis in the BOX Petition to diverge from the process contemplated in the statute in this case by lifting the suspension of the BOX PIP fee while it conducts the proceedings to determine whether to approve or disapprove BOX's proposed rule change. Importantly, commenters have raised material concerns (including one who presented supporting data) that call into question whether BOX's proposal unduly burdens competition and whether it is consistent with the Act. Among other things, the Commission will consider these issues, as well as BOX's assertion that its proposed fees are comparable to fees in effect at other options exchanges, during the conduct of the proceedings on BOX's proposal.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

---

28 See BOX Petition, supra note 2, at 10.

29 See id. at 9-10.

30 See 15 U.S.C. 78s(b)(3)(C).

Chairman Schapiro not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65598 / October 20, 2011

Admin. Proc. File No. 3-14252

In the Matter of the Application of

RICHARD A. NEATON
3071 Rivershore Lane
Port Charlotte, FL 33953

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Violations of Membership and Conduct Rules

Misstatements and Omissions on Forms U4

Registered representative of member firm of registered securities association willfully submitted Forms U4 that did not disclose, and willfully failed to update Forms U4 to disclose, disciplinary actions and sanctions imposed on him by state bar disciplinary board. *Held*, association's findings of violation and sanction imposed are *sustained*.

APPEARANCES:

Richard A. Neaton, pro se.

Marc Menchel, *Alan Lawhead*, *James Wrona*, and *Gary Dernelle*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: February 8, 2011
Last brief received: April 28, 2011

30 of 49

I.

Richard A. Neaton ("Neaton"), formerly a registered representative of various member firms, seeks review of FINRA disciplinary action.[1] FINRA found that Neaton willfully failed to amend his Uniform Application for Securities Industry Registration or Transfer ("Form U4") to disclose two suspensions and the subsequent revocation of his license to practice law and willfully failed to disclose the bases for those sanctions, all in violation of NASD Conduct Rule 2110 and Membership Rule IM-1000-1.[2] For those violations, FINRA barred him from associating in any capacity with any FINRA member firm.[3] Because FINRA found that Neaton's failures to disclose were willful, he is also subject to a statutory disqualification.[4] We base our findings on an independent review of the record.

II.

A. Neaton Enters the Securities Industry

Neaton practiced law in Michigan from 1973 until 1999, when he gave up his law practice and moved to Florida. Neaton became registered with FINRA through a member firm on March 8, 1995 as an Investment Company and Variable Contracts Products Representative.

---

[1] On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008). FINRA's disciplinary action was instituted after the consolidation of NASD and NYSE, but the conduct at issue took place before the consolidated rules took effect. Accordingly, NASD conduct rules apply and references to FINRA herein include references to NASD.

[2] NASD Conduct Rule 2110 requires members to observe "high standards of commercial honor and just and equitable principles of trade." NASD Membership Rule IM-1000-1 prohibits the filing, in connection with membership or registration as a registered representative, of information so incomplete or inaccurate as to be misleading.

[3] FINRA also ordered him to pay costs.

[4] Securities Exchange Act Section 3(a)(39), 15 U.S.C. § 78c(a)(39) (defining "statutory disqualification").

B. Neaton's Law License Is Suspended for the First Time

On June 5, 1995, the Attorney Discipline Board of the State Bar of Michigan ("Discipline Board")[5] issued a Notice of Suspension and Restitution against Neaton, suspending his law license for three years with a retroactive start date of December 1, 1993. The Discipline Board found, among other things, that Neaton, while representing a client in a personal injury matter, failed to provide the insurance carrier with documentation of his client's injuries, failed to keep his client reasonably informed and allowed the statute of limitations to expire, falsely advised his client that he had settled her claims, and delivered to his client a draft from his personal account, falsely representing to his client that this constituted her share of the settlement. The Discipline Board further found that Neaton, in a second, unrelated matter, affixed a client's signature to a draft entrusted to him for the client's benefit, failed to deposit the funds into a trust account, commingled the funds by depositing them into his own account, misappropriated the funds by paying them to his client in the personal injury matter, and made numerous false statements to the client concerning the funds. The Discipline Board also ordered Neaton to pay costs and restitution, which Neaton did. Neaton did not amend his Form U4 to disclose this action.

C. Neaton Faces Further Discipline Board Charges, Changes Jobs, and Files a New Form U4

Less than four months after the Discipline Board first suspended Neaton's license to practice law, Neaton decided to change firms and interviewed for a position as a registered representative with Dennis Harrelson, a general agent for Securian Financial Services ("Securian"),[6] a FINRA member firm. By that time, the Discipline Board had instituted a second action against Neaton.

On October 15, 1995, Neaton executed a Form U4 with Securian. Neaton responded "no" to Form U4 questions 22(E)(1) and 22(E)(6), which asked:

> "[h]as . . . any state regulatory agency . . . ever . . . found you to have made a false statement or omission or been dishonest, unfair or unethical?"
>
> "[h]as . . . any state regulatory agency . . . ever . . . revoked or suspended your license as an attorney . . . ?"

---

[5] The Discipline Board serves as the adjudicative arm of the Michigan Supreme Court for discharge of its exclusive constitutional responsibility to supervise and discipline Michigan attorneys. Attorney Discipline Board, http://www.adbmich.org/ (Last visited July 22, 2011).

[6] During the period at issue, Securian was variously known as MIMLIC Sales Corporation and Ascend Financial Services, Inc.

The Form U4 required that, if the applicant answered "yes" to any question, he or she must provide an explanation. The form further required the applicant to certify that he or she had an obligation to file a timely amendment "whenever changes occur to answers previously reported" and to assure that information "is currently complete and accurate." On October 31, 1995, Neaton became registered with Securian as an Investment Company and Variable Contracts Products Representative.[7]

D. Neaton's Law License Is Suspended a Second Time

Neaton traveled to Michigan to defend himself in the second Discipline Board action. On August 26, 1996, the Discipline Board issued a second Notice of Suspension and Restitution against Neaton, suspending his law license for four years, retroactively from June 1, 1995. The Discipline Board found, among other things, that Neaton had neglected a *habeas corpus* matter; made false representations to his client; affixed, or caused to be affixed, the signatures of two proposed expert witnesses on two affidavits without the witnesses' knowledge or consent; improperly affixed his signature as a notary on one affidavit; affixed, or caused to be affixed, a fictitious name as notary on the other affidavit; and misappropriated client funds.

Neaton did not amend his Form U4 following the Discipline Board's second disciplinary action.

E. Neaton's Law License is Revoked

On February 2, 2001, the Michigan State Bar issued a Notice of Revocation and Restitution against Neaton, instantaneously revoking his law license. The Discipline Board found that Neaton had, among other things, failed to return trust funds to their rightful beneficiaries; commingled trust funds with his own; made misrepresentations as to his investment of the trust funds; and misappropriated funds held in trust as a fiduciary. At the hearing, Neaton admitted that he never disclosed the 2001 disciplinary action to Securian. Again, Neaton did not amend his Form U4 following the actions of the Discipline Board.

F. Neaton Again Changes Firms and Completes a New Form U4

On April 28, 2006, Securian terminated Neaton's registrations through the firm, and Neaton became registered with Mutual Services Corporation ("Mutual") as an Investment Company and Variable Contracts Products Representative and a Corporate Securities Limited Representative.

---

[7] In August 1998, Neaton became registered through Securian as a Corporate Securities Limited Representative.

To register with Mutual, Neaton completed a new Form U4, which he signed on January 31, 2006. Neaton answer "no" to whether:

> his "authorization to act as an attorney" had ever been "revoked or suspended;" and "any state regulatory agency [had] . . . ever . . . found [him] to have made a false statement or omission or been dishonest, unfair or unethical."[8]

Neaton testified that, when he completed the 2006 Form U4, he thought that, because he had "already disclosed the suspensions to [Securian] and they didn't tell [him that he] needed to change that answer to yes" he should respond "no" to the question regarding suspension of authorization to act as an attorney. He further testified that he answered "no" to question 14D(1)(a) (regarding whether a state regulatory agency had found that he had made a false statement or engaged in dishonest, unfair, or unethical conduct) because he believed the question "applied to investment-related activities." Neaton admitted that he did not disclose the Discipline Board actions against him to anyone at Mutual when he became associated there.

G. Neaton Discloses the Sanctions

After Neaton began working at Mutual, a dispute arose concerning an insurance policy that Neaton originated while registered with Securian. In a May 2006 deposition, Neaton disclosed the Discipline Board's suspensions and revocation of his law license. On May 22, 2007, Securian filed an amended Uniform Termination Notice for Securities Industry Registration ("Form U5"), stating Securian intended to conduct an internal review "upon learning that Mr. Neaton's license to practice law in Michigan had been revoked."

Mutual received a copy of the Form U5. Rick Ohlrich, a Mutual Vice President, asked Neaton for a written response on May 29, 2007. Neaton subsequently responded.

H. FINRA Investigation

Shortly after Securian submitted the amended Form U5, FINRA's Department of Enforcement ("Enforcement") commenced an investigation of Neaton. On November 2, 2007,

---

[8] While the Form U4 had changed somewhat since 1995 (when Neaton filed with Securian), the questions at issue here remained materially the same. Question 22(E)(1) on Neaton's Securian Form U4 is identical (with the addition of one word) to question 14D(1)(a) on the version that he filed with Mutual.

Question 22(E)(6) on the Form U4 Neaton filed at Securian asks "[h]as . . . any state regulatory agency ever . . . revoked or suspended your license as an attorney?" Question 14F on the Form U4 filed with Mutual asks "[h]ave you ever had an authorization to act as an attorney . . . revoked or suspended?"

after FINRA had begun its investigation, Neaton filed an amended U4, on which he answered "yes" to question 14F:

"[h]ave you ever had an authorization to act as an attorney . . . revoked or suspended?"

However, Neaton once again responded "no" to the question:

"[h]as . . . any state regulatory agency . . . ever . . . found you to have made a false statement or omission or been dishonest, unfair, or unethical?"[9]

On the form's Regulatory Action Disclosure Reporting Page ("DRP"), Neaton disclosed that the Discipline Board had suspended twice and subsequently revoked his law license; Neaton did not provide any additional information about the Discipline Board's findings against him.[10]

I. Proceedings Below

On October 8, 2008, Enforcement filed a complaint against Neaton. Before the Hearing Panel, Neaton asserted that he based his responses to the Form U4 questions at issue on a conversation that he had with Harrelson and oral instructions provided by an unidentified Securian employee.

At the hearing, Neaton and Harrelson agreed that, during his interview in September 1995, Neaton had stated that he was involved in an action related to his former law practice. However, Harrelson's and Neaton's accounts of what Neaton said differ. Neaton testified that he disclosed to Harrelson that he did not "have a license anymore" to practice law, that he had "relinquished that license voluntarily, and that [he] had also just recently settled a client complaint, and that [he] also [had] another complaint pending against [him] . . . from the Grievance Commission of the . . . Michigan State Bar." Neaton further testified that Harrelson asked him to "keep [him, Harrelson] posted on . . . what happens on the complaint."

However, Harrelson testified that Neaton did not tell him that he was no longer licensed as an attorney and that Securian "would have never hired [Neaton] had they known" about the suspension of his law license. Harrelson further testified that Neaton told him that he was the subject of a "customer complaint" related to his former law practice and that Neaton had characterized the issue as not being "a big thing at all," "minor," and as a "disagreement with a customer" "over a fee." Harrelson also stated that he "didn't even know that . . . the Bar" was involved and that he thought that Neaton just "had a disagreement with a customer." Harrelson told Neaton to report back to the broker-dealer with the issue's resolution.

---

[9] There were no changes to the form itself of the Form U4 between 2006 and 2007.

[10] Mutual terminated Neaton's employment on May 21, 2008 and since then, he has not been associated with any FINRA member firm.

Neaton also testified that he had a conversation with someone working for Harrelson, "probably [Harrelson's] office administrator," the "gist" of which was that he should "complete [the Form U4] like [he] did at" his former firm. Neaton claimed that he understood that he was "being asked to reaffirm [his] initial answers on" his original Form U4 – although he had been the subject of intervening discipline by the Discipline Board. Harrelson testified that it was not part of his job to advise people on how to fill out the Form U4, and that his office "just [passed] them out." Harrelson further testified that he "absolutely [did] not" instruct Neaton not to disclose anything on the Form U4 in relation to the complaint.

Harrelson's and Neaton's accounts further conflict as to what Neaton disclosed following the Discipline Board's second disciplinary action. Neaton testified that he "had a phone conversation with [Harrelson] and told him" that there was "another order of suspension entered against [him]," that Harrelson responded by saying that "everybody deserves a second chance" and that Harrelson "never got back to [him] after that." Harrelson testified that Neaton never disclosed any action against him by the Discipline Board.

The Hearing Panel did not find Neaton credible. The Hearing Panel found that even based on Neaton's testimony, his disclosure "minimized and obfuscated the serious nature of the 1995 suspension . . . ." The Hearing Panel held that Harrelson's testimony was credible and that Neaton did not disclose the nature of the 1996 suspension. The Hearing Panel further found that Neaton "was untruthful in his characterization of the pending action [to Harrelson] as 'not serious'" given the nature of the allegations against him.

While registered through Securian, Neaton was required to fill out an annual compliance questionnaire.[11] Harrelson testified that it "absolutely" would have been brought to his attention if a representative in his office had given a "yes" answer to any of the questions on the questionnaire, and that, to his knowledge, Neaton never disclosed any of the Discipline Board sanctions against him on these questionnaires. Neaton does not claim that he disclosed any of the Discipline Board sanctions against him on these questionnaires. Finally, Harrelson testified that he had a conversation with Neaton following the 2007 disclosure of the Discipline Board actions. Harrelson asked Neaton why he "didn't . . . divulge all this stuff before." Neaton replied that "had [he] divulged that stuff all those years before, [he] would have lost [his] license already."

---

[11] For example, question 4 on the 2004 Annual Compliance Questionnaire, asked "while at the firm . . . has . . . any . . . state regulatory body sanctioned you?" and question 6 asked "during your association with the firm, have any judgments been entered against you?" Neaton responded "no" to both questions in 2004.

In a decision dated June 5, 2009, a FINRA Hearing Panel found that Neaton had willfully failed to amend his Form U4 to disclose the suspensions and revocation of his license to practice law, in violation of Rules 2110 and IM-1000-1. The Hearing Panel fined Neaton $5,000 and suspended him from associating with a member firm in any capacity for one year. Neaton appealed the Hearing Panel decision to FINRA's National Adjudicatory Council ("NAC"), which affirmed the Hearing Panel's findings but barred him in all capacities for his misconduct. This appeal followed.

III.

NASD Membership Rule IM-1000-1 prohibits the filing, in connection with membership or registration as a registered representative, of information so incomplete or inaccurate as to be misleading. This rule applies to Form U4, which is used by FINRA and other self-regulatory organizations to determine the fitness of applicants for registration as securities professionals.[12] We have repeatedly stated, "[t]he candor and forthrightness of [individuals making these filings] is critical to the effectiveness of this screening process."[13] Because "[r]egistration of broker-dealers is a means of protecting the public,"[14] every person submitting a Form U4 has the obligation to ensure that the information provided on the form is true and accurate. Filing a misleading Form U4 also violates NASD Rule 2110, requiring adherence to just and equitable principles of trade to which every person associated with a FINRA member is held.[15]

A. Neaton Violated Membership Rule IM-1000-1 and Conduct Rule 2110

Article V, Section 2(c) of the NASD By-Laws provides that every Form U4 filed with FINRA be kept current at all times by supplementary amendments that must be filed within thirty days of learning of the facts or circumstances giving rise to the amendment. The duty to provide

---

[12] *Scott Mathis*, Exchange Act Rel. No. 61120 (Dec. 7, 2009), 97 SEC Docket 23228, 23235, *appeal docketed*, No. 10-429 (2d Cir. Feb. 5, 2010); *Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328 (July 17, 2009), 96 SEC Docket 18882, 18885 n.8; *Jason A. Craig*, Exchange Act Rel. No. 59137 (Dec. 22 2008), 94 SEC Docket 12694, 12698; *Douglas J. Toth*, Exchange Act Rel. No. 58074 (July 1, 2008), 93 SEC Docket 7380, 7387-88, *petition denied*, 319 F. App'x 184 (3d Cir. 2009).

[13] *Mathis*, 97 SEC Docket at 23235; *Emerson*, 96 SEC Docket at 18889; *Rosario R. Ruggiero*, 52 S.E.C. 725, 728 (1996) (quoting *Thomas R. Alton*, 52 S.E.C. 380, 382 (1995)) (sustaining denial of association where statutorily disqualified person had failed to amend his Form U4 to disclose statutorily disqualifying event).

[14] *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

[15] *Alton*, 52 S.E.C. at 382 (citing *Kauffman*, 51 S.E.C. 838, 840 (1993); *Roy Ray Seaton*, 47 S.E.C. 131, 133-34 (1979)).

accurate information and to amend the Form U4 to provide current information assures regulatory organizations, employers, and members of the public that they have all material, current information about the securities professional with whom they are dealing. On his Forms U4, Neaton certified that he had an obligation to keep his Form U4 current at all times and file timely supplementary amendments.

Neaton does not challenge FINRA's finding that he failed to disclose the Discipline Board's disciplinary actions against him on two initial Forms U4 and failed timely to amend his Forms U4 to disclose those actions. On June 5, 1995, the Discipline Board suspended Neaton's law license for the first time. However, although a registered representative since March 8, 1995, Neaton did not amend his Form U4 to reflect the imposition of the sanction. On October 15, 1995, Neaton executed a new Form U4 with Securian. Because the Discipline Board had, by that time, suspended his law license for making misstatements to clients, commingling and misappropriation of client funds, and ethical violations, Neaton provided false answers by responding "no" to two questions: "[h]as . . . any state regulatory agency . . . ever . . . found you to have made a false statement or omission or been dishonest, unfair or unethical?" and "[h]as...any state regulatory agency . . . ever . . . revoked or suspended your license as an attorney . . . . ?" Following the Discipline Board's second suspension of his law license on August 26, 1996 for professional negligence, misrepresentations, forgery, and misappropriation, Neaton did not amend his Form U4. Again, following the Discipline Board's revocation of his license on February 2, 2001, Neaton did not amend his Form U4. Thus, his false "no" responses remained on file with FINRA, Securian, and the Central Registration Depository.

Continuing this pattern of behavior, when Neaton executed a new Form U4 with Mutual on January 31, 2006, he falsely responded "no," failing to disclose the Discipline Board's findings and sanctions – important information about his disciplinary history explicitly sought by the form's questions. While Neaton eventually amended his Form U4 on November 2, 2007, he did so only after FINRA began an investigation, and then only disclosed the Discipline Board's sanctions, not the bases for its several actions against him. Thus, Neaton's repeated false answers and failures to amend his Forms U4 to disclose the Discipline Board's disciplinary actions over the course of nearly twelve years are clear violations of Membership Rule IM-1000-1 and Conduct Rule 2110.

B. Neaton's Violations Were Willful

Neaton challenges only FINRA's finding that his failures to disclose were willful, a finding that results in his statutory disqualification. A person is deemed to be subject to a "statutory disqualification" under Section 3(a)(39) of the Securities Exchange Act of 1934[16] if, among other things, "such person . . . has willfully made or caused to be made in any application . . . to become associated with a member of a self-regulatory organization . . . any

---

16 *See supra* note 4.

statement which was at the time, and in light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application . . . any material fact which is required to be stated therein."

As the United States Court of Appeals for the District of Columbia stated, "willfully" under the federal securities laws means that the respondent "intentionally committ[ed] the act which constitutes the violation."[17] It does not require that the person "also be aware that he is violating one of the Rules or Acts."[18]

The evidence shows that Neaton voluntarily provided false answers on his Forms U4 and thus willfully violated Membership Rule IM-1000-1 and Conduct Rule 2110. Neaton does not suggest that he was unaware of the Discipline Board's findings and sanctions. Indeed, Neaton admittedly paid the costs imposed upon him concurrent with the 1995 suspension and traveled to Michigan to testify in the 1996 action. Thus, he was aware of the Discipline Board's findings and that the sanctions were serious. Even so, he voluntarily answered "no" to the Form U4 questions soliciting the disclosure of disciplinary actions of the type taken against him by the Discipline Board.

Neaton contends that the NAC erred in its finding of willfulness because he "did not intend to furnish a false answer about [his] attorney discipline history." He makes several arguments to support this contention.

1. Neaton asserts his actions were not willful but merely negligent. He contends that he relied on "the words and actions of [his] compliance officers and supervisors," attempting to shift the responsibility for his false Form U4 responses to others. For example, Neaton asserts that, once he declared his attorney disciplinary history to Mutual in 2007 (after Securian had filed its amended Form U5), Mutual's "silence reinforced my erroneous understanding of my duty to amend my U4." He contends that Mutual's failure to advise him "should vitiate Enforcement's claim of willfulness." However, securities industry registrants "must take responsibility for

---

17 *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (citing *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 802-03 (D.C. Cir. 1965)); *see also Maria T. Giesige*, Investment Advisers Act Rel. No. 2886 (May 29, 2009), 95 SEC Docket 17154, 17161 n.10; *Brendan E. Murray*, Advisers Act Rel. No. 2809 (Nov. 21, 2008), 94 SEC Docket 11961, 11967-68 n.10.

18 *Wonsover*, 205 F.3d at 414.

compliance and cannot be excused for lack of knowledge, understanding or appreciation of these requirements."[19] Accordingly, if he found questions to be ambiguous, Neaton had a "duty to determine whether disclosure was required."[20]

2. Neaton asserts that he disclosed the 1995 Discipline Board suspension and the then-pending 1996 action to Harrelson. Neaton asserts that his violations were not willful because "it is clear that before [he] signed [his] Form U4 on October 15, 1995, [he] was not trying to conceal from [Harrelson his] problems with the State Bar of Michigan."

As discussed above, Harrelson testified that Neaton merely told him that "he had a complaint with a customer over a fee." Neaton continues to dispute Harrelson's testimony that he did not disclose the suspensions of his law license. Neaton claims that he "told [Harrelson] about [his] law license issues" and that he was "not instructed to place anything into writing."

The Hearing Panel found that, even accepting Neaton's version of events, he "obfuscated" the seriousness of the 1995 Discipline Board suspension and was "untruthful in his characterization of the pending [1996] action." The Panel further found that Harrelson's testimony was credible and that "[Neaton] did not disclose the nature of the 1996 Suspension."[21] "Credibility determinations of an initial fact finder are entitled to considerable weight because they are based on hearing the witnesses' testimony and observing their demeanor."[22] Such determinations "can be overcome only where the record contains substantial evidence for doing

---

[19] *Guang Lu*, Exchange Act Rel. No. 51047 (Jan. 14, 2005), 84 SEC Docket 2639, *aff'd*, 179 F. App'x 702 (D.C. Cir. 2006).

[20] *Mathis*, 97 SEC Docket at 23237. *See Jason A. Craig*, Exchange Act Rel. No. 59137 (Dec. 22, 2008), 94 SEC Docket 12694, 12698 (holding that registered representative has a "duty to determine whether the information he was providing on Form U4 was complete and accurate").

[21] Neaton cites to *Dept. of Enforcement v. Kelsey*, 2004 WL 3031423 (N.A.S.D.R. June 29, 2004) for the proposition that evidence of willfulness in providing false answers on Forms U4 is insufficient if it supports a finding of negligence. We believe this cite is inapposite. In that proceeding, the Hearing Panel found that, unlike Neaton, Kelsey disclosed his felony charge to his supervisor in 1998. Moreover, the *Kelsey* Hearing Panel "did not find it necessary to make willfulness findings" with regards to the 1998 Form U4 since it found that the Respondent willfully omitted information on a subsequent Form U4. We also note that the *Kelsey* determination was not appealed to the Commission, and it did not express a view as to the result.

[22] *Janet Gurley Katz*, Exchange Act Rel. No. 61449 (Feb. 1, 2010), 97 SEC Dicjet 25094 n.22, *appeal filed*, No. 10-1068 (D.C. Cir. Mar. 26, 2010); see also *Laurie Jones Canady*, 54 S.E.C. 65, 78 n.24 (1999).

so."[23] Because we see no reason to overturn the Hearing Panel's credibility findings, we find no merit to Neaton's assertion that he disclosed to Harrelson the Discipline Board's actions against him.

In any event, even if Neaton had disclosed to Harrelson, that disclosure would not relieve Neaton of the obligation to provide correct answers on the Form U4. The Form U4 is designed to provide information about an applicant's fitness to be in the securities industry to the member firm, FINRA, other regulators, and potential customers.[24] Neaton admitted that he did not disclose the 2001 revocation to Securian, nor did he disclose any of the disciplinary actions to Mutual when he began work there.

In an attempt to refute Harrelson's testimony, Neaton attached to his brief a September 10, 2007 letter from Harrelson to Patricia Bourgeois, a FINRA examiner ("Attachment A"). Neaton claims that Attachment A proves that Harrelson "knew that [Neaton] faced a client complaint concerning [his] law license."

Neaton did not introduce Attachment A before FINRA. Under Commission Rule of Practice 452, we may admit additional evidence where the evidence is material and where there exist reasonable grounds for failing to produce the evidence earlier.[25] However, Neaton has failed to show that Attachment A meets either of these requirements. The information contained in the letter is not material. It merely duplicates Harrelson's testimony. In Attachment A, Harrelson stated that "[i]n the initial hiring process, it was discovered that Mr. Neaton had a customer complaint related to his law license in the State of Michigan." This statement is consistent with Harrelson's testimony that Neaton told him that "[Neaton] had a customer complaint from Michigan with his law practice." Moreover, Attachment A is dated well over a year before the Panel Hearing date of February 19, 2009. Neaton has offered no explanation for not introducing it earlier and we find no reasonable grounds for his failure to adduce Attachment A before FINRA.[26] Therefore, we decline to admit Attachment A.

---

23 *Id.* at 78 (citing *Anthony Tricarico*, 51 S.E.C. 457, 460 (1993)).

24 *Craig*, 94 SEC Docket at 12702.

25 17 C.F.R. § 201.452. Neaton did not file a motion with us seeking to adduce additional evidence.

26 See *CMG Institutional Trading, LLC*, Exchange Act Rel. No. 59325, 95 SEC Docket 13802, 13809 n.20 (Jan. 30, 2009) (determining not to adduce into the record documents proffered by applicants not admitted into the record before FINRA and unaccompanied by motion showing, as Rule 452 requires, "with particularity that the evidence is material and that there were reasonable grounds for the failure to adduce such evidence previously").

3. Neaton further asserts that "this woman" working for Harrelson told him to fill out the Form U4 "like [he] did before at [his previous employer]." Neaton claims that he understood her instructions to mean that he was "to reaffirm [his] initial answers on" his earlier Form U4. Such faulty logic would allow an applicant to "freeze" his/her background at a favorable point in time and avoid disclosure of subsequent negative events relevant to the applicant's fitness to remain in the securities industry. This assertion is wholly at odds with the requirement of NASD By-Law Article V, Section 2(c), which requires that information be accurate and updated timely. Neaton had notice of this requirement from the Form U4, where he certified to his "continuing obligation to amend and update information required by Form [U4]."

4. Neaton suggests that he determined not to disclose the Discipline Board actions on the Mutual Form U4 in 2006 because he "was already unauthorized to practice law before any of the disciplinary orders were entered," since he voluntarily gave up his license in 1993. However, his voluntary withdrawal from the practice of law did not prevent the Discipline Board from suspending and then revoking his authority to practice. Neaton's interpretation of this Form U4 question is contrary to its plain language (*i.e.*, whether the applicant's authority to practice law had "ever" been suspended or revoked). And, as stated above, if he found questions to be ambiguous, Neaton had a "duty to determine whether disclosure was required."[27] Similarly, the language of neither the Form U4 asking whether the applicant had ever been found to have engaged in dishonest or unethical conduct nor Securian's 2004 questionnaire suggests that those questions were limited to findings arising from investment activity.

5. Neaton testified that when he "was told to update [his] U4" at Mutual in 2006, he thought that this construction meant that he was "to provide information that [he] hadn't provided already to anybody else in the past." Even if Neaton had fully disclosed to Harrelson the sanctions against him, that disclosure could not absolve him from disclosing that information to an entirely different firm. As discussed above, the suspensions and revocation of Neaton's law license were relevant to Mutual's and FINRA's determination of his fitness. There was no indication that anyone at Mutual was notified of the Discipline Board actions until after Securian filed the amended Form U5 in May 2007. And as Neaton acknowledged at the hearing, FINRA did not have notice of his history with the Michigan Bar until he amended his Form U4 in 2007.

6. Neaton argues that the length of time before which he amended his U4 is somehow consistent with a finding of negligence. We disagree that his conduct demonstrates negligence. Neaton was subject to a series of disciplinary actions and yet, although he changed firms twice,

---

[27] Mathis, 97 SEC Docket at 23237; *see Craig*, 94 SEC Docket at 12700 (holding that a registered representative has a "duty to determine whether the information he was providing on Form U4 was complete and accurate").

he failed to make the required disclosure. Not only did Neaton fail to disclose the sanctions on his new Forms U4, he failed to disclose the sanctions on Securian's annual compliance questionnaires.[28] We conclude that Neaton's conduct was willful.

C. The Discipline Board's Actions and Sanctions Were Material

Neaton does not dispute that the Discipline Board disciplinary findings and sanctions were material. The test of materiality is whether the omitted information would have "significantly altered the total mix of information made available."[29] Information about the Discipline Board's actions would have alerted Neaton's potential employers to his history of defying professional rules and standards, and engaging in dishonest and fraudulent activities. Indeed, Harrelson testified that Securian would not have hired Neaton if the firm had been informed that his license to practice law was suspended. This information was also material to investors to assess whether, given Neaton's problematic history, they should engage in transactions with him and to regulators in assessing Neaton's fitness because it would have provided them notice of his history of disobedience and client abuse.

Neaton himself recognized the importance of this information. As Harrelson testified, he asked Neaton why he had not disclosed the suspensions and revocation of his license. Neaton responded "had I divulged that stuff all those years before, I would have lost my license already." In his brief, Neaton disputes Harrelson's recollection of this conversation, claiming he had told Harrelson "that given Securian's current position about the service agreement, it is clear that had [he] disclosed the revocation in 2001, [he] would have been terminated." Neaton did not testify to that version of events before the Hearing Panel. However, even his current interpretation of the conversation – that disclosure would have terminated his service agreement – confirms that the information was material.

* * *

Accordingly, we find that Neaton's failure to disclose on his Form U4 the Discipline Board's disciplinary findings and the resulting suspensions and revocation of his law license willfully violated Membership Rule IM-1000-1 and Conduct Rule 2110.[30]

---

28 *See supra* note 11.

29 *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (holding that, in the context of determining materiality under the antifraud provisions of the Exchange Act § 10(b) and Rule 10b-5 thereunder, to fulfill the materiality requirement "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available") (internal citation omitted).

30 Neaton complains that FINRA cited his experience and training as a lawyer as (continued...)

IV.

Neaton argues FINRA's disciplinary proceedings denied him due process and were unfair. We conclude that the Hearing Panel's actions did not deprive Neaton of a fair proceeding.

A. Neaton complains that the Hearing Panel wrongly struck affirmative defenses alleging that FINRA staff prevented him from settling this matter before the issuance of a complaint and failed to provide him notice that he was entitled to have counsel present at an on-the-record interview ("OTR").

FINRA is not a state actor and thus, traditional Constitutional due process requirements do not apply to its disciplinary proceedings.[31] Rather, FINRA is required to "provide a fair procedure for the disciplining of members and persons associated with members" under Exchange Act Sections 15A(b)(8) and 15A(h)(1). Thus, Neaton's arguments with regards to the alleged denial of 5th Amendment due process are inapplicable.

As a general matter, Neaton's affirmative defenses relate primarily to "the conduct of Enforcement during the *investigation*" (emphasis added). Exchange Act Section 15A(b)(8) requires SROs to provide a "fair procedure" in an adjudicatory proceeding. This statutory requirement does not extend to investigations. The purpose of an investigation is to "determine whether the [SRO's] investigation has produced evidence meriting further proceedings"[32] – not to determine whether a violation has actually occurred.

Neaton specifically complains about Enforcement's refusal to engage in settlement negotiations with him following an Enforcement attorney's "promise" to send Neaton a draft settlement document. FINRA staff had discretion to enter into settlement negotiations.

---

[30] (...continued)
evidence of why he should have known that he had to disclose the Discipline Board disciplinary actions against him. Our decision does not rely on Neaton's legal background. Neaton's violations are based on his failure to comply with the high standards to which FINRA holds all registered representatives.

[31] *See, e.g., Desiderio v. Nat'l Ass'n of Sec. Dealers, Inc.*, 191 F.3d 198, 206 (Sept. 22, 1999) (rejecting due process claim by concluding "NASD is a private actor, not a state actor" in the context of a due process challenge); *Craig M. Biddick*, Exchange Act Rel. No. 63453 (Dec. 7, 2010) 99 SEC Docket 35510 A1, 35510 A17 ("self-regulatory organizations such as FINRA are not state actors for purposes of due process claims"); *Emerson, Jr.*, 96 SEC Docket at 18892 (noting that "as a general matter, self-regulatory organizations ('SROs') are not state actors and thus are not subject to the Constitution's due process requirements").

[32] *David C. Ho*, Exchange Act Rel. No. 54481 (Sept. 22, 2006), 88 SEC Docket 3194, 3200, *aff'd*, 2007 WL 1224027 (7th Cir. 2007) (unpublished).

However, under FINRA's rules no settlement is effective until accepted by the NAC.[33] We have previously held that such negotiations are not relevant to our determination of sanctions in a contested proceeding.[34] Thus, any settlement negotiations are irrelevant to our decision here.

Neaton also asserts that, when Enforcement sent him notice of an OTR, it failed to include so-called "Addendum A," which provided notice that a witness is entitled to request counsel from his firm. However, at the beginning of the OTR, Enforcement provided Neaton with a copy of Addendum A and asked him if he had any questions before the OTR began. Neaton said that he did not, and he did not ask for counsel during the OTR. We conclude that Neaton waived this objection.

B. Neaton complains that the Hearing Panel found that he submitted false and forged affidavits "to a court." He also asks that the Hearing Panel decision be set aside. However, it is "the decision of the NAC, not the decision of the Hearing Panel, that is the final action of FINRA which is subject to Commission Review."[35]

C. Neaton claims that the hearing officer's sanctions were somehow motivated by his attempts to contact FINRA's Ombudsman. We find nothing in the record to support this assertion. He further complains that the hearing officer "conducted a personal conversation with her former colleagues" in Enforcement after the hearing. We do not believe this conversation is sufficient evidence of bias by the hearing officer. In any event, our *de novo* review of evidence cures whatever incidence of bias, if any, that may have existed.[36]

---

33 Rules 9270(e)(2), 9270(f)(2). A self regulatory organization "is not obligated to accept an offer once made . . . ." *Clyde J. Bruff*, 53 S.E.C. 880, 886 (1998), *aff'd*, 198 F.3d 253 (9th Cir. 1999).

34 *Graham Loving & Co.*, 46 S.E.C. 269, 272 (1976); *see also Justin F. Ficken*, Exchange Act Rel. No. 58802 (Oct. 17, 2008), 94 SEC Docket 10887, 10893 n.31 (and cases cited therein).

35 *Harry Friedman*, Exchange Act Rel. No. 64486 (May 13, 2011), __ SEC Docket ___, ___ n.21 (quoting *Glodek*, 97 SEC Docket 22035 n.16), 2011 WL 1825025, at *7 (May 13, 2011).

36 *Richard G. Cody*, Exchange Act Rel. No. 64565 (May 27, 2011), __ SEC Docket __, __ n.79, 2011 WL 2098202, at *19 (May 27, 2011).

V.

Pursuant to Exchange Act Section 19(e)(2), we sustain FINRA sanctions unless we find, giving due regard to the public interest and the protection of investors, that the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.[37] FINRA fined Neaton $5,000 and barred him. We sustain the sanction imposed by FINRA because, as explained below, we believe that it is neither excessive nor oppressive in light of Neaton's violative conduct and that it will adequately serve the public interest and protect investors.

FINRA's decision to fine and suspend Neaton is consistent with FINRA Sanction Guidelines.[38] For filing a false, misleading, or inaccurate Form U4, the Guidelines recommend a fine between $2,500 and $50,000 and a suspension for five to thirty business days. In egregious cases, the Guidelines recommend consideration of a longer suspension of up to two years or a bar.[39] In evaluating the appropriate sanction to impose for this violation, the Guidelines provide three "Principal Considerations," only one of which – the "[n]ature and significance of [the] information at issue" – is relevant here.[40]

We conclude, as did FINRA, that Neaton's failure to disclose the bases of the Discipline Board's actions and the resulting two suspensions and revocation of his law license was egregious. Neaton's omissions were significant. The Discipline Board's actions were based on a wide range of dishonest conduct and ethical violations, including misappropriation of client funds, forgery, misstatements to clients, and neglect of his professional duties, resulting in suspensions and the revocation of his license to practice law. Each of these findings and sanctions suggested Neaton's lack of fitness to be in the securities industry. For example, Harrelson testified that he never would have hired Neaton had he known about the suspensions of his law license.

---

[37] 15 U.S.C. § 78s(e)(2). Neaton does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

[38] FINRA promulgated the Sanction Guidelines in an effort to achieve greater consistency, uniformity, and fairness in the sanctions that are imposed for violations. Although the Sanction Guidelines do not bind the Commission, they serve as a benchmark in reviewing sanctions under Exchange Act Section 19(e)(2). *Craig*, 94 SEC Docket at 12701 n.27.

[39] FINRA Sanction Guidelines at 73-74.

[40] FINRA Sanction Guidelines at 73.

The omissions occurred over a long period of time – nearly twelve years.[41] The suspensions and revocation of his license were highly relevant to investors, employers, and regulators. Thus, we disagree with Neaton's assertion that "no one was harmed by [his] failure to amend [his] U4 in a timely manner." Neaton deprived Securian, Mutual, FINRA, and his customers of information on which to determine whether to hire him, and if so, whether he required heightened supervision, whether to do business with him, or whether to permit him to register. Moreover, Neaton has not demonstrated that the violations would cease in the future. When Neaton amended his Form U4 in 2007, following the commencement of Enforcement's investigation, he continued to respond "no" to Question 14(D)(1)(a) (asking whether he had been found to have made a false statement or omission or to have engaged in dishonest, unfair or unethical conduct) and failed to disclose the bases for the Discipline Board's several actions against him.

Neaton also demonstrates that he does not understand his responsibilities as a securities professional. He attempts to excuse his violations by asserting that the "process of completing [his] October 1995 U4 was bifurcated," *i.e.*, he initially filled out the form in September 1995 and then executed it in October 1995. We note that either date is after the first Discipline Board action in June 1995. In any event, the responsibility for supplying accurate information on the Form U4 lay with Neaton. He had the obligation to review his responses before signing the form, particularly when he certified that he had "read and [understood] the items and instructions on [the] form and that [his] answers . . . [were] true and complete to the best of [his] knowledge."

Neaton claims that he relied on the "silence" of Harrelson and Mutual. Neaton reiterates that "Harrelson knew that [he] no longer had a law license." The Forms U4 did not ask whether he had a law license but whether that license had "ever" been suspended or revoked and whether he had been found to have been unethical or dishonest. In any event, we have found that Neaton did not make full disclosures to Harrelson in 1995, never disclosed his 2001 revocation to Harrelson, and did not disclose any of the Discipline Board's actions or sanctions to Mutual until 2007.

Neaton also takes issue with FINRA's statement that he "should not have relied upon [his] firms for direction in filling out and amending the U4." Neaton's assertion suggests that he did not, and does not, understand his obligations as a participant in the securities industry. As discussed above, Neaton, as a registered representative, and not his supervisors, had the affirmative duty to fill out his forms accurately and completely, and to amend them in a timely fashion.

---

[41] The Sanctions Guidelines set forth "Principal Considerations in Determining Sanctions," applicable to all violations, including "[w]hether the respondent engaged in the misconduct over an extended period of time" and "[w]hether the respondent engaged in numerous acts and/or a pattern of misconduct." FINRA Sanction Guidelines at 6.

Neaton complains about what he characterizes as FINRA's "administrative arrogance."[42] He claims that "the NAC . . . [commented] upon the merits of [the Discipline Board] cases without their full records in evidence." Neaton stipulated to the Discipline Board's findings. This proceeding was directed to Neaton's failure to disclose these actions. He is not entitled to level a collateral attack against the Discipline Board's proceedings here.

Neaton states that he had no "investment related [sic] customer complaint alleging fraud, deceptive sales practices, or mishandling of any customer funds."[43] He also has "never been arrested or convicted of a crime." However, we have stated that the absence of a disciplinary history is not mitigative.[44]

We find that the fine and bar imposed in this case are remedial and not punitive. The information Neaton failed to disclose was material in determining whether he could fulfill the high standards of conduct demanded of associated persons. By not disclosing the information, Neaton demonstrated his inability to fulfill this high standard. In addition, the fine and bar will serve as a deterrent to others in the industry by encouraging them to be forthright in their responses to questions on their Forms U4, even where detection of dishonest responses seems

---

42 As part of this claim, Neaton renews the procedural arguments discussed in Section III *supra*.

43 He states that he received a written reprimand in 1997 in connection with advertising for a seminar and a customer complaint about a sales commission.

44 *See, e.g., Kevin Glodek*, Exchange Act Rel. No 60937 (Nov. 4, 2009), 97 SEC Docket 22027, 22038 n.24 (and cases cited therein)), *aff'd,* 416 F. App'x 95 (2d Cir. 2011).

unlikely.[45] Accordingly, we sustain this sanction because it is neither excessive nor oppressive, is remedial, and will protect investors and the public interest.

An appropriate order will issue.[46]

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

Elizabeth M. Murphy
Secretary

---

[45] *See Steadman v. SEC*, 603 F.2d 1126, 1142 (5th Cir. 1979) ("[T]he Commission also may consider the likely deterrent effect its sanctions will have on others in the industry.")

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 65598 / October 20, 2011

Admin. Proc. File No. 3-14252

In the Matter of the Application of

RICHARD A. NEATON
3071 Rivershore Lane
Port Charlotte, FL 33953

For Review of Disciplinary Action Taken by

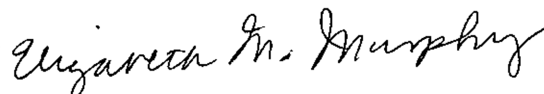
FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action taken, and the costs imposed, by FINRA against Richard A. Neaton be, and they hereby are, sustained.

By the Commission.



Elizabeth M. Murphy
Secretary

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65596 / October 20, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14596

In the Matter of **Arthur J. Cutillo,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Arthur J. Cutillo ("Cutillo") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Cutillo was licensed to practice law in the State of New York in August 2006 and was licensed to practice law in the State of New Jersey in December 2005.

2. The Appellate Division of the Supreme Court of the State of New York has disbarred Cutillo from the practice of law effective January 2011. Cutillo has been temporarily suspended from practicing law in New Jersey until final resolution of an ethics proceeding.

3. On January 14, 2011 Cutillo pled guilty to one count of securities fraud, in violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 17, Code of Federal Regulations, Sections 240.10b-5 and 240.10b5-2, and Title 18, United States Code, Section Two; and one count of conspiracy to commit securities fraud, in violation of Title 18, United States Code, Section 371, before the United States District Court for the Southern District of New York, in *United States v. Arthur Cutillo*, 10 CR 0056. As a result of this conviction, Cutillo was

[1] Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or of 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."

sentenced to 30 months imprisonment in a federal penitentiary and ordered to pay a $200 assessment and to forfeit $378,608.

III.

In view of the foregoing, the Commission finds that Cutillo has been disbarred by the Supreme Court of the State of New York and has been convicted of a felony, all within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Arthur Cutillo is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

SECURITIES AND EXCHANGE COMMISSION

Release No. IA-3305; File No. S7-42-11; October 24, 2011

Order Approving Filing Fees for Exempt Reporting Advisers and Private Fund Advisers

Section 204(c) of the Investment Advisers Act of 1940 ("Advisers Act") authorizes the Securities and Exchange Commission ("Commission") to require investment advisers to file applications and other documents through an entity that the Commission designates and to pay the reasonable costs associated with such filings. The Commission recently adopted a new rule requiring exempt reporting advisers to file portions of Form ADV on a periodic basis.[1] As with registered advisers, exempt reporting advisers must file Form ADV through the Investment Adviser Registration Depository ("IARD"), which is operated by the Financial Industry Regulatory Authority ("FINRA").

In addition, the Commission recently proposed a new rule that would require any adviser registered with the Commission and managing one or more private funds (a "private fund adviser") to file proposed Form PF on a periodic basis.[2] On September 30, 2011, the Commission issued notice of its determination that, if the Form PF proposal is

---

1 "Exempt reporting advisers" are investment advisers relying on the exemption from registration under section 203(l) or 203(m) of the Advisers Act. The Commission adopted new rule 204-4 on June 22, 2011. *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. IA-3221 (June 22, 2011), 76 FR 42950 (July 19, 2011) ("Implementing Adopting Release").

2 The Commission proposed new rule 204(b)-1 on January 26, 2011. *See* section II.C of *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, Investment Advisers Act Release No. 3145 (January 26, 2011), 76 FR 8068 (February 11, 2011) ("Form PF Proposing Release"). "Private fund" is defined in section 202(a)(29) of the Advisers Act.

adopted, FINRA will develop and maintain the filing system for Form PF as an extension of the existing IARD (the "Notice").[3]

Following discussions with Commission staff, FINRA recommended a schedule of filing fees for exempt reporting advisers and private fund advisers.[4] With respect to exempt reporting advisers, FINRA recommended a filing fee of $150 for each initial and annual report on Form ADV. With respect to private fund advisers, FINRA recommended filing fees of $150 for the proposed quarterly filings of Form PF and $150 for the proposed annual filings.[5] In the Notice, the Commission indicated its intent to approve filing fees for these filings consistent with these recommendations.

The Notice also explained that the fee for exempt reporting advisers filing Form ADV would apply starting with the date on which this order is published in the Federal Register and, if the Form PF proposal is adopted, the fees applicable to private fund advisers would apply starting with the effective date of rule 204(b)-1.

The Notice gave interested persons an opportunity to request a hearing and stated that an order approving these filing fees would be issued unless a hearing were ordered. No request for a hearing has been filed, and no hearing has been ordered.

---

3 *See Approval of Filing Fees for Exempt Reporting Advisers and Private Fund Advisers*, Investment Advisers Act Release No. 3297 (Sept. 30, 2011), 76 FR 62100 (Oct. 6, 2011).

4 FINRA letter dated September 28, 2011, available at http://www.sec.gov/rules/other/2011/finraletter092811-pferafees.pdf.

5 Under the proposal, advisers managing $1 billion or more in hedge fund assets, combined liquidity fund and registered money market fund assets or private equity fund assets would file Form PF on a quarterly basis. All other private fund advisers would file on an annual basis. *See* sections II.B and II.C of the Form PF Proposing Release.

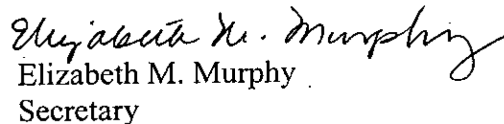
IT IS THEREFORE ORDERED, pursuant to Section 204(c) of the Advisers Act, that:

For initial reports and annual updating amendments on Form ADV filed on or after [insert date of publication in the Federal Register], the filing fee due from exempt reporting advisers is $150.

For quarterly reports on Form PF filed on or after the effective date of rule 204(b)-1 under the Advisers Act, the filing fee due from private fund advisers is $150.

For annual reports on Form PF filed on or after the effective date of rule 204(b)-1 under the Advisers Act, the filing fee due from private fund advisers is $150.

By the Commission.



Elizabeth M. Murphy
Secretary

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65597 / October 20, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14597

In the Matter of **Jason C. Goldfarb,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Jason C. Goldfarb ("Goldfarb") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Goldfarb was licensed to practice law in the State of New York in 2004.

2. The Supreme Court of the State of New York has disbarred Goldfarb from the practice of law effective April 2011.

3. On April 21, 2011 Goldfarb pled guilty to one count of securities fraud, in violation of Title 15, United States Code, Sections 78j(b) and 78ff, Title 17, Code of Federal Regulations, Sections 240.10b-5 and 240.10b5-2, and Title 18, United States Code, Section Two; and one count of conspiracy to commit securities fraud, in violation of Title 18, United States Code, Section 371, before the United States District Court for the Southern District of New York, in *United States v. Jason Goldfarb*, 10 CR 0056. As a result of this conviction, Goldfarb was sentenced to three years in a federal penitentiary and ordered to pay a $200 assessment and a $32,500 fine, and to forfeit $1,103,131.

---

1 Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or of 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."

III.

In view of the foregoing, the Commission finds that Goldfarb has been disbarred by the Supreme Court of the State of New York and has been convicted of a felony, all within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Jason Goldfarb is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65600 / October 20, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3329 / October 20, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-10937

In the Matter of Michael G. Horsey, CPA	ORDER GRANTING APPLICATION FOR REINSTATEMENT TO APPEAR AND PRACTICE BEFORE THE COMMISSION AS AN ACCOUNTANT

On November 18, 2002, Michael G. Horsey ("Horsey") 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 Horsey pursuant to Rule 102(e) of the Commission's Rules of Practice.[1] Horsey consented to the entry of the 2002 Order without admitting or denying the findings therein. This order is issued in response to Horsey's application for reinstatement to practice before the Commission as an accountant.

At all times relevant to the 2002 Order, Horsey was a certified public accountant who was duly licensed by the Commonwealth of Pennsylvania, and a partner with Mitchell & Titus LLP ("Mitchell & Titus"). Horsey was the engagement partner for his firm's audits of the financial statements of MERL Holdings Inc.com ("MERL") for its fiscal years ended December 31, 1997 and December 31, 1998. The Commission alleged that Horsey (in his capacity as the engagement partner), the concurring review partner, and the senior manager failed to conduct their fiscal 1997 and 1998 audits of MERL's financial statements in accordance with Generally Accepted Auditing Standards ("GAAS"), and issued an audit report which wrongly stated that MERL's financial statements were prepared in conformity with Generally Accepted Accounting Principles ("GAAP"). Specifically, the Commission alleged that because they failed to exercise due professional care and maintain an attitude of professional skepticism, failed to obtain sufficient competent evidential matter, and failed to staff the audits with accountants who had

[1] *See* Accounting and Auditing Enforcement Release No. 1667 dated November 18, 2002 (the "2002 Order"). Horsey was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

adequate technical training and audit proficiency, Horsey, the concurring review partner, and the senior manager engaged in improper professional conduct.

Horsey has met all of the conditions set forth in his suspension order and, in his capacity as an independent accountant, has stated that he will comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including, among others the requirements relating to registration, inspections, concurring partner reviews and quality control standards. 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, Horsey agrees to have his work reviewed by the independent audit committee of the public company for which he works, or in some other manner acceptable to the Commission.

Horsey is currently subject to probation under the Pennsylvania State Board of Accountancy that is scheduled to end in January, 2013. Failure to abide by the terms of his probation could result in the suspension of Horsey's CPA license. Horsey has attested that he will notify the Commission if he is found to have violated the terms of the probation. He also has attested that he understands that the suspension of his CPA license could result in the revocation of the reinstatement of his privilege to appear or practice before the Commission as an accountant.

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 the information supplied, representations made, and undertakings agreed to by Horsey, it appears that he has complied with the terms of the 2002 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 Horsey, 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, and by undertaking to comply with all requirements of the Commission and the Public Company Accounting Oversight Board, including among others, the requirements relating to requirements relating to registration, inspections, concurring partner reviews and quality control standards, in his practice before the Commission as an independent accountant has shown good cause for reinstatement. Therefore, it is accordingly,

---

[2] Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Michael G. Horsey, CPA is hereby reinstated to appear and practice before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-65602; File No. 4-640]

Inaugural Roundtable of the Financial Reporting Series Entitled "Uncertainty in Financial Statements: How Much to Recognize and How Best to Communicate It"

AGENCY: Securities and Exchange Commission.

ACTION: Notice of roundtable discussion; request for comment.

SUMMARY: The Commission staff will hold a public roundtable discussion to consider financial statement measurements (and associated disclosures) that incorporate judgments about future events. The discussion will be open to the public with seating on a first-come, first-served basis. Members of the public may also listen by webcast on the SEC website at http://www.sec.gov. The roundtable discussion will take place in the Multipurpose Room (Room L-006) at the SEC Headquarters located at 100 F Street NE, Washington, DC. Feedback is welcomed regarding any of the topics to be addressed at the roundtable.

DATES: The roundtable discussion will take place on Tuesday, November 8, 2011, commencing at 10:00 a.m. and ending at 5:00 p.m. The Commission will accept comments regarding issues addressed at the roundtable until December 8, 2011.

FOR FURTHER INFORMATION CONTACT: J. Mike Starr, Deputy Chief Accountant, or Eric West, Associate Chief Accountant, at (202) 551-5300, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-640 on the

subject line.

Paper Comments:

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

All submissions should refer to File Number 4-640. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

SUPPLEMENTARY INFORMATION: This will be the inaugural roundtable of the Financial Reporting Series. The Financial Reporting Series was instituted by SEC staff to assist in the proactive identification of risks related to, and areas of potential improvements in, the reliability and usefulness of financial information provided to investors. In this regard, the Financial Reporting Series is intended to facilitate balanced discussions of implementation issues or emerging issues in financial reporting.

Feedback is welcomed regarding any of the topics to be addressed at the roundtable. The panel discussions will focus on the following topics and questions:

1. Please provide feedback on any topics where the extent of uncertainty in an accounting measurement is less useful to investors and why a more certain measurement would be preferable. Likewise, provide feedback on those topics where a measurement with

uncertainty gives investors useful information and why it is preferable to a more certain measurement.

2. For those topics where uncertain measurements are useful to investors, how should the uncertainties be incorporated into the measure? Please explain the reasons for the measurement method(s) you selected.
3. What information do investors utilize to understand uncertainty? Please describe why such information is useful and, if it is not disclosed in the financial statements, indicate its source.
4. What are the challenges for investors in understanding the nature and extent of measurement uncertainty?
5. As measurement uncertainty increases, please explain whether (and how, if applicable) it changes the investor's expectation of preparers and auditors.
6. For preparers, what are the challenges in or impediments to providing investors with information to understand the nature and extent of measurement uncertainties?
7. What are the challenges for auditors in evaluating management's judgments related to measurement uncertainties?
8. Please provide feedback on whether (and how) a change in the auditor's responsibility or role would enhance the investor's understanding of the nature and extent of measurement uncertainties.
9. Please provide any additional comments or suggestions pertinent to how much uncertainty to recognize and how best to communicate it.

By the Commission.

Elizabeth M. Murphy
Secretary

October 20, 2011

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3303 / October 21, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14598

In the Matter of AMIT V. PATEL, 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 Amit V. Patel ("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. Patel is a 49 year-old mechanical engineer. He has been unemployed since 2007 and resides in Shoreview, Minnesota. He is a dual citizen of the United States and India. Patel is not registered with the Commission as an investment adviser, or in any other capacity, and

has never been associated with a brokerage firm or any other entity registered with the Commission. Nevertheless, at all times relevant to this action, Patel acted as an investment adviser.

2. On September 16, 2011, a final judgment was entered by consent against Patel, 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; and Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Amit V. Patel, Civil Action Number 0:10-cv-04937-RHK-FLN, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged that Patel operated an affinity fraud in which he raised at least $2.4 million from at least five individuals in 2008 and 2009. He offered and sold promissory notes and convinced investors to grant him trading authority over money contained in online brokerage accounts. While doing so, Patel misrepresented his intended use of the money, the risks of his trading, the source of the money used to pay the guaranteed fixed returns, and falsely guaranteed repayment of investors' principal. Patel settled without admitting or denying the Commission's allegations. The District Court entered final judgment on that basis.

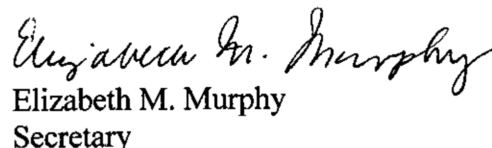
IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Patel 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.

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

Commissioner Walter not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9269 / October 21, 2011

Administrative Proceeding
File No. 3-14594

In the Matter of CREDIT SUISSE ASSET MANAGEMENT, LLC, Respondent.	ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION

I.

Credit Suisse Asset Management, LLC ("CSAM") has submitted a letter, dated October 14, 2011, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from CSAM's settlement of an administrative proceeding commenced by the Commission.

II.

On October 19, 2011, pursuant to the Offer of Settlement of Credit Suisse Asset Management, LLC, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and 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") against CSAM. In the Order, the Commission found that Credit Suisse Alternative Capital, LLC (f/k/a Credit Suisse Alternative Capital, Inc. and the predecessor of CSAM) misrepresented key deal terms, namely the process by which the investment portfolio was selected, in connection with a $1 billion collateralized debt obligation known as Class V Funding III. The Commission further found that CSAM violated Section 206(2) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 17(a)(2) of the Securities Act of 1933 and ordered CSAM to cease and desist from committing or causing any violations or any future violations of these provisions.

III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if the issuer or, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 203(e) of the 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).

IV.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9270 / October 24, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65608 / October 24, 2011

INVESTMENT ADVISERS ACT OF 1940
Release No. 3304 / October 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14599

In the Matter of

BANCO ESPIRITO SANTO S.A.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Banco Espirito Santo S.A. ("Respondent" or "BES").

II.

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

of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

This matter concerns BES's violations of the broker-dealer and investment adviser registration provisions, as well as the securities transaction registration provisions, of the federal securities laws. BES, a commercial bank headquartered in Portugal, maintained relationships with approximately 3,800 U.S. residents, primarily Portuguese immigrants, who held products deemed to be securities under U.S. law in their brokerage and advisory accounts with BES between 2004 and 2009 ("U.S. Customers" and "U.S. Clients"), and offered the U.S. Customers brokerage services and the U.S. Clients investment advice. However, BES was not registered with the Commission as a broker-dealer or investment adviser, and it offered and sold securities to U.S. Customers and U.S. Clients without the intermediation of a registered broker-dealer. None of these securities transactions was registered and many of the securities offerings did not qualify for an exemption from registration, as applicable.

By acting as a broker-dealer and investment adviser to U.S. Customers and U.S. Clients without registering with the Commission, BES violated Section 15(a) of the Exchange Act and Section 203(a) of the Advisers Act. BES also violated Sections 5(a) and 5(c) of the Securities Act by offering and selling securities in the U.S. without registration and without an exemption from registration.

Respondent

1. Respondent is the principal subsidiary of Espirito Santo Financial Group, a company based in Luxembourg that owns the financial services-based businesses of Espirito Santo Group. Respondent is a commercial bank headquartered in Lisbon, Portugal with more than 700 branches located throughout the world. Although BES does not have a retail branch office in the U.S., it does operate a state-licensed money transmission service, Espirito Santo e Comercial Lisboa, Inc. ("ESCLINC"). Respondent's stock is listed on the Euronext stock exchange.

2. Respondent's U.S. Customers and U.S. Clients consist almost exclusively of Portuguese immigrants residing in the U.S. These individual U.S. Customers and U.S. Clients are clustered in urban areas in the Northeast; as of November 2009, approximately eighty-five percent of BES's U.S. Customers and U.S. Clients lived in the states of New Jersey, New York, Connecticut, Massachusetts, and Rhode Island.

---

[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.

BES's Business Activities in the U.S.

3. Respondent provided brokerage and advisory services to U.S. Customers and U.S. Clients through several avenues.

4. BES had a department located in Portugal — *Departmento de Marketing de Comunicacao & Estudo do Consumidor* (Department of Marketing, Communications, and Customer Research) — responsible for mailing marketing materials, including materials marketing securities to Respondent's customers who resided outside of Portugal. These materials, while not tailored specifically to U.S. residents, were sent to Respondent's U.S. Customers.

5. Beginning in 2004, BES retained a third party to operate a customer service call center, the ES Contact Center. Beginning in 2007, the ES Contact Center had two employees located in Portugal who were dedicated to servicing BES's U.S. Customers ("U.S. Representatives"). The U.S. Representatives offered various financial products to Respondent's U.S. Customers over the phone, including securities.

6. The U.S. Representatives were not registered as representatives of a broker-dealer, nor were they associated with a Commission-registered broker-dealer. These individuals were not residents of the U.S. and did not hold any U.S. securities licenses.

7. BES offered brokerage services from time to time to U.S. Customers through its money transmitter business, ESCLINC, which had locations in Connecticut, New Jersey, and Rhode Island. In addition to its primary function as a money transmitter, ESCLINC also served as a point of contact for BES's U.S. Customers' banking and investment activities.

8. None of the persons who worked for ESCLINC was registered as an investment adviser representative or a representative of a broker-dealer, nor were they affiliated with a Commission-registered investment adviser or broker-dealer.

9. In 2004, BES created an International Private Banking ("IPB") division based in Portugal to primarily service and provide advisory services to affluent clients residing outside of Portugal, including in the U.S. The IPB serviced Respondent's clients by dedicating one or more IPB relationship managers to a geographic region. The IPB relationship managers were primarily responsible for marketing Respondent's entire portfolio of financial services, including offering securities and providing advice regarding these securities, to IPB clients. These clients were offered a greater variety of investment products, including bonds, than regular retail customers typically were, and were also provided with BES's market research.

10. Starting in 2005, BES dedicated one IPB relationship manager ("IPB RM") to the U.S. market. Approximately 225 U.S. Clients were serviced by the IPB RM ("U.S. IPB Clients"). The U.S. IPB RM visited the U.S. approximately twice a year for two to three weeks at a time, meeting with approximately 30-50 U.S. IPB Clients. The U.S.-dedicated IPB RM also serviced U.S. IPB Clients from Portugal by telephone, facsimile, and email. During these communications, the IPB RM discussed the U.S. IPB Clients' BES accounts and financial products, including securities; helped to effect transactions in financial

products; and urged U.S. IPB Clients to buy, sell, or hold certain financial products.

11. None of the persons who served as the U.S.-dedicated IPB RM was registered as an investment adviser representative or a representative of a broker-dealer, or associated with a Commission-registered investment adviser or broker-dealer. These individuals were not residents of the U.S. and did not hold any U.S. securities licenses.

12. BES offered and sold a variety of securities to U.S. Customers and U.S. Clients. Prior to ceasing this conduct in 2009, Respondent sold securities and provided investment advice to approximately 3,800 U.S. Customers and U.S. Clients. BES sold several different types of securities to U.S. Customers and U.S. Clients, including:

    a) debt securities issued by third-party entities such as the Royal Bank of Scotland, HBOS plc, Lloyds Bank, Prudential, Limited Brands, Europe Immobiliere, HSH Nordbank, Old Mutual, Banco Panamericano, Banco do Brasil, and Banco Mercantilo do Brasil;

    b) debt and other group-guaranteed securities issued by BES and BES-affiliated entities;

    c) interests in Portuguese analogs to mutual funds (these funds were sponsored by BES and BES-affiliated entities);

    d) *Planos Poupanca Reforma* ("PPRs") – tax advantaged retirement products linked to the performance of a specified index or basket of securities;

    e) other securities held in *Gestao Discricionaria de Carteiras* ("GDC") accounts – customer accounts over which BES had discretionary authority to purchase securities, based on the investment profile agreed upon between BES and the GDC account holder; and

    f) guaranteed interest rate products that are linked to the performance of a specified index or basket of securities.

13. There was no registration statement filed or in effect for securities issued or sponsored by BES and BES-affiliated entities. Registration statements also were not filed or in effect for substantially all of the other securities BES offered and sold to U.S. Customers and U.S. Clients.

14. BES knew or should have known of its need to comply with the federal securities laws when providing brokerage and advisory services to U.S. Customers and U.S. Clients. For example, in 2007, BES identified the need to research the laws of other jurisdictions where it operated and consulted with counsel regarding its compliance with the laws of these certain other jurisdictions. At the same time, despite a significant presence in the U.S., BES failed to conduct such an analysis for its U.S. operations. BES has a U.S.-based wholly-owned subsidiary that is a member of FINRA and has been registered with the Commission as a broker-dealer since at least 2004. Despite having this U.S.-based wholly-owned subsidiary at its disposal, BES did not use this wholly-owned

subsidiary as an intermediary for any of the offers or sales of securities referenced above.

15. BES charged U.S. Customers and U.S. Clients various commissions and fees on their accounts (including management fees on GDC accounts) and for securities transactions. The commissions and fees charged depended on the type of account (*i.e.* brokerage or advisory), security, and transaction. Between 2004 and 2010, Respondent received approximately $1,650,000 in commissions and fees from U.S. Customers' and U.S. Clients' securities accounts and transactions.

16. As a result of the conduct described above, BES willfully[2] violated Sections 5(a) and 5(c) of the Securities Act, Section 15(a) of the Exchange Act, and Section 203(a) of the Advisers Act.

BES's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertaking

Respondent has undertaken to pay to each U.S. Customer and U.S. Client interest on securities purchased by the U.S. Customer or U.S. Client through BES, less any payments, other than principal payments on such securities, received pursuant to the terms of such securities, and to compensate each U.S. Customer and U.S. Client for any realized or unrealized losses with respect to securities purchased through BES. The interest shall accrue from the date of purchase of such securities by the U.S. Customer or U.S. Client until (and including) the last day of the fiscal quarter immediately preceding the date that an offer for payment conducted pursuant to this Order is mailed to the U.S. Customer or U.S. Client in a given state or, in the case of securities that have previously matured or been sold, until the date of maturity or sale, and the rate shall be set at the greater of the interest rate determined pursuant to 28 U.S.C. § 1961 or by the applicable interest rate prescribed by the law of the state in which the U.S. Customer or U.S. Client resides. Any payment made by BES to (i) U.S. Customers or U.S. Clients who have sold or returned their securities to BES for a consideration equivalent to at least the purchase price of such security, or (ii) as part of a settlement with a U.S. Customer or U.S. Client arising from their purchase of securities from or through BES shall be deemed to be a payment in satisfaction of this undertaking as to that U.S. Customer or U.S. Client.

In determining whether to accept the Offer, the Commission has considered this undertaking.

---

[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)).

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act, Section 15(a) of the Exchange Act, and Section 203(a) of the Advisers Act.

B. Respondent shall, within 7 days of the entry of this Order, pay disgorgement of $1,650,000, prejudgment interest of $363,518, and a civil money penalty in the amount of $4,950,000 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 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 BES as the Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and wire transfer, money order or check shall be sent to Associate Director Sanjay Wadhwa, Division of Enforcement, Securities and Exchange Commission, Three World Financial Center, Suite 400, New York, NY 10281.

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 ACT OF 1933
Release No. 9271 / October 24, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65609 / October 24, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14600

In the Matter of **Pipeline Trading Systems LLC,** **Fred J. Federspiel, and** **Alfred R. Berkeley III,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Pipeline Trading Systems LLC ("Pipeline Trading"), Fred J. Federspiel, and Alfred R. Berkeley III (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting

Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. SUMMARY

1. Pipeline Trading (together with its parent, "Pipeline") operated an alternative trading system ("ATS"), a private stock-trading platform commonly referred to as a "dark pool." Pipeline held out its ATS as a "crossing network" that anonymously matched customers' interests in trading large amounts of stock. However, Pipeline did not disclose to its customers that the overwhelming majority of the shares traded on its ATS were bought or sold by a wholly owned subsidiary of Pipeline.

2. The undisclosed subsidiary (the "Affiliate") was entirely owned and funded by Pipeline, which created the Affiliate to provide liquidity to Pipeline's customers.

3. Pipeline advertised that it had "no prop[rietary trading] desk gaming [customer] orders." Its advertising and other public statements repeatedly claimed that the trading opportunities on the ATS were "natural," that the ATS would not reveal the side (*i.e.*, whether an order was to buy or to sell) or price of a customer order before a trade was completed, that the ATS denied "arbitrageurs" and "high-frequency traders" information needed to "front run,"[1] that it provided a refuge from "predators," and that it prevented "pre-trade information leakage."

4. These claims were false and misleading in that the Affiliate was on the other side of the vast majority of trades executed on the ATS. The Affiliate sought to predict the side and price of Pipeline customers' orders and then trade on the same side as those orders in other trading venues before filling them on the ATS.

5. While Pipeline on the advice of its counsel disclosed to most of its customers the possibility of unspecified Pipeline affiliates trading on the Pipeline ATS, it assured its customers that any affiliate trading on the ATS would receive no preferential treatment and would "have no access to order or trade data of other subscribers." In fact, Pipeline occasionally revealed to the Affiliate, after the trades were consummated, order and trade data of other customers. Pipeline also provided the Affiliate with certain access and information that improved the Affiliate's ability to trade advantageously, including certain electronic connectivity to the ATS, input into designing ATS rules for deterring predatory conduct, and information about ATS operations and Pipeline's methods of policing for predatory behavior that were not known to other customers.

---

[1] Pipeline did not use the term "front run" to mean the illegal practice of a broker-dealer misusing specific customer order information to trade stock for its own account in advance of, and to the detriment of, its customer. References in this Order to "front running" or "trading in front" are not meant to refer to that practice.

6. From August 2004 to March 2010, Pipeline violated the Commission's Regulation ATS by omitting to disclose, in required filings with the Commission, the Affiliate as an entity involved in the operation of the alternative trading system.

7. By virtue of the conduct described herein, Pipeline Trading violated Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS under the Exchange Act, and Federspiel and Berkeley caused Pipeline Trading to violate Section 17(a)(2) of the Securities Act and Rules 301(b)(2) and 301(b)(10) of Regulation ATS.

B. RESPONDENTS

8. **Pipeline Trading Systems LLC**, a Delaware limited liability company headquartered in New York, New York, is a registered broker-dealer. Since 2004, Pipeline Trading has operated a registered ATS pursuant to Regulation ATS under the Exchange Act.

9. **Fred J. Federspiel**, age 48 and a resident of Larchmont, New York, is Pipeline's founder and CEO. Prior to March 16, 2010, he was Pipeline's President. Federspiel is a registered representative and supervisory principal at Pipeline Trading.

10. **Alfred R. Berkeley III**, age 67 and a resident of Baltimore, Maryland, is Pipeline's chairman. From December 19, 2003 until March 16, 2010, he was Pipeline's CEO. Berkeley is a registered representative and supervisory principal at Pipeline Trading. Berkeley is a former Vice Chairman and President of the NASDAQ Stock Market.

C. OTHER ENTITY

11. **Pipeline Financial Group, Inc.** ("Pipeline Financial"), a Delaware corporation headquartered in New York, New York, is a holding company that wholly owns Pipeline Trading and the Affiliate. Pipeline Financial was founded in 1999 as e-Xchange Advantage Corporation. Pipeline Financial and Pipeline Trading have offices in New York, Boston, Chicago, San Francisco, and London. Together they currently have approximately 85 employees.

D. FACTS

Market Background

12. An alternative trading system is a privately operated platform for trading securities.

13. Many customers use ATSs to avoid moving the price of a stock merely by placing an order to buy or sell it. Traditional trading venues, such as stock exchanges, typically post information about available orders. Exchanges reveal an order's size (the number of shares a trader wants to buy or sell) and price (the amount a buyer is willing to pay, called a "bid," and the amount a seller is willing to receive, called an "ask" or "offer"). Traditional trading venues also publish quotations from market makers of the prices at which they are willing to buy and sell stocks. The

highest published bid and lowest published offer generally available at any given time nationwide are referred to as the National Best Bid and Offer, or NBBO.

14. When information about a large order becomes known by other market participants, or "leaks out," an opportunistic firm can trade in front of that order to the detriment of the firm that placed it. For example, if an institutional investor is seeking to buy (or sell) a large amount of stock, the opportunistic firm can immediately buy shares at the lowest prevailing offers (or sell shares short at the highest prevailing bids). Because the lowest offers (or highest bids) have been removed from the market, the best offers become higher (or the best bids become lower). The market price thus moved up (or down) in response to increased demand (or supply). Having bid the price up (or down), the opportunistic firm can make money by selling its shares at the new higher price (or buying shares at the new lower price), knowing that the demand (or supply) from the institutional investor's order will continue to keep the price high (or low).

15. ATSs are designed to avoid such pre-trade market impact. ATSs often display little or no information about their customers' orders and, accordingly, are referred to as "dark pools." When a dark platform matches orders, the market impact described above may be avoided or minimized because customers' trading interests are not publicized before a trade is executed.

16. Pipeline created its ATS as a type of dark pool that would allow customers to trade large amounts of stock, claiming that this would minimize market impact. According to a 2003 Pipeline internal business plan, "Institutions have always had a problem trading large blocks of shares. Whenever information about a large institutional order leaks out to the market, several market intermediaries step in front of such an order. This often results in an adverse movement in the market price for large trades."

17. Emphasizing features of the ATS that were designed to prevent customers' order information from leaking to the market, Pipeline's marketing targeted institutional investors – mutual funds, pension funds, insurance companies, and other large asset managers, referred to in industry parlance as the traditional "buy side." Typically, those firms buy or sell a security as a long term investment. Pipeline's ATS was also known to be open to brokerage firms (referred to as the "sell-side") and hedge funds.

18. Institutional investors are wary of so-called "predators" – typically broker-dealers and high frequency trading firms that seek to profit from short-term price fluctuations. Institutional investors are normally concerned that predators will use small orders to "sniff out," or test for the presence of, a much larger institutional order. By risking only a small amount of capital on the smaller order, the predator can gain information that can be used to trade in piecemeal fashion in front of the institutional order for the predator's own profit and to the detriment of the institutional investor.

19. Pipeline sought to prevent or deter this practice by imposing large minimum sizes for orders on its ATS. The large minimums would prevent block orders from being broken up into smaller, "leaky" trades, and at the same time force would-be predators to risk a large amount of capital to sniff out an institutional order. Pipeline's minimum order size for each stock – 10,000,

25,000 or 100,000 shares, depending on the stock – was called the "LBQ," for Large Block Quantity.

Pipeline Overview

20. Pipeline launched its ATS on September 9, 2004. Its customers entered into subscription agreements with Pipeline pursuant to which the customers agreed to pay a commission for each share bought or sold on the ATS.

21. Pipeline's customers placed orders by using Pipeline's Block Board, a proprietary graphical interface on customers' computers. When a customer placed an order, the Block Board displayed the stock symbol in a small orange-colored box on all other customers' computers. This "orange light" did not indicate the order's side, price, or size. However, for the orange light to turn on, the price had to be reasonable and the order had to be at least as large as the applicable LBQ. Reasonably priced meant a customer's bid or offer price was within a proprietarily calculated range known as the "BPR," for Block Price Range.

22. If two customers entered "market" orders (*i.e.*, orders to buy or sell at the best prevailing market prices) on the ATS for the same stock and the orders were on opposite sides, a trade would take place. The price of the trade would be the mid-point of the NBBO at the time of the trade.

23. From the outset, Pipeline wanted to generate enough liquidity – that is, trading opportunity – to attract customers.

24. After considering other options, Pipeline created a firm to provide some of that liquidity. Several months before the ATS launch, Pipeline created the Affiliate as an ATS user. According to a June 2004 memo that Pipeline Financial's Director of Research sent to Federspiel and Berkeley, the Affiliate was to "[k]eep the Block Board active" and "[p]rovide a baseline fill rate for early Pipeline adopters" by frequently placing orders and trading with Pipeline customers.

25. After consulting with a law firm experienced in securities law matters, Pipeline included a disclosure in most of its subscriber agreements that unspecified affiliates of Pipeline Financial or its investors could be trading on the ATS.

26. Pipeline did not disclose the Affiliate's role in providing liquidity on the ATS. As further set forth below, Pipeline made statements in its marketing materials and press releases that portrayed Pipeline as a leading platform to find "natural" counterparties. These statements were inconsistent with the Affiliate's predominant role in transactions on the ATS.

27. Ten months after the ATS launch, Pipeline changed the Affiliate's name from Exchange Advantage LLC to Aurora Technology Partners LLC ("Aurora") in order to obscure the Affiliate's connection to Pipeline. Pipeline chose Aurora's name after the Director of Research wrote that it "should sound like a technology firm, consulting or software." In July 2006, to further obscure the Affiliate's connection to Pipeline, Pipeline transferred the Affiliate's operations from Aurora to Milstream Strategy Group LLC, a new, wholly owned subsidiary of Pipeline Financial.

28. For most of the life of the ATS, Pipeline and the Affiliate were located in the same building, although on different floors.

29. The Affiliate traded only on an intra-day basis. That is, it exited all its stock positions before the close of trading every afternoon and never took a long-term interest in any security. The Affiliate simply focused on matching the other side of orders placed by Pipeline's customers.

30. From the launch until May 2006, Pipeline Financial's Director of Research, who principally designed the ATS, managed the Affiliate. During most of that time, the Director of Research personally conducted trades for the Affiliate.

31. For the first four months after the ATS launch, the Affiliate was party to transactions accounting for 97.5% of the shares traded on the ATS. In 2005, the Affiliate was party to 87% of the ATS trading volume. This pattern persisted with occasional variation. From the launch until December 31, 2009, the Affiliate participated in approximately 80% of the trading volume on the ATS. Therefore, Pipeline customers in substance overwhelmingly traded with the Affiliate, and not with each other.

32. Pipeline was aware that its customers generally expected to trade with other customers, not with an affiliate of Pipeline, and that the Affiliate participated in the overwhelming majority of the trading volume on the ATS. Pipeline also was aware that a full disclosure of the Affiliate's role could drive customers away.

Pre-positioning

33. To reduce the risks associated with buying and selling shares on the ATS and improve its financial performance, the Affiliate commonly sought to pre-position, or trade in front of Pipeline's customers' orders. When the Affiliate judged that a customer had placed an order on the ATS to purchase shares, the Affiliate would buy shares of the same stock in other market centers and then seek to sell the shares to that customer on the ATS. Conversely, when the Affiliate judged that a customer had placed an order on the ATS to sell shares, the Affiliate would sell shares of the same stock short in other market centers and then seek to cover these short shares by buying from that customer on the ATS.

34. Although the Block Board did not reveal whether an order was a buy or a sell, the Affiliate's traders sought to predict the side of customer orders in order to then trade on the same side as those orders in other trading venues before filling them on the ATS. By, among other things, looking to market conditions and recent trading history on the ATS and by placing test orders in Pipeline and in other dark pools, the Affiliate had some success in making these predictions.

35. Pipeline took certain actions that facilitated the Affiliate's pre-positioning in front of Pipeline customer orders. Pipeline provided the Affiliate a type of electronic connection to the ATS, one otherwise provided only to customers who were institutional investors. When a customer's order turned a stock symbol orange on the Block Board (or when the opposite happened, *i.e.*, an orange light went off and the stock reverted to "white"), Pipeline customers without that con-

nection could know that only from human observation of their computers' graphical interface. The Affiliate, however, received the information in a more easily processed form, as data sent over a FIX line. (FIX is a protocol for transmitting order information in the financial industry.) These FIX messages, which included the BPR every time a stock turned orange or white, allowed the Affiliate to construct a database that tracked the precise times during which each stock was orange and white, as well as certain price information. This database allowed the Affiliate more efficiently and accurately to assess the persistence, side, and approximate limit price of customer orders.

36. The Affiliate developed a practice of placing large numbers of orders only to cancel them immediately afterwards – "flashing," in industry jargon. The Affiliate did this, among other reasons, to assess the interest of Pipeline's customers.

37. Federspiel encouraged the Affiliate to place orders in specific stocks or categories of stocks that Federspiel thought would interest Pipeline's customers. After the close of trading, Federspiel sometimes told the Affiliate's manager that the Affiliate had missed certain opportunities and asked why it had not traded particular stocks. Other times, Federspiel and other Pipeline employees telephoned the Affiliate during the trading day to ask the Affiliate to trade specific stocks.

Marketing the ATS

"Natural," "Predator-proof" Crossing

38. Pipeline repeatedly described its ATS as a crossing network that protected institutional investors from the market impact associated with predatory trading. For example, in a 2005 statement shared with journalists and industry analysts, Berkeley emphasized that "Pipeline's new technology reduces market impact by denying day traders, predatory dealers and other speculators the information they need to front run institutional investors' orders."

39. Pipeline represented to its customers that its trading system was designed to prevent users from uncovering customer order information for the purpose of trading in front of those orders. In user guides, marketing materials, and other public statements, Pipeline stated that:

- Pipeline was an "anonymous Alternative Trading System designed to help users cross blocks without revealing the direction of their trading interest to anyone prior to completion of a large trade."
- "[B]ecause your order is hidden, you can leave it in Pipeline for hours without leaking any information or moving the market."
- "[T]he Pipeline Block Board has become the preferred source of liquidity for a rapidly growing group of buy and sell side block traders intent upon moving large blocks without tipping their hands to predators and front runners."
- Pipeline's ATS was "leak-proof" and "predator-proof."

- "[W]ith Pipeline, pre-trade leakage of critical information is eliminated. Pipeline gives block traders the ability to attract giant contras while frustrating the prying eyes of predators."

- According to Federspiel, "Traders [using Pipeline] experience the simplicity and speed of anonymously executing large blocks without moving the market. Relieved from predators and front runners, traders can quickly and quietly unearth block liquidity – generating more fills with less slippage."

- Pipeline was "a refuge from predators and front runners."

- According to Berkeley, Pipeline "acts as a confidential channel, specifically to bring natural buyers and sellers together . . . without disseminating their intentions."

- According to Federspiel, the Pipeline ATS reduced "the predatory practices that can occur in traditional trading venues . . . to the point of extinction."

- "Pipeline's unique pay-to-play model prevents pre-trade information leakage."

- According to Berkeley, "Pipeline minimizes market impact by keeping . . . the details of the trader's intentions secret" and "is optimized to meet the block trader's need to operate invisibly in the market . . . free from backing away and front running."

40. In a December 3, 2004 email, Federspiel instructed Pipeline's sales force as follows:

> If a potential user is concerned that people would use the system to try to guess that someone else might be on the same side, we could say this: the scenario you laid out might make some kind of theoretical sense, but in practice, no one is behaving that way.

41. Pipeline also consistently marketed the ATS as providing "natural" liquidity. While there is no standard definition of "natural" liquidity, the term is generally understood to exclude a trading opportunity generated by a dealer or by the trading venue itself specifically for the purpose of filling a given customer's order. Nevertheless, in 2004 and 2005, at times when the Affiliate accounted for 90% or more of the ATS trading volume, Federspiel wrote in emails to customers:

- "If you find yourself too busy to watch the Block Board, you can simply place orders and collect the in-line execution reports, finding natural liquidity without influencing the market."

- "We want to be your preferred destination to find natural liquidity, and more importantly, to actually trade with it."

- "Many of you have told us you want to use Pipeline for large naturals in less liquid names."

42. In 2007, when the Affiliate accounted for approximately 80% of the ATS trading volume, Federspiel wrote in emails to customers:

- On March 12, 2007, "traders were even more successful in their active search for natural contra liquidity. We are excited to build toward a future where traders have even more control over their search for naturals."
- "On Tuesday, July 3[, 2007], Pipeline will help you find giant natural trades through the 1PM close of the retail-sized markets."

43. A number of Pipeline press releases misleadingly implied that rising trading volume on the ATS was attributable to increasing numbers of "natural" trades executed on the system. In fact, that increased volume was due to the Affiliate's trading. In particular:

- On March 22, 2006, Pipeline issued a press release written by Federspiel announcing that Pipeline had "executed a record 26,639,000 shares on March 21, 2006." The press release continued: "'More and more block traders are adding Pipeline to their trade management strategies,' said Fred Federspiel, President and Founder. 'Traders are finding natural liquidity in mega-block size for stocks that otherwise trade in bits and pieces. The result is a real savings.'" But the volume record had nothing to do with "natural" liquidity: on March 21, 2006, the volume of customer-to-customer trades had actually gone *down* as compared with the preceding day. The reported volume jump was due entirely to a spike in the volume of trades between customers and the Affiliate.
- On April 6, 2006, Pipeline issued a press release written or approved by Federspiel announcing a volume record for April 5, 2006 that was largely attributable to a spike in the Affiliate's purchase and sale of shares on the ATS. The press release quoted Federspiel: "Traders are finding that Pipeline is an impact-free tool to generate large block naturals."
- On June 5, 2007, Pipeline issued a press release authored or approved by Federspiel with the headline "Block Traders Flock to Pipeline for Large Natural Liquidity / The Block Market™ Sustains Record Growth." The press release announced volume records for May 2007, and quoted Federspiel saying: "Our continuous growth in volume is a result of our rapidly growing customer base – now totaling over 500 firms – and technology integration efforts, which make it easier for many . . . users to leverage Pipeline to generate giant natural trades." The press release also quoted Federspiel saying: "More and more block traders understand that Pipeline provides the best chance to find large natural liquidity." The volume records reported in the press release, however, were not a result of natural liquidity: they were entirely due to increases in the volume of trades involving the Affiliate.
- Additional volume records were reported in a similarly misleading fashion in Pipeline press releases dated July 9, 2007, and February 5, 2008.

44. In an advertisement that Federspiel approved for inclusion in an April 2007 industry magazine and that referred to Pipeline as a "crossing network," Federspiel said that "The Block Market™ from Pipeline offers unsurpassed ability to find and trade with natural liquidity" and that Pipeline's approach "maximizes a trader's probability of capturing natural liquidity."

"No prop desk"

45. Some operators of ATSs own proprietary trading desks that trade securities on their ATSs with the operators' own money. Pipeline's customers believed that Pipeline was not such an ATS. Pipeline specifically instructed its sales force to tell customers that there was "no prop desk at Pipeline attempting to game your block orders."

"Denying statistical arbitrageurs the information they need to front run"

46. In press releases and other marketing materials issued in 2008 and 2009, Pipeline stated that its ATS provided protection against "statistical arbitrageurs" and "high-frequency trading operations." For example, a press release dated June 10, 2008 (authored or approved by Federspiel), and certain user guides claimed that Pipeline "optimize[s] the execution of giant orders while denying statistical arbitrageurs the information they need to front run." Press releases dated July 31, 2008, December 2, 2008, February 26, 2009, and March 2, 2009 (all authored or approved by Federspiel), contended that Pipeline "optimize[s] the execution of giant orders while denying statistical arbitrageurs the information they'd need to take advantage of institutional orders . . . . It was built from the ground up to deliver impact-free block liquidity in the face of increasingly sophisticated predators." On August 17, 2009, Pipeline issued a press release in which Federspiel said: "Our mission is to help buy-side desks get all the liquidity they need while minimizing losses to high-frequency trading operations." At all relevant times, however, the Affiliate sought to predict the side and price of Pipeline customers' orders and then trade on the same side as those orders in other trading venues before filling them on the ATS.

47. Berkeley edited, reviewed and/or approved the June 10, 2008, July 31, 2008, and February 26, 2009 press releases.

48. In a July 2009 interview with an industry magazine, Berkeley stated that "High-frequency traders are the natural enemy of . . . the large institutional investor" and that "most market centers are doing things that disadvantage the . . . institutional investor, because they're doing things to advantage the high-frequency trader."

49. Berkeley also stated in the July 2009 interview that "we have some of the smartest guys in the country figuring out how to make it hard to see customer orders." He also stated that high-frequency trading firms were not his "audience," but were "very relevant for our customers because those high-frequency firms are front-running institutions." He further stated that Pipeline was practically the only ATS operator committed to serving "the traditional buyside" (institutional investors) because "almost everyone else is addicted to the volume that comes from high-frequency trading." At the time, however, the Affiliate was a high-frequency firm that sought to predict the side and price of Pipeline customers' orders and then typically traded on the same side as those orders in other trading venues before filling them on the ATS.

"Policing" the system

50. Pipeline instructed its sales force to represent that Pipeline policed the ATS to limit "gaming" behavior. On April 24, 2006, Federspiel suggested that the sales force tell its customers that Pipeline monitors "whether there's any systematic way to gain knowledge of, and take advantage of, Pipeline orders. . . . The results show zero – that . . . there is no profitable way to game the system."

51. On January 25, 2008, Federspiel wrote to the sales staff:

> Today we suspended access indefinitely for [a user].
>
> As you know we monitor activity, looking for firms with unusual activity patterns on the system. Because obtaining any actionable information in Pipeline is so difficult (LBQs make it virtually impossible to come up with a profitable gaming strategy), most parties who try give up. But we still actively police the system and in this case determined that the [suspended user] was not acting in the interests of the Pipeline community. We end up needing to do this about twice a year.

52. Pipeline trained its sales staff to tell customers that Pipeline conducts "human policing" for "indications of behavior which is not beneficial to the entire community." However, Pipeline's sales force did not disclose the Affiliate's role on the ATS or its trading behavior.

Conflicts of Interest

53. Early in the life of the ATS, the Affiliate lost money on its trading, with Pipeline viewing the losses as a marketing cost. In May 2006, Federspiel replaced the Director of Research with the Affiliate's head trader ("Head Trader") as the Affiliate's manager. Federspiel believed that the Head Trader could reduce the Affiliate's losses.

54. Pipeline's senior management recognized that there could be "a direct conflict of interest" between the Affiliate and a customer whose order it was seeking to fill. In any given trade, the better the price the customer received, the worse the price the Affiliate received, and vice versa.

55. Pipeline implemented an incentive system designed to address that conflict. Around May 2006, Federspiel, Berkeley, the Director of Research, Pipeline Financial's CFO ("CFO"), and the Head Trader agreed on a bonus system for the Affiliate's traders to motivate them to trade profitably while at the same time reducing their incentive to trade to the detriment of Pipeline's customers. Under the system, each trader received payments based on the sum of three quantities: (1) the profits and losses from the employee's trading (incentivizing traders to generate profits and avoid losses for Pipeline); (2) a quantity known as the Execution Quality Rebate, or EQR (incentivizing traders to provide executions to Pipeline's customers at prices that were not unfavorable to the customers); and (3) $0.007 for each share that the trader executed on the ATS (incentivizing traders to execute a high volume of trades opposite customers on the ATS).

56. EQR was calculated by subtracting, for each trade on the ATS, (a) the price at which the Affiliate actually filled a customer's order from (b) the stock's average price on the market, weighted by volume (known as volume-weighted average price, or VWAP) in the 10 minutes immediately before and after when the trade took place on the ATS. This so-called 20-minute VWAP was intended to serve as a measure of good execution quality for Pipeline's customers.

57. Accordingly, Pipeline compensated the Affiliate's traders both for trading profitably and for filling customer orders at prices that, from the customer's standpoint, were favorable as compared to market prices in the 20 minutes surrounding the trade – a compensation methodology designed to mitigate the conflict of interest between the Affiliate and the customers on the opposite side of the Affiliate's trades.

58. Under the supervision of the Head Trader, the Affiliate's trading gradually became less unprofitable. For the years 2004 through 2006, the Affiliate lost approximately $19.7 million on its trading. In 2007, the Affiliate had almost no net trading losses. By early 2008, Federspiel, Berkeley, and the CFO discussed the Affiliate as potentially an "asset rather than a potential liability" and that its financial results should be a "core part of the Company." The Affiliate's trading profits in 2008, 2009, and 2010 were $18.4 million, $9.3 million, and $4.5 million, respectively.

59. Over the life of the Affiliate through 2010, the expenses associated with operating the Affiliate, including compensation, exceeded the gains from trading.

Execution Quality

60. Pre-trade market impact is commonly measured by comparing the price at which a customer's order was executed with market prices at the time the customer placed its order. This measurement is known as "implementation shortfall" or an "arrival price" comparison. Institutional investors generally want to minimize shortfalls – that is, they want to trade at prices close to the arrival price.

61. The Affiliate's participation in a trade generally was associated with greater departures from the arrival price in comparison to when two customers traded, even if the Affiliate's pre-positioning did not cause all of the pre-trade price movement.

62. Beginning in 2006, Pipeline began using a different price benchmark as its dominant measure of execution quality on the ATS: VWAP in the twenty minutes surrounding the execution time, which was the same benchmark used to calculate bonuses for the Affiliate's traders. Thus, Pipeline deemed an execution "good" from a buying customer's standpoint if the customer's order was filled at or lower than 20-minute VWAP. For a selling customer, an execution was deemed "good" if it took place at or higher than 20-minute VWAP.

63. The EQR system gave the Affiliate and its traders an incentive to create those good executions on the ATS relative to 20-minute VWAP. However, this metric is not the sole measure of trade execution, and did not measure price movements occurring before or after the 20-minute window. Prices in trades with the Affiliate were less favorable when measured by reference to the price of the stock at the time the customer placed its order than when measured by reference to 20-minute VWAP surrounding the time of execution of the Affiliate's trade with the customer.

64. Pipeline occasionally disciplined customers by limiting or terminating their access to the ATS. Pipeline did this when it determined that a customer was taking advantage of other customers. Pipeline had no fixed rules or criteria for making disciplinary decisions. In general, Pipeline exercised discretionary judgment based on the 20-minute VWAP measurement.

65. Pipeline never disciplined the Affiliate by limiting or terminating its access to the ATS.

"All Pipeline subscribers are treated equally"

66. Pipeline repeatedly told its customers that all ATS subscribers, including Pipeline affiliates, are treated equally.

67. On June 1, 2009, and with Federspiel's knowledge, Pipeline emailed a letter from its compliance officer to each of its customers that read in part:

> While affiliates of Pipeline Trading Systems LLC may submit orders for themselves or on behalf of others to the Pipeline ATS, they do not receive any preferential treatment in accessing the system. Specifically, our policy is that affiliates (i) have no access to order or trade data of other subscribers; (ii) receive the same information about orange, yellow and black lights as non-affiliates; and (iii) are subject to the same price-time prioritization rules as non-affiliates. In other words, all Pipeline subscribers are treated equally.

68. Approximately one week later and with Federspiel's knowledge, Pipeline emailed its customers a disclosure that read in part (emphasis in original):

> Subscribers to Pipeline may be affiliated with Pipeline's parent, Pipeline Financial Group, Inc., and, as such, trade equity and/or option securities via Pipeline. Pipeline affiliates do not receive any advantage whatsoever in their trading on the Pipeline ATS. Our policy is that affiliates (i) are subject to the same price-time prioritization rules as non-affiliates; (ii) receive the same information about orange and black lights as non-affiliates; and (iii) have no access to order or trade data of other subscribers.

69. In April 2010, Pipeline sent its customers a disclosure that read in part:

> Subscribers to Pipeline include affiliates that effect transactions for their own proprietary account. Such affiliates do not receive any advantage in their trading on the Pipeline ATS. Our policy is that affiliates (i) are subject to the same price-display-time prioritization rules as non-affiliates; (ii) receive the same information about orange and yellow lights as non-affiliates; and (iii) have no access to order or trade data of other subscribers.

70. Despite these representations, Pipeline provided the Affiliate with certain advantages.

71. First, the Affiliate, unlike other customers, knew that Pipeline assessed execution quality on the ATS largely using the 20-minute VWAP. The Affiliate therefore could participate in trades with implementation shortfall and still provide customers with good execution quality, as measured by Pipeline, so long as the price movement occurred at least 10 minutes before the Affiliate executed a trade with another Pipeline customer. In aggregate, trades between customers and the Affiliate were associated with greater implementation shortfall than trades between two customers – although factors other than the Affiliate's trading activity may have caused much of the shortfall.

72. Second, Pipeline provided the Affiliate with a FIX connection to the Block Board. This connectivity conferred an advantage by making it much easier to track history and activity on the Block Board. Pipeline denied a request for such a connection from at least one customer out of concern that the customer, a broker-dealer and market maker, would use the advantage to "game" the ATS and trade to the detriment of Pipeline customers.

73. Third, the Affiliate received the boundaries of the BPR each time a stock went from orange to white or from white to orange even after Pipeline, at a certain point in 2010, stopped providing that data to virtually all other users. This information assisted the Affiliate in determining the side and approximate price of customer orders.

74. Fourth, Pipeline solicited and received input from the Affiliate on Pipeline's determination of LBQ for each stock traded on the ATS. Pipeline's marketing materials repeatedly represented that the LBQ, which Pipeline advertised as a key "predator proofing" device, was determined by the stock's trading volume in accordance with criteria advertised by Pipeline – namely, 100,000-share minimums for stocks trading more than 5,000,000 shares per day, 25,000-share minimums for stocks trading less than 5,000,000 and more than 500,000 shares per day, and 10,000-share minimums for stocks trading 500,000 shares per day or less. As a result of the Affiliate's input, however, LBQ size sometimes departed from these criteria.

75. Customers were not invited to provide the same degree of input as the Affiliate. On January 6, 2006, the Director of Research asked Federspiel "What do you think should be the communication strategy [*i.e.*, to customers] on LBQ changes?" Federspiel replied, "I don't want to draw too much attention to LBQ changes."

76. In general, the larger the LBQ, the greater the dollar amount of the minimum order size, and therefore the riskier it was for the Affiliate or any other trader to "pre-position" to its own advantage and potentially to the detriment of the customer on the other side of the trade. Federspiel supervised the setting of LBQ sizes and knew that in many cases the LBQs were lower than they would have been if Pipeline had determined the LBQs solely based on the stock's trading volume. In many cases, the decision to maintain a lower LBQ for a given stock (e.g., 25,000 shares rather than 100,000 shares) was influenced by the objectives of reducing the Affiliate's risk of losing money on trades with customers and enabling the Affiliate to trade more actively with customers, thereby increasing the overall volume of trades on the ATS and commissions earned by Pipeline.

77. Fifth, Pipeline provided the Affiliate with information regarding other ATS features designed to "predator proof" the ATS. For example, soon after launch, Pipeline began randomizing

the amount of time during which a stock would stay orange before reverting to white once an order had been cancelled or filled. Pipeline randomly selected this orange-to-white interval between approximately one minute and two minutes. According to Pipeline, this feature was intended to make information revealed by the Block Board "fuzzier," and therefore deter predators.

78. Pipeline told its customers about this randomized feature, but it did not tell customers the specific minimum and maximum intervals. However, Pipeline provided the Affiliate the exact range. In addition, Pipeline solicited and received the Affiliate's input on the range.

79. Sixth, Pipeline provided the Affiliate with information on the ATS and its Block Board that was not provided to other customers. For instance, on November 22, 2006, Pipeline provided the Affiliate with documentation for the Block Board's software that included detailed specifications for certain features that could be used to assess more accurately the existence and price of a potential matching order. Pipeline did not share the documentation, which bore a stamp indicating it was "for internal distribution only," with customers.

Commission Filings

80. In its filings with the Commission pursuant to Regulation ATS, Pipeline made a series of material misstatements and omissions.

81. Regulation ATS required Pipeline to disclose on Form ATS "any entity . . . that will be involved in the operation of the alternative trading system." The Affiliate was such an entity. It was created specifically to provide liquidity on the ATS, where it completely dominated the trading volume, and the compensation of its staff was tied to the execution quality that Pipeline's customers received.

82. However, Pipeline's Form ATS filings, which were reviewed by Federspiel and Berkeley, did not disclose the Affiliate until March 2010, at which point Pipeline described the Affiliate as "an affiliate of Pipeline Trading Systems" that "effects transactions on the Pipeline ATS, providing liquidity on the ATS."

83. Moreover, some of Pipeline's Form ATS filings attached user guides and other marketing materials containing the false or misleading information referred to above, including descriptions of the basic nature of the ATS, the selection of LBQ size, and Pipeline's guarantee of anonymity.

Inadequate Safeguards for Customers' Confidential Trading Information

84. The Commission's Regulation ATS requires an ATS to "establish adequate safeguards and procedures to protect subscribers' confidential trading information," and specifies that such safeguards and procedures must include "limiting access to the confidential trading information of subscribers to those employees of the alternative trading system who are operating the system or responsible for" compliance functions. The regulation also requires an ATS to have "adequate oversight procedures to ensure" compliance with the safeguards and procedures for protecting confidential trading information.

85. Pipeline failed to comply with these requirements. Although he was not seeking to take advantage of customers, Pipeline Financial's Director of Research, with the knowledge of Federspiel and Berkeley, accessed or received confidential customer information in the period, from the launch of the ATS in 2004 through the spring of 2006, when he also served as the manager in charge of the Affiliate and as a trader at the Affiliate. This information, which the Director of Research generally received only after the consummation of trades, included customers' identities and the side, size, and price of their orders in the very stocks that he and others at the Affiliate were trading.

86. As a member of Pipeline's senior management, the Director of Research had access to information on Pipeline's sales efforts. On at least two occasions, in September 2005 and February 2006, the Director of Research told traders at the Affiliate the names of new or prospective Pipeline customers.

87. From time to time, representatives of Pipeline failed to strictly maintain the confidentiality of other information concerning customers. On at least several occasions, for example, Federspiel provided the Affiliate information about orders on the ATS, such as that recent orders in certain stocks had come from "a dealer," or a customer who was "aggressive" or "passive," or a "consistent" or "selective" customer. Similarly, after he left the Affiliate, the Director of Research occasionally told the Affiliate traders after the close of trading the side and approximate size of orders in a particular stock, or the type of account placing the orders. On one occasion, the head of Pipeline's help desk called the Head Trader with the side and precise size of a customer's interest in a stock.

E. VIOLATIONS

88. As a result of the conduct described above, Pipeline Trading "willfully"[2] violated:

a. Section 17(a)(2) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, obtaining 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.

b. Rule 301(b)(2) of Regulation ATS, which requires an ATS to file an amendment on Form ATS at least 20 days prior to implementing a material change to the operation of the ATS, 30 days after the end of a quarter when information contained in an initial operation report filed on Form ATS becomes inaccurate, and promptly upon discovering that an initial operation report filed on Form ATS or an amendment on Form ATS was inaccurate when filed; and

c. Rule 301(b)(10) of Regulation ATS, which requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information and to

[2] As explained in footnote 3 below, "willfully" means only that the actor intentionally committed the act which constitutes the violation. There is no requirement that he also be aware that he is violating the securities laws.

adopt and implement adequate oversight procedures to ensure that the safeguards and procedures for protecting subscribers' confidential trading information are followed.

89. As a result of the conduct described above, Federspiel and Berkeley caused Pipeline Trading to violate Section 17(a)(2) of the Securities Act and Rule 301(b)(10) of Regulation ATS, and, pursuant to Sections 15(b)(6) and 21B(a)(3) of the Exchange Act, are liable for civil penalties for their "willful"[3] acts or omissions that were a cause of Pipeline Trading's violations of Rule 301(b)(2) of Regulation ATS.

IV.

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

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

A. Respondent Pipeline Trading cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

B. Respondent Federspiel cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

C. Respondent Berkeley cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Regulation ATS promulgated under the Exchange Act.

D. Respondent Pipeline Trading shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $1,000,000 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

[3] Sections 15(b)(6)(A) and 21B(a)(3) of the Exchange Act authorize the Commission to impose sanctions, including civil penalties, against any associated person of a broker-dealer for, among other things, willfully causing to be made in any report required to be filed with the Commission statements which were, at the time and in the light of the circumstances under which they were made, false or misleading with respect to any material fact, or omissions of any material facts in any such report which were required to be stated therein. A Form ATS is a report required to be filed with the Commission within the meaning of Sections 15(b)(4)(A) and 21B(a)(3). 17 CFR § 242.301(b)(2)(vi). As used in the governing provisions of law, "willfully" means only that the actor "intentionally committed the act which constitutes the violation." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965); *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). "There is no requirement that the actor also be aware that he is violating one of the Rules or Acts," 344 F.2d at 8, and, accordingly, this use of the word "willful" does not reflect a finding that the Respondents acted with the intention to violate the law or knowledge that they were doing so.

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, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Pipeline Trading 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 George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

E. Respondent Federspiel shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Federspiel 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 George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

F. Respondent Berkeley shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Such payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, Accounts Receivable, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Berkeley 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 George S. Canellos, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 3307 / October 24, 2011

INVESTMENT COMPANY ACT OF 1940
Rel. No. 29841 / October 24, 2011

Admin. Proc. File No. 3-14194

In the Matter of MICHAEL R. PELOSI	ORDER GRANTING EXTENSION

I.

The Chief Administrative Law Judge, Brenda P. Murray, has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of time to issue an initial decision in this proceeding. For the reasons set forth below, we have determined to grant the law judge's motion.

On January 14, 2011, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") against Michael R. Pelosi, formerly a vice president and portfolio manager of Halsey Associates, Inc., a registered investment adviser. The OIP alleges that Pelosi knowingly or recklessly misrepresented account performance returns to his investment advisory clients in quarterly and annual correspondence by exaggerating account gains and minimizing losses in violation of antifraud provisions of the Investment Advisers Act of 1940.[2] According to the OIP, "Pelosi's performance returns varied significantly from the true performance returns calculated by Halsey."

The OIP directs the presiding law judge to hold a public hearing to take evidence regarding the allegations and the appropriate sanctions, and to issue an initial decision no later than 300 days from the date of service of the OIP, *i.e.*, by November 21, 2011. On

---

1 17 C.F.R. § 201.360(a)(3).

2 Specifically, the OIP alleges violations of Advisers Act Sections 206(1) and 206(2). 15 U.S.C. § 80b-6(1), (2).

September 28, 2011, Judge Murray filed a motion pursuant to Commission Rule of Practice 360(a)(3)[3] requesting an extension of time of forty-five days to issue such decision.

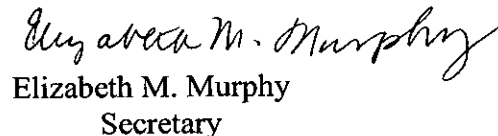
II.

We adopted Rules of Practice 360(a)(2) and 360(a)(3) as part of an effort to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings,[4] setting mandatory deadlines for completion of administrative hearings. We further provided for the granting of extensions to those deadlines under certain circumstances, if supported by a motion from the Chief Administrative Law Judge.[5]

Judge Murray supports her extension request by stating that, "[l]ast weekend, the law clerk assigned to [the case] . . . had an accident in which he broke his right elbow." She further states that "[t]he law clerk has been assigned to the case for some time and has almost completed his analysis of the evidentiary record; however, as a result of the accident, he cannot use his right hand for several weeks." Judge Murray concludes that "[i]t would not expedite matters to reassign the case to another law clerk because that person would have to spend considerable time becoming familiar with a substantial evidentiary record." Under the circumstances, it appears appropriate in the public interest to grant the Chief Law Judge's request and to extend the deadline for issuance of a decision in this matter.

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this matter be, and it hereby is, extended until January 5, 2012.

By the Commission.



Elizabeth M. Murphy
Secretary

---

3 17 C.F.R. § 201.360(a)(3).

4 *See Adopting Release*, Securities Act Rel. No. 8240 (June 11, 2003), 80 SEC Docket 1463.

5 While we intend to grant extensions sparingly, we may authorize an extension on the basis of the Chief Administrative Law Judge's motion, if we determine that "additional time is necessary or appropriate in the public interest." 17 C.F.R. § 201.360(a)(3).

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65621 / October 25, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3332 / October 25, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14603

In the Matter of **WILLIAM J. TENNANT, CPA,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of William J. Tennant, CPA, pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Tennant is a certified public accountant, licensed in New York, although his license has lapsed.

2. On September 7, 2011, a judgment of conviction was entered against Tennant in United States v. William Tennant, No. 08 CR 972 (DAB), in the United States District Court for

[1] Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

the Southern District of New York, finding him guilty of one count of securities fraud in connection with his role as an officer of, and then consultant to, Duane Reade Inc. and its successor Duane Reade Holdings Corp.

3. As a result of this conviction, Tennant was sentenced to time served and three years of supervised release and was ordered to pay a criminal fine of $10,000.

III.

In view of the foregoing, the Commission finds that Tennant has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED that William Tennant is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

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

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65620 / October 25, 2011

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3331 / October 25, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14602

In the Matter of **ANTHONY J. CUTI, CPA,** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Anthony J. Cuti pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Cuti is a certified public accountant, licensed in New York, although his license has lapsed.

2. On September 7, 2011, an amended judgment of conviction was entered against Cuti in United States v. Anthony Cuti, No. 08 CR 972 (DAB), in the United States District Court

[1] Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

for the Southern District of New York, finding him guilty of one count of conspiracy to commit false statements in SEC filings, false statements to auditors, and false books and records; one count of securities fraud and three counts of false filings with the SEC in connection with his role as Chairman of the Board, Chief Executive Officer and President of Duane Reade Inc. and its successor Duane Reade Holdings Corp.

3. As a result of this conviction, Cuti was sentenced to 36 months imprisonment in a federal penitentiary and three years supervised release and ordered to pay a criminal fine of $5 million. The Court has ordered that restitution may be ordered at a later date.

III.

In view of the foregoing, the Commission finds that Cuti has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED that Anthony Cuti is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Paredes not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 28, 2011

In the Matter of	:	
CURATECH INDUSTRIES, INC.,	:	ORDER OF SUSPENSION OF TRADING
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 CuraTech Industries, Inc. ("CuraTech") because of questions that have arisen regarding the accuracy of publicly disseminated information, concerning, among other things: (1) the company's assets; (2) the company's business operations, (3) the company's current financial condition; and/or (4) issuances of shares in company stock. CuraTech's common stock is presently quoted on OTC Link (formerly, "Pink Sheets") operated by OTC Markets Group, Inc. under the symbol "CUTC."

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the company listed above is suspended for the period from 9:30 a.m. EDT, October 28, 2011, through 11:59 p.m. EST, on November 10, 2011.

By the Commission.

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. 65652 / October 28, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14606

In the Matter of	:	
	:	
CURATECH INDUSTRIES, INC.,	:	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING**
Respondent.	:	

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 CuraTech Industries, Inc. ("CuraTech" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. CuraTech (CIK No. 0001302143) was a Nevada corporation with its principal place of business in Salt Lake City, Utah. In or about May 2010, the corporate status of CuraTech was permanently revoked by the Nevada Secretary of State. CuraTech has a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. CuraTech's securities are presently quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc.

B. DELINQUENT PERIODIC FILINGS

1. CuraTech has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission, in that it has not filed an Annual Report on Form 10-K since April 15, 2009 for the period ended December 31, 2008, and has not filed any quarterly reports since December 10, 2009 for the period ended June 30, 2009 (*see* Chart of Delinquent Filings, attached hereto as Appendix 1).

2. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

3. 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.

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

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

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

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

B. Whether it is necessary or appropriate for the protection of investors to suspend for a period not exceeding twelve months or to revoke the registration of each class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act.

IV.

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

IT IS 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)].

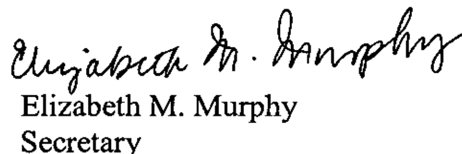
If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules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

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

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

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

By the Commission.



Elizabeth M. Murphy
Secretary

Attachment

APPENDIX 1

Chart of Delinquent Filings for CuraTech Industries, Inc.

Form Type	Period Ended	Due Date	Months Delinquent (as of 9/31/2011)
10-Q	09/30/09	11/14/09	23
10-K	12/31/09	03/31/10	18
10-Q	03/31/10	05/15/10	16
10-Q	06/30/10	08/14/10	13
10-Q	09/30/10	11/14/10	10
10-K	12/31/10	03/31/11	6
10-Q	03/31/11	05/15/11	4
10-Q	06/30/11	08/14/11	1

Chairman Schapiro
Commissioner Walter
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65643 / October 27, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14605

In the Matter of

FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC.,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against the Financial Industry Regulatory Authority, Inc. ("FINRA" 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 FINRA and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of FINRA's production of altered documents in response to a document request made by the Commission's Chicago Regional Office inspection staff ("the Commission inspection staff").

Specifically, on August 7, 2008, the Director of FINRA's Kansas City District Office ("the Director") caused the alteration of three records of staff meeting minutes just hours before producing them to the Commission inspection staff, making them inaccurate and incomplete.

The Director's misconduct is the third instance during an eight year period in which a FINRA employee, or an employee of its predecessor, the National Association of Securities Dealers, Inc. ("NASD"), provided altered or misleading documents to the Commission. Although FINRA has endeavored to improve its procedures and training since document integrity issues came to light in May 2006 and December 2007, those efforts were not effective in preventing the Director's misconduct.

Respondent

FINRA, located in Washington, DC, is a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act. It was created on July 30, 2007 through the consolidation of NASD and the member regulation, enforcement and arbitration functions of the New York Stock Exchange ("NYSE"). As a registered association, FINRA has the statutory obligation to comply with the Exchange Act and to enforce compliance by its members with the Exchange Act and its own rules. It is the largest independent regulator of securities firms doing business with the public in the United States. As of December 31, 2010, FINRA oversaw nearly 4,600 brokerage firms, approximately 163,000 branch offices and almost 631,000 registered securities representatives.

Other Relevant Entities

NASD, formerly located in Washington, DC, was a national securities association registered with the Commission pursuant to Section 15A of the Exchange Act until it was consolidated with the member regulation, enforcement and arbitration operations of the NYSE to form FINRA in July 2007.

---

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

Facts

FINRA Fails to Furnish Complete and Accurate Records

On July 28, 2008, FINRA's Kansas City District Office received a document request from the Commission inspection staff. The request related to a previously announced inspection of FINRA's Kansas City District Office, which is responsible for conducting FINRA's regulatory programs in seven states.

Item 36 of the document request letter asked for "Minutes of District staff meetings conducted between November 1, 2005 and the present." On August 7, 2008—hours before furnishing the Commission inspection staff with FINRA's response to Item 36—the Director caused the minutes for meetings that took place on August 28, 2006, September 22, 2006 and January 31, 2007 to be altered. Specifically, certain information was deleted or edited, while in other instances, entire passages were removed or changed. With respect to all three altered documents, the original author's signature was changed to the Director's.

FINRA Alerts the Commission Staff To Document Integrity Issues in Kansas City Inspection

FINRA learned of the Kansas City District's document integrity issues through a whistleblower complaint submitted on June 11, 2010. Using FINRA's EthicsPoint System, an anonymous individual alleged that the Director instructed another FINRA employee to alter Staff Meeting Minutes before they were burned to a CD and provided to the Commission in connection with an oversight inspection of the District Office. Within days of receiving the complaint, FINRA initiated an internal investigation led by its Internal Audit staff. Also, FINRA's Internal Audit staff verbally communicated the whistleblower allegations to FINRA's Audit Committee on July 13, 2010.

Based on Internal Audit's findings, the Director tendered his resignation from FINRA on September 20, 2010. That same day, FINRA sent a letter notifying staff from the Commission's Chicago Regional Office and its Division of Enforcement about the Director's conduct. Internal Audit reported the results of its investigation to FINRA's Audit Committee on September 21, 2010.

FINRA's Internal Guidance on Document Integrity

FINRA employees have produced altered or misleading documents to Commission inspection staff on three separate occasions over the past eight years. In one instance during 2004, an NASD director misled Commission examiners by providing misdated or otherwise altered documents. In a separate, unrelated instance in 2005, misleading documents, purportedly intended for internal-use only, were produced to a Commission inspection team.

NASD took corrective actions to address these specific failures prior to NASD's consolidation with certain regulatory functions of the NYSE to form FINRA in July 2007. In

addition, FINRA cooperated with the Commission staff investigating FINRA's document integrity problems and implemented improved procedures and training related to document integrity.

Notwithstanding these improvements, the Commission finds that FINRA has not ensured the integrity of documents provided to the Commission, as demonstrated by the Kansas City Director causing the alteration of three records just hours before FINRA produced them to Commission inspection staff, rendering them inaccurate and incomplete.

Violation of Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1

As a result of the conduct described above, FINRA violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1. Section 17(a)(1) of the Exchange Act requires a national securities association such as FINRA to make and keep for prescribed periods such records, and to furnish such copies thereof, as the Commission by rule prescribes as necessary or appropriate in the public interest, for the protection of investors, or for other purposes set forth in the Exchange Act. Exchange Act Rule 17a-1(a) requires a national securities association to keep and preserve at least one copy of all correspondence, records, and other documents made or received by it in the course of its business as such and in the conduct of its self-regulatory activity. Rule 17a-1(c) requires a national securities association promptly to furnish the Commission with a copy of any such document that the Commission requests. The requirement that a national securities association keep and furnish records to the Commission includes the requirement that those records be complete and accurate.

The preparation, maintenance and furnishing of complete and accurate records are essential to the proper functioning of a national securities association as a self-regulatory organization. As described above, FINRA failed to keep and furnish complete and accurate records made or received by it in the course of its business as such and in the conduct of its self-regulatory activity.

FINRA's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

Undertakings

Respondent FINRA has undertaken to:

A. Provide training to all of its employees outlining past document integrity issues, which will incorporate a fact scenario based upon the Kansas City conduct, and emphasize FINRA's zero-tolerance policy regarding the alteration of documents.

B. Develop a podcast on document integrity to be shown to all current staff and to all new employees upon hiring.

C. Address directly the importance of document integrity at a company-wide town hall meeting, annual regulatory meetings, and during Senior Management onsite visits to all district offices.

D. Require senior members of its Office of Liaison and Counsel to meet in-person or remotely with every business unit scheduled for an on-site exam prior to the production of documents to the Commission to emphasize the importance of document integrity.

E. Engage an Independent Consultant (the "Consultant"), not unacceptable to the Commission, within thirty (30) days of the issuance of this Order.

   i. FINRA will require the Consultant to: (1) conduct a one-time comprehensive review of FINRA's policies and procedures and training relating to document integrity; (2) assess whether the policies and procedures and training are reasonably designed and implemented to ensure the integrity of documents provided to the Commission; and (3) make recommendations for the enhancement of FINRA's policies and procedures and training as may be necessary in light of the Consultant's review and assessment.

   ii. FINRA will require the Consultant to submit a report of his/her findings and recommendations (the "Report") to the FINRA Board within three (3) months of the Consultant's engagement. Within thirty (30) days of receiving the Report, the FINRA Board will adopt all recommendations made by the Consultant, subject to Section E.iii below, and take steps necessary to commence implementation of all such recommendations. FINRA will direct the Consultant to provide promptly copies of the Report to the Commission's Deputy Director of Enforcement.

   iii. Within thirty (30) days of receiving the Report, the FINRA Board may notify the Consultant, in writing, of any recommendation(s) that it considers to be unduly burdensome or impractical with an explanation of why the recommendation is unduly burdensome or impractical. The FINRA Board and the Consultant shall attempt in good faith to reach an agreement on an alternative recommendation that is reasonably designed to accomplish the same objectives as the recommendation in question. If an agreement is reached, FINRA will direct the Consultant to amend his/her recommendation(s), reissue the Report within fifteen (15) days of reaching an agreement, and the FINRA Board shall adopt the Consultant's recommendation(s) within thirty (30) days of receiving the amended Report. In the event that the FINRA Board and the Consultant are unable to agree on an alternative recommendation within forty five (45) days of the FINRA Board's written notification, the Consultant's recommendation shall be binding and the FINRA Board shall adopt the Consultant's original recommendation(s) within thirty (30) days.

iv. Within nine (9) months of the FINRA Board's receipt of the Consultant's Report, or receipt of the Consultant's amended Report if applicable under Section E.iii above, FINRA will certify in writing to the Commission's Deputy Director of Enforcement that all of the Consultant's recommendations adopted by the FINRA Board have been implemented or, if the Consultant determines that any recommendation cannot be implemented within nine (9) months, will be implemented within the period specified by the Consultant.

v. FINRA shall require the Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with FINRA, 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 Commission's Deputy Director of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with FINRA, 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.

vi. FINRA shall expend sufficient funds to permit the Consultant to discharge all of their duties, including, but not limited to, providing adequate funds for the retention of outside counsel and/or professionals.

F. 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 the Commission's Deputy Director of Enforcement, with a copy to the Office of Chief Counsel of the Commission's Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

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

A. Respondent FINRA shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-1 thereunder; and

B. Respondent FINRA shall comply with its undertakings as enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9272 / October 31, 2011

SECURITIES EXCHANGE ACT OF 1934
Release No. 65657 / October 31, 2011

INVESTMENT COMPANY ACT OF 1940
Release No. 29854 / October 31, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14607

In the Matter of **DAVID STORY** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against David Story ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of Story's sale of securities of unregistered offerings to investors located in the United States and Spain. Beginning in or around September 2006, Story solicited investors located in the United States and Spain to invest with Story, promising investors a guaranteed return of 5% per month. Story represented that the funds would be used to invest in futures trading, with the safety of principal being the primary concern. Instead of investing funds as promised, Story used investor funds to pay earlier investors and to pay for his own personal expenses.

Respondent

1. David Story, age 36, is a Nevada resident. Story sold securities in unregistered offerings to investors located in the United States and Spain. Story has never been registered as a broker-dealer or associated with a broker or dealer registered with the Commission.

Other Relevant Entities

2. U.S. Ventures International, LLC, ("USVI") was a Utah limited liability company with its principal place of business in Salt Lake City, Utah. David Story was the manager and registered agent for USVI. USVI, through Story, sold securities to investors. USVI is defunct.

3. Siim, S.L. ("Siim") was a Spanish limited liability entity controlled by Story. Siim was created as a software development company. During 2007, investors transferred funds to Siim for investment in futures trading. Siim is defunct.

Background

4. Beginning in September 2006 Story sold securities in unregistered offerings to at least 35 investors in the United States and Spain through his companies, U.S. Ventures International and Siim. Story raised at least $3,844,000 from investors. Story claimed that investors' funds would be invested in a fund which engaged in futures trading, that investors' principal would be secure and that investors would receive returns of 5% per month. Story also represented to investors that their principal would be available for immediate return upon a ten day notice. Story did not provide investors with any financial information before they invested.

5. Story's representations to investors were materially misleading. Story did not have a trading program whereby investor funds would be secure. Investors' principal was not maintained in a secure, liquid account but was instead transferred to a fund operated by Robert L. Holloway ("Holloway") and U.S. Ventures, LLC ("U.S. Ventures"). The funds were then used to make interest and principal payments to earlier investors and to pay for Story's personal expenses. A civil injunctive action was filed in the United States District Court for the District of Utah in which Holloway and U.S. Ventures were named as relief defendants, SEC v. Novus Technologies, LLC et al., 2:07cv0235 (D. Utah). The Commodity Futures Trading Commission also filed a civil injunctive action in the United States District Court for the District of Utah, naming Holloway and U.S. Ventures as defendants, CFTC v. U.S. Ventures, LC et al., 2:11cv00099 (D. Utah).

6. For a period of seven months Story solicited funds from investors raising $3,844,000 from at least 35 investors. Upon making a determination to invest funds with Story, USVI issued promissory notes to investors, which were signed by Story. Investors deposited funds in bank accounts controlled by Story. Story then authorized the transfer of investor funds from those bank accounts to bank accounts controlled by Holloway. Story also authorized the payment of purported interest payments to investors and prepared and provided account statements for investors. Story has repaid investors their principal investment.

7. The securities Story sold were not registered with the Commission and no exemption from the registration requirements of the Securities Act was available for the sale of the securities. Story received compensation for his sale of securities in the form of a profit sharing arrangement whereby any profits received above the 5% return guaranteed to investors were returns to Story.

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

9. As a result of the conduct described above, Story willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the unregistered offer and sale of securities.

10. As a result of the conduct described above, Story willfully violated Section 15(a) of the Exchange Act, which prohibits the offer and sale of securities by an unregistered broker or dealer.

Civil Penalties

11. Respondent has submitted a sworn Statement of Financial Condition dated January 19, 2011, and other evidence and has asserted his 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 Story's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent Story cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Story 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, 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.

C. Based upon Respondent's sworn representations in his Statement of Financial Condition dated January 19, 2011, and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

D. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of a penalty should not be ordered; (3) contest the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65658 / October 31, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14139

In the Matter of

HECTOR GALLARDO,
MICHAEL ZURITA, and
ORION TRADING, LLC,

Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND CEASE-AND-DESIST ORDERS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO MICHAEL ZURITA AND ORION TRADING, LLC

I.

On November 24, 2010, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Michael Zurita ("Zurita") and Orion Trading, LLC ("Orion") (collectively, "Respondents").

II.

In response to these proceedings, Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Michael Zurita and Orion Trading, LLC ("Order"), as set forth below.

III.

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

Summary

In 2007, Zurita, the President of Florida-based registered broker-dealer Orion and the supervisor responsible for Orion's New York branch office, failed to reasonably supervise Hector Gallardo ("Gallardo"), a registered representative of Orion. Zurita failed to follow-up on red flags that made him aware that an Orion customer was communicating with Gallardo about stock market investments that would pay returns in excess of twelve percent per month (144% annualized) and that the customer was proposing to enter into a profit sharing arrangement with Gallardo, which violated Orion's procedures. Zurita failed to take reasonable steps to investigate Gallardo's conduct, which would have led to detecting and preventing Gallardo's violations of the antifraud provisions of the securities laws.

In addition, as Orion's President, Zurita was responsible for establishing, maintaining, and implementing policies, procedures, and systems that are reasonably designed to detect violative activity by Orion's registered representatives. Orion and Zurita failed to develop reasonable systems to implement Orion's Written Supervisory Procedures with respect to prohibited transactions. In addition, for several months in 2006 and 2007, Orion and Zurita permitted an unlicensed foreign associate to perform the functions of a registered representative at Orion's New York branch office.

Respondents

1. Orion is a California limited liability company with its principal place of business in Orlando, Florida. Orion has been registered as a broker-dealer with the Commission since June 1998. Orion conducts business under the name Brokerlatino, among others. From 2005 to 2007, Orion maintained a branch office in New York City.

2. Zurita, age 58, is a resident of Orlando, Florida. Zurita, the president and a part owner of Orion, is a registered representative of Orion and holds Series 7 and 24 licenses. He also held a Series 63 license that expired in October 2004. Zurita was Orion's Chief Compliance Officer during the relevant period. Orion also employed an outside compliance consultant.

---

[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.

Other Relevant Parties

3. Hector Gallardo ("Gallardo"), age 39, was a registered representative in Orion's New York branch office from January to September 2007. Gallardo has held Series 7 and 63 licenses.

4. Armando Jaramillo ("Jaramillo"), age 41, worked in Orion's New York branch office, as a foreign associate, in 2006 and 2007. Jaramillo's Series 7 license expired in May 2004.

Background

5. In 2006, a foreign finder that Orion employed in Bolivia solicited two Bolivian citizens to invest in U.S. equity markets through Orion. The two Bolivian investors in turn solicited and bundled funds from other Bolivian retail investors for the purpose of investing those funds in the U.S. equity markets through Orion. Over time, the two Bolivian investors collected and pooled approximately $1.5 million from at least 375 individual Bolivians. In early 2007, Gallardo convinced the Bolivian investors to name him as their registered representative, telling them that he could provide better investment returns. Lured by Gallardo's promises, the two Bolivian investors provided Gallardo with a total of approximately $1.154 million for Gallardo to invest on their behalf. Gallardo promised that he would invest in unspecified initial public offerings and/or in investment vehicles offered or managed by a separate investment company that he operated. Gallardo falsely told the Bolivian investors that his investment company could guarantee a nine to fifteen percent monthly return regardless of market volatility, and returned approximately $275,000 of the two Bolivian investors' investments in his company to them as illusory "distributions" to maintain the ruse that their investments were performing well.

6. Gallardo's investment company was a complete sham, and he never invested any of the investors' money in any initial public offerings. Instead, Gallardo invested and lost approximately $190,000 of the investors' funds in stocks and options and misappropriated the remainder of the investors' money, approximately $685,000. After transferring hundreds of thousands of dollars to a personal checking account, Gallardo used money in that account to pay his and his family's personal expenses, including airline tickets and multiple trips to Atlantic City.

7. Gallardo's scheme fell apart in September 2007, when the two Bolivian investors demanded to see returns on the initial public offerings of stock in which Gallardo told them he had invested. Because Gallardo could not produce the returns, the Bolivian investors refused to invest further and subsequently lost all contact with Gallardo. The Bolivian investors

lost $876,193 of their and the other 375 investors' money through the investment with Gallardo and his phony investment company.

<u>Zurita and Orion Fail Reasonably to Supervise Gallardo</u>

8. Although stationed in Florida, Zurita was the supervisor responsible for Orion's New York branch office during the relevant period because Orion did not have any qualified supervisory personnel on-site in New York. Zurita recruited Gallardo to be the person in charge of Orion's New York branch office in approximately December 2006. Zurita knew of Gallardo from pre-Orion dealings with Gallardo; such dealings were comprised of telephonic conversations. Zurita did not meet with Gallardo in person before retaining him. Zurita knew, however, that Gallardo had little-to-no previous supervisory experience and had never run a branch office. Despite Gallardo's lack of experience, Zurita hired Gallardo in January 2007. After travelling to Orion's branch office in New York in January 2007, Zurita did not travel to that office until September 2007. While Zurita hired Gallardo with the understanding that Gallardo would obtain a Series 24 license, thereby becoming licensed to be a branch manager, Zurita knew that Gallardo never took the examination. Zurita therefore remained the person with ultimate responsibility for Orion's New York branch office throughout 2007.

9. In 2007, during the period in which Gallardo carried out his fraud against the Bolivian investors, Zurita did not reasonably follow up on a series of red flags that should have put Zurita on notice as to suspicious activity between Gallardo and the two Bolivian investors. In particular, in March 2007, following a review of Gallardo's emails, Zurita identified the following email that Gallardo received from one of the two Bolivian investors:

> *I mentioned to you that we are representatives of a company that recruit people that want to invest in the stock market but the condition is that we should pay the client at least 12% (minimum), ideally it would be to pay 15% so that the company also makes money. If you get to make more than 15% on a monthly basis we give you the benefit of 30% of the excess, in this there is a lot of acceptance in that we could send, on average, $100,000 per month. I would like your opinion in this respect, you can call me on my cell phone . . . . I would request you call me urgently because we currently have $100,000 to deposit. If you do not reach us by telephone, send us an email.*

(translated from the Spanish original). After seeing this email (the "March 2007 email"), Zurita did not reasonably follow-up on the matter, even though Zurita knew that an Orion customer was communicating with Gallardo about stock market investments that would pay returns in excess of twelve percent *per month* (144% annualized) and was proposing to enter into a profit sharing arrangement with the registered representative, Gallardo. Although the accounts contemplated by the email were never opened at Orion, the email put Zurita on notice that Gallardo was raising money for a business enterprise of a customer, who was fronting for an unspecified group of

other investors, was considering a profit-sharing arrangement with a firm customer, and may have promised a firm customer exorbitant returns on investments.

10. Zurita's concerns about the March 2007 email were sufficiently serious that on multiple occasions from March to May, Zurita sent Gallardo emails demanding a copy of Gallardo's written response to the customer. However, Gallardo never responded to Zurita, and Zurita took no reasonable steps to determine whether Gallardo had handled the request consistent with Orion's policies and procedures, which required Gallardo to provide Zurita with a copy of Gallardo's written response on the day that Gallardo sent it, or whether disciplinary steps were necessary. Nor did Zurita attempt to contact the customer himself, although he had spoken to the customer directly when the customer had asked to switch his accounts to Gallardo. Throughout this period, Zurita still intended for Gallardo to take his Series 24 examination so Gallardo could become Orion's New York branch manager.

11. Three months after the March 2007 email, Zurita received further notice that Gallardo was dealing with the customer concerning accounts at Orion that involved possible payments to unnamed "clients" of the customer. Zurita again failed to reasonably respond to this red flag. Specifically, in June 2007, the customer, who maintained a personal account at Orion, complained in an email to Zurita that Zurita had failed to respond to the customer's request to wire funds from his accounts at Orion. The customer further wrote that he was "very concerned because we need to pay our clients." Zurita responded that Gallardo would liquidate certain positions in the "portfolio" to raise cash to facilitate the requested transfer.

12. Zurita missed other red flags that should have put him on notice about the risks that Gallardo posed to Orion's customers and Gallardo's failure to comply with Orion's policies and procedures. For example, in April 2007, another registered representative in Orion's New York branch office raised concerns about potential cold calling by unregistered employees of the branch. Zurita failed to visit Orion's New York branch office or otherwise make reasonable efforts to investigate the operations of the New York branch office or Gallardo's conduct.

13. Throughout the period when Gallardo was defrauding the Bolivian investors, Zurita was Orion's president and was designated as its Chief Compliance Officer. Zurita was also responsible for establishing reasonable policies and procedures and reasonable systems to implement those policies and procedures to detect violative activity by Orion's registered representatives. Orion's Written Supervisory Procedures ("WSP") had a lengthy list of "prohibited transactions/actions." The WSP identified Zurita as the Orion person responsible for implementing this section and specified the actions required if Zurita detected prohibited transactions, including "[c]onferring with [the] employee," "[i]ssuing a written admonition," and "[r]estricting the activities of or the transaction handled by the employee." Orion's list of prohibited transactions included "[r]aising money . . . as an agent for any business enterprise whatsoever without the advance written consent of [Zurita];" "[w]arranting or guaranteeing the present/future value or price of any security or warranting that any company, partnership, or issuer of securities will meet its obligations, promises, or comply with its representations to

investors;" and "[r]eceiving compensation for securities transactions from anyone (clients or other securities dealers or representatives) for services rendered [including] ... commissions of any sort."

14. Orion and Zurita failed to develop reasonable systems to implement the WSPs with respect to the prohibited transactions. The March 2007 email from the Bolivian investor to Gallardo that Zurita reviewed involved several transactions on Orion's prohibited list. When Zurita saw the March 2007 email, however, he took no reasonable steps other than to ask for Gallardo's written response to the customer. Gallardo ignored this request, and other subsequent requests from Zurita. Despite Gallardo's obduracy, Zurita took no other steps to investigate Gallardo's activities. If Zurita had followed up on the red flags of prohibited transactions by Gallardo, it is likely that he would have prevented and detected Gallardo's violations of the antifraud provisions of the securities laws.

15. In addition, Orion's WSP referenced a "branch office inspection program." Orion and Zurita failed reasonably to implement the firm's branch office inspection program. In particular, there is no evidence that Zurita ever developed any specific protocol for inspecting the New York branch office, and in fact neither Zurita nor any other Orion supervisor inspected the branch office at any time from January to September 2007, despite the numerous red flags involving the New York office that Zurita learned of in 2007.

Orion Employed an Unlicensed Foreign Associate

16. Zurita permitted an unlicensed foreign associate to perform the functions of a registered representative at the New York branch office in 2006 and 2007.[2] Jaramillo, a foreign associate affiliated with Orion, began working in Orion's New York branch office by early 2006. Zurita knew that Jaramillo reported to the New York branch office virtually every day. Jaramillo's activities included trading in and otherwise servicing existing customer accounts as well as opening new accounts. Jaramillo worked in Orion's New York branch office until the summer of 2007, when Orion terminated him.

Violations

17. As a result of the conduct described above, Zurita and Orion failed reasonably to supervise Gallardo within the meaning of Section 15(b)(4)(E) of the Exchange Act, which requires broker-dealers reasonably to supervise persons subject to their supervision with a view toward preventing and detecting Gallardo's violations of the antifraud provisions of the federal securities laws.

[2] FINRA defines a "foreign associate" as a person associated with a FINRA member who is not a citizen, national, or resident of the United States and who conducts all of his securities activities outside the jurisdiction of the United States with persons who are not citizens, nationals, or residents of the United States. *See* FINRA Manual, NASD Rule 1100(a).

18. As a result of the conduct described above, Orion willfully[3] violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder, which require registration of individuals effecting securities transactions in accordance with standards set forth by a national securities association of which the broker-dealer is a member.

19. As a result of the conduct described above, Zurita willfully aided and abetted and caused Orion's violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

Undertakings

Respondent Orion has undertaken to:

Following the entry of this Order, and in no event later than fourteen (14) days from the entry of this Order, to hire an individual with appropriate supervisory licenses and qualifications to assume supervisory authority at Orion. In compliance with this requirement, (a) Orion has agreed upon entry of this Order to hire such an individual who will physically be present at Orion's Orlando office at least two (2) weeks a month; and (b) Orion has agreed to hire an individual who shall be physically working out of its Orlando office as soon thereafter as may reasonably be practicable, but in no event more than sixty days after entry of this Order.

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 Ken C. Joseph, Assistant Director, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, New York, 10281, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

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

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

---

[3] 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)).

A. Respondent Zurita cease and desist from committing or causing any violations and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

B. Respondent Orion cease and desist from committing or causing any violations and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

C. Respondent Zurita be, and hereby is:

> barred 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;

with the right to apply for reentry after three (3) 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.

D. Respondent Orion is censured.

E. Respondent Zurita shall pay a civil money penalty of $35,000 to the United States Treasury. Payment shall be made in the following installments: $20,000 shall be due within ten (10) days after entry of this Order, and $15,000 plus prejudgment interest pursuant to 31 U.S.C. § 3717, running from the date of entry of this Order, shall be due within ninety (90) days after entry 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 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 Zurita 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 Ken C. Joseph, Assistant Director, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, New York, 10281.

F. Respondent Orion shall pay a civil money penalty of $50,000 to the United States Treasury. Payment shall be made in the following installments: $25,000 shall be due within ten (10) days after entry of this Order, and $25,000 plus prejudgment interest pursuant to 31 U.S.C. § 3717, running from the date of entry of this Order, shall be due within ninety (90) days after entry 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 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 Orion 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 Ken C. Joseph, Assistant Director, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, New York, 10281.

G. Respondent Orion shall comply with the undertakings enumerated in Section III. above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 65661 / October 31, 2011

ADMINISTRATIVE PROCEEDING
File No. 3-14608

In the Matter of Advanced Remote Communication Solutions, Inc., American Aircraft Corp. (a/k/a Codima, Inc.), Avicena Group, Inc., Blowout Entertainment, Inc., Bottomline Home Loan, Inc., and Bytewatch Technologies, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Advanced Remote Communication Solutions, Inc., American Aircraft Corp. (a/k/a Codima, Inc.), Avicena Group, Inc., Blowout Entertainment, Inc., Bottomline Home Loan, Inc., and Bytewatch Technologies, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Advanced Remote Communication Solutions, Inc. (CIK No. 700941) is a suspended California corporation located in El Cajon, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Remote Communication Solutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the

period ended September 30, 2002, which reported a net loss of over $13.6 million for the prior nine months.

2. American Aircraft Corp. (a/k/a Codima, Inc.) (CIK No. 794803) is a dissolved Oregon corporation located in Long Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Aircraft 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 August 31, 1993, which reported a net loss of over $597,000 for the six months ended May 31, 1993. On February 16, 1996, an order was entered against American Aircraft by the Commission pursuant to Exchange Act Section 21C to cease and desist from violations of the Exchange Act, including Section 13(a).

3. Avicena Group, Inc. (CIK No. 1317092) is a delinquent Delaware corporation located in South San Francisco, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Avicena Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2008, which reported a net loss of over $2.7 million for the prior three months. Avicena Group was the subject of a trading suspension issued by the Commission pursuant to Exchange Act Section 12(k) on February 12, 2009 due to questions concerning the accuracy of publicly available information regarding ownership and control of the company. As of October 26, 2011, the company's stock (symbol "AVCE") was traded on the over-the-counter markets.

4. Blowout Entertainment, Inc. (CIK No. 1016626) is a forfeited Delaware corporation located in Portland, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Blowout Entertainment is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1998, which reported a net loss of over $2.7 million for the prior nine months. On March 22, 1999, Blowout Entertainment filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was terminated on November 12, 1999.

5. Bottomline Home Loan, Inc. (CIK No. 1017130) is a revoked Nevada corporation located in Monrovia, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bottomline Home Loan 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 over $183,000 for the prior twelve months. As of October 26, 2011, the company's stock (symbol "BOTM") was traded on the over-the-counter markets.

6. Bytewatch Technologies, Inc. (CIK No. 1120090) is a New Jersey corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bytewatch Technologies 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, 2005, which reported a net loss of over $1,000 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires 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].

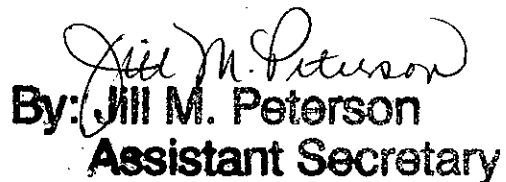
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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



COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 4

RIN 3038-AD03

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

Release No. IA-3308; File No. S7-05-11

RIN 3235-AK92

Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF

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

ACTION: Joint final rules.

SUMMARY: The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, "we" or the "Commissions") are adopting new rules under the Commodity Exchange Act and the Investment Advisers Act of 1940 to implement provisions of Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The new SEC rule requires investment advisers registered with the SEC that advise one or more private funds and have at least $150 million in private fund assets under management to file Form PF with the SEC. The new CFTC rule requires commodity pool operators ("CPOs") and commodity trading advisors ("CTAs") registered with the CFTC to satisfy certain CFTC filing requirements with respect to private funds, should the CFTC adopt such requirements, by filing Form PF with the SEC, but only if those CPOs and CTAs are also registered with the SEC as investment advisers and are required to file Form PF under the

Advisers Act. The new CFTC rule also allows such CPOs and CTAs to satisfy certain CFTC filing requirements with respect to commodity pools that are not private funds, should the CFTC adopt such requirements, by filing Form PF with the SEC. Advisers must file Form PF electronically, on a confidential basis. The information contained in Form PF is designed, among other things, to assist the Financial Stability Oversight Council in its assessment of systemic risk in the U.S. financial system.

DATES: The effective date for CEA rule 4.27, Advisers Act rule 204(b)-1 and Form PF is March 31, 2012. See section III of this Release for compliance dates.

FOR FURTHER INFORMATION CONTACT: **CFTC:** Amanda L. Olear, Special Counsel, Telephone: (202) 418-5283, E-mail: aolear@cftc.gov, or Kevin P. Walek, Assistant Director, Telephone: (202) 418-5463, E-mail: kwalek@cftc.gov, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, DC 20581; **SEC:** David P. Bartels, Senior Counsel, or Sarah G. ten Siethoff, Senior Special 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 CFTC is adopting rule 4.27 [17 CFR 4.27] under the Commodity Exchange Act ("CEA")[1] and Form PF.[2] The SEC is adopting

---

1 7 U.S.C. 1a.

2 Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the Form. Sections 3 and 4 of the Form are adopted solely by the SEC.

rule 204(b)-1 [17 CFR 275.204(b)-1] and Form PF [17 CFR 279.9] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act").[3]

TABLE OF CONTENTS

I. BACKGROUND 4
A. The Dodd-Frank Act and the Financial Stability Oversight Council 4
B. International Coordination 11
II. DISCUSSION 14
A. Who Must File Form PF 18
1. "Hedge Fund" Definition 22
2. "Liquidity Fund" Definition 29
3. "Private Equity Fund" Definition 29
4. Large Private Fund Adviser Thresholds 31
5. Aggregation of Assets under Management 41
6. Reporting for Affiliated and Sub-advised Funds 48
7. Exempt Reporting Advisers 49
B. Frequency of Reporting 50
1. Annual and Quarterly Reporting 50
2. Reporting Deadlines 54
3. Initial Reports 58
4. Transition Filings, Final Filings and Temporary Hardship Exemptions 58
C. Information Required on Form PF 59
1. Section 1 of Form PF 63
2. Section 2 of Form PF 77
3. Section 3 of Form PF 97
4. Section 4 of Form PF 99
5. Aggregation of Master-Feeder Arrangements, Parallel Fund Structures and Parallel Managed Accounts 109
D. Confidentiality of Form PF Data 112
E. Filing Fees and Format for Reporting 115
III. EFFECTIVE AND COMPLIANCE DATES 117
IV. PAPERWORK REDUCTION ACT 120
A. Burden Estimates for Annual Reporting by Smaller Private Fund Advisers 122

---

[3] 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to Advisers Act rule 204(b)-1, or any paragraph of this rule, we are referring to 17 CFR 275.204(b)-1 of the Code of Federal Regulations in which this rule will be published. In addition, when we refer to the "Investment Company Act," or any paragraph of the Investment Company Act, we are referring to 15 U.S.C. 80a of the United States Code, at which the Investment Company Act of 1940 is codified.

B. Burden Estimates for Large Hedge Fund Advisers 127
C. Burden Estimates for Large Liquidity Fund Advisers 130
D. Burden Estimates for Large Private Equity Advisers 133
E. Burden Estimates for Transition Filings, Final Filings and Temporary Hardship Exemption Requests 136
F. Aggregate Hour Burden Estimates 138
G. Cost Burden 138
V. ECONOMIC ANALYSIS 142
A. Benefits 145
B. Costs 158
C. CFTC Statutory Findings 175
1. General Costs and Benefits 177
2. Section 15(a) Determination 178
VI. FINAL REGULATORY FLEXIBILITY ANALYSIS 181
A. Need for and Objectives of the New Rule 181
B. Significant Issues Raised by Public Comment 182
C. Small Entities Subject to the Rule 182
D. Projected Reporting, Recordkeeping and other Compliance Requirements .184
E. Agency Action to Minimize Effect on Small Entities 184
VII. STATUTORY AUTHORITY 186
TEXT OF FINAL RULES 187

I. BACKGROUND

A. The Dodd-Frank Act and the Financial Stability Oversight Council

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[4] One significant focus of this legislation is to "promote the financial stability of the United States" by, among other measures, establishing better monitoring of emerging risks using a system-wide perspective.[5] To further this goal, the Act establishes the Financial Stability Oversight Council ("FSOC") and directs it to monitor risks to the U.S. financial system. The Act

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

5 S. REP. NO. 111-176, at 2-3 (2010) ("Senate Committee Report").

also gives FSOC a number of tools to carry out this mission.[6] For instance, FSOC may determine that a nonbank financial company will be subject to the supervision of the Board of Governors of the Federal Reserve System ("FRB") if the company may pose risks to U.S. financial stability as a result of its activities or in the event of its material financial distress.[7] In addition, FSOC may issue recommendations to primary financial regulators, like the SEC and CFTC, for more stringent regulation of financial activities that FSOC determines may create or increase systemic risk.[8]

The Dodd-Frank Act anticipates that various regulatory agencies, including the Commissions, will support FSOC.[9] To that end, the Dodd-Frank Act amended section 204(b) of the Advisers Act to require that the SEC establish reporting and recordkeeping requirements for advisers to private funds,[10] many of which must also

---

6 *See* Sections 113 and 120 of the Dodd-Frank Act. In a recent rulemaking release, FSOC explained that its response to any potential threat to financial stability will be based on an assessment of the circumstances. *See Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, Financial Stability Oversight Counsel Release (Oct. 11, 2011) ("FSOC Second Notice").

7 Section 113 of the Dodd-Frank Act. The Dodd-Frank Act also directs FSOC to recommend to the FRB heightened prudential standards for designated nonbank financial companies. Section 112(a)(2) of the Dodd-Frank Act.

8 Section 120 of the Dodd-Frank Act.

9 *See, e.g.*, section 112(d)(1) of the Dodd-Frank Act, which authorizes FSOC to collect information from member agencies to support its functions. *See also* FSOC Second Notice, *supra* note 6 (explaining that information reported on Form PF will be important to FSOC's policy-making in regard to the assessment of systemic risk among private fund advisers).

10 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, but for section 3(c)(1) or 3(c)(7) of that Act." Section 3(c)(1) of the Investment Company Act provides 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." Section 3(c)(7) of the Investment

register for the first time as a consequence of the Dodd-Frank Act.[11] These new requirements may include maintaining records and filing reports containing such information as the SEC deems necessary and appropriate in the public interest and for investor protection or for the assessment of systemic risk by FSOC.[12] The SEC and CFTC must jointly issue, after consultation with FSOC, rules establishing the form and content of any reports to be filed under this new authority.[13]

On January 26, 2011, in a joint release, the CFTC and SEC proposed new rules and a new reporting form intended to implement this statutory mandate.[14] In the release,

---

Company Act provides 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.

11 *See* sections 402, 403, 407 and 408 of the Dodd-Frank Act. The SEC recently adopted rule 203-1(e) providing a transition period for certain private advisers previously relying on the repealed exemption in section 203(b)(3) of the Advisers Act. The transition rule requires these advisers to register with the SEC by March 30, 2012. *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. IA-3221 (June 22, 2011), 76 FR 42,950 (July 19, 2011) ("Implementing Adopting Release"). *See also 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. IA-3222 (June 22, 2011), 76 FR 39,646 (July 6, 2011) ("Exemptions Adopting Release").

12 The Dodd-Frank Act does not identify specific information to be included in these reports, but section 204(b) of the Advisers Act does require that the records and reports required under that section cumulatively include a description of certain information about private funds, such as the amount of assets under management, use of leverage, counterparty credit risk exposure, and trading and investment positions for each private fund advised by the adviser. *See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*, Investment Advisers Act Release No. 3145 (January 26, 2011), 76 FR 8,068 (February 11, 2011) ("Proposing Release") at n. 13 and accompanying text.

13 *See* section 211(e) of the Advisers Act.

14 As discussed below, Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the Form.

the SEC proposed new Advisers Act rule 204(b)-1, which would require private fund advisers to file Form PF periodically with the SEC.[15] In addition, the CFTC proposed new rule 4.27,[16] which would require private fund advisers that are also registered as CPOs or CTAs with the CFTC to satisfy certain proposed CFTC systemic risk reporting requirements, should the CFTC adopt such requirements, by filing Form PF.[17] Today, we are adopting these proposed rules and Form PF with several changes from the proposal that are designed to respond to commenter concerns. Consistent with the proposal, advisers must report on Form PF certain information regarding the private funds they

---

15 Throughout this Release, we use the term "private fund adviser" to mean any investment adviser that (i) is registered or required to register with the SEC (including any investment adviser that is also registered or required to register with the CFTC as a CPO or CTA) and (ii) advises one or more private funds. Advisers solely to venture capital funds or advisers solely to private funds that in the aggregate have less than $150 million in assets under management in the United States that rely on the exemption from registration under, respectively, section 203(l) or 203(m) of the Advisers Act ("exempt reporting advisers") are not required to file Form PF. *See infra* section II.A.7 of this Release.

16 Because the CFTC is not adopting the remainder of proposed CEA rule 4.27 at the same time as it is adopting this rule, the CFTC has modified the designation of CEA rule 4.27(d) to be the sole text of that section. *See Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations* (Jan. 26, 2011), 76 FR 7976 (Feb. 11, 2011) ("CFTC Proposing Release"). Additionally, the CFTC has made some revisions to the text of rule 4.27 to: (1) clarify that the filing of Form PF with the SEC will be considered substitute compliance with certain CFTC reporting obligations (*i.e.*, for Schedules B and C of Form CPO-PQR and Schedule B of Form CTA-PR as proposed) should the CFTC determine to adopt such requirements and (2) to allow CPOs and CTAs who are otherwise required to file Form PF the option of submitting on Form PF data regarding commodity pools that are not private funds as substitute compliance with certain CFTC reporting obligations (*i.e.*, for Schedules B and C of Form CPO-PQR and Schedule B of Form CTA-PR as proposed) should the CFTC determine to adopt such requirements.

17 For these private fund advisers, filing Form PF through the Form PF filing system would be a filing with both the SEC and CFTC. Irrespective of their filing a Form PF with the SEC, the CFTC has proposed that all private fund advisers that are also registered as CPOs and CTAs with the CFTC would be required to file Schedule A of Form CPO-PQR (for CPOs) or Schedule A of Form CTA-PR (for CTAs). *See* CFTC Proposing Release, *supra* note 16.

manage, and this information is intended to complement information the SEC collects on Form ADV and information the CFTC separately has proposed to collect from CPOs and CTAs.[18] Collectively, these reporting forms will provide FSOC and the Commissions with important information about the basic operations and strategies of private funds and help establish a baseline picture of potential systemic risk in the private fund industry.

The SEC is adopting Advisers Act rule 204(b)-1 and Form PF to enable FSOC to obtain data that will facilitate monitoring of systemic risk in U.S. financial markets. Our understanding of the utility to FSOC of the data to be collected is based on our staffs' consultations with staff representing the members of FSOC. The design of Form PF is not intended to reflect a determination as to where systemic risk exists but rather to provide empirical data to FSOC with which it may make a determination about the extent to which the activities of private funds or their advisers pose such risk. The information made available to FSOC will be collected for FSOC's use by the Commissions in their role as the primary regulators of private fund advisers. The policy judgments implicit in the information required to be reported on Form PF reflect FSOC's role as the primary user of the reported information for the purpose of monitoring systemic risk. The SEC would not necessarily have required the same scope of reporting if the information reported on Form PF were intended solely for the SEC's use.

---

18 *See* Proposing Release, *supra* note 12, at n. 16, comparing the purposes of Form ADV and Form PF. References in this Release to Form ADV or terms defined in Form ADV or its glossary are to the form and glossary as amended in the Implementing Adopting Release, *supra* note 11.

We expect the information collected on Form PF and provided to FSOC will be an important part of FSOC's systemic risk monitoring in the private fund industry.[19] We note that, simultaneous with the consultations between our staffs and the staff representing FSOC's members, FSOC has been building out its standards for assessing systemic risk across different kinds of financial firms and has proposed guidance and standards for determining which nonbank financial companies should be designated as subject to FRB supervision.[20] In its most recent release on this subject, FSOC confirmed that the information reported on Form PF is important not only to conducting an assessment of systemic risk among private fund advisers but also to determining how that assessment should be made.[21]

---

[19] *See* section 204(b) of the Advisers Act. Today, regulators have little reliable data regarding this rapidly growing sector and frequently have to rely on data from other sources, which when available may be incomplete. *See, e.g.*, FSOC 2011 Annual Report, http://www.treasury.gov/initiatives/fsoc/Pages/annual-report.aspx ("FSOC 2011 Annual Report") at 69. The SEC recently adopted amendments to Form ADV that will require the reporting of important information regarding private funds, but this includes little or no information regarding, for instance, performance, leverage or the riskiness of a fund's financial activities. *See* Implementing Adopting Release, supra note 11. The data collected through Form PF will be more reliable than existing data regarding the industry and significantly extend the data available through the revised Form ADV.

[20] *See, e.g.*, FSOC Second Notice, *supra* note 6; *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, Financial Stability Oversight Council Release (Jan. 18, 2011), 76 FR 4,555 (Jan. 26, 2011); *Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, Financial Stability Oversight Council Release (Oct. 1, 2010), 75 FR 61,653 (Oct. 6, 2010).

[21] *See* FSOC Second Notice, *supra* note 6 ("[FSOC] recognizes that the quantitative thresholds it has identified for application during [the initial stage of review] may not provide an appropriate means to identify a subset of nonbank financial companies for further review in all cases across all financial industries and firms. While [FSOC] will apply [such] thresholds to all nonbank financial companies, including... asset management companies, private equity firms, and hedge funds, these companies may pose risks that are not well-measured by the quantitative thresholds approach.... Using [Form PF] and other data, [FSOC] will consider whether to establish an additional set of

The Commissions received more than 35 letters responding to the proposal, with trade associations, investment advisers and law firms accounting for most of the comments. Commenters representing investors were generally supportive of the proposal but thought it should have required more of private fund advisers.[22] Some of these supporters argued, in particular, for more detailed and more frequent reporting than we proposed.[23] In contrast, advisers and those writing on their behalf expressed concern regarding the scope, frequency and timing of the proposed reporting.[24] A number of these commenters generally supported the systemic risk monitoring goals of the Dodd-Frank Act or the broad framework of the proposal but argued that specific aspects of the

---

metrics and thresholds tailored to evaluate hedge funds and private equity firms and their advisers.").

22 *See, e.g.*, comment letter of the American Federation of Labor and Congress of Industrial Organizations (Apr. 12, 2011) ("AFL-CIO Letter"); comment letter of the Council of Institutional Investors (Apr. 11, 2011) ("CII Letter") (agreeing that "the SEC's proposal will facilitate FSOC's ability to promote the soundness of the U.S. financial system" but noting that the commenter's own working group report favored real-time reporting of position-level information).

23 *See* AFL-CIO Letter ("We support the Proposed Rule, but believe it should be strengthened in a few key areas by requiring more frequent reporting, omitting the arbitrary distinction by investment strategy, and adding additional disclosure requirements necessary to protect investors and prevent systemic risks."); comment letter of the Americans for Financial Reform (Apr. 12, 2011) ("AFR Letter") (endorsing the AFL-CIO Letter).

24 *See, e.g.*, comment letter of the Alternative Investment Management Association (Apr. 12, 2011) ("AIMA General Letter"); comment letter of the Investment Adviser Association (Apr. 12, 2011) ("IAA Letter"); comment letter of the Managed Funds Association (Apr. 8, 2011) ("MFA Letter"); comment letter of the Private Equity Growth Capital Council (Apr. 12, 2011) ("PEGCC Letter"); comment letter of Seward & Kissel, LLP (Apr. 12, 2011) ("Seward Letter"); comment letter of the Securities Industry and Financial Markets Association, Asset Management Group (Apr. 12, 2011) ("SIFMA Letter").

proposal were impractical or burdensome.[25] We respond to these comments in section II of this Release.

This rulemaking is intended primarily to support FSOC, consistent with the mandate to adopt private fund reporting requirements under the Dodd-Frank Act. Determinations made with respect to the Form PF reporting requirements have been made in furtherance of this goal and to comply with this legislative mandate.

B. International Coordination

The Dodd-Frank Act states that FSOC shall coordinate with foreign financial regulators in assessing systemic risk.[26] In recognition of this, our proposal discussed the potential importance of international regulatory coordination in responding to future financial crises.[27] A number of groups have continued to advance international efforts relating to the collection of systemic risk information. For example, recent reports from the Financial Stability Board ("FSB"), International Monetary Fund ("IMF") and Bank for International Settlements ("BIS") emphasize the importance of identifying and

---

25 *See, e.g.*, comment letter of BlackRock Inc. (Apr. 12, 2011) ("BlackRock Letter"); IAA Letter (stating that they "fully support the Commission's goal of enhancing transparency of private funds that may be deemed to present systemic risk to the U.S. financial markets" but arguing that the proposal is too broad in scope); MFA Letter (supporting "the approach proposed by the SEC and CFTC to collect information from registered private fund managers through periodic, confidential reports on Form PF" and stating that the collection of data from market participants, including investment advisers and the funds they manage, "is a critical component of effective systemic risk monitoring and regulation").

26 *See* section 175(b) of the Dodd-Frank Act. *See also* Proposing Release, *supra* note 12, at nn. 19-22 and accompanying text.

27 *See* Proposing Release, *supra* note 12, at section I.B.

addressing gaps in the information available to systemic risk regulators.[28] One goal of this coordination is to collect comparable information regarding private funds, which will aid in the assessment of systemic risk on a global basis.[29] Several commenters agreed that international coordination in connection with private fund reporting is important and encouraged us to take an approach consistent with international precedents.[30]

To this end, our staffs have consulted with the United Kingdom's Financial Services Authority (the "FSA"), the European Securities and Markets Authority ("ESMA"), the International Organization of Securities Commissions ("IOSCO") and Hong Kong's Securities and Futures Commission.[31] The FSA was the first to develop significant experience with hedge fund reporting, conducting a voluntary, semi-annual survey beginning in October 2009 by sampling large hedge fund groups based in the

---

[28] *See, e.g.*, FSB, IMF and BIS, *Macroprudential Policy Tools and Frameworks, Update to G20 Finance Ministers and Central Bank Governors* (Feb. 14, 2011) (highlighting the need for "[d]esign and collection of better information and data to support systemic risk identification and modelling [sic]"); FSB, *Shadow Banking: Scoping the Issues, A Background Note of the Financial Stability Board* (Apr. 12, 2011) ("FSB Shadow Banking Report") ("authorities should cast the net wide, looking at all non-bank credit intermediation to ensure that data gathering and surveillance cover all the activities within which shadow banking-related risks might arise"); FSB and IMF, *The Financial Crisis and Information Gaps, Implementation Progress Report* (June 2011) ("Report on Information Gaps").

[29] *See, e.g.*, Report on Information Gaps, *supra* note 28, at 5. The Commissions expect that they may share information reported on Form PF with various foreign financial regulators under information sharing agreements in which the foreign regulator agrees to keep the information confidential.

[30] *See, e.g.*, comment letter of the American Bar Association, Federal Regulation of Securities Committee and Private Equity and Venture Capital Committee (Apr. 11, 2011) ("ABA Committees Letter"); AIMA General Letter; comment letter of the Committee on Capital Markets Regulation (Apr. 12, 2011) ("CCMR Letter").

[31] These consultations began prior to issuance of the Form PF proposal and have continued during the development of the final rules and Form. *See also* Proposing Release, *supra* note 12, at nn. 24-32 and accompanying text.

United Kingdom.[32] IOSCO, in turn, used the guidelines established in the FSA Survey, together with its own report on hedge fund oversight, in coordinating a survey of hedge funds conducted by IOSCO's members (including the SEC and CFTC) as of the end of September 2010.

Most recently, ESMA has proposed its own template for private fund reporting, which shares many common elements with the FSA Survey (as well as the IOSCO survey and Form PF).[33] ESMA's proposed template will serve as the basis for mandatory private fund reporting in Europe under the European Union's Directive on alternative investment fund managers ("EU Directive") and is expected eventually to supersede the FSA Survey in the United Kingdom. The proposed ESMA template is broader in scope than the FSA Survey, requiring information about a wide range of alternative investment funds, including private equity funds, venture capital funds and real estate funds.[34] Form PF includes many of the types of information collected through the FSA Survey and proposed to be collected in the ESMA template, and a number of the changes we are

---

[32] *See, e.g.*, Financial Services Authority, *Assessing the Possible Sources of Systemic Risk from Hedge Funds: A Report on the Findings of the Hedge Fund Survey and the Hedge Fund as Counterparty Survey* (July 2011), *available at* *http://www.fsa.gov.uk/pubs/other/hedge_fund_report_july2011.pdf* ("FSA Survey"). *See also* Proposing Release, *supra* note 12, at nn. 27-30 and accompanying text.

[33] *See ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive*, ESMA/2011/209 (July 2011), available at http://www.esma.europa.eu/index.php?page=consultation_details&id=185 ("ESMA Proposal"). *See also* Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EU and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 (published July 1, 2011, in the Official Journal of the European Union).

[34] For additional discussion of international efforts relating to systemic risk monitoring in private equity funds, *see* Proposing Release, *supra* note 12, at nn. 33-35 and accompanying text.

making from the proposal further align Form PF with these international approaches to private fund reporting.[35]

II. DISCUSSION

The SEC is adopting Form PF and rule 204(b)-1 under the Advisers Act with several changes from the proposal that are designed to respond to commenter concerns. Under the new rule, SEC-registered investment advisers must report systemic risk information to the SEC on Form PF if they advise one or more private funds.[36] The final rule and changes from the proposal are discussed below.[37]

In addition, the CFTC is adopting rule 4.27 with minor revisions.[38] This new rule provides that, for registered CPOs and CTAs that are also registered as investment advisers with the SEC and are required to file Form PF, filing Form PF serves as substitute compliance for certain of the CFTC's proposed systemic risk reporting requirements should the CFTC adopt such requirements.[39] The CFTC has revised the

---

[35] *See, e.g.*, *infra* notes 227, 231, 244-246, 258, 279, 283 and 297 and accompanying text.

[36] *See* Advisers Act rule 204(b)-1.

[37] As noted above, section 204(b) of the Advisers Act gives the SEC authority to establish both reporting and recordkeeping requirements for private fund advisers. *See supra* note 12 and accompanying text. One commenter asked why the SEC proposed reporting requirements before proposing recordkeeping requirements for private fund advisers, expressing concern that advisers would need to know what records to maintain in order to report on Form PF. *See* comment letter of Congressman Darrell E. Issa, Chairman of the House Committee on Oversight and Government Reform (Sept. 20, 2011) ("Issa Letter"). Recordkeeping requirements serve a number of important purposes, such as ensuring that advisers maintain adequate documentation relevant to the disposition of their clients' and investors' assets and that SEC examiners are able to effectively inspect advisers' operations. The SEC does not believe, however, that establishing recordkeeping requirements is a necessary prerequisite to establishing reporting requirements.

[38] *See supra* note 16.

[39] *See* CEA rule 4.27. For purposes of this rule, it is the CFTC's position that any false or misleading statement of a material fact or material omission in the jointly adopted

new rule to allow CPOs and CTAs who are otherwise required to file Form PF the option of submitting on Form PF data regarding commodity pools that are not private funds as substitute compliance with certain of the CFTC's proposed systemic risk reporting requirements should the CFTC adopt such requirements.[40] The CFTC believes that the revisions to the CEA rule adopted in this Release provide additional clarity with respect to the filing obligations of dually registered CPOs and CTAs. Because commodity pools that are reported or required to be reported on Form PF are categorized as hedge funds for purposes of Form PF, as discussed below, CPOs and CTAs filing Form PF need to complete only the sections applicable to hedge fund advisers.[41]

As discussed above and in the Proposing Release, we have designed Form PF, in consultation with staff representing FSOC's members, to provide FSOC with information important to its understanding and monitoring of systemic risk in the private fund industry.[42] Based on our staffs' consultations with staff representing FSOC's members, we expect that FSOC will use the information collected on Form PF, together with market data from other sources, to assist in determining whether and how to deploy its regulatory tools. This may include, for instance, identifying private funds that merit further analysis or deciding whether to recommend to a primary financial regulator, like

---

sections (sections 1 and 2) of Form PF that is filed by these CPOs and CTAs shall constitute a violation of section 6(c)(2) of the CEA.

40 *Id.*

41 Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the Form. Accordingly, private fund advisers that are also CPOs or CTAs would be obligated to complete only section 1 and, if they meet the applicable threshold, section 2 of Form PF.

42 *See* Proposing Release, *supra* note 12, at section II.A and at n. 49.

the SEC or CFTC, more stringent regulation of the financial activities of the private fund industry.[43]

Although the Form we are adopting will provide information useful to FSOC's regulatory mission, the Form has not been designed to be FSOC's exclusive source of information regarding the private fund industry.[44] FSOC's recently proposed guidance regarding its process for designating nonbank financial companies that may pose risks to U.S. financial stability for FRB supervision helps to illustrate how FSOC may use the Form PF data along with other data sources.[45] This guidance would establish a three-stage process for determinations, at least in non-emergency situations. In the first and second stages, FSOC would screen firms using progressively more granular analyses of publicly available data and data that, like Form PF, are collected by other regulators. In the third stage, FSOC would work with the Office of Financial Research ("OFR") to conduct an in-depth review of specific firms identified in the first two stages, and this would generally involve OFR collecting additional, targeted information directly from these firms.[46] Similarly, in determining whether to exercise its other authorities for

---

[43] *See supra* note 6.

[44] *See* Proposing Release, *supra* note 12, at n. 50 and accompanying text.

[45] *See* FSOC Second Notice, *supra* note 6. *See also* section 113 of the Dodd-Frank Act for a discussion of the matters that FSOC must consider when determining whether a U.S. nonbank financial company will be supervised by the FRB and subject to prudential standards.

[46] *See* sections 153 and 154 of the Dodd-Frank Act. One commenter expressed support for our approach, agreeing that, "Form PF should be used to obtain enough information to make a preliminary assessment, which can be followed up with data requests and dialogue for those firms who may potentially pose systemic risks – Form PF should not be considered the 'complete picture' of the private fund industry." AIMA General Letter.

addressing potential systemic risks, we expect that FSOC would likely utilize data from other sources in addition to Form PF.

Form PF is primarily intended to assist FSOC in its monitoring obligations under the Dodd-Frank Act, but the Commissions may use information collected on Form PF in their regulatory programs, including examinations, investigations and investor protection efforts relating to private fund advisers. In section VI.A of this Release, we discuss some of the ways in which the SEC could use proposed Form PF data for its regulatory activities and investor protection efforts.

As discussed in more detail below, the amount and type of information required on Form PF varies based on both the size of the adviser and the types of funds managed. For instance, Form PF requires more detailed information from advisers managing a large amount of hedge fund or liquidity fund assets than from advisers managing fewer assets or other types of funds. This scaled approach is intended to provide FSOC with a broad picture of the private fund industry while relieving smaller advisers from much of the detailed reporting.[47] Based on our staffs' consultations with staff representing FSOC's members, we understand that obtaining this broad picture will help FSOC to contextualize its analysis and assess whether systemic risk may exist across the private fund industry and to identify areas where OFR may want to obtain additional

---

47 In this Release, we refer to advisers that do not satisfy a Large Private Fund Adviser threshold as "smaller private fund advisers." This is not intended to imply that these advisers are small, only that they fall under certain of the Form's reporting thresholds. *See* section VI of this Release for a discussion of entities that are regarded as small for purposes of the Advisers Act.

information. This scaled approach is also designed to reflect the different implications for systemic risk that may be presented by different investment strategies.

A. Who Must File Form PF

An investment adviser must file Form PF if it: (1) is registered or required to register with the SEC; (2) advises one or more private funds; and (3) had at least $150 million in regulatory assets under management attributable to private funds as of the end of its most recently completed fiscal year.[48] A CPO or CTA that is also registered or required to register with the SEC as an investment adviser and satisfies the other conditions described above must file Form PF with respect to any commodity pool it manages that is a "private fund" and may file Form PF with respect to any commodity pool it manages that is not a "private fund."[49] By filing Form PF with respect to these commodity pools, a CPO will be deemed to have satisfied certain filing requirements for these pools under the CFTC's regulatory regime should the CFTC adopt such requirements.[50]

We have modified the conditions under which an adviser must file Form PF by adding a minimum reporting threshold of $150 million in private fund assets under

---

48 *See* Advisers Act rule 204(b)-1. This rule requires advisers to calculate the value of private fund assets under management pursuant to instructions in Form ADV, which provide a uniform method of calculating assets under management for regulatory purposes under the Advisers Act. *See* Implementing Adopting Release, *supra* note 11, at section II.A.3 (discussing the rationale underlying the new instructions for calculating assets under management for regulatory purposes).

49 *See supra* note 10 for the definition of "private fund."

50 *See* CEA rule 4.27. In the Proposing Release, the CFTC stated that a CPO registered with the CFTC that is also registered as a private fund adviser with the SEC will be deemed to have satisfied its filing requirements for Schedules B and C of Form CPO-PQR by completing and filing the applicable portions of Form PF for each of its commodity pools that satisfy the definition of "private fund" in the Dodd-Frank Act.

management.[51] Under the proposal, all private fund advisers registered with the SEC would have been required to file Form PF. The Dodd-Frank Act modified the Advisers Act's minimum registration requirements so that most advisers with less than $100 million in assets under management must register with one or more states rather than the SEC.[52] In addition, the Dodd-Frank Act created exemptions from SEC registration for advisers solely to venture capital funds and for advisers solely to private funds that in the aggregate have less than $150 million in assets under management in the United States.[53] As a result, under our proposed approach, most advisers with under $100 million in assets under management, and many advisers with less than $150 million in private fund assets under management, would not have reported on Form PF because they would not be registered with the SEC. However, some registered advisers with relatively few private fund assets would have been required to report on Form PF while exempt advisers with less than $150 million in private fund assets under management would not have been required to file Form PF.

Commenters argued that this outcome was not justified from a systemic risk perspective and recommended a minimum reporting threshold for advisers based on the amount of private fund assets under management.[54] One commenter proposed setting the

---

[51] *See* Advisers Act rule 204(b)-1.

[52] *See* section 203A of the Advisers Act. *See also* Implementing Adopting Release, *supra* note 11, at section II.A.

[53] *See* sections 203(l) and 203(m) of the Advisers Act and rules 203(l)-1 and 203(m)-1 under the Advisers Act. *See also* Exemptions Adopting Release, *supra* note 11.

[54] *See, e.g.*, IAA Letter; Seward Letter. Two commenters also supported a minimum reporting threshold based on the size of individual funds, suggesting an exclusion for funds "with net asset values of less than $250 million and that are less than 5% of a manager's assets under management...." MFA Letter; *see also* BlackRock Letter. We do

threshold at $150 million to match the new private fund adviser exemption under section 203(m) of the Advisers Act.[55] From the perspective of systemic risk monitoring, it does not appear at this time that the value of gathering this information from registered advisers with less than $150 million in private fund assets under management justifies the burden to these advisers.

Most private fund advisers that are required to file Form PF will only need to complete section 1 of the Form. This section requires advisers to provide certain basic information regarding any private funds they advise in addition to information about their private fund assets under management and their funds' performance and use of leverage. We describe the information to be collected under section 1 of Form PF in further detail in section II.C.1 of this Release.

As discussed below, however, certain larger private fund advisers must complete additional sections of Form PF, which require more detailed information.[56] Specifically,

---

not believe that a threshold based on fund size would be appropriate because the aggregate amount of assets in smaller funds that an adviser controls may contribute significantly to the adviser's total ability to affect financial markets and the $150 million minimum reporting threshold that we are adopting, based on the adviser's private fund assets under management, will adequately differentiate between advisers with only smaller funds and those with significant fund assets.

55 *See* IAA Letter.

56 *See* Instruction 3 to Form PF. With this scaled approach, the reporting requirements we are adopting reflect the Dodd-Frank Act directive that, in formulating systemic risk reporting and recordkeeping for investment advisers to mid-sized private funds, the SEC take into account the size, governance, and investment strategy of such funds to determine whether they pose systemic risk. *See* section 203(n) of the Advisers Act. The Dodd-Frank Act also provides that the SEC may establish different reporting requirements for different classes of fund advisers, based on the type or size of private fund being advised. *See* section 204(b) of the Advisers Act.

three types of "Large Private Fund Advisers" would be required to complete certain additional sections of Form PF:

- Any adviser having at least $1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter;[57]
- Any adviser managing a liquidity fund and having at least $1 billion in combined regulatory assets under management attributable to liquidity funds and registered money market funds as of the end of any month in the prior fiscal quarter;[58] and
- Any adviser having at least $2 billion in regulatory assets under management attributable to private equity funds as of the last day of the adviser's most recently completed fiscal year.[59]

These large advisers must complete additional sections of Form PF, with large hedge fund advisers completing section 2 and large liquidity fund and private equity fund advisers completing sections 3 and 4, respectively.[60] The information each of these

---

57 *See* Instruction 3 to Form PF. To determine whether an adviser must file a quarterly report at the end of the second quarter, it must look to its hedge fund assets under management as of the end of each month in the first quarter. *See infra* text accompanying note 112. We have modified the amount of this threshold from the proposal. For a discussion of this modification and the reasons for establishing the threshold at this amount, see below in section II.A.4.a of this Release (including notes 90-92 and accompanying text).

58 *See supra* note 57. For a discussion of the reasons for establishing the threshold at this amount, see below in section II.A.4.a of this Release.

59 *See* Instruction 3 to Form PF. For a discussion of the reasons for establishing the threshold at this amount, see below in section II.A.4.a of this Release.

60 As adopted, Form PF requires advisers to determine whether they meet the large adviser thresholds less frequently than was proposed (quarterly rather than daily for hedge fund

sections requires is tailored to the type of fund, focusing on relevant areas of financial activity that have the potential to raise systemic concerns. We discuss these areas of financial activity as they relate to hedge funds, liquidity funds and private equity funds in greater detail in the Proposing Release and below.[61]

1. "Hedge Fund" Definition

Registered advisers managing hedge funds must submit information on Form PF regarding the financing and activities of these funds in section 1 of the Form, and large hedge fund advisers are required to provide additional information in section 2 of the Form.[62] Form PF defines "hedge fund" generally to include any private fund having any one of three common characteristics of a hedge fund: (a) a performance fee that takes into account market value (instead of only realized gains); (b) high leverage; or (c) short

---

and liquidity fund advisers and annually rather than quarterly for private equity advisers). We discuss this change in section II.A.4 of this Release.

[61] *See* sections II.A.1, II.A.2 and II.A.3 of the Proposing Release, *supra* note 12, and sections II.C.2, II.C.3 and II.C.4 of this Release.

[62] Several commenters debated whether the hedge fund industry generally, or any hedge fund in particular, could pose systemic risk. *See, e.g.*, AFL-CIO Letter and CII Letter, identifying hedge fund activities that could have systemic consequences; and AIMA General Letter and MFA Letter, arguing that no hedge fund operating today is likely to be systemically significant. Even among skeptical commenters, however, there was recognition that "there is no concrete data to draw conclusions either way, and that the exercise [of reporting] will be useful to allow the FSOC to make evidence-based conclusions." AIMA General Letter; *see also* MFA Letter. As discussed in the Proposing Release, we believe that Congress expected hedge fund advisers would be required to report under Title IV of the Dodd-Frank Act and that information regarding certain activities of hedge funds may be important to FSOC's monitoring of systemic risk. *See* Proposing Release, *supra* note 11, at nn. 54-61 and accompanying text.

selling.[63] Solely for purposes of Form PF, a commodity pool that is reported or required to be reported on Form PF is treated as a hedge fund.

A number of commenters addressed the "hedge fund" definition. Some of these suggested that we eliminate the distinctions among fund types and instead require all advisers to complete the entire Form so that advisers could not use the definitions to avoid reporting requirements.[64] Others, however, urged us to narrow the definition so that fewer funds would be classified as hedge funds.[65] Form PF generally requires more information regarding hedge funds than other types of funds, and in most cases, an adviser must conclude that a fund is not a hedge fund in order to classify it as one of the six other types of private fund defined in Form PF.[66] As a result, narrowing the "hedge fund" definition in Form PF could have a significant effect on reporting. Commenters persuaded us, however, that certain revisions to the proposed definition would result in a more accurate grouping of funds, thereby improving the quality of the data collected and, at the same time, reducing the reporting burdens on some advisers.[67]

---

[63] *See* Glossary of Terms to Form PF. We are defining the term "hedge fund" in Form PF solely for purposes of determining what information an adviser is required to report on the Form. This definition does not apply with respect to any other form or regulation of either Commission unless otherwise specified. The SEC has recently adopted this same definition in amendments to Form ADV. *See* Implementing Adopting Release, *supra* note 11, at nn. 248-255 and accompanying text. The CFTC has not adopted any definition of "hedge fund" beyond that adopted solely for purposes of Form PF.

[64] *See, e.g.*, AFL-CIO Letter.

[65] *See, e.g.*, ABA Committees Letter; AIMA General Letter; IAA Letter; PEGCC Letter; SIFMA Letter; comment letter of TCW Group, Inc. (Apr. 12, 2011) ("TCW Letter").

[66] *See* Glossary of Terms to Form PF. Altogether, the seven types of private fund defined in Form PF are: (1) hedge fund; (2) liquidity fund; (3) private equity fund; (4) real estate fund; (5) securitized asset fund; (6) venture capital fund; and (7) other private fund.

[67] The "hedge fund" definition, as well as the six other private fund definitions used in Form PF, are also included in the SEC's recent revisions to Form ADV. *See*

First, we have expressly excluded from the "hedge fund" definition in Form PF vehicles established for the purpose of issuing asset backed securities ("securitized asset funds").[68] One commenter noted that these funds could have been categorized as hedge funds under our proposal, which was not the intended result.[69] Although the issuance of asset backed securities may have systemic risk implications, the questions on Form PF regarding hedge funds would not yield relevant data regarding securitized asset funds. As a result, including responses regarding securitized asset funds in the hedge fund data could distort the information FSOC obtains from questions directed at hedge funds.

Second, we have modified clause (a) of the "hedge fund" definition in Form PF, which classifies a fund as a hedge fund if it uses performance fees or allocations that are calculated by taking into account unrealized gains. One commenter pointed out that even

---

Implementing Adopting Release, *supra* note 11, at section II.C.1. Although the SEC received no comments on these same definitions in the context of that rulemaking, the SEC believes that having consistent definitions in the two forms is important. As a result, the SEC considered in the context of that rulemaking the comments received on these definitions in Form PF and determined, when adopting revisions to Form ADV, to make several changes in that form. The changes we are making to these definitions as used in Form PF conform the two sets of definitions so that both forms use identical terms (with the exception that, for purposes of Form PF, all commodity pools about which an adviser is reporting are treated as hedge funds, while in Form ADV, only commodity pools that are private funds are treated as hedge funds). *See* Implementing Adopting Release, *supra* note 11, at nn 248-255. The CFTC has not adopted any definition of "hedge fund" beyond that adopted solely for purposes of Form PF.

68 Specifically, the "hedge fund" definition in Form PF now refers to any private fund having one of the listed characteristics and excludes securitized asset funds. Under the proposal, a fund that satisfied the "hedge fund" definition would have been categorized as a hedge fund even if it otherwise would have satisfied the "securitized asset fund" definition. As adopted, Form PF defines "securitized asset fund" as any private fund "whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders." We have also modified this definition from the proposal so that it is no longer defined by reference to the "hedge fund" definition. *See* Glossary of Terms to Form PF.

69 *See* TCW Letter.

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.[70] It was not intended 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).[71]

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."[72] Funds should not be classified as hedge funds for purposes of Form PF based solely on this practice, and we have clarified that clause (a) would not include performance fees or allocations the calculation of which

---

70 *See* TCW Letter.

71 Some commenters objected to clause (a) of the "hedge fund" definition more generally, arguing that it is too broad because some traditional/long only funds use performance fees or allocations calculated by taking into account unrealized gains. *See, e.g.*, AIMA General Letter; TCW Letter. However, based on our staffs' discussions with staff representing FSOC's members, we believe that funds using these types of fees are often active in markets that FSOC may desire to monitor for concentration risks. In addition, Form PF is intended to provide FSOC with a broad picture of the private fund industry so that it has context against which to assess systemic risk. An important part of this is gathering information about funds with similar characteristics, such as performance fees based on unrealized gains, so that industry-wide comparisons can be made. The inclusion of any particular fund in a reporting group, whether as a result of the private fund definitions or the reporting thresholds, does not represent a conclusion that the fund engages in activities that pose systemic risk.

72 *See* PEGCC Letter.

may take into account unrealized gains solely for the purpose of reducing such fees or allocations to reflect net unrealized losses.

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.[73] However, short selling appears to be, for purposes of Form PF, 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. On the other hand, we also understand 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 persuaded that including funds within the definition of "hedge fund" in Form PF 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.[74]

Commenters arguing that, instead of a definition, the Commissions should take an approach similar to that used in the FSA Survey, which outlined common hedge fund characteristics and allowed an adviser "to make its own good faith judgment as to

---

73 *See* IAA Letter; PEGCC Letter; SIFMA Letter; TCW Letter.

74 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 categorize funds that engage in certain types of market activity, and therefore, whether the definition applies should not depend on the form in which the fund engages in that activity.

whether a particular fund is a hedge fund," were not persuasive.[75] Such an approach could effectively defer to the adviser the determination of whether to report on Form PF information about hedge funds – an approach that might be appropriate for a voluntary survey, like the FSA's, but one that would significantly compromise the value of data collected for FSOC and thus would fail to achieve the purpose of this rulemaking.

Two other commenters suggested instead that we eliminate all of the private fund definitions and require that every private fund adviser complete the entire Form.[76] These commenters were concerned that any distinction among funds tied to the amount or type of information required would encourage advisers to change strategies in order to avoid reporting. Although we are sensitive to these concerns, we believe that distinguishing fund types is important for two reasons. First, by distinguishing among types of funds, we are able to limit the information collection burdens on advisers to funds for which the information is most relevant.[77] Second, separating reported data by fund strategy allows extraneous information to be excluded, which we believe will improve its utility to FSOC and the Commissions.

Several commenters also expressed concern that clauses (b) and (c) of the "hedge fund" definition in Form PF are too broad because many funds have the capacity to

---

75 ABA Committees Letter. *See also* AIMA General Letter; IAA Letter; Seward Letter.

76 *See* AFL-CIO Letter; AFR Letter.

77 For instance, one commenter, in agreeing that Form PF appropriately differentiates "between the reporting requirements for hedge funds and private equity funds," pointed out that section 2 of the Form, which would be completed by large hedge fund advisers, contains many questions that "are not relevant to private equity funds." This commenter also explained that requiring response to "questions that are not directly related to" the operations of private equity advisers would impose burdens on both FSOC and the advisers. *See* comment letter of Lone Star U.S. Acquisitions (Apr. 12, 2011) ("Lone Star Letter").

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.[78] These commenters generally argued that clauses (b) and (c) should focus on actual or contemplated use of these practices rather than potential use. Changes to the "hedge fund" definition in response to these comments have not been made because 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. Thus, the suggested approach could result in incomplete data sets for hedge funds, a class of funds that may be systemically significant. However, a private fund would not be a "hedge fund" for purposes of Form PF 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 duration) and a reasonable investor would understand, based on the fund's offering documents, that the fund will not engage in these practices.

Finally, some commenters recommended that a fund should not be classified as a "hedge fund" for purposes of Form PF unless it satisfies at least two of the prongs of the "hedge fund" definition (rather than any one prong).[79] The definition is designed to identify funds that are an appropriate subject for the higher level of reporting to which

---

[78] *See, e.g.*, AIMA General Letter; IAA Letter; PEGCC Letter; SIFMA Letter; TCW Letter.

[79] *See, e.g.*, Lone Star Letter; PEGCC Letter; TCW Letter.

hedge funds will be subject under Form PF, and, based on our staffs' consultations with staff representing FSOC's members, we believe that any one of the identified characteristics is sufficient to appropriately distinguish a fund for this purpose. We have not, therefore, made the change these commenters suggested. The changes to the "hedge fund" definition discussed above are intended to more accurately group private funds for purposes of Form PF and, thereby, improve the quality of information reported.

2. "Liquidity Fund" Definition

Registered advisers managing liquidity funds must submit information on Form PF regarding the financing and activities of these funds in section 1 of the Form, and large liquidity fund advisers are required to provide additional information in section 3 of the Form.[80] For purposes of Form PF, a "liquidity fund" is 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.[81] Commenters did not address the "liquidity fund" definition, which the SEC is adopting as proposed.

3. "Private Equity Fund" Definition

Registered advisers managing private equity funds must submit information on Form PF regarding the financing and activities of these funds in section 1 of the Form,

---

[80] Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the Form. Section 3 of the Form, which requires more specific reporting regarding liquidity funds, is only required by the SEC.

[81] *See* Glossary of Terms to Form PF. As discussed in the Proposing Release, liquidity funds can resemble registered money market funds, certain features of which may make them susceptible to runs and thus create the potential for systemic risk. *See* Proposing Release, *supra* note 12, at section II.A.2.

and large private equity advisers are required to provide additional information in section 4 of the Form.[82] Consistent with the proposal, Form PF defines "private equity fund" as 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.[83] Two commenters advocated for a definition of "private equity fund" that would not depend on whether a fund is a hedge fund.[84] This approach could, however, create gaps between the definitions and encourage advisers to structure around the reporting requirements.[85] The changes we have made to the "hedge fund" definition substantially address the concerns of these commenters.[86] Therefore, we

---

[82] Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the Form. Section 4 of the Form, which requires more specific reporting regarding private equity funds, is only required by the SEC.

[83] *See* Glossary of Terms to Form PF. The definitions of "real estate fund" and "venture capital fund" are being adopted as proposed, and changes to the definition of "securitized asset fund" are discussed above. *See supra* note 69. These definitions are primarily intended to exclude these types of funds from our definition of "private equity fund" to improve the quality of data reported on Form PF relating to private equity funds.

[84] *See* PEGCC Letter (proposing an alternative that largely inverts the proposed "hedge fund" definition but would allow for short selling and soften other distinctions); SIFMA Letter (suggesting an alternative that would define a "private equity fund" as a private fund having "a large number of sophisticated, third-party institutional and high net worth investors" and satisfying ten additional criteria, including that "the fund and its investment activities are not subject to regulatory restrictions or limitations.").

[85] Some commenters were concerned that creating any distinctions among funds would encourage advisers to change strategies in order to avoid reporting. *See supra* note 76 and accompanying text. The SEC believes, based on its staff's consultations with staff representing FSOC's members, that this risk is best addressed by tightly integrating the definitions.

[86] *See supra* notes 64-79 and accompanying text for a discussion of comments on the "hedge fund" definition and the changes we are making from the proposal. Some of these comments reflected concern that the breadth of the "hedge fund" definition would cause it to capture some private equity funds. Commenters arguing for an independent "private equity fund" definition expressed similar concerns. As discussed above, certain

believe that the proposed approach to defining "private equity fund" continues to be appropriate for the purposes of Form PF.

4. Large Private Fund Adviser Thresholds

a. Amounts

As noted above, we are adopting a threshold of $1.5 billion in hedge fund assets under management for large hedge fund adviser reporting, $1 billion in combined liquidity fund and registered money market fund assets under management for large liquidity fund adviser reporting, and $2 billion in private equity fund assets under management for large private equity fund adviser reporting.[87] These thresholds are designed so that the group of Large Private Fund Advisers filing Form PF will be relatively small in number but represent a substantial portion of the assets of their respective industries. For example, we estimate that approximately 230 U.S.-based advisers each managing at least $1.5 billion in hedge fund assets represent over 80 percent of the U.S. hedge fund industry based on assets under management.[88] Similarly,

---

of the changes we are making to the "hedge fund" definition are designed to address these concerns.

87 As proposed, we are requiring that an adviser determine whether it meets a threshold and qualifies as a large hedge fund adviser, large liquidity fund adviser or large private equity adviser based solely on the assets under management attributable to the particular types of fund. Two commenters suggested that we instead require advisers to aggregate all of their assets under management, regardless of strategy, for purposes of the thresholds. *See* AFL-CIO Letter; AFR Letter. These commenters cautioned that our approach could allow advisers with substantial private fund assets under management to nevertheless avoid classification as a Large Private Fund Advisers. We are sensitive to these commenters' concerns, but we continue to believe that the hedge fund, liquidity fund and private equity fund business models are sufficiently distinct that for FSOC's purposes they are most appropriately analyzed on a separate basis.

88 *See Billion Dollar Club*, HEDGEFUND INTELLIGENCE ("HFI") (Oct. 3, 2011). We estimate that, in addition to the 230 U.S.-based hedge fund advisers that will exceed the threshold, approximately 23 non-U.S. private fund advisers will also be classified as large

SEC staff estimates that the approximately 155 U.S.-based advisers each managing over $2 billion in private equity fund assets represent approximately 75 percent of the U.S. private equity fund industry based on committed capital.[89]

The threshold we are adopting for large hedge fund advisers reflects an increase from the $1 billion threshold that we proposed. We do not expect, however, that this increase will substantially change the group of advisers that were estimated in the proposal would be classified as large hedge fund advisers. Rather, the change is intended simply to adjust for a difference in how assets under management are measured in Form PF compared to how they are measured in the commercial databases that we consulted in

---

hedge fund advisers, for a total of approximately 250 large hedge fund advisers. We have based this estimate of non-U.S. advisers on IARD data as of October 1, 2011, showing that, among currently registered private fund advisers, fewer than 10% are non-U.S. advisers. (We are not aware of any reason that recent changes in the exemptions available under the Advisers Act would affect the relative representation of U.S. and non-U.S. advisers.) One commenter suggested that estimates based on HFI data should be grossed up because the database is under-inclusive. *See* comment letter of the Alternative Investment Management Association (Jul. 26, 2011) ("AIMA AUM Letter"). Although we acknowledge that this database is likely somewhat under-inclusive, we believe that the amount of assets under management not represented in the database is relatively small because the aggregate amount of assets reported to the database is consistent with other data sources estimating the total size of the hedge fund industry. In addition, we believe the uncounted assets are likely skewed toward the smaller advisers in the industry because the identity and size of the industry's largest advisers are relatively consistent across sources. As a result, although this database may under-represent the total amount of hedge fund industry assets under management, the count of large hedge fund advisers is likely to be relatively accurate. The changes to the "hedge fund" definition discussed above will likely result in fewer funds being classified as hedge funds than under the proposed definition. However, these changes are intended to more accurately group private funds for purposes of Form PF and should more closely align the definition to the estimates discussed above.

89 Preqin. The Preqin data relating to private equity fund committed capital is available in File No. S7-05-11. We estimate that, in addition to the 155 U.S.-based private equity advisers that will exceed the threshold, approximately 16 non-U.S. private fund advisers will also be classified as large private equity advisers, for an approximate total of 170 large private equity advisers. *See supra* note 88 for a discussion of the basis for this estimate.

proposing the $1 billion threshold amount. Form PF uses the definition of "regulatory assets under management" that the SEC recently adopted in connection with amendments to its Form ADV. This definition measures assets under management *gross* of outstanding indebtedness and other accrued but unpaid liabilities. One commenter pointed out, however, that the assets under management that advisers report to the currently available third-party databases are generally calculated on a *net* basis.[90] In other words, without adjustment, our proposed threshold of $1 billion in gross assets would have captured advisers with less than $1 billion in net assets, expanding the group of advisers classified as large hedge fund advisers beyond what we intended.[91] We believe this revised threshold strikes an appropriate balance between obtaining

---

90 *See* AIMA AUM Letter.

91 We are not aware of any existing source with data regarding the gross assets under management of U.S. hedge fund managers. Therefore, based on our staffs' consultations with staff representing FSOC's members, we have established this threshold by multiplying the proposed threshold by an industry average leverage ratio of 1.5 times net assets. The commenter suggested that industry leverage ranges between 1.5 and 3 times net assets but noted that leverage ratios over the preceding 12 months had dropped to 1.1 times investment capital. *See* AIMA AUM Letter; *see also* MFA Letter (citing leverage ratios from 3.0 to as low as 1.16); Andrew Ang, *et al.*, *Hedge Fund Leverage*, NATIONAL BUREAU OF ECONOMIC RESEARCH (Feb. 2011). We have used a leverage ratio at the lower end of this range because, without data regarding the industry's gross assets, it cannot confidently be estimated that a higher threshold would capture a portion of the industry sufficient to allow FSOC to effectively perform systemic risk assessments. Also, although the definition of "regulatory assets under management" is measured gross of certain liabilities, it does not capture all forms of leverage that may be included in the sources cited in the AIMA AUM Letter, such as off-balance sheet leverage. As a result, the leverage implied by "regulatory assets under management" may be lower than the leverage estimated based on these sources. The AIMA AUM Letter also suggested that the average leverage ratio used should be asset-weighted because advisers with over $1 billion in net assets under management tend to use greater amounts of leverage. However, these larger advisers would exceed the threshold even if measured on a net basis. The adjustment to the threshold to account for leverage is most relevant for the middle group of advisers, not the large advisers, and the leverage ratio we have used is consistent with the leverage ratio this commenter estimates for advisers with $200 million to $1 billion in net assets under management.

information regarding a significant portion of the hedge fund industry while minimizing the burden imposed on smaller advisers.[92]

An adviser managing liquidity funds must combine liquidity fund and registered money market fund assets for purposes of determining whether it meets the threshold for more extensive reporting regarding its liquidity funds. Liquidity funds and registered money market funds often pursue similar strategies, invest in the same securities and present similar risks. An adviser is, however, only required to report information about unregistered liquidity funds on Form PF. This information will supplement data the SEC collects about registered money market funds on its Form N-MFP and provide FSOC a more complete picture of large liquidity pools and their management. The SEC expects this approach to the reporting threshold to capture approximately 80 of the most significant managers of liquidity funds.[93] Commenters supported this approach, which we are adopting as proposed.[94]

Based on our staffs' consultations with staff representing FSOC's members, we believe that requiring basic information from all registered advisers over the minimum reporting threshold but more extensive and detailed information only from advisers meeting the higher thresholds is important to enabling FSOC to obtain a broad picture of

---

92 Similar adjustments to the thresholds applicable to liquidity fund advisers and private equity fund advisers have not been made because we understand these strategies typically involve little leverage at the fund level. *See infra* note 306 and accompanying text.

93 *See also* Proposing Release, *supra* note 12, at n. 89. The estimate of the number of large liquidity fund advisers is based on the number of advisers with at least $1 billion in registered money market fund assets under management, as reported on Form N-MFP as of October 1, 2011.

94 *See* AFL-CIO Letter; AFR Letter.

the private fund industry. We understand that obtaining this broad picture will help FSOC to contextualize its analysis and assess whether systemic risk may exist across the private fund industry and to identify areas where OFR may want to obtain additional information. At the same time, requiring that only these Large Private Fund Advisers complete additional reporting requirements under Form PF will provide systemic risk information for a substantial majority of private fund assets while minimizing burdens on smaller private fund advisers that are less likely to pose systemic risk concerns.

Although thresholds set at a higher amount could still yield information regarding much or a majority of the private fund industry's assets under management, such thresholds would potentially impede FSOC's ability to obtain a representative picture of the private fund industry. The activities of private fund advisers may differ significantly depending on size because, for instance, some strategies may be practical only at certain scales.[95] As a result, obtaining information regarding, for instance, 50 percent or 60 percent of the industry's assets under management may not be sufficient to confidently draw conclusions regarding the remaining portion of the industry. However, because relatively few advisers manage most of the industry's assets under management, a substantial reduction in the potential burdens of reporting can be achieved without sacrificing the ability to obtain a more representative picture. For example, setting the

---

95 For example, one commenter cited evidence suggesting that the use of leverage varies significantly with fund size, though they did not state whether this variation continues among advisers with over $1 billion in net assets under management. *See* AIMA AUM Letter. *See also* Ibbotson, Roger G., Peng Chen, and Kevin X. Zhu, 2011, *The ABCs of Hedge Funds: Alphas, Betas, and Costs*, FINANCIAL ANALYSTS JOURNAL 67 (1) ("Ibbotson, et al.") at 17-18 (discussing possible explanations for observed differences in returns for larger and smaller hedge funds).

threshold to cover, for instance, 80 percent of industry assets under management rather than 100 percent would relieve thousands of advisers from more detailed reporting while still obtaining a reasonably representative picture.[96] There are, however, limits to the range within which this tradeoff can be effectively made. For example, setting the thresholds to cover, for instance, 60 percent of industry assets under management rather than 80 percent would relieve a relatively small segment of advisers from more detailed reporting but might not result in a picture broad enough to be representative. Accordingly, the thresholds have been established to balance FSOC's need for a broad, representative set of data regarding the private fund industry with the desire to limit the potential burdens of private fund systemic risk reporting.

Commenters expressed support for a tiered reporting system based on size.[97] However, most commenters thought the proposed threshold of $1 billion was either too high or too low.[98] Commenters arguing for a lower threshold expressed concern that, at $1 billion, regulators would receive insufficient information to monitor certain types of market behavior with potentially systemic consequences.[99] In contrast, a number of

---

[96] In the PRA analysis below, the SEC estimates that the large adviser thresholds will result in approximately 500 advisers reporting additional information in section 2, 3 or 4 of Form PF while approximately 3,070 advisers will report information only in section 1 and another 700 will not report on Form PF at all because of the minimum reporting threshold. *See infra* section IV.A of this Release.

[97] *See, e.g.*, comment letter of Coalition of Private Investment Companies (Mar. 31, 2011) ("CPIC Letter") and MFA Letter.

[98] Compare AFL-CIO Letter and AFR Letter (supporting a lower threshold) to AIMA General Letter; IAA Letter; MFA Letter; PEGCC Letter; SIFMA Letter (supporting a higher threshold). *See also* comment letter of George Merkl (Feb. 22, 2011) ("Merkl February Letter") (supporting the proposed thresholds).

[99] *See* AFL-CIO Letter (arguing that the proposal would not allow regulators to monitor "herding" behavior, which it defines as the tendency for market participants to trade

commenters argued that even an adviser with $1 billion in assets under management could not pose systemic risk.[100] Several of these commenters supported an increase to $5 billion, which they argued would still capture over half the hedge fund industry while ensuring that advisers have sufficient operational capabilities to complete the Form.[101]

We have carefully considered these comments in light of the information we understand FSOC desires and its intended use by FSOC. Based on this, the SEC has determined to adopt the proposed threshold for large liquidity fund advisers and to increase the threshold for large private equity fund advisers to $2 billion. We are adopting the threshold for large hedge fund advisers with the corrective change discussed

---

together on one side of the market; also suggesting that, at a minimum, advisers with between $150 million and $1 billion in assets under management "should be required to complete all applicable sections of Form PF on a semi-annual basis."); AFR Letter.

100 *See, e.g.*, AIMA General Letter (also questioning whether the SEC and FSOC have the capacity to analyze the data from all the advisers above the proposed threshold); IAA Letter; MFA Letter; comment letter of Olympus Partners (Apr. 1, 2011) ("Olympus Letter"); PEGCC Letter (preferring that there be no large adviser category for private equity fund advisers because, in their view, these advisers pose little systemic risk); Seward Letter; SIFMA Letter; comment letter of the United States Chamber of Commerce, Center for Capital Markets Competitiveness (Apr. 12, 2011) ("USCC Letter").

101 *See, e.g.*, AIMA General Letter (asserting that a $5 billion threshold "still captures around 50-60% of the US hedge fund industry assets or just over 75 large hedge fund managers."); MFA Letter ("Based on estimates, 77 hedge fund managers representing approximately 50-60% of hedge fund industry assets would exceed this [$5 billion] threshold."); Seward Letter; USCC Letter (citing figures similar to those provided in the AIMA General Letter and the MFA Letter in support of a $5 billion threshold). Other commenters asserted that the thresholds should take into account measures of leverage or derivatives exposures rather than just assets under management. *See, e.g.*, ABA Committees Letter; AIMA General Letter. As discussed above, measuring these thresholds using "regulatory assets under management," as defined in Form ADV, implies adjustment for some forms of leverage. Two commenters suggested that, instead of assets under management, the adviser's proprietary assets are the most appropriate measure of assets at risk. *See* PEGCC Letter; USCC Letter. However, private fund advisers exercise significant discretion over the assets they manage, which makes assets under management a more accurate measure of an adviser's ability to affect the U.S. financial system.

above. Although we understand commenters' concerns that the proposed thresholds are too high and will not permit regulators to detect certain group behaviors among smaller private fund advisers, we believe at this time that the amount of additional information that would be required for this purpose would impose a significant burden on these smaller advisers and not significantly expand FSOC's ability to understand the industry.

On the other hand, in light of the information we understand FSOC desires and its intended use by FSOC, we are also not persuaded that a larger increase in the thresholds would be appropriate. Commenters supporting an increase may be correct that an adviser just exceeding these thresholds could not be large enough to pose systemic risk. However, the thresholds are not intended to establish a cutoff separating the risky from the safe but rather to provide FSOC with sufficient context for the assessment of systemic risk while minimizing the burden imposed on smaller advisers.[102] We understand based on our staffs' consultation with staff representing FSOC's members that, in order to assess potential systemic risk posed by the activities of certain funds, FSOC would benefit from access to data about funds that, on an individual basis, may not be a source of systemic risk. As discussed above, the increase that some commenters supported would result in coverage of a substantially smaller part of the industry, potentially impeding FSOC's ability to obtain a broad picture of the private fund industry.[103]

---

[102] *See supra* text accompanying notes 94-96. As noted above, the FSOC Second Notice highlights that even establishing guidelines for evaluating private fund advisers may require the context that Form PF will provide. *See supra* note 21.

[103] In particular, the activities of private fund advisers may differ significantly depending on size and that the portion of industry assets represented by advisers with over $5 billion in private fund assets under management may look substantially different from the portion

The SEC is, however, persuaded that an increase in the threshold for large private equity advisers that is smaller than some commenters advocated can be made without sacrificing the ability to obtain a broad picture of the private equity industry. SEC staff estimates that an increase in this threshold to $2 billion from the proposed $1 billion will reduce the portion of U.S. private equity industry assets covered by the more detailed reporting in section 4 of the Form from approximately 85 percent to approximately 75 percent.[104] At the same time, it reduces the number of U.S.-based advisers SEC staff estimates will be categorized as large private equity advisers from approximately 270 to approximately 155.[105] This will significantly mitigate the number of advisers subject to the more detailed reporting while still covering a substantial majority of industry assets. As a result of this change, section 4 of Form PF will cover a smaller portion of U.S. private equity industry assets than section 2 covers of U.S. hedge fund industry assets. However, the SEC believes this result is appropriate because private equity funds tend to pursue a narrower range of strategies than hedge funds, reducing concerns regarding the level of representativeness.

b. Frequency of Testing

The proposal would have required hedge fund and liquidity fund advisers to measure whether they had crossed these thresholds on a daily basis and private equity advisers to measure them on a quarterly basis. The proposed approach was based on our

---

of industry assets represented by advisers with between, for instance, $1 billion and $5 billion.

104 *See supra* note 89.

105 *See supra* note 89.

understanding that, as a matter of ordinary business practice, advisers are aware of hedge fund and liquidity fund assets under management on a daily basis, but are likely to be aware of private equity fund assets under management only on a quarterly basis.

However, several commenters argued that advisers would have difficulty monitoring on a daily basis the value of private funds holding complex or illiquid investments.[106] One commenter also noted that, in any given quarter, an adviser could experience significant spikes in the value of its assets under management.[107] These commenters suggested a variety of alternatives, such as testing at the end of the prior reporting period,[108] using an average over the period (possibly based on values at the end of each month in the quarter),[109] or testing at the end of each month.[110] We are persuaded that requiring daily testing of complex or illiquid investments could impose a substantial burden on some advisers, and we have, accordingly, modified the Form so that advisers need only test whether their hedge fund or liquidity fund assets meet the relevant threshold as of the end of each month.[111] In addition, as some commenters suggested, the test will look back one quarter so that these advisers know at the start of each reporting period whether they will be required to complete the more detailed reporting required of large hedge fund advisers and large liquidity fund advisers.[112] We did not adopt an

---

106 *See, e.g.*, ABA Committees Letter; BlackRock Letter; MFA Letter; Seward Letter.

107 *See* ABA Committees Letter.

108 *See* BlackRock Letter; MFA Letter.

109 *See* ABA Committees Letter; AIMA General Letter; IAA Letter.

110 *See* Seward Letter.

111 *See* Instruction 3 to Form PF.

112 *Id. See also supra* note 108.

approach using an average because it would add unnecessary complexity and potentially allow an adviser whose assets under management have grown significantly during a quarter to delay more detailed reporting for an additional quarter.

Commenters also objected to the proposed quarterly testing with respect to private equity advisers, suggesting that even such infrequent testing may be difficult for some advisers.[113] As we discuss in further detail below, large private equity fund advisers will be required to report information regarding their private equity funds only on an annual (rather than quarterly) basis, with the result that quarterly testing of the threshold is unnecessary.[114] Accordingly, advisers need only test whether their private equity fund assets meet the relevant threshold at the end of each fiscal year.[115]

5. *Aggregation of Assets under Management*

For purposes of determining whether an adviser meets the $150 million minimum reporting threshold or is a Large Private Fund Adviser for purposes of Form PF, the adviser must aggregate together:

- assets of managed accounts advised by the firm that pursue substantially the same investment objective and strategy and invest in substantially the same positions as private funds advised by the firm ("parallel managed accounts")

---

113 *See* Merkl February Letter (noting that some private equity funds do not provide first and third quarter financial statements to investors); PEGCC Letter (suggesting annual testing and asserting that the less volatile nature of private equity investments would not justify the cost of quarterly valuation).

114 *See* section II.B of this Release.

115 *See* Instruction 3 to Form PF.

unless the value of those accounts exceeds the value of the private funds with which they are managed;[116] and

- assets of private funds advised by any of the adviser's "related persons" other than related persons that are separately operated.[117]

These aggregation requirements are designed to prevent an adviser from avoiding Form PF reporting requirements by re-structuring how it provides advice.

We have modified these aggregation requirements from the proposal. As adopted, an adviser may exclude parallel managed accounts if the value of those accounts is greater than the value of the private funds with which they are managed.[118] This change recognizes that, as some commenters noted, an adviser managing a relatively small amount of private fund assets could end up crossing a reporting threshold simply because it has a significant separate account business using a similar strategy.[119] We believe this approach is consistent with section 204(b) of the Advisers Act, the focus of

---

[116] *See* Instructions 1, 3, 5, and 6 to Form PF; and Glossary of Terms to Form PF. *See also* definitions of "dependent parallel management account," "hedge fund assets under management," "liquidity fund assets under management," and "private equity fund assets under management" in the Glossary of Terms to Form PF.

[117] *See* Instructions 3 and 5 to Form PF. "Related person" is defined generally as: (1) all of the adviser's officers, partners, or directors (or any person performing similar functions); (2) all persons directly or indirectly controlling, controlled by, or under common control with the adviser; and (3) all of the adviser's employees (other than employees performing only clerical, administrative, support or similar functions). For purposes of Form PF, a related person is "separately operated" if the advisers is not required to complete section 7.A. of Schedule D to Form ADV with respect to that related person. *See* Glossary of Terms to Form PF and Glossary of Terms to Form ADV. In addition, an adviser may, but is not required to, file one consolidated Form PF for itself and its related persons. *See infra* section II.A.6 of this Release.

[118] *See supra* note 116.

[119] *See* IAA Letter; TCW Letter.

which is private fund reporting.[120] We remain concerned, however, that advisers focusing on private funds may increasingly structure investments as separate accounts to avoid Form PF reporting requirements, which could diminish the utility to FSOC of the information collected on Form PF.[121] Accordingly, an adviser must still include the value of parallel managed accounts in determining whether it meets a reporting threshold if the value of those accounts is less than the value of the private funds managed using substantially the same strategy.[122]

---

120 An adviser managing primarily separate accounts would, of course, still be subject to the applicable Form PF reporting requirements if its private fund assets, taken alone, would cause it to exceed one or more reporting thresholds.

121 Commenters disagreed over whether such evasion was likely. One commenter supported the proposed aggregation rules, agreeing that they "will prevent [an adviser from splitting itself] into smaller components to avoid reporting requirements that are triggered by the amount of assets that are managed by an investment adviser." Merkl February Letter. Another commenter, however, was skeptical that advisers would re-structure to avoid reporting because clients typically determine the structure of their investments. *See* IAA Letter. Although clients may in many cases dictate the form of investment, we believe that advisers are not without influence in such structuring decisions and may prefer to avoid reporting on Form PF. (We note that advisers, as fiduciaries, may not subordinate clients' interests to their own such as by altering the structure of investments in a way that is not in the client's best interest in an attempt to remain under the reporting thresholds.)

122 *See supra* note 116. Some commenters also encouraged us to narrow the definition of "parallel managed account" so that fewer accounts or fewer types of accounts would be covered. *See, e.g.*, AIMA General Letter; IAA Letter (suggesting that we replace "substantially the same" with the "same"); comment letter of the Investment Company Institute (Apr. 12, 2011); TCW Letter (suggesting we exclude registered investment companies, undertakings for collective investment in transferable securities (UCITS) and SICAVs). We have, however, determined to adopt this definition as proposed because we believe that it appropriately reflects the total amount of assets that an adviser is managing using a particular strategy. In addition, the changes we are making with respect to how these account assets are treated for purposes of the reporting thresholds, as well as changes discussed below that allow advisers not to aggregate these account assets with their private funds for reporting purposes, substantially address the concerns of these commenters. *See infra* note 335 and accompanying text.

We have also modified these aggregation requirements from the proposal so that advisers may exclude the assets under management of related persons that are separately operated.[123] There was general support for the proposed aggregation of related persons.[124] However, commenters argued that "[r]equiring aggregation of funds managed by 'any related person' is not possible for many large institutions such as a large firm which operates under separate business units with independent asset management functions and decision making by affiliated entities."[125]

We are persuaded that advisers may have difficulty gathering the information necessary to aggregate the assets of related persons whose operations are genuinely independent of their own and that, with an appropriate standard of separateness, the risk of evasion is substantially mitigated. Having considered several existing SEC standards of separateness, we believe that the most appropriate for this purpose is the standard the SEC recently adopted in Item 7.A of Form ADV for determining whether an adviser must complete section 7.A of Schedule D to that form with respect to a related person.[126] Although the Item 7.A standard was adopted for a somewhat different regulatory

---

123 *See supra* note 117. *See also* Proposing Release, *supra* note 12, for the proposed version of Instructions 3, 5 and 6 to Form PF.

124 *See*, *e.g.*, Merkl February Letter.

125 TCW Letter. *See also* IAA Letter.

126 One commenter suggested that we use the standard under section 13 of the Securities Exchange Act of 1934 ("Exchange Act") or look to whether the related persons "share information about investment decisions on a real time basis." TCW Letter. We are concerned that using the standard under sections 13(d) and 13(g) of the Exchange Act would impose additional burdens on advisers as compared to the Item 7.A standard because advisers will not necessarily have considered the former in the ordinary course of business, and we believe the alternative proposed by this commenter would make it too easy to conclude that a related person is separately operated.

purpose, we believe it suits this role as well. In addition, every adviser filing Form PF will have already considered this standard with respect to its related persons, which means that applying the standard in the context of Form PF will impose little or no incremental burden on advisers. Accordingly, for purposes of determining whether an adviser meets one or more of the reporting thresholds, the adviser need only aggregate its private fund assets with those of its related persons for which it is required to complete section 7.A of Schedule D to Form ADV.[127]

For purposes of both the reporting thresholds and responding to questions on Form PF, an adviser may exclude any assets invested in the equity of other private funds.[128] In addition, if any of the adviser's private funds invests substantially all of its assets in the equity of other private funds and, aside from those investments, holds only cash, cash equivalents and instruments intended to hedge currency risk, the adviser may complete only section 1b with respect to that fund and otherwise disregard that fund.[129]

---

[127] *See supra* note 117. The relevant instruction to Item 7.A of Form ADV reads as follows: "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."

[128] *See* Instruction 7 to Form PF. The adviser must, however, treat these assets consistently for purposes of Form PF. For example, an adviser may not count these assets when determining whether the fund's borrowing may exceed half its net asset value and then disregard these assets for purposes of the reporting thresholds. Although this instruction allows an adviser to disregard these investments in other private funds, it would not allow an adviser to disregard any liabilities of the-private fund, even if incurred in connection with an investment in other private funds.

[129] *See* Instruction 7 to Form PF. Solely for purposes of this instruction, an adviser is also permitted to treat as a private fund any non-U.S. fund that would be a private fund had it

These instructions are intended to avoid duplicative reporting, which reduces the burden of reporting for advisers and improves the quality of the data reported.

Based on our staffs' consultation with staff representing FSOC's members, we have expanded from the proposal the scope of assets that may be disregarded under this instruction. The proposed instruction would have allowed advisers to disregard only fund of funds that invest exclusively in other private funds.[130] Commenters expressed concern that the proposed instruction would prove too narrow to accommodate many funds of funds, noting that these funds often hold cash or some amount of direct investments.[131] These commenters generally sought a broader exclusion for funds of funds, suggesting alternatives that would allow these funds to hold essentially unlimited dollar amounts of direct investments while not reporting on Form PF.[132] In light of the purpose for which

---

used U.S. jurisdictional means in offering its securities. 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 infra* note 134; Exemptions Adopting Release, *supra* note 11, at n.294 and accompanying text.

130 *See* the Proposing Release, *supra* note 12, for the proposed version of Instruction 7 to Form PF. We have also added a new Instruction 8, which clarifies that, except as provided in Instruction 7, all investments in other funds should be included for all purposes under Form PF but that advisers are not required to "look through" the other funds to the underlying assets (unless the other fund's purpose is to act as a holding company for the private fund's investments).

131 *See, e.g.*, ABA Committees Letter; comment letter of Akina Limited (Feb. 25, 2011) ("Akina Letter"); MFA Letter; PEGCC Letter; comment letter of Sidley Austin, LLP (submitted to the CFTC) (Apr. 12, 2011) ("Sidley Letter"); SIFMA Letter.

132 *Id.* Some commenters also suggested that advisers should not report even the limited information required in section 1b with respect to funds of funds. *See, e.g.*, ABA Committees Letter; Sidley Letter; SIFMA Letter. However, as one commenter pointed out, these funds may be employing leverage at the fund of funds level, which would not be reported if these funds did not complete this section. *See* Merkl February Letter. In addition, information collected in section 1b will provide regulators with information regarding the extent of these funds' investments in other private funds, and certain of the information collected in this section may be important to our investor protection mission. *See infra* notes 133 and 197.

information is collected on Form PF, we are not convinced that an adviser should not have to report on a fund's direct investments simply because it primarily holds investments in other private funds. However, we are persuaded that our proposed exception for funds of funds was too narrow in that it did not allow for a *de minimis* amount of cash, cash equivalents and currency hedges. These limited non-private fund holdings appear unlikely, on their own, to raise systemic concerns. We are also persuaded that, even where a fund is not necessarily a "fund of funds" but holds investments in other private funds, reporting on those investments is unnecessary because information regarding the other private funds will, in most cases, be reported separately on Form PF, and we have modified the instructions accordingly.[133]

If an adviser's principal office and place of business is outside the United States, the adviser may exclude 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.[134] This approach is designed to reduce the

---

133 *See* Instruction 7 to Form PF. We have, however, added a new question 10 to Form PF, which requires the adviser to disclose the amount that each private fund has invested in other private funds. This will allow regulators to understand the extent to which these investments occur and are otherwise being disregarded on Form PF. *See infra* note 197.

134 *See* Instruction 1 to Form PF. This portion of Instruction 1 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 11, at n.294 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* Glossary of Terms to Form PF. "United States person" is defined for purposes of Form PF by reference to the definition in rule 203(m)-1, which tracks the definition of a "U.S. person" under Regulation S but contains a special rule for discretionary accounts maintained for the benefit of United States persons. *See* Exemptions Adopting Release, *supra* note 11, at section II.B.4.

duplication of reporting requirements that foreign regulators may impose and to allow an adviser to report with respect to only those private funds that are more likely to implicate U.S. regulatory interests.

6. *Reporting for Affiliated and Sub-advised Funds*

An adviser may, but is not required to, report the private fund assets that it manages and the private fund assets that its related persons manage on a single Form PF.[135] This is intended to provide private fund advisers with reporting flexibility and convenience, allowing affiliated entities that share reporting and risk management systems to report jointly while also permitting affiliated entities that operate separately to report separately. Commenters did not address this aspect of the proposal, which we are adopting as proposed.

With respect to sub-advised funds, to prevent duplicative reporting, only one adviser should report information on Form PF with respect to that fund.[136] For reporting efficiency and to prevent duplicative reporting, if the adviser that completes information in section 7.B.1. of Schedule D to Form ADV with respect to any private fund is also required to file Form PF, the same adviser is responsible for reporting on Form PF with respect to that fund.[137] However, if the adviser that completes information on Schedule D

---

135 *See* Instruction 2 to Form PF. *See supra* note 117 for the definition of "related person."

136 Each adviser that meets the criteria for reporting on Form PF has an independent obligation to file the Form with respect to every fund it advises. *See* Advisers Act rule 204(b)-1(a); Instructions 1 and 3 to Form PF. However, when one adviser files Form PF with respect to a fund for a given reporting period, the other advisers are relieved of their obligation to file for that fund.

137 *See* Instruction 4 to Form PF. We have modified this instruction from the proposal to clarify who would report in the case that the adviser completing section 7.B.1 of Schedule D to Form ADV with respect to a particular private fund is an exempt reporting

to Form ADV with respect to the private fund is not required to file Form PF (such as in the case of an exempt reporting adviser), then another adviser must report on that fund on Form PF.[138] If none of the advisers to a fund is required to file Form PF because they are all exempt reporting advisers or do not exceed the minimum reporting threshold, Instruction 4 to Form PF would not require any adviser to file the Form with respect to that fund. Commenters did not address this aspect of the proposal.

7. *Exempt Reporting Advisers*

Only private fund advisers registered with the SEC (including those that are also registered with the CFTC as CPOs or CTAs) must file Form PF.[139] As noted above, the Dodd-Frank Act created exemptions from SEC registration under the Advisers Act for advisers solely to venture capital funds and for advisers solely to private funds that in the aggregate have less than $150 million in assets under management in the United States.[140] We believe that Congress' determination to exempt these advisers from SEC registration indicates Congress' belief that regular reporting of detailed systemic risk information may not be necessary because they are sufficiently unlikely to pose this kind of risk.[141] After consultation with staff representing FSOC's members and in light of the basic

---

adviser or does not meet the new minimum reporting threshold of $150 million in private fund assets under management.

138 *See* Instruction 4 to Form PF. *See supra* note 48 and accompanying text.

139 *See* Advisers Act rule 204(b)-1.

140 *See supra* note 53 and accompanying text.

141 *See* Senate Committee Report, *supra* note 5, at 74 ("The Committee believes 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. 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."). *See also* Exemptions Adopting Release, *supra* note 11.

information that the SEC obtains from exempt reporting advisers on Form ADV, the SEC did not propose to extend Form PF reporting to these advisers.[142] Commenters that addressed this aspect of the proposal agreed that exempt reporting advisers should not be required to file Form PF, and we have adopted this approach as proposed.[143]

B. Frequency of Reporting

1. Annual and Quarterly Reporting

Most private fund advisers, including large private equity advisers and smaller private fund advisers, are required to complete and file Form PF only once per fiscal year.[144] Large hedge fund advisers and large liquidity fund advisers, on the other hand, must update information relating to their hedge funds or liquidity funds, respectively, each fiscal quarter.[145] Periodic reporting will permit FSOC to monitor periodically certain key information relevant to assessing systemic risk posed by these private funds on both an individual and aggregate basis. More frequent, quarterly reporting for large

---

[142] *See* Implementing Adopting Release, *supra* note 11, for a discussion of the information exempt reporting advisers are required to provide on Form ADV.

[143] *See* AIMA General Letter; Lone Star Letter. To the extent an exempt reporting adviser is registered with the CFTC as a CPO or CTA, the CFTC has proposed that the adviser would be obligated to file either Form CPO-PQR or CTA-PR, respectively.

[144] *See* Instruction 9 to Form PF.

[145] Even these advisers, however, need only update information regarding other types of funds they manage on an annual basis. For example, a large hedge fund adviser that also manages a small amount of liquidity fund and private equity fund assets must update information relating to its hedge funds each quarter but only needs to update information relating to its liquidity funds and private equity funds when it submits its fourth quarter filing. An adviser that is both a large hedge fund adviser and a large liquidity fund adviser must file quarterly updates regarding both its liquidity funds and hedge funds. *See* Instruction 9 to Form PF.

hedge fund and large liquidity fund advisers is necessary in order to provide FSOC with timely data to identify emerging trends in systemic risk.[146]

The filing requirements we are adopting differ from the proposal in two principal respects. First, the proposal would have required large private equity advisers to report on a quarterly, rather than annual, basis. Second, under the proposal, once an adviser became subject to quarterly reporting, it would have been required to update information with respect to all of its private funds each quarter (not just for the type of private fund that caused it to exceed the large adviser threshold).[147]

---

146 *See* Proposing Release, *supra* note 12, at section II.C. We also noted in the Proposing Release that we understood hedge fund advisers already collect and calculate on a quarterly basis much of the information that Form PF requires relating to hedge funds. One commenter argued that this is only true with respect to the information required in sections 1a and 1b of Form PF. *See* comment letter of Fidelity Investments (Apr. 12, 2011) ("Fidelity Letter"); *see also* MFA Letter. We have taken these comments into account in determining to extend the reporting deadlines for hedge fund advisers, as discussed below in section II.B.2 of this Release. We note, however, that another commenter also stated that "Form PF for the most part... [requests] information that is part of, or should be part of, the existing risk management processes at the responding institutions," and as such "this information will either be something the adviser produces already, or arguably should." Comment letter of MSCI Inc. (submitted to the CFTC) (Apr. 11, 2011) ("MSCI Letter"). Commenters did not address the ability of liquidity funds to prepare and submit quarterly filings, and we continue to believe, as discussed in the Proposing Release, that most liquidity fund advisers collect on a monthly basis much of the information that we are requiring in section 3 of Form PF and that quarterly reporting should, as a result, be relatively efficient for these advisers.

147 The proposal also would have required reporting based on calendar quarters rather than the adviser's fiscal quarters. We have made this change because some advisers with quarterly updating obligations will now only need to update information about certain funds on an annual basis. The annual reporting is intended to align with typical end of fiscal year reporting activities, and requiring advisers to file separate annual and fourth quarter reports would impose additional burdens. We believe this change will, in practice, have little effect on the reporting (based on IARD data as of October 1, 2011, only about 2% of all registered advisers report a fiscal year ending in a month other than March, June, September or December, though the total may be slightly higher because IARD does not distinguish among, for instance, mid-month and end-of-month fiscal year ends).

A number of commenters responded to our proposal regarding the frequency of reporting. One agreed that quarterly reporting would be appropriate, and two others argued that advisers should report even more frequently because market conditions and portfolios can change rapidly.[148] On the other hand, a number of commenters disagreed with the proposal, suggesting instead that Large Private Fund Advisers should report no more than semi-annually.[149] These commenters argued that semi-annual reporting would reduce the burden to advisers while also giving regulators more time to analyze the data, and several compared Form PF to the FSA Survey, which has been conducted on a voluntary, semi-annual basis.[150] Another commenter stated that the generally illiquid portfolios of private equity funds fluctuate little in value throughout the year, in its view, making quarterly reporting unnecessary.[151]

After consultation with staff representing FSOC's members, we continue to believe that quarterly reporting is important to provide FSOC with meaningfully current information with respect to the hedge fund and liquidity fund industries and to allow FSOC to identify rapidly emerging trends among these types of funds.[152] Although some commenters suggested that the speed with which markets and portfolios change may warrant even more frequent reporting, we believe at this time that the additional benefit

---

148 *See* CPIC Letter (supporting the proposal with respect to large private funds advisers); AFL-CIO Letter and AFR Letter (arguing for more frequent reporting).

149 *See, e.g.*, ABA Committees Letter; BlackRock Letter; Fidelity Letter; comment letter of Kleinberg, Kaplan, Wolff & Cohen, P.C. (submitted to the SEC) (Apr. 12, 2011) ("Kleinberg General Letter"); MFA Letter; SIFMA Letter; USCC Letter.

150 *See, e.g.*, ABA Committees Letter; Kleinberg General Letter.

151 *See* PEGCC Letter.

152 Moreover, we believe that quarterly reporting helps to discourage "window-dressing" around the reporting dates. *See infra* notes 285-292 and accompanying text.

to FSOC from reporting more often than once a quarter would not justify the additional burdens imposed on advisers.[153] On the other hand, we are also not convinced that less frequent (*e.g.*, semi-annual) reporting would provide sufficient, or sufficiently timely, information to enable FSOC to identify and respond to rapidly emerging trends. In addition, we believe that international approaches to private fund reporting may be shifting in favor of quarterly, rather than semi-annual, reporting.[154]

With respect to large private equity advisers, however, the SEC is persuaded that the generally illiquid nature of private equity fund portfolios means that trends emerge more slowly in that sector.[155] As a result, the proposal has been modified so that large private equity advisers are required to report information regarding private equity funds on an annual basis only.[156]

Fewer commenters addressed the frequency of reporting for smaller advisers. One commenter agreed that annual reporting would be appropriate for these advisers,[157] and several others argued that smaller advisers should report more frequently, proposing at least semi-annual filings.[158] Again, although we acknowledge the potential value of more frequent reporting from smaller private fund advisers, we are concerned about the

---

[153] *See supra* note 148. We also note that FSOC has the authority to direct OFR to gather additional data where systemic risk concerns merit the reporting. *See*, *e.g.*, sections 153 and 154 of the Dodd-Frank Act.

[154] ESMA's proposed reporting template would impose quarterly reporting requirements on private fund advisers. *See* ESMA Proposal, *supra* note 33.

[155] *See supra* note 151.

[156] *See* Instruction 9 to Form PF.

[157] *See* AIMA General Letter.

[158] *See* AFL-CIO Letter; AFR Letter. *See also* MFA Letter (arguing that all advisers, large and small, should report on a semi-annual basis).

burden this would impose. At this time, we are not convinced that more frequent reporting from smaller private fund advisers would, from a systemic risk monitoring perspective, be justified by the value of the additional data.

As noted above, the requirements we are adopting also differ from the proposal in that even those advisers who must report on a quarterly basis are only required to do so with respect to the type of fund that caused them to exceed the reporting threshold. We are adopting this approach in part because these other funds will include private equity funds, venture capital funds and real estate funds, all of which are likely to have generally illiquid portfolios and for which we believe annual reporting is appropriate, as explained above. This approach also reflects the different implications for systemic risk that may be presented by different investment strategies.

2. Reporting Deadlines

Large private equity advisers and smaller private fund advisers have 120 days from the end of their fiscal years to file Form PF.[159] In contrast, large hedge fund advisers have 60 days from the end of each fiscal quarter, and large liquidity fund advisers have 15 days.[160] The deadlines we are adopting for large hedge fund advisers, large private equity advisers and smaller advisers are longer than the deadlines we

---

159 *See* Instruction 9 to Form PF; Advisers Act rule 204(b)-1(a).

160 *See* Instruction 9 to Form PF. As discussed above, a large hedge fund adviser (or large liquidity fund adviser) that also manages other types of funds must file quarterly updates with respect to its hedge funds (or liquidity funds, as applicable) but only needs to update information regarding its other funds when it files its fourth quarter update. Such an adviser may comply with its filing obligations by initially filing a fourth quarter update that includes only information about its hedge funds (or liquidity funds, as applicable) within 60 days (or 15 days, as applicable) and then amending its filing within 120 days after the end of the quarter to include information about its other funds.

proposed. In particular, we have extended the deadline for large hedge fund advisers from 15 days to 60 days, the deadline for large private equity fund advisers from 15 days to 120 days and the deadline for smaller private fund advisers from 90 days to 120 days.[161]

The proposed deadline of 15 days for large hedge fund and private equity fund advisers attracted significant opposition. Commenters offered a number of reasons to extend the deadline, including that: (1) 15 days is not enough time to prepare and submit a report with reliably accurate data, particularly where the adviser must value illiquid fund assets;[162] (2) other SEC reporting requirements allow more time;[163] (3) the FSA Survey has allowed more time (approximately 30 to 45 days in the most recent surveys) and required less detail;[164] (4) the same personnel will be closing the books at the end of the quarter and completing Form PF;[165] and (5) the more current the information

---

161 We noted in the Proposing Release that the proposed 90 day deadline would allow these advisers to file amendments at the same time as they file their Form ADV annual updating amendment, which may make certain aspects of the reporting more efficient, such as reporting assets under management. Proposing Release, *supra* note 12, at section II.C. We believe these efficiencies will still be realized because the reporting continues to be "as of" the same date as the annual reports on Form ADV and an adviser may still file on or after the date on which it files Form ADV.

162 *See, e.g.*, ABA Committees Letter; AIMA General Letter; BlackRock Letter; IAA Letter; MFA Letter; USCC Letter.

163 *See, e.g.*, ABA Committees Letter (noting that Forms N-SAR and N-Q, used by registered investment companies, allow 60 days); AIMA General Letter (pointing to Form 13F (allowing 45 days), Form 10-K (allowing at least 60 days), and Form 10-Q (allowing at least 40 days)); Fidelity Letter; Kleinberg General Letter; MFA Letter (pointing to the 120 days allowed for audited financial statements under the Advisers Act custody rule); TCW Letter.

164 *See, e.g.*, AIMA General Letter; IAA Letter.

165 *See, e.g.*, Kleinberg General Letter.

reported, the greater the consequences should it become public.[166] These commenters suggested alternatives that ranged from 45 to 120 days.[167] We understand from the comments, however, that the proposed reporting deadlines would be more problematic for some types of advisers than for others. For instance, commenters focusing on private equity advisers generally suggested longer deadlines than commenters focusing on hedge fund advisers, and the valuation of illiquid portfolios is likely to be a more common problem for private equity advisers.[168] Also, although a number of commenters addressed hedge fund advisers and private equity advisers, none commented specifically on whether liquidity fund advisers could meet the proposed deadline.

We are persuaded that longer deadlines are appropriate for large hedge fund advisers and large private equity fund advisers and that, with respect to large private equity fund advisers in particular, the work required to value the generally illiquid portfolios of private equity funds favors a substantially longer reporting deadline than

---

166 *See, e.g.*, AIMA General Letter; Kleinberg General Letter. Some commenters also pointed to the Form's proposed signature page, which would have required advisers to certify that the information provided is "true and correct," arguing that this standard would be difficult to satisfy in 15 days. *See, e.g.*, AIMA General Letter. As discussed below, we are not adopting the proposed certification requirement. *See infra* notes 183-185 and accompanying text.

167 *See, e.g.*, AIMA General Letter (45 days); Akina Letter (120 days for private equity fund data); BlackRock Letter (120 days); CPIC Letter (45 days, at least initially); Fidelity Letter (preferably 90 days, but no less than 45 days); IAA Letter (90 days); Kleinberg General Letter (60 days); Lone Star Letter (60 days for private equity fund data); Merkl February Letter (four months for private equity fund data); MFA Letter (120 days); PEGCC Letter (at least 90 days for private equity fund data); Seward Letter (120 days); SIFMA Letter (120 days); TCW Letter (60 days); USCC Letter (120 days).

168 *Id.*

was proposed.[169] A few commenters favored a deadline for large hedge fund advisers longer than the one we are adopting, but several commenters indicated that a deadline shorter than the one we are adopting would be adequate.[170] We believe that our revised approach strikes an appropriate balance between the need to provide FSOC with timely data and the ability of these advisers to prepare and submit Form PF. We also believe it will reduce the burden of reporting for these advisers.

Fewer commenters addressed the proposed reporting deadline of 90 days for smaller advisers. One commenter supported the proposal,[171] but several argued that smaller advisers should have more than 90 days to prepare and submit their filings.[172] Several commenters noted that the Advisers Act custody rule allows advisers up to 120 days to distribute audited financial statements to investors when relying on the annual audit provision under that rule.[173] We believe that our revised deadline of 120 days will enable these advisers to benefit from the availability of financial statements and also help to avoid crowding advisers' calendars with end of year reporting obligations while at the same time providing FSOC with reasonably timely data.

---

[169] We note that many of the questions in section 4, which large private equity fund advisers must file, relate to information that should be available on the financial statements of their portfolio companies. By extending the deadline to 120 days for these advisers, we anticipate that the burden of reporting will be reduced because, in many cases, they will now be able to delay reporting until after receiving financial statements from their portfolio companies.

[170] *See supra* note 167.

[171] *See* AIMA General Letter.

[172] *See, e.g.*, BlackRock Letter (120 days); MFA Letter (120 days); PEGCC Letter (150 days for private equity fund data).

[173] *See, e.g.*, BlackRock Letter; MFA Letter; USCC Letter. *See also* Advisers Act rule 206(4)-2(b)(4).

3. Initial Reports

Newly registering private fund advisers are subject to the same Form PF reporting deadlines as currently registered advisers.[174] Advisers are not, however, required to file Form PF with respect to any period that ended prior to the effective date of their registrations. Accordingly, a smaller private fund adviser that registers during its 2013 fiscal year must file Form PF within 120 days following the end of its 2013 fiscal year. It would not, however, need to file Form PF for its 2012 fiscal year. Similarly, a large hedge fund adviser that registers during its third fiscal quarter must file Form PF within 60 days following the end of that quarter but need not file for the preceding fiscal quarter.[175]

We have extended the deadlines for initial filings from the 15 days that we proposed. One commenter argued that the proposed deadline would be too short and suggested 90 days instead.[176] We believe the revised initial filing deadlines are more consistent with the deadlines for updating Form PF discussed above in section II.B.2 of this Release.

4. Transition Filings, Final Filings and Temporary Hardship Exemptions

An adviser must file Form PF to report that it is transitioning to only filing Form PF annually with the Commissions or to report that it no longer meets the

---

174 *See* Advisers Act rule 204(b)-1(a); *supra* section II.B.2 of this Release.

175 Whether an adviser is a large hedge fund or large liquidity fund adviser would be determined as of the date specified in Form PF, not the date of registration. When filing an initial Form PF, a large hedge fund or large liquidity fund adviser that also manages other types of private fund may rely on the instructions in the Form allowing it to delay updating information regarding these other fund types when filing an update.

176 *See* AIMA General Letter.

requirements for filing Form PF no later than the last day on which the adviser's next Form PF update would be timely.[177] This allows us to determine promptly whether an adviser's discontinuance in reporting is due to it no longer meeting the form's reporting thresholds as opposed to a lack of attention to its filing obligations. Advisers may also avail themselves of a temporary hardship exemption in a similar manner as with other SEC filings if they are unable to file Form PF electronically in a timely manner due to unanticipated technical difficulties.[178] No commenters addressed the proposed transition filings, final filings or temporary hardship exemption, and we are adopting them as proposed.

C. Information Required on Form PF

The questions contained in Form PF reflect relevant requirements and considerations under the Dodd-Frank Act, consultations with staff representing FSOC's members, and the Commissions' experience in regulating those private fund advisers that are already registered with the Commissions. As discussed above, with respect to hedge fund advisers in particular, the information collected on Form PF is also broadly based on the guidelines initially developed in the FSA Survey and the IOSCO report on hedge fund oversight, and many of the more detailed items are similar to questions proposed to be

---

[177] *See* Instruction 9 to Form PF.

[178] *See* Advisers Act rule 204(b)-1(f); Instruction 14 to Form PF. The adviser would complete and file on paper Item A of section 1a and section 5 of Form PF, checking the box in section 1a indicating that it is requesting a temporary hardship exemption. The adviser must file any request for a temporary hardship exemption no later than one business day after the electronic Form PF filing was due. The adviser must then submit the filing that is the subject of the Form PF paper filing in electronic format with the Form PF filing system no later than seven business days after the filing was due.

included in ESMA's reporting template.[179] Form PF has been designed to collect information to assist FSOC in monitoring and assessing systemic risks that private funds may pose, as discussed in section II.A above.

Commenters' reactions to the scope of Form PF varied, with some proposing further enhancements and others arguing that the proposed reporting is excessive. Commenters arguing for expanded reporting recommended additional questions about counterparty exposures and short selling or suggested having all advisers complete the entire form.[180] In contrast, critics of the proposal argued that information required on Form PF would be unduly burdensome to provide or is available to regulators from other sources.[181] A few commenters who objected to other aspects of the proposal recommended adding several questions that were originally proposed on Form ADV.[182] Although this would expand the Form, these commenters believed that these questions, which relate to valuation, beneficial ownership and the identity of service providers, would require competitively sensitive or proprietary information and would be more appropriately reported confidentially on Form PF.

As discussed in greater detail below, Form PF, as adopted, addresses the concerns of many commenters with changes from the proposal that we believe will significantly reduce the burden of reporting and clarify how commenters are expected to respond. At

---

179 *See supra* section I.B of this Release.

180 *See, e.g.*, AFL-CIO Letter; AFR Letter; Merkl February Letter; MSCI Letter; comment letter of Plexus Consulting Group (Feb. 28, 2011). *See also supra* note 76 and accompanying text.

181 *See, e.g.*, AIMA General Letter; IAA Letter; Olympus Letter; PEGCC Letter. *See infra* note 309 and accompanying text.

182 *See* IAA Letter; MFA Letter; Seward Letter.

the same time, the final Form preserves much of the information that the proposal would require. Our revised approach is intended to respond to industry concerns while still providing FSOC the information it needs to monitor systemic risk across the private fund industry.

Two of the changes we are making, in particular, illustrate this revised approach. The first is the removal of the proposed certification language. This would have required an authorized individual to affirm "under penalty of perjury" that the statements made in Form PF are "true and correct."[183] This certification was borrowed from the SEC's existing Advisers Act reporting form, Form ADV. However, a number of commenters expressed concern that such a standard would be inappropriate for Form PF because the Form requires advisers to provide estimates and exercise significant judgment in preparing responses.[184] In consideration of the nature of the information required on Form PF, we are persuaded that a certification is unnecessary and that a signature

---

183 *See* Question 2 and Instruction 11 to Form PF. If the adviser is also registered with the CFTC as CPO or CTA, the signature page also requires the signatory to acknowledge that misstatements or omissions of material fact on Form PF constitute a violation of the CEA. This acknowledgement is included simply to remove any doubt created by the filing of the Form through the SEC rather than directly with the CFTC, which is merely a matter of convenience for advisers.

184 *See, e.g.*, ABA Committees Letter; AIMA General Letter; Kleinberg General Letter; MFA Letter; PEGCC Letter. Some of these commenters also saw the certification standard and the reporting deadlines as related issues, arguing that the more quickly advisers are required to report, the less confidence they will have in their estimates. *See, e.g.*, BlackRock Letter; Fidelity Letter; PEGCC Letter; SIFMA Letter; USCC Letter. As discussed above in section II.B.2 of this Release, we have also extended the proposed filing deadlines. Several commenters compared Form PF to other SEC forms and suggested that we either require just a signature without a certification or that we use a less stringent standard, such as good faith. *See* MFA Letter (pointing to the certification in the SEC's Schedule 13G). *See also* ABA Committees Letter (comparing Form PF to other SEC forms, including Form N-SAR, Form N-Q, Schedule 13D and Schedule 13G); AIMA General Letter (pointing to Schedule 13G); BlackRock Letter; Kleinberg General Letter.

confirming that the Form is filed with proper authority is sufficient.[185]

The second change is to increase the ability of advisers to rely on their internal methodologies when reporting on Form PF.[186] A number of commenters encouraged this approach, recommending "that the instructions to the Form be modified to confirm that advisers be able to rely on the same internal reporting procedures and practices when reporting on the Form that they would use when reporting to advisory clients, unless directly contradicted by the instructions."[187] The revised approach strikes an appropriate balance between easing the burden on advisers by allowing them to rely on their existing practices and ensuring that FSOC receives comparable data across the industry. This

---

185 We note, however, that even absent the certification, a willful misstatement or omission of a material fact in any report filed with the SEC under the Advisers Act is unlawful. *See* section 207 of the Advisers Act. We have also added an instruction to the Form that clarifies when an adviser is required to amend its filing to correct an error. In particular, Instruction 16 to Form PF explains that an adviser is not required to update information that it believes in good faith properly responded to Form PF on the date of filing even if that information is subsequently revised for purposes of the adviser's recordkeeping, risk management or investor reporting (such as estimates that are refined after completion of a subsequent audit). The instruction also explains that large hedge fund advisers and large liquidity fund advisers that comply with their fourth quarter filing obligations by submitting an initial filing followed by an amendment in accordance with Instruction 8 to Form PF will not be viewed as affirming responses regarding one fund solely by providing updated information regarding another fund at a later date.

186 *See* Instruction 15 to Form PF. As noted in the instruction, we would expect reporting on Form PF to be consistent with information the adviser uses for internal and investor reporting purposes. Methodologies also must be consistently applied, and to the extent we have indicated how an adviser should respond to a question, the answer should be consistent with our instructions. In addition to this general instruction, we have increased the ability of advisers to rely on their own methodologies with a number of specific changes throughout the Form, including permitting advisers to report performance using their existing practices, allowing flexibility in reporting interest rate sensitivities and changing the frequency and substance of reporting for large private equity advisers. *See, e.g.*, *infra* notes 202, 241-242, 247-248 and 258-260 and accompanying text and section II.C.4.

187 BlackRock Letter. *See also* IAA Letter; MFA Letter; PEGCC Letter; SIFMA Letter; TCW Letter.

change is intended, together with the removal of the certification, to clarify that Form PF does not require the time or expense involved in, for instance, an audit of the information included on Form PF, and we anticipate that these changes will reduce the burden that many advisers incur in completing the Form.[188]

The information that Form PF requires and the changes made from the proposal are discussed in detail below.

1. Section 1 of Form PF

Each adviser required to file Form PF must complete all or part of section 1. This section of the Form is divided into three parts: section 1a requires information regarding the adviser's identity and assets under management, section 1b requires limited information regarding the size, leverage and performance of all private funds subject to the reporting requirements, and section 1c requires additional basic information regarding hedge funds. We are adopting Form PF with several changes to the information that advisers are required to report in section 1. These changes, which are discussed in detail below, are intended to respond to industry concerns while still providing FSOC the information it needs to monitor systemic risk across the private fund industry. In general, we expect that these changes will reduce the burden of responding to the Form and more closely align the Form with ESMA's proposed reporting template.

a. Section 1a of Form PF

Item A of section 1a seeks identifying information about the adviser, such as its name and the name of any of its related persons whose information is also reported on the

---

188 If audited information is available at the time an adviser files Form PF, we would of course expect responses to Form PF to be consistent with that audited information.

adviser's Form PF. The adviser will also be required to provide its large trader identification number, if any.[189] The addition of the large trader identification number will enhance the value of Form PF information by allowing it to be quickly and accurately linked to other information that may be available to the SEC while imposing little additional burden. Section 1a also requires basic aggregate information about the private funds managed by the adviser, such as the portion of gross (*i.e.*, regulatory) and net assets under management attributable to certain types of private funds.[190] This identifying information will assist us and FSOC in monitoring the amount of assets managed by private fund advisers and the general distribution of those assets among various types of private funds.[191] This information also provides data about the size of the adviser, the nature of the adviser's activities and the extent to which assets are managed rather than owned, which are factors that FSOC must consider in making a

---

189 *See* Question 1 on Form PF.

190 *See* Question 3 on Form PF. This question requires the adviser to report the portion of its assets under management that are attributable to hedge funds, liquidity funds, private equity funds, real estate funds, securitized asset funds, venture capital funds, other private funds, and funds and accounts other than private funds. We have modified the instructions to Question 3 to improve their consistency and to respond to a commenter's request for clarification regarding the meaning of "funds and accounts other than private funds." *See* MFA Letter. We have also determined not to adopt a proposed question that would have required advisers to report their aggregate gross and net regulatory assets under management because this information can be derived from the data reported in Question 3. *See* the Proposing Release, *supra* note 12, for the proposed Question 3 on Form PF.

191 Question 4 in section 1a of Form PF also permits an adviser to explain any assumptions it made in responding to Form PF. This question is optional. One commenter expressed support for "providing space for managers to describe any assumptions they make in responding to a question," and we are adopting this question substantially as proposed. *See* MFA Letter.

determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[192]

b. Section 1b of Form PF

Section 1b of Form PF elicits certain identifying and other basic information about each private fund the adviser manages. The adviser generally must complete a separate section 1b for each private fund.[193] This section of the Form requires reporting of each private fund's gross and net assets and the aggregate notional value of its derivative positions.[194] It also requires basic information about the fund's borrowings, including a breakdown showing whether the creditor is based in the United States and whether it is a financial institution.[195] Advisers must also report the percentage of the

---

[192] *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

[193] However, if the adviser elects to report on an aggregated basis regarding the funds comprising a master-feeder arrangement or a parallel fund structure, it would only file a single section 1b for the master fund in the master-feeder arrangement or for the largest fund in the parallel fund structure. We have modified the approach to aggregation of master-feeder arrangements and parallel fund structures to allow advisers more flexibility in determining how to report. *See* Instruction 5 to Form PF. This change is discussed in greater detail below in section II.C.5 of this Release.

[194] *See* Questions 8, 9 and 13 on Form PF. With respect to Question 13 and similar questions regarding the value of derivatives, the Form requires the adviser to report the gross notional value of its funds' derivative positions, except that options must be reported using their delta adjusted notional value. *See* Instruction 15 to Form PF. In contrast, Questions 8 and 9, and similar questions that refer to gross asset value or net asset value, require valuations based on the instruction in Form ADV for calculating regulatory assets under management. *See* definitions of "gross asset value" and "net asset value" in the Glossary to Form PF.

[195] *See* Question 12 on Form PF. One commenter suggested that the amount of borrowings should be netted where a private fund is both a lender to and a creditor of a counterparty. *See* MFA Letter. The commenter's approach would, however, obscure the total amount of leverage the fund has incurred, and we have clarified that such amounts should not be netted. Also, in response to this commenter, we have modified the instructions to clarify that collateral should not be netted against borrowings. We have also modified this question, and other questions on the Form requiring a breakdown of creditor types, to split the non-financial institution category into U.S. and non-U.S. creditors. This change

fund's equity held by the five largest equity holders, which provides information about the concentration of the fund's investor base.[196] Two new questions, which we have added in connection with other changes to the Form, also require the value of the fund's investments in other private funds and of the parallel managed accounts managed alongside the fund.[197]

---

is intended to increase the usefulness of this data for the FRB's flow of funds report, which is an important tool for evaluating trends in and risks to the U.S. financial system. *See infra* note 475.

We proposed that advisers completing section 1b also report the identity of, and amount owed to, each creditor to which the fund owed an amount equal to or greater than 5 percent of the fund's net asset value as of the reporting date. *See* the Proposing Release, *supra* note 12, for the proposed Question 10 on Form PF. This question has been moved to section 2b of the Form so that only large hedge fund advisers must provide this information. This change is intended to respond to commenter concerns that completing this question will be burdensome but also preserve information regarding interconnectedness that may be important to FSOC's monitoring of systemic risk among large hedge funds. *See*, *e.g.*, PEGCC Letter.

196 *See* Question 15 on Form PF. For purposes of this question and Question 16 on Form PF, 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)). The proposal would have required that advisers report the number of beneficial owners of the fund. However, we are not adopting this question because, as a result of our revised approach to reporting on parallel managed accounts, this information will largely duplicate information collected on Form ADV, and we do not believe that receiving updated responses on a quarterly basis from large hedge fund advisers and large liquidity fund advisers is necessary with respect to this information. *See infra* section II.C.5 of this Release. *See also* the Proposing Release, *supra* note 12, for the proposed Question 12(a) on Form PF; Question 13 of section 7.B.1. of Schedule D to Form ADV.

197 *See* Questions 10 and 11 on Form PF. Question 10, which asks for the value of the fund's investments in other private funds, has been added because our expanded Instruction 7 otherwise allows these investments to be disregarded on Form PF and it is important that FSOC have a basic measure of the extent of assets not otherwise reflected on the Form. This will also serve as a measure of interconnectedness among private funds. *See supra* notes 128 and 131 and accompanying text for a discussion of Instruction 7. Question 11, relating to the value of parallel managed accounts, has been added for similar reasons. *See infra* section II.C.5 of this Release for a discussion of our revised approach to reporting on parallel managed accounts.

Section 1b also requires that advisers report in response to Question 17 the performance of each fund, both on a gross basis and net of management fees and incentive fees and allocations. Advisers must provide performance information that is consistent with the performance results they report to investors (or use internally, if not reported to investors). Advisers are required, at a minimum, to report annual performance results for the fund's most recently completed fiscal year but only need to report monthly and quarterly performance information if that information is already being calculated for the fund.

Question 17 has been modified from the proposal in response to commenter concerns regarding the burden of providing performance results in the form proposed.[198] In particular, it omits the requirement to report the change in net asset value, allows advisers to report performance gross and net of management fees and incentive fees and allocations (rather than gross and net of incentive fees and allocations only) and makes reporting of monthly and quarterly performance mandatory only for those funds for which advisers are already calculating performance results with that frequency. Commenters were concerned primarily that the proposed instructions to this question would require advisers to calculate performance in a manner different from that used for investor reporting purposes or more frequently than is their current practice.[199] A number of commenters explained that funds with illiquid portfolios, such as private equity funds, typically do not calculate performance on a monthly (and in many cases,

---

198 *See infra* notes 199 and 200.

199 *See, e.g.*, ABA Committees Letter; MFA Letter (recommending that "the Form be revised to request (i) gross performance and (ii) performance net of all fees" and suggesting that advisers be permitted to report what they report to private fund investors).

even quarterly) basis and that calculating performance more frequently would impose a significant burden on these advisers.[200] As discussed above, we are persuaded that trends emerge more slowly in private funds having illiquid portfolios, meaning that developments in these funds may be tracked using information reported on a less frequent basis.[201] We believe that the revised approach, which allows advisers to rely on their existing procedures for calculating and reporting fund performance, significantly reduces the burden of responding to this question but will nonetheless yield valuable information for FSOC.[202]

We have also added to section 1b two questions that the SEC originally proposed as part of the expanded private fund reporting in Form ADV.[203] The first, Question 14, requires that advisers report the assets and liabilities of each fund broken down using categories that are based on the fair value hierarchy established under U.S. generally accepted accounting principles ("GAAP").[204] The second, Question 16, requires that

---

200 *See, e.g.*, ABA Committees Letter; IAA Letter; Merkl February Letter; MFA Letter; PEGCC Letter; SIFMA Letter; TCW Letter.

201 *See supra* text accompanying note 156.

202 *See* Question 17 on Form PF. *See also* Proposing Release, *supra* note 12, at text accompanying n. 115 for a discussion of potential uses for this data.

203 *See* Questions 14 and 16 on Form PF.

204 Advisers must report this information annually (or on their fourth quarter updates, in the case of large hedge fund and large liquidity fund advisers). This question will provide information indicating the illiquidity and complexity of a fund's portfolio and the extent to which the fund's value is determined using metrics other than market mechanisms. In a recent rulemaking release, FSOC identified this fair value categorization as the type of information that may be important for assessing liquidity risk and maturity mismatch, one factor in determining whether a nonbank financial company may pose systemic risk. *See* FSOC Second Notice, *supra* note 6. *See also 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") for the proposed version of Form ADV, Part 1A, section 7.B.(1)A. of Schedule D, question 12.

advisers provide the approximate percentage of each fund beneficially owned by certain types of investors.[205] As discussed in the Implementing Adopting Release, the SEC determined not to adopt these questions on Form ADV in response to commenter concerns that they would result in the public disclosure of competitively sensitive or proprietary information.[206] We have added these questions to Form PF (with the modifications discussed below) because, as the SEC explained in the Implementing Adopting Release, this information may be important to FSOC's systemic risk monitoring activities and to our investor protection mission.[207]

Commenters responding to these questions as proposed on Form ADV argued that they would be difficult or burdensome to complete. With respect to Question 14, commenters argued that some private funds – especially non-U.S. funds – do not use generally accepted accounting principles (whether U.S. or international) or obtain audited financial statements, making the requirement to report a breakdown of fair values

---

See also FASB ASC 820-10-50-2b.

We have modified this question from the proposal to expressly include definitions for Levels 1, 2 and 3 of the hierarchy. This change is intended to minimize ambiguity for advisers that do not utilize GAAP or another international accounting standard that requires the contemplated breakdown of assets and liabilities. Advisers that already prepare this breakdown for financial reporting purposes should respond to this question using the fair value hierarchy established under the applicable accounting standard.

205 *See* the Implementing Proposing Release for the proposed version of Form ADV, Part 1A, section 7.B.(1)A. of Schedule D, question 17.

206 *See* Implementing Adopting Release, *supra* note 11, at nn. 246-247. Information filed on Form ADV is made available to the public through the Investment Adviser Public Disclosure (IAPD) website. In contrast, information filed on Form PF will generally remain confidential. *See infra* section II.D of this Release.

207 *Id.* Several commenters responding to the Proposing Release also encouraged us to move these questions from Form ADV to Form PF. *See* IAA; MFA Letter; Seward Letter.

potentially costly.[208] We understand, however, that the group of funds not using some form of generally accepted accounting standard is relatively small and that most private funds already utilize GAAP or other international accounting standards that require the contemplated breakdown of assets and liabilities.[209] In addition, funds are not required to adopt GAAP for these purposes, and Question 14 does not require that the *valuations* within the breakdown of assets and liabilities be audited, or even determined in accordance with GAAP. For instance, an adviser could rely on the procedure for

---

208 Comment letter of the American Bar Association, Federal Regulation of Securities Committee and Private Equity and Venture Capital Committee (Jan. 31, 2011) (commenting on the Implementing Proposing Release, *supra* note 204) ("ABA Committees Implementing Proposal Letter"); comment letter of the Alternative Investment Management Association (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204) ("AIMA Implementing Proposal Letter"); comment letter of Dechert LLP (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204); comment letter of the Investment Adviser Association (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204) ("IAA General Implementing Proposal Letter"); comment letter of Katten, Muchin, Rosenman, LLP (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204); comment letter of George Merkl (Jan. 25, 2011) (commenting on the Implementing Proposing Release, *supra* note 204); comment letter of the National Venture Capital Association (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204). Some of these commenters further contended that investors would bear any new audit costs or that advisers would not necessarily have audited numbers within 90 days after fiscal year end, when Form ADV is due. *See, e.g.*, ABA Committees Implementing Proposal Letter; AIMA Implementing Proposal Letter; IAA General Implementing Proposal Letter.

209 *See, e.g.*, Implementing Proposing Release, *supra* note 204, at n. 56. Indeed, even in the context of this rulemaking, the Managed Funds Association suggested that we use a GAAP standard to measure advisers' assets, asserting that "GAAP information is regularly reported across the industry and is a data point that most managers track in the ordinary course...." MFA Letter. Others advisers may use international accounting standards requiring substantially similar information. In the Implementing Adopting Release, the SEC estimated that only about 3% of registered advisers have at least one private fund client that may not be audited. *See* Implementing Adopting Release, *supra* note 11, at nn. 634-636 and accompanying text.

calculating fair value that is specified in a private fund's governing documents.[210] As a result, we are not convinced that the aggregate burden attributable to this reporting is unreasonable or even as significant as some commenters contend. The question has, however, been modified from the proposal to require a breakdown only by category and not by class.[211] For advisers that do not already prepare this breakdown for financial reporting purposes, this revised approach will significantly reduce the work required to respond to this question.[212] Such advisers may, nevertheless, incur additional costs to complete this question, and we are sensitive to these costs. We believe, however, that this question will provide valuable information for FSOC's systemic risk monitoring activities and our investor protection mission and that the associated burden is warranted.[213]

---

210 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. The fund's governing documents may provide, for example, that the fund's general partner determines the fair value of the fund's assets. We would, however, 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 assets and liabilities for this purpose.

This question has been modified from the proposal to include a column titled "cost-based" for those assets and liabilities valued on the fund's financial statements using a measurement attribute other than fair value. This change recognizes that, even among advisers that already prepare a similar fair value breakdown for financial reporting purposes in accordance with GAAP, some assets and liabilities are not accounted for at fair value and, therefore, would not be included in the fair value hierarchy disclosures.

211 In other words, although an adviser will need to provide the fund's aggregate assets and liabilities categorized as Level 1, 2 or 3, it will not need to indicate the types of assets and liabilities in each of those categories.

212 In addition, for advisers that already prepare this breakdown for financial reporting purposes, this revised approach will reduce the amount of information that needs to be re-entered on Form PF.

213 *See supra* note 204 for a discussion of potential uses for this data.

Commenters also expressed concern regarding the burden of reporting the types of beneficial owners investing in each fund, as required in Question 16.[214] One of these commenters noted, for instance, that many advisers either do not have this information or keep this information on a basis different from that set out in the Form.[215] We believe, however, that many advisers to private funds are already collecting some of this beneficial ownership data as part of their processes for analyzing compliance with exemptions under the Investment Company Act and the Securities Act of 1933.[216] To the extent this information is not currently collected, we do not anticipate that adding this to the information advisers already routinely collect from fund investors will impose a significant burden. We acknowledge, however, that advisers managing funds with securities outstanding prior to the adoption of Form PF would have to take additional steps in order to obtain this information because the investor diligence process will already have been completed. As a result, with respect to beneficial interests outstanding prior to March 31, 2012, that have not been transferred on or after that date, advisers may respond to Question 16 using good faith estimates based on data available to them without making additional inquiries of investors.

---

214 Comment letter of Debevoise & Plimpton, LLP (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204) ("Debevoise Implementing Proposal Letter"); IAA General Implementing Proposal Letter; comment letter of Shearman & Sterling, LLP (Jan. 24, 2011) (commenting on the Implementing Proposing Release, *supra* note 204) ("Shearman Implementing Proposal Letter"). These commenters argued that advisers may have difficulty obtaining the required information for certain types of funds, particularly for funds established before the adoption of the reporting requirement.

215 *See* IAA General Implementing Proposal Letter (stating that the reporting would require "significant system enhancements").

216 15 U.S.C. 77a.

Question 16 has also been modified by adding a row for non-U.S. investors about which the adviser does not have and cannot reasonably obtain beneficial ownership information.[217] This change acknowledges that obtaining beneficial ownership information about certain non-U.S. investors may be difficult for some advisers and ameliorates that burden by allowing advisers to report only the size of the ownership interest about which data is not available. We have also modified from the proposal some of the other categories in this question based on our consultations with staff representing FSOC's members. In particular, we have split out categories regarding individuals and pension plans to obtain a slightly more granular breakdown and added a category for sovereign wealth funds and foreign official institutions. We intend these changes to increase the usefulness of this data for the FRB's flow of funds report, a tool that is used for evaluating trends in and risks to the U.S. financial system.[218]

The information that section 1b requires is designed to allow FSOC to monitor certain systemic trends for the broader private fund industry, such as how certain kinds of private funds perform and exhibit correlated performance behavior under different economic and market conditions and whether certain funds are taking significant risks that may have systemic implications. It is also intended to allow FSOC to monitor borrowing practices across the private fund industry, which may have interconnected

---

[217] An adviser may only report in this category beneficial ownership interests that are held through a chain involving one or more third-party intermediaries. If the beneficial owner has, for instance, simply interposed a wholly-owned holding company or trust as the legal owner, the interest would need to be reported in one of the other categories of beneficial owner.

[218] *See infra* note 475. *See also* Flow of Funds Accounts of the United States, *available at* http://www.federalreserve.gov/releases/z1/.

impacts on banks and thus the broader financial system. Question 14, which requires that advisers report the assets and liabilities of each fund broken down using categories that are based on the fair value hierarchy established under GAAP, will provide information indicating the illiquidity and complexity of a fund's portfolio and the extent to which the fund's value is determined using metrics other than market mechanisms. In a recent rulemaking release, FSOC identified this fair value categorization as the type of information that may be important for assessing liquidity risk and maturity mismatch, one factor in determining whether a nonbank financial company may pose systemic risk.[219] Finally, as noted above, certain of the information that section 1b requires is designed for use in the FRB's flow of funds report, a tool that is used for evaluating trends in and risks to the U.S. financial system.[220]

c. Section 1c of Form PF

Section 1c is the final part of section 1 and requires advisers to report information regarding the hedge funds they manage, if any. This information includes each fund's investment strategies[221] and the percentage of the fund's assets managed using high-

---

219 *See supra* note 204.

220 *See supra* note 218 and accompanying text.

221 *See* Questions 19 and 20 on Form PF. One commenter, although advising caution in using strategy data to analyze industry trends, asserted that the reporting could provide valuable information about emerging systemic risk. *See* MSCI Letter ("a buildup of assets in one or a set of related strategies should cause the FSOC to question the market's capacity to support such a strategy..." and create "conditions where crowded trades could be unwound quickly, with a systemic impact."). Another commenter suggested that we revise the question to allow reporting as of the end of the reporting period rather than over the course of the period and to permit advisers to report based on capital allocation rather than net asset value. *See* MFA Letter. We have revised the instructions to permit both these options. We have, however, also retained the requirement to report based on

frequency trading strategies.[222] Advisers must also report each hedge fund's significant counterparty exposures (including identity of counterparties).[223] In response to comments, we have modified the questions regarding counterparty exposures to clarify instructions and to reduce the reporting burden by more closely aligning the requirements with information already determined in connection with many contractual trading arrangements.[224]

Finally, section 1c requires information regarding each hedge fund's trading and clearing practices in Question 24 and activities conducted outside the securities and derivatives markets in Question 25. Some commenters supported the reporting required in Question 24.[225] However, one commenter expressed concern that the question as proposed would require burdensome manual aggregation.[226] In response, we have simplified this question by requiring a less detailed breakdown, removing the sub-classes

---

percentage of net asset value because we believe this will provide valuable information regarding leverage.

222 *See* Question 21 on Form PF. Some commenters suggested removing this question because, in their view, it would not provide information relevant to systemic risk assessment. *See, e.g.*, AIMA General Letter; MFA Letter. This information may, however, be important to understanding how hedge funds interact with the markets and their role in providing trading liquidity. We have modified the instructions to this question to make it easier for advisers to determine whether a particular fund is using a relevant strategy.

223 *See* Questions 22 and 23 on Form PF.

224 *See* MFA Letter. Specifically, these questions have been modified to (i) clarify that exposure should be mark-to-market exposure (rather than potential exposure), (ii) narrow the conditions under which affiliates are treated as a single counterparty group in order to track legal and contractual arrangements among the parties, (iii) focus on counterparties generally (rather than just trading counterparties), (iv) reference exposures before taking into account collateral postings and (v) be less prescriptive regarding the treatment of assets in custody and unsettled trades.

225 *See* AFL-CIO Letter; AFR Letter.

226 *See* MFA Letter.

of securities and derivatives included in the proposal. We expect that, by requiring less refinement in the categories of investments, these changes will reduce the burden of responding to this question. The revisions also align this question with the similar questions in the FSA Survey and ESMA's proposed reporting template.[227]

The information required in section 1c is designed to enable FSOC to monitor systemic risk that could be transmitted through counterparty exposure, track how different strategies are affected by and correlated with different market stresses, and follow the extent of private fund activities conducted away from regulated exchanges and clearing systems. This information could be important to understanding interconnectedness, which relates to the factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[228]

Several commenters agreed that some or all of the information required in section 1c would be valuable.[229] For instance, one commenter, referring to the counterparty information, argued that "[f]rom a systemic risk perspective, this is the most relevant information on the form, as it goes to the heart of the issue of connectivity."[230] Some of these questions, including those about significant trading counterparty exposures and trading and clearing practices, are based on the FSA Survey, and some of the changes from the proposal discussed above more closely align this section with the FSA Survey

---

[227] *See* ESMA Proposal, *supra* note 33.

[228] *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

[229] *See* AFL-CIO Letter; AFR Letter; MSCI Letter.

[230] *See* MSCI Letter; *infra* note 274.

and ESMA's proposed reporting template, which will promote international consistency in hedge fund reporting.[231]

2. *Section 2 of Form PF*

A private fund adviser must complete section 2 of Form PF if it had at least $1.5 billion in hedge fund assets under management as of the end of any month in the prior fiscal quarter.[232] This section of the Form requires additional information regarding the hedge funds these advisers manage, which we have tailored to focus on relevant areas of financial activity that have the potential to raise systemic concerns. This information corresponds to areas of potential concern that were identified in the Proposing Release and is designed to assist FSOC in monitoring and assessing the extent to which stresses at hedge funds could have systemic implications.

We are adopting Form PF with several changes to the information that advisers are required to report in section 2. These changes, which are discussed in detail below, are intended to respond to industry concerns while still providing FSOC the information it needs to monitor systemic risk across the hedge fund industry. In general, we expect that these changes will reduce the burden of responding to the Form and more closely align the Form with ESMA's proposed reporting template.

---

231 For example, ESMA's proposed reporting template would ask for identification of the hedge fund's top five counterparties in terms of net credit exposure. It would also ask for estimates of the percentage of the fund's securities or derivatives traded on a regulated exchange versus over the counter and the percentage of the fund's derivatives and repos cleared by a central clearing counterparty versus bilaterally. In addition, the template would require advisers to identify a predominant trading strategy using categories similar to those on Form PF. *See* ESMA Proposal, *supra* note 33.

232 *See* Instruction 3 to Form PF; *supra* section II.A.4 of this Release.

a. Section 2a of Form PF

Section 2a requires certain aggregate information about the hedge funds the adviser manages. For example, Question 26 requires the adviser to report the value of assets invested (on a short and long basis) in different types of securities and commodities (*e.g.*, different types of equities, fixed income securities, derivatives, and structured products). One commenter acknowledged the importance of collecting this information, agreeing that it "could feed a variety of possible systemic risk indices."[233] Some commenters, however, expressed concern regarding the amount of detail required in this question,[234] and the commenter who generally supported this question nonetheless thought the asset classes placed too much emphasis on asset backed securities when compared with other asset classes.[235] In response, the amount of detail regarding asset backed securities has been reduced so that the adviser need only provide a breakdown of mortgage backed securities, asset backed commercial paper, collateralized debt and loan obligations, other asset backed securities and other structured products.[236] We continue

---

233 MSCI Letter.

234 *See*, *e.g.*, ABA Committees Letter; MFA Letter.

235 *See* MSCI Letter.

236 This question has also been modified to separate foreign exchange derivatives used for investment from those used for hedging in response to a comment arguing that the proposed category should exclude foreign currency hedges. *See* MFA Letter. We have also added a category for physical real estate, which was not included in the FSA Survey but has been added in ESMA's proposed reporting template, in order to increase international consistency. *See* ESMA Proposal, *supra* note 33; *see also supra* note 31. In addition, following consultation with staff representing FSOC's members, we have separated investments in money market funds from other types of cash management funds and deposits from other types of cash equivalents. These changes are intended to provide additional detail regarding how cash equivalents are held because, at times of economic stress, these forms of holdings may have different implications for systemic risk.

to believe, however, that the remaining detail in this question is justified by the potential value of this information to FSOC's systemic risk monitoring activities.[237] One commenter suggested that, instead of the proposed categories of assets, we allow advisers to report based on GAAP classifications under FAS 157.[238] We do not believe this is a workable alternative because FAS 157 does not employ a standard set of asset classes, and the value of this information depends in part on the ability of regulators to make comparisons across funds.[239] We also believe that our approach is more consistent with international hedge fund reporting standards.[240]

Question 26 also requires the adviser to report the duration, weighted average tenor or 10-year bond equivalent of fixed income portfolio holdings (including asset backed securities). This differs from the proposal, which would have required all advisers to report duration. We are giving advisers the option of instead reporting weighted average tenor or 10-year bond equivalents because we understand from comments received that advisers use a wide range of metrics to measure interest rate sensitivity.[241] We expect that this revised approach will reduce the burden of reporting because advisers will generally be able to rely on their existing practices when providing this information. This approach may limit the ability of regulators to make comparisons

---

237 *See* Proposing Release, *supra* note 12, at text accompanying n. 120 for a discussion of potential uses for this data.

238 *See* MFA Letter (this comment letter refers only to GAAP categories, but the commenter clarified on a call with staff that it was referring to the classifications under FAS 157).

239 We note that nothing would prevent an adviser from relying on its classifications of assets for financial reporting purposes when completing Form PF to the extent that asset classes overlap.

240 *See* FSA Survey; ESMA Proposal, *supra* note 33.

241 *See* ABA Committees Letter; MFA Letter.

across advisers but will still yield valuable information about sensitivities to interest rate changes.[242]

Question 27 requires the adviser to report the value of turnover in certain assets classes (including listed equities, corporate bonds, sovereign bonds and futures) in the hedge funds' portfolios during the reporting period. This is intended to provide an indication of the adviser's frequency of trading in those markets and the amount of liquidity hedge funds contribute to those markets. The proposal would have required the adviser to calculate a single turnover rate for its entire hedge fund portfolio. However, commenters warned that this would prove difficult to calculate if an adviser trades in many different instrument types and, in particular, that the value of certain types of derivatives would overwhelm the influence of other instruments on the aggregate turnover number.[243] These commenters suggested instead that we ask for turnover by asset class, as was done in the FSA Survey (and, more recently, ESMA's proposed reporting template).[244] We found these comments persuasive and have revised the question to request turnover in targeted asset classes.[245]

---

[242] *See* MSCI Letter (arguing that duration information may not be valuable for making comparisons across the industry because there are many ways in which it may be calculated).

[243] *See* ABA Committees Letter; MFA Letter. Some commenters also argued that this question would not provide information valuable to monitoring systemic risk. *See, e.g.*, ABA Committees Letter; Fidelity Letter; SIFMA Letter. However, based on our consultation with staff representing FSOC's members, we believe that turnover will provide important insight into the role of hedge funds in providing trading liquidity in certain markets.

[244] *See* FSA Survey, *supra* note 32; ESMA Proposal, *supra* note 33.

[245] This is generally consistent with the international standards, though, unlike the FSA Survey and ESMA's proposed reporting template, we do not include derivatives (other

Question 27 has also been revised to request turnover data expressed as the value of transactions during the period rather than as a rate. This change has been made in order to make the data easier to compare to broader market data and to improve the comparability of the data with data that is or would be collected on the FSA survey and ESMA's proposed reporting template. In addition, we believe that the revised approach will be less burdensome for advisers than calculating the proposed portfolio turnover rate because advisers would have been required to determine the value of purchases and sales during the period as an intermediate step in calculating the portfolio turnover rate.[246]

Finally, in response to Question 28, the adviser must report a geographical breakdown of investments held by the hedge funds it advises.[247] This question has been modified from the proposal to require a less detailed breakdown (focusing on regions rather than countries) with additional, separate disclosure regarding investment in particular countries of interest. These changes are intended to respond to comments we received suggesting that advisers do not track this information in a manner consistent with our proposed, more granular geographical breakdown.[248] We anticipate that the

---

than futures) because we have focused on assets classes where we believe turnover is currently most likely to occur at rates that raise systemic concerns.

246 *See* the Proposing Release, *supra* note 12, for the proposed definition of "turnover rate" in the Glossary of Terms to Form PF.

247 *See* Question 28 on Form PF.

248 *See* ABA Committees Letter; MFA Letter. We have not, as one commenter suggested, used any particular service provider's methodology of categorizing geographical exposures because our staff understands, based on conversations with industry representatives, that there is no single methodology that hedge fund advisers employ. *See* MFA Letter (suggesting that we use "Bloomberg's country of risk methodology"). In response to commenter concerns, we have removed some of the instructions regarding how the location of investments should be determined and expanded Instruction 15 to explain that the numerator should be calculated in the same manner as gross asset value.

revised approach will reduce the burden of responding to this question because the less granular categories should allow more advisers to rely on their existing classifications.

The information required in section 2a is designed to assist FSOC in monitoring asset classes in which hedge funds may be significant investors and trends in hedge funds' exposures. In particular, it is intended to allow FSOC to identify concentrations in particular asset classes (or in particular geographic regions) that are building or transitioning over time. It will also aid FSOC in examining large hedge fund advisers' role as a source of liquidity in different asset classes. In some cases, section 2a requires that the information be broken down into categories that are designed to facilitate use in the FRB's flow of funds report, a tool that is used for evaluating trends in and risks to the U.S. financial system.[249] This information also is designed to address requirements under section 204(b)(3) of the Advisers Act specifying certain mandatory contents for records and reports that must be maintained and filed by advisers to private funds. For example, it will provide information about the types of assets held and trading practices.

One commenter expressed concern that advisers do not collect or calculate the exposure or turnover information that section 2a requires on a monthly basis or track

---

See MFA Letter. These changes allow advisers to rely on their internal methodologies and service provider reports in determining where to report investments and, by using gross asset value, rather than the more general value definition set out in Instruction 15, avoid the possibility that the reported value of certain derivative instruments would overwhelm the influence of other instruments. We have also added a "supranational" region, which is intended to capture investments that, because of their multinational scope, cannot meaningfully be placed in a single region.

249 *See supra* note 218 and *infra* note 475. For example, in some cases the data is required to be broken down between issuers that are financial institutions and those that are not. The FRB publishes flow of funds data on a quarterly basis.

geographical concentrations.[250] As discussed above, we are adopting section 2a with several changes that are designed to address commenters' concerns and reduce the reporting burden, though we continue to believe that monthly exposure and turnover values will be important to allow FSOC to track trends in the industry and to discourage "window dressing."[251] We acknowledge that advisers may incur additional burdens in responding to these questions, and we have taken this into account in considering the costs and benefits of this rulemaking.[252] The revised approach to the information required in section 2a strikes an appropriate balance between the burden imposed and need for the information.

b. Section 2b of Form PF

Consistent with our proposal, section 2b of Form PF requires a large hedge fund adviser to report certain additional information about any hedge fund it advises that has a net asset value of at least $500 million as of the end of any month in the prior fiscal quarter (a "qualifying hedge fund").[253] Two commenters disagreed with limiting

---

250 *See* ABA Committees Letter.

251 *See infra* notes 285-292 and accompanying text. *See also* Proposing Release, *supra* note 12, at text accompanying n. 120 for a discussion of potential uses for this data.

252 *See infra* sections IV.B and V of this Release (discussing increases in our burden and cost estimates in response to comments received).

253 *See* Instruction 3 to Form PF. An adviser is not required to complete section 2 with respect to a fund of hedge funds that satisfies the requirements described in Instruction 7 to Form PF. For purposes of determining whether a private fund is a qualifying hedge fund, the adviser must aggregate any parallel funds and funds that are part of the same master-feeder arrangement and, to the extent discussed above in section II.A.5 of this Release, any parallel managed accounts and relevant funds of related persons. *See* Instructions 5 and 6 to Form PF and the definition of "qualifying hedge fund" in the Glossary of Terms to Form PF. *See also infra* section II.C.5 of this Release for a discussion of parallel funds, master-feeder arrangements and aggregation for reporting

reporting on section 2b to hedge funds with net assets of $500 million or more, arguing that information regarding smaller funds is important to monitoring certain group behaviors relevant to systemic risk and that smaller funds are equally likely to engage in improper activities, such as insider trading.[254] Two other commenters argued for a higher threshold, suggesting that no fund of this size could be systemically important.[255] We are adopting the threshold as proposed because we believe it balances the needs of FSOC for information regarding relatively large hedge funds and the burdens of the more detailed reporting that section 2b requires.[256]

Also consistent with our proposal, Question 30 in section 2b requires reporting of the same information as that requested in section 2a regarding exposure to different types of assets except, in this case, the information is reported for each qualifying hedge fund, rather than on an aggregate basis. This question has been modified from the proposal in the same manner as Question 26.[257]

---

purposes. This aggregation is intended to prevent an adviser from structuring its activities to avoid the reporting requirements.

254 *See* AFL-CIO Letter; AFR Letter.

255 *See* Fidelity Letter (arguing that the FSA threshold of $500 million, upon which the qualifying hedge fund threshold used in the Form PF is based, should be scaled to $2.4 billion based on the relative size of equity markets in the United States and the United Kingdom); SIFMA Letter. As discussed above, these comments appear to be based on the mistaken premise that the thresholds are intended to establish a cutoff separating the risky from the safe. To the contrary, the reporting thresholds are intended only to ensure that FSOC has sufficient context for its analysis while minimizing the burden imposed on advisers. We understand based on our staffs' consultation with staff representing FSOC's members that, in order to assess potential systemic risk posed by the activities of certain funds, FSOC would benefit from access to data about funds that, on an individual basis, may not be a source of systemic risk.

256 In addition, certain of the information that would be obtained with respect to smaller hedge funds will already have been captured on an aggregate basis in section 2a.

257 *See supra* notes 233-242 and accompanying text for a discussion of those changes.

Section 2b also requires, on a per fund basis, data not requested in section 2a. For instance, the adviser must report information regarding the qualifying hedge fund's portfolio liquidity,[258] holdings of unencumbered cash[259] and concentration of positions.[260] These questions have been modified from the proposal to allow advisers to rely more on their own methodologies in responding, consistent with our changes to Instruction 15 to the Form, and to align the Form more closely with ESMA's proposed reporting template.

---

[258] *See* Question 32 on Form PF. This question requires reporting of the percentage of the fund's portfolio capable of being liquidated within different time periods. *See* Proposing Release, *supra* note 12, at text accompanying n. 124 for a discussion of potential uses for this data. We have modified the instructions to this question to address commenter concerns by allowing advisers to rely more on their own methodologies in responding. *See* CCMR Letter; MFA Letter. We have also conformed the liquidity periods to those included in ESMA's proposed reporting template. *See* ESMA Proposal, *supra* note 33. One commenter objected to the question more generally, saying that the data is not currently tracked in the manner required and many firms would need to "devote significant time and resources" to building models and systems. TCW Letter. Another commenter, however, supported this question, noting that "[t]his [information] is increasingly a request of hedge fund investors, particularly for comingled funds, where a given investor can be adversely impacted by a sudden large redemption by another party." MSCI Letter. We have taken into account both of these comments in considering the costs and benefits of this rulemaking and believe that the value of the information to FSOC warrants the potential burden imposed. *See infra* sections IV.B and V of this Release (discussing increases in our burden and cost estimates in response to comments received).

[259] *See* Question 33 on Form PF. In response to a comment we received, we have modified the definition of "unencumbered cash" to include the value of "overnight repos" used for liquidity management (so long as the assets purchased are U.S. treasury securities or agency securities) because we are satisfied that, for this purpose, the liquidity of these positions is sufficiently cash-like. *See* MFA Letter.

[260] *See* Questions 34 and 35 on Form PF. Question 34 requires the total number of open positions held by the fund, and Question 35 requires reporting, for each position that represents 5% or more of the fund's net asset value, of the position's portion of the fund's net asset value and sub-asset class. One commenter asked for clarification regarding the meaning of "position," as used in these questions and elsewhere in the Form. *See* MFA Letter. In response, we have added an instruction to the Form explaining that advisers should determine whether a set of legal and contractual rights constitutes a "position" in a manner consistent with their internal recordkeeping and risk management procedures. *See* Instruction 15 to Form PF. This general instruction also supplants the detailed instructions proposed in Question 35, which have, accordingly, been removed.

A new Question 31 has been added, which requires the adviser to identify the reporting fund's base currency because this information is necessary to interpret responses to questions regarding foreign exchange exposures and the effect of changes in currency rates on the reporting fund's portfolio.[261]

In Questions 36 through 38, the adviser must also provide information regarding the fund's collateral practices with counterparties.[262] These questions have been significantly modified from the proposal in order to reduce the amount of detail required, including by removing the breakdown of collateral into initial and variation margin. These changes were made because a commenter persuaded us that "[w]hile some of this information is potentially illuminating in the context of systemic risk... this section [as proposed] is more burdensome than it need be for its purpose."[263] We have also modified these questions by requiring information regarding rehypothecation only with respect to the fund's aggregate collateral (rather than on a counterparty-by-counterparty basis). Commenters persuaded us that, because collateral is often fungible, this question would have been difficult to answer as proposed and that the additional detail is unnecessary.[264] We anticipate that these changes will reduce the burden of responding to these questions.

Question 39 in section 2b also requires the adviser to report whether the hedge fund cleared any trades directly through a central clearing counterparty ("CCP") during

---

[261] *See also* Question 30, regarding reporting fund exposures, and Question 42, regarding the effect of changes in certain market factors on the fund's portfolio.

[262] Questions 36 and 37 focus on collateral practices with the fund's top five counterparties, and Question 38 focuses on rehypothecation of the fund's aggregate collateral.

[263] MSCI Letter.

[264] *See* MFA Letter; MSCI Letter.

the reporting period. The proposal would have required the adviser to identify the three CCPs to which the fund has the greatest net counterparty credit exposure and provide the amount of that exposure. The information this question requires has been significantly reduced because commenters argued persuasively that the fund's relationship is typically with a swap dealer, futures commission merchant or direct clearing member who then interacts with the CCP rather than directly with a CCP and that, as a result, advisers "may not have easy access to the data requested by this question."[265] If responses to the revised question indicate that many reporting funds clear transactions directly through CCPs, the Commissions may consider in the future whether a question like the one proposed should be added to the Form. The change to Question 39 will reduce the burden of responding to the Form.

The information that Questions 30 through 35 require is designed to assist FSOC in monitoring the composition of hedge fund exposures over time as well as the liquidity of those exposures. In addition, information reported in response to Questions 36 through 38 is intended to aid FSOC in its monitoring of credit counterparties' unsecured exposure to hedge funds as well as the hedge fund's exposure and ability to respond to market stresses. Finally, Question 39 is intended to assist FSOC in monitoring whether hedge funds and CCPs become increasingly interconnected over time. This information could be important to understanding, for instance, concentrations in the hedge fund industry and interconnectedness, which relate to the factors that FSOC must consider in

---

[265] MFA Letter; *see also* AIMA General Letter.

making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[266]

Section 2b also requires for each qualifying hedge fund data regarding certain hedge fund risk metrics. For instance, Question 40 requires the adviser to report value at risk ("VaR") for each month of the reporting period if, during the reporting period, the adviser regularly calculated a VaR metric for the qualifying hedge fund. One commenter confirmed that, "[f]or all but the most illiquid strategies, hedge fund managers utilize these statistical measures [VaR and similar measures] for internal management and for investor reporting."[267] We are adopting this question substantially as proposed but with several clarifying changes.[268]

In Question 41, the adviser must also indicate whether there are risk metrics other than, or in addition to, VaR that it considers important to managing the fund's risks. Several commenters, noting that some advisers do not use VaR, expressed concern that a negative response regarding the use of VaR would create a presumption that the adviser

---

266 *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

267 *See* MSCI Letter. This commenter, however, cautioned that variability in the calculation of VaR will make meaningful aggregation of this information difficult and suggested removing the question. As proposed, in order to minimize the reporting burden associated with this question, we are not requiring that all advisers calculate VaR using a standardized set of assumptions. Although this approach may, as the commenter suggested, reduce the ability of regulators to make comparisons across hedge funds using this data, we believe that it will also provide valuable risk information with respect to individual funds.

268 For instance, we have specified the units for reporting the confidence interval and weighting factor, combined the "none" and "equal" weighting options and clarified that the monthly reporting should be at the end of each month and not for the span of the month.

is not prudently managing risk.[269] This new question will give advisers an opportunity to indicate that they are using risk metrics other than VaR, and it will also provide valuable information regarding industry practice that may inform FSOC's understanding of risk management and future rulemakings.

In addition, Question 42 requires the adviser to report the impact on the fund's portfolio from specified changes to certain identified market factors, if regularly considered in formal testing in the fund's risk management, broken down by the long and short components of the qualifying hedge fund's portfolio. We are adopting this question with several changes from the proposal.[270] Most of the changes clarify the instructions, but the question has also been modified so that an adviser may omit a response to any market factor that it did not regularly consider in formal testing even if the factor could have an impact on the fund's portfolio or the adviser considered it qualitatively.[271] Under the proposal, an adviser would have been permitted to omit a response with respect to a market factor only if it did not regularly consider that factor in the reporting fund's risk management, whether in formal testing or otherwise. This change has been made in response to commenter concerns regarding the potential burden of responding to this

---

269 *See* IAA Letter; MFA Letter.

270 These include changes intended to clarify (1) how the fund's portfolio should be separated into long and short components, (2) the period over which the changes should be deemed to occur and (3) how to address factors that would otherwise become negative when a given change is applied. We have also modified the magnitude of some of the market factor changes that advisers must test in order to reflect recent data on the frequency with which such changes may occur.

271 For this purpose, "formal testing" means that the adviser has models or other systems capable of simulating the effect of a market factor on the fund's portfolio, not that the specific assumptions outlined in the question were used in testing. If the factor is relevant but not tested, the adviser would need to check a box to that effect but would not report a numerical response.

question.[272] We believe it will reduce that burden in the aggregate because fewer advisers will need to provide detailed responses and for individual advisers because those without existing quantitative models will not be required to build or acquire them in order to respond to the question.

Some commenters would have preferred removal of Question 42 entirely, arguing that it would not yield information valuable to systemic risk monitoring because the variability in responses would hinder the ability of regulators to make comparisons across funds.[273] However, although variability in the assumptions used to complete the question may limit certain types of industry-wide comparisons, the variability itself, when taken together with other information collected on the Form, may provide important comparative information. Based on our staffs' consultations with staff representing

---

272 *See, e.g.*, TCW Letter. This commenter wrote that "[a]n analyst at the firm estimated that it would take one to two days for the firm's systems to compute and verify the data for one fund's response to [this question]." Based on a discussion with this commenter, our staff understands that this estimate assumes that the fund holds securities that are very complex to model (such as non-agency mortgage backed securities) and that the modeling is intended to achieve a high level of confidence. Our staff further understands that for many other asset classes, this modeling would require minutes or hours rather than days and that, even for complex securities, advisers are able to obtain approximations about which they are reasonably confident in significantly less time. As a result, we believe that this commenter's estimate represents an effort significantly beyond the likely *average* burden this question requires. We also understand that the majority of the estimated one to two days represents time spent allowing the adviser's systems to calculate the responses and not employee hours. We note, finally, that we have significantly extended the filing deadline for large hedge fund advisers, reducing the likelihood that this task will compete with other tasks for the firm's computing resources and, consequently, the potential systems costs associated with this question. *See supra* section II.B.2 of this Release. Nonetheless, we have taken this comment into account in considering the costs and benefits of this rulemaking. *See infra* sections IV.B and V of this Release (discussing increases in our burden and cost estimates in response to comments received).

273 *See* IAA Letter; TCW Letter.

FSOC's members, we believe this question will also provide valuable risk information with respect to individual funds.[274]

Item D of section 2b also requires reporting of certain financing information for each qualifying hedge fund in Question 43. This question includes a monthly breakdown of the fund's secured and unsecured borrowing, the value of the collateral and other credit support posted in respect of the secured borrowing and the types of creditors. Question 43 has been modified from the proposal to clarify instructions and remove some of the detail regarding collateral postings (including information regarding rehypothecation of collateral, which is now covered on an aggregate basis elsewhere in section 2b).[275] We anticipate that these changes will reduce the burden of responding to this question. One commenter argued that advisers would have difficulty responding to the parts of Question 43 relating to the fund's borrowings via prime brokerage because they lack transparency into the prime brokerage relationship.[276] This comment suggests, however, that prime brokers do not currently report this information to advisers, not that advisers are unable to obtain this information on request. It should be noted that advisers have successfully completed the FSA Survey, which includes a similar breakdown of

---

[274] *See* Proposing Release, *supra* note 12, at text accompanying n. 127 (discussing potential uses for this data). One commenter suggested removing this question in favor of expanding the questions regarding counterparty exposures so that an adviser would complete those questions using multiple stress scenarios to probe for contingent exposures. *See* MSCI Letter; *see also supra* note 230. We believe at this time that the question we are adopting strikes a more appropriate balance between the value of the information collected and the burden of reporting.

[275] *See supra* note 264 and accompanying text.

[276] *See* MFA Letter.

borrowings (though not the collateral information), and that the revisions we have made to this question simplify the collateral reporting requirements.

An adviser must also report in Questions 44 and 45 the fund's total notional derivatives exposures as well as the net mark-to-market value of its uncleared derivatives positions and the value of the collateral and other credit support posted in respect of those uncleared positions. Under the proposal, advisers would have reported only the notional value of the fund's derivatives positions and the value of collateral posted in respect of those positions. One commenter pointed out, however, that the "absolute value of notional values cannot meaningfully be compared to variation margin amounts" because margin is posted based on net market values rather than notional amounts.[277] At this commenter's suggestion, this question has been revised to request both notional value and net market value. We have, however, narrowed the scope of transactions about which collateral information is requested. Specifically, an adviser is required to report market values and collateral values only for transactions that are not cleared by a CCP. We have taken this approach because we believe margining practices associated with cleared derivatives make obtaining information regarding collateral practices in connection with those transactions unnecessary. For the same reasons discussed above in connection with changes made to Questions 36 and 37, this question has been revised to reduce the amount of detail required regarding the posting of collateral.[278] We anticipate that these changes will, on net, reduce the burden of responding to Questions 44 and 45

---

[277] *See* MFA Letter.

[278] *See supra* notes 262-264 and accompanying text.

and, by allowing comparisons of collateral practices to net exposures, provide more valuable information for FSOC.

In response to Questions 46 and 47, the adviser must provide a breakdown of the term of the fund's available financing and the identity of, and amount owed to, each creditor to which the fund owed an amount equal to or greater than 5 percent of the fund's net asset value as of the reporting date.[279] One commenter argued that the breakdown of available financing should not include uncommitted lines of credit because the lender may not provide them on request.[280] However, the extent to which financing may become rapidly unavailable is precisely the information this question is designed to elicit. We are adopting Questions 46 and 47 substantially in the form proposed.[281]

The information that Item D of section 2b requires is designed to assist FSOC in monitoring, among other things, the qualifying hedge fund's leverage, the unsecured exposure of credit counterparties to the fund, and the committed term of that leverage, which may be important to monitor if the fund comes under stress. This information is also relevant to the fund's interconnectedness and leverage, which relate to factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[282]

---

279 To improve international consistency, we have conformed the liquidity periods in Question 46 to those included in ESMA's proposed reporting template. *See* ESMA Proposal, *supra* note 33. As explained above, we have moved Question 47 from section 1b to section 2b. *See supra* note 195.

280 *See* MFA Letter.

281 *But see, supra* note 279. We have also added an instruction to Question 47 clarifying that the precise legal name of the creditor is not required.

282 *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

Item E of section 2b requires the adviser to report information about each qualifying hedge fund's investor composition and liquidity. Questions 48 and 49, for example, require information regarding the fund's side-pocket and gating arrangements. These questions have been modified to increase their clarity and to require numerical responses regarding gating arrangements only if investors have withdrawal or redemption rights in the ordinary course, potentially reducing the number of advisers that need to respond to all elements of Question 49. Question 48 has also been expanded so that the adviser must check a box indicating whether additional assets have been placed in a side-pocket since the end of the prior reporting period. Without this additional information, FSOC would not be able to distinguish between advisers frequently using side-pockets and those who have simply had a side-pocket in place for an extended period. We believe, therefore, that this additional information will be important to interpreting the information proposed to be collected. We do not anticipate that this addition will significantly increase the burden of responding to this question because we believe that advisers already track assets held in side-pockets and the response only requires checking a box.

Finally, the adviser must provide, in Question 50, a breakdown of the percentage of the fund's net asset value that is locked in for different periods of time. This question has been modified from the proposal to clarify instructions and to improve international consistency by conforming the liquidity periods to those included in ESMA's proposed reporting template.[283]

---

[283] *See* ESMA Proposal, *supra* note 33.

The information that Item E of section 2b requires is designed to allow FSOC to monitor the hedge fund's susceptibility to failure through investor redemptions in the event the fund experiences stress due to market or other factors. For instance, this information, together with information collected in Questions 32 and 46 and elsewhere on the Form, is intended to assist FSOC in determining whether the fund may have a mismatch in the maturity or liquidity of its assets and liabilities, which relate to factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[284]

Certain data in the Form, while filed with the Commissions on an annual or quarterly basis, must be reported on a monthly basis to provide sufficiently granular data to allow FSOC to better identify trends and to mitigate "window dressing."[285] Nearly all of these requirements appear in section 2 of the Form, which only large hedge fund advisers complete. Although no commenters expressly supported the monthly data requirements within the Form, some commenters recommended that large advisers be required to file more often than quarterly, which could impose a greater burden than monthly reporting on a quarterly filing.[286] Several commenters, however, suggested that advisers should only report data as of the end of the quarterly reporting period.[287] One commenter, while conceding that some funds already report certain data to investors on a

---

284 *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

285 *See, e.g.*, Questions 27, 28, 31, 33, 34, 43, 44, 45 and 56 on Form PF.

286 *See* AFL-CIO Letter; AFR Letter. *See also* CII Letter.

287 *See, e.g.*, BlackRock Letter (arguing that data should be provided, at most, on a quarterly basis); Fidelity Letter; MFA Letter; SIFMA Letter (proposing that reporting be no more frequent than quarterly, at least for private equity fund advisers).

monthly basis, asserted that such monthly reporting involves significantly less data and is based on internal valuation estimates only.[288] Other commenters doubted that advisers would engage in "window dressing" and argued that the increased costs to advisers would outweigh the benefits.[289]

Based on our staffs' consultations with staff representing FSOC's members, we agree with commenters who argued that rapidly changing markets and portfolios merit collecting certain information more often than on a quarterly basis, and we are not persuaded that the large hedge fund and large liquidity fund advisers required to respond to these questions will be overwhelmed by this reporting. Also, as discussed above, we have made several changes that increase the ability of advisers to rely on their own internal methodologies in responding to the Form, which is expected to ease the burden of reporting monthly information by clarifying that advisers need not incur substantial additional burdens in verifying the data.[290] Finally, the monthly data about which commenters were most concerned were the monthly performance data proposed to be collected in section 1b of the Form.[291] Question 17 has, however, been modified to require monthly data only in the case that the adviser is already calculating it, making the reporting burden essentially one of copying information onto the Form.[292] Accordingly,

---

288 *See* BlackRock Letter.

289 *See, e.g.*, Fidelity Letter; MFA Letter.

290 *See supra* note 188 and text accompanying.

291 *See* Question 17 on Form PF; *supra* section II.C.1.b of this Release.

292 *See supra* nn. 198-202 and accompanying text.

except as discussed above, we are adopting the requirements to report monthly information as proposed.

3. *Section 3 of Form PF*

A private fund adviser must complete section 3 of Form PF if it manages one or more liquidity funds and had at least $1 billion in combined liquidity fund and registered money market fund assets under management as of the end of any month in the prior fiscal quarter.[293] Section 3 requires that the adviser report certain information for each liquidity fund it manages. The adviser must provide information regarding the fund's portfolio valuation and its valuation methodology, as well as the liquidity of the fund's holdings.[294] This section also requires information regarding whether the fund, as a matter of policy, is managed in compliance with certain provisions of rule 2a-7 under the Investment Company Act, which is the principal rule through which the SEC regulates registered money market funds.[295] Items B and C of section 3 require the adviser to report the amount of the fund's assets invested in different types of instruments,

---

293 *See* sections II.A.2 and II.B.4 of this Release for the definition of "liquidity fund" and a discussion of this reporting threshold. *See also* Instructions 3, 5 and 6 to Form PF. Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the form. Section 3 of the form, which requires more specific reporting regarding liquidity funds, is only required by the SEC.

294 *See* Questions 52, 53 and 55 on Form PF. The SEC has modified the instructions to Question 55 to clarify the units in which responses are to be reported and to clarify that the net asset value requested in parts (a) and (b) of Question 55 is the net asset value reported to current and prospective investors, which may or may not be the same as the net asset value reported in Questions 9 and 55(c), which are based on fair value.

295 *See* Question 54 of Form PF. The restrictions in rule 2a-7 are designed to ensure, among other things, that money market funds' investing remains consistent with the objective of maintaining a stable net asset value. Many liquidity funds state in investor offering documents that the fund is managed in compliance with Investment Company Act rule 2a-7 even though that rule does not apply to liquidity funds.

information for each open position of the fund that represents 5 percent or more of the fund's net asset value and information regarding the fund's borrowings.[296] Finally, Item D of section 3 asks for certain information regarding the fund's investors, including the concentration of the fund's investor base and the liquidity of its ownership interests.[297]

The information that section 3 requires is designed to assist FSOC in assessing the risks undertaken by liquidity funds, their susceptibility to runs, and how their investments might pose systemic risks either among liquidity funds or through contagion to registered money market funds. In addition, this information is intended to aid FSOC in monitoring leverage practices among liquidity funds and their interconnectedness to securities lending programs, which relate to factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[298] Finally, this information will assist FSOC in assessing the extent to which the liquidity fund is being managed consistent with restrictions imposed on registered money market funds that might mitigate their likelihood of posing systemic

---

296 *See* Questions 56-59 on Form PF. The SEC has modified these questions from the proposal by removing instructions that have been supplanted by general instructions. *See* Instruction 15 to Form PF.

297 *See* Questions 60-64 on Form PF. 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)). The SEC has made clarifying changes to the instructions to Question 64. To improve international consistency, the SEC has also conformed the liquidity periods in Question 64 to those included in ESMA's proposed reporting template. *See* ESMA Proposal, *supra* note 33.

298 *See* section 113(a) of the Dodd-Frank Act; FSOC Second Notice, *supra* note 6.

risk. Commenters generally did not address the requirements of section 3, and the SEC is, therefore, adopting this section of the Form substantially as proposed.[299]

4. Section 4 of Form PF

A private fund adviser must complete section 4 of Form PF if it had at least $2 billion in private equity fund assets under management as of the end of its most recently completed fiscal year.[300] This section of the Form requires additional information regarding the private equity funds these advisers manage, which has been tailored to focus on relevant areas of financial activity that have the potential to raise systemic concerns. As discussed in the Proposing Release, information regarding the activities of private equity funds, certain of their portfolio companies and the creditors involved in financing private equity transactions may be important to the assessment of systemic risk.[301] The Proposing Release identified two practices of private equity funds, in particular, that could result in systemic risk: (1) the potential shift of market risk to lending institutions when bridge loans cannot be syndicated or refinanced;[302] and (2) the

---

299 The SEC received only one comment specifically addressing the requirements of section 3, which questioned whether requiring information regarding investor liquidity is appropriate considering the focus of liquidity funds on short-term investments. *See* MFA Letter. The SEC continues to believe that this information is important to understanding whether a fund may suffer a mismatch between the maturity of its obligations and the maturity of its investments and is, therefore, adopting this question substantially as proposed. *But see, supra* note 297.

300 *See* Instruction 3 to Form PF. *See also* sections II.A.3 and II.B.4 of this Release for the definition of "private equity fund" and a discussion of this reporting threshold. Form PF is a joint form between the SEC and the CFTC only with respect to sections 1 and 2 of the form. Section 4 of the form, which requires more specific reporting regarding private equity funds, is only required by the SEC.

301 *See* Proposing Release, *supra* note 12, at section II.A.3.

302 *See* Proposing Release, *supra* note 12, at nn. 71-73 and accompanying text.

imposition of substantial leverage on portfolio companies that may themselves be systemically significant.[303]

Several commenters agreed that the activities identified in the Proposing Release are important areas of concern for monitoring systemic risk with respect to private equity funds.[304] Other commenters, however, disagreed with the analysis, arguing that private equity funds and their advisers do not have the potential to pose systemic risk.[305] These commenters affirmed that certain characteristics identified in the Proposing Release, including limitations on investor redemption rights and an absence of significant leverage at the fund level, are common to private equity funds and tend to mitigate their potential for systemic risk.[306]

The SEC acknowledges that several potentially mitigating factors suggest that private equity funds may have less potential to pose systemic risk than some other types of private funds, and this has been taken into account in requiring substantially less

---

303 *See* Proposing Release, *supra* note 12, at nn. 74-75 and accompanying text.

304 *See, e.g.*, AFL-CIO Letter (pointing to evidence that the use of so-called "covenant-lite" loans is again expanding); CPIC Letter (noting the importance of gathering information about all types of entities using leverage and asserting that, "the Commission should not be pressured to scale back further or provide broad exemptions for private equity funds."); Merkl February Letter. *See also* Proposing Release, *supra* note 12, at n. 73 and accompanying text (discussing risks associated with "covenant-lite" loans).

305 *See, e.g.*, Olympus Letter; PEGCC Letter (contending that private equity funds are like any other shareholders and that they should not be singled out for "a discriminatory and onerous reporting regime designed to monitor how their portfolio companies use leverage."); SIFMA Letter.

306 *See, e.g.*, Olympus Letter; PEGCC Letter; SIFMA Letter. These commenters also noted that these funds typically focus on long-term investments and are legally isolated from the financial obligations of portfolio companies and other funds. They also asserted that private equity funds and their investments tend to be relatively small and are not interconnected. *See also* Proposing Release, *supra* note 12, at n. 77 and accompanying text.

information with respect to private equity funds than with respect to hedge funds or liquidity funds. The design of Form PF, however, is not intended to reflect a determination as to where systemic risk exists but rather to provide empirical data to FSOC with which it may make a determination about the extent to which the activities of private equity funds or their advisers pose such risk.[307] Based on SEC staff's consultation with staff representing FSOC's members, the SEC continues to believe that targeted information regarding private equity leverage practices may be important to FSOC's monitoring of systemic risk.[308]

One commenter argued that, if the SEC is concerned only with the use of leverage, the information could be gathered more effectively from the financial institutions that lend the money or, in the case of leveraged portfolio companies that are themselves financial institutions, incur the debt.[309] Staff representing FSOC's members has explained to the SEC's staff, however, that collecting leverage data from private

---

[307] One industry observer has explained the importance of transparency in allowing regulators to examine where risks may exist in the alternative investment industry, arguing that, "[r]egulation has to aim at trying to prevent the next crisis, not simply cleaning up the mess from the previous one. It may indeed be the case that the alternative investment industry is too small and/or is leveraged at too low a level, at least relative to average bank sector leverage, to be a likely source of future systemic harm but the opacity issue, which has for a long time hampered supervisors' efforts to understand the industry's significance, makes this hard to tell. Requiring the industry to submit at least to disclosure and transparency obligations that help regulators and central banks do a better job of identifying systemic risk concentrations in the system is a reasonable step forward. Resistance to the imposition of obligations of this sort would merely serve to suggest that there is something to hide." Eilis Ferran, *The Regulation of Hedge Funds and Private Equity: A Case Study in the Development of the EU's Regulatory Response to the Financial Crisis*, University of Cambridge and European Corporate Governance Institute (Feb. 2011).

[308] *See* Proposing Release, *supra* note 12, at section II.A.3.

[309] *See* PEGCC Letter.

equity advisers has several potential advantages. First, it provides a more complete accounting than other data sources of the leverage that may have been imposed on portfolio companies. Although portfolio companies may take on leverage through financial institutions regulated in the United States, they may also incur leverage from other sources, including hedge funds and foreign financial institutions. As a result, portfolio company leverage information collected through U.S. bank regulators would likely provide an incomplete picture and may fail to capture trends with potential systemic importance, such as greater reliance on leverage obtained from outside the regulated financial sectors or from foreign sources. Even if regulators are only concerned about the risks that a portfolio company's debt may impose on financial institutions, those risks cannot be fully understood without information regarding the company's entire balance sheet, including debt from other sources.

Second, because the SEC understands that private equity advisers routinely track the leverage of their portfolio companies, collecting data directly from these advisers is likely to be the most efficient means of monitoring portfolio company leverage. In contrast, obtaining portfolio company leverage information through bank regulators could be less efficient because (1) banks are less likely to be actively tracking leverage information specifically attributable to portfolio companies, (2) bank regulators do not have a single collection mechanism for this data and (3) data may need to be aggregated across several different bank regulators.

Third, collecting leverage data from private equity advisers would fill gaps in the data that could appear if FSOC were to attempt aggregating information from many different U.S. bank regulators. It also provides a check on any data that may be collected

from other sources. Indeed, other types of information that the SEC collects from investment advisers has already proven valuable in cross-checking data that bank regulators collect.[310]

Fourth, FSOC has stated that it is concerned that leveraged lending practices can raise systemic risk concerns.[311] Private equity advisers are repeat participants in the leveraged loan market (often more so than other types of companies that access credit through these markets), and tracking their portfolio company leverage practices can signal trends in emerging risks in those markets. Indeed a recent study found that the private equity fund sponsors' bank relationships were an important factor in explaining the favorable loan terms obtained by private equity portfolio companies, both as a result of the private equity sponsor's repeat interactions reducing information asymmetries and the competition among banks to cross-sell other business to the private equity sponsor.[312] This empirical data suggests that collecting data on private equity portfolio company leverage trends in fact may be the most efficient way to collect systemic risk trend data for the broader leveraged loan market because private equity portfolio companies' practices in this area may be a bellwether due to their sponsors' repeat player status. In

---

310 The SEC's Form N-MFP, for instance, has provided a valuable check against information that banking regulators collect with respect to portfolio holdings of registered money market funds.

311 *See* FSOC 2011 Annual Report, supra note 19, at 12 ("Although it is difficult to make definitive determinations regarding the appropriateness of risk pricing, there have been some indicators that credit underwriting standards might have overly eased in certain products, such as leveraged loans, reflecting the dynamics of competition among arranging bankers. …Sound underwriting standards, which were abandoned in the run-up to the crisis, will encourage greater investor confidence and stability in the market")

312 *See* Victoria Ivashina & Anna Kovner, *The Private Equity Advantage: Leveraged Buyout Firms and Relationship Banking*, 24 REV. OF FIN. STUDIES 7 (July 2011).

addition, this approach appears consistent with an emerging international approach favoring broad monitoring of credit intermediation across the economy.[313]

The SEC is, however, adopting Form PF with several significant changes that reduce the frequency of reporting with respect to private equity funds, as discussed above, and more closely align the required reporting with information available on portfolio company financial statements. These changes, which are discussed in detail below and in section II.B of this Release, are intended to respond to industry concerns while still providing FSOC the information it needs to monitor the potential for systemic risk across the private fund industry. In general, we expect that these changes will reduce the burden of responding to the Form.

Section 4 requires that large private equity advisers report certain information for each private equity fund they manage, including certain information about guarantees of portfolio company obligations and the leverage of the portfolio companies that the fund controls. Specifically, Question 66 requires information about the amount of guarantees that the adviser, the reporting fund or any other related person of the adviser issues in respect of a portfolio company's obligations.[314] Questions 67 through 70 require the

---

313 *See* FSB Shadow Banking Report, *supra* note 28; ESMA Proposal, *supra* note 33; Proposing Release, *supra* note 12, at n. 33. *See also* CPIC Letter (affirming the importance of gathering information about all types of entities using leverage).

314 Following consultation with staff representing FSOC's members, we have broadened the scope of this question to capture guarantees from the adviser and its related persons rather than just those from the reporting fund. This change is intended to allow FSOC and other regulators to confirm broadly whether the adviser or the reporting fund has direct or indirect exposure to the liabilities of portfolio companies in excess of the amounts of their investments. In addition to Question 66, the proposal included a separate question regarding the fund's borrowings, but a commenter pointed out that this substantially duplicated the information requested in Question 13 on Form PF, so the proposed question is not being adopted. *See* comment letter of George Merkl (Mar. 23, 2011). *See*

adviser to report: (1) the weighted average debt-to-equity ratio of controlled portfolio companies in which the fund invests, (2) the range of that debt-to-equity ratio among these portfolio companies and (3) the aggregate gross asset value of these portfolio companies.[315]

In addition, Questions 71 and 72 ask for the total amount of borrowings categorized as current liabilities and as long-term liabilities on the most recent balance sheets of the fund's controlled portfolio companies. These questions replace the question that the SEC proposed, which would have required advisers to report the maturity profile of the debt of its private equity funds' controlled portfolio companies.[316] This change has been made in response to commenter concerns regarding the burden of gathering the data

---

also the Proposing Release, *supra* note 12, for the proposed version of Question 57 on Form PF.

[315] A "controlled portfolio company" is defined as a portfolio company that is controlled by the private equity fund, either alone or together with the private equity fund's affiliates or other persons that are, as of the reporting date, part of a club or consortium investing in the portfolio company. "Control" has the same meaning as used in Form ADV and generally means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract, or otherwise. *See* Glossary of Terms to Form PF; Glossary of Terms to Form ADV. One commenter suggested the average ratio required in Question 68 would be unreliable because it depends on accounting methodologies, which may vary. *See* PEGCC Letter. While this measure may have its limitations, the SEC believes, based on its staff's consultations with staff representing FSOC's members, that this question will provide an important indication of portfolio company leverage and is not aware of an alternative that would yield more reliable information without imposing additional burdens on advisers. Question 70, regarding the aggregate gross asset value of the reporting fund's controlled portfolio companies, has been added to provide a measure of scale as context for interpreting the average leverage ratio. An adviser must already know this information in order to calculate the average leverage ratio, so the SEC does not expect this addition to meaningfully increase the reporting burden.

[316] *See* the Proposing Release, *supra* note 12, (discussing the proposed version of Question 62 on Form PF).

that would have been required to respond to the question as proposed.[317] The SEC anticipates that these changes will reduce the burden of responding to these questions because less information is required and the information will be readily available on the financial statements of the fund's controlled portfolio companies.

In response to Questions 73 and 74, the adviser must report the portion of the controlled portfolio companies' borrowings that is payment-in-kind or zero coupon,[318] and whether the fund or any of its controlled portfolio companies experienced an event of default on any of its debt during the reporting period.[319] In addition, Question 75 requires the adviser to provide the identity of the institutions providing bridge financing to the adviser's controlled portfolio companies and the amount of that financing. Question 76 requires certain information if the fund controls any financial industry portfolio company, such as the portfolio company's name, its debt-to-equity ratio, and the percentage of the portfolio company beneficially owned by the fund.[320] Question 79 requires the adviser to

---

317 *See* IAA Letter.

318 *See* Question 73 on Form PF. One commenter argued that the SEC should not include this question because it has not identified any systemic risk associated with this type of indebtedness. *See* PEGCC Letter. The indebtedness in question, however, allows the borrower to increase its leverage by deferring interest payments (all at a time subsequent to the creditors making their credit determinations) and may result in additional risk being shifted to systemically important financial institutions or other holders of the debt.

319 *See* Question 74 on Form PF. One commenter suggested this question should cover only controlled portfolio companies rather than all of the fund's portfolio companies, and the SEC has made this change. *See* ABA Committees Letter; *see also infra* discussion accompanying notes 324-327. This commenter also suggested that potential events of default that have not ripened into events of default should not require an affirmative response, and the SEC has modified the instructions to this address this comment.

320 A "financial industry portfolio company" generally is defined as a nonbank financial company, as defined in the Dodd-Frank Act, or a bank, savings association, bank holding company, financial holding company, savings and loan holding company, credit union, or other similar company regulated by a federal, state or foreign banking regulator. *See*

report whether any of its related persons co-invest in any of the fund's portfolio companies.

The information that Question 66 requires is intended to provide FSOC information regarding the exposure of large private equity advisers and their funds to the risks of their portfolio companies. The information that Questions 67 through 76 require is designed to allow FSOC to assess the potential exposure of banks and other lenders to the portfolio companies of funds managed by large private equity advisers and to monitor whether trends in those areas could have systemic implications. Information reported in response to Question 76 is also intended to allow FSOC to monitor investments by the funds of large private equity advisers in companies in the financial industry that may be particularly important to the stability of the financial system.

Finally, Questions 77 and 78 require a breakdown of the fund's investments by industry and by geography.[321] Two commenters suggested removing these questions, arguing that the value of the information would not exceed the burden of reporting it.[322] Regulators, however, will be able to use this information to monitor global and industry

---

Glossary of Terms to Form PF. One commenter suggested this question should cover only controlled portfolio companies rather than all of the fund's portfolio companies, and the SEC has made this change. *See* ABA Committees Letter; *see also* IAA Letter; *see also infra* discussion accompanying notes 324-327. The SEC has added a requirement to report the gross asset value of each financial industry portfolio company to provide a measure of scale as context for interpreting the leverage ratio. This information should be readily available on portfolio company financial statements, so the SEC does not expect this addition to meaningfully increase the reporting burden.

[321] The SEC has modified the instructions to these questions to reflect clarifications suggested by a commenter. *See* Merkl February Letter. Question 78, which requires a geographical breakdown of investments in portfolio companies, has also been modified for reasons discussed above. *See supra* note 247 and accompanying text.

[322] *See* Merkl February Letter; PEGCC Letter.

concentrations among private equity funds, and concentration is one of the factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision under the Dodd-Frank Act.[323] In addition, the information required is largely based on the financial statements of the controlled portfolio companies and, therefore, should be readily available to the adviser.

Most of the reporting in section 4 relates to portfolio companies because the SEC understands that leverage in private equity structures is generally incurred at the portfolio company level. This reporting is limited to *controlled* portfolio companies, rather than portfolio companies generally, to ensure that advisers are able to obtain the relevant information without incurring potentially substantial additional burdens. Several commenters suggested, however, that the proposed standard of "control" was too low, leaving advisers responsible for reporting information they may not be entitled to access.[324] The SEC is not persuaded that advisers are likely to have such difficulty obtaining the information required concerning controlled portfolio companies because the majority of this information is available from the financial statements of the portfolio companies or relates to the fund's own investments in the portfolio companies.[325] In

---

[323] *See* section 113(a) of the Dodd-Frank Act.

[324] *See, e.g.*, ABA Committees Letter (suggesting instead "a standard of majority voting control"); IAA Letter (asserting that an adviser may not have access to some of the required data "even if the fund owns 50% or more of such portfolio company"); PEGCC Letter. *See supra* note 315 (discussing the definition of "control.)"

[325] Advisers may not know the North American Industry Classification System, or NAICS, codes for its controlled portfolio companies, but this information should be readily obtainable from the company. The details regarding bridge loans required in Question 75 on the Form may not be available directly from a controlled portfolio company's financial statements, but it is likely either that the adviser was involved in arranging or consenting to the loans (because the loans were an important part of the fund's

addition, modifications from the proposal have replaced a requirement for information that may not have been available on portfolio company financial statements with a requirement for information that will appear on any audited portfolio company's financial statements.[326] Accordingly, the SEC is adopting the definition of "controlled portfolio company" substantially as proposed.[327]

Two commenters supported collecting the information proposed to be required in section 4.[328] However, they also argued that the required reporting should not be restricted to controlled portfolio companies but should extend to all of the fund's portfolio companies. In their view, the largest portfolio companies are the least likely to have a controlling shareholder and the most likely to pose systemic risk. The SEC is sensitive to this concern but believes at this time that requesting information regarding all portfolio companies would increase the difficulty of responding to section 4 without a sufficiently large corresponding increase in the value of the data collected.

5. Aggregation of Master-Feeder Arrangements, Parallel Fund Structures and Parallel Managed Accounts

For purposes of reporting information on Form PF, an adviser may provide information regarding master-feeder arrangements and parallel fund structures in the

---

investment in the company or because they were incurred after the fund obtained a controlling interest in the company) or were the subject of the fund's due diligence prior to investing in the company.

326 *See supra* note 317 and accompanying text.

327 The SEC has, however, made one change to this definition, which clarifies that whether a group is a club or consortium for this purpose should be determined as of the reporting date. In other words, the adviser need not aggregate the control rights of another fund with those of its own solely because, at some point prior to the reporting date, such as the date of acquisition, they formed a club or consortium.

328 *See* AFL-CIO Letter; AFR Letter.

aggregate or separately, provided that it does so consistently throughout the Form.[329] For example, an adviser may complete either a single section 1b for all of the funds in a master-feeder arrangement or a separate section 1b for each fund in the arrangement. Any adviser choosing to aggregate funds in the reporting must check the "yes" box in Question 6 or Question 7, as applicable, and, in the case of Question 7, provide the additional information required with respect to the other funds in the parallel fund structure.[330] Advisers are not required to report information regarding parallel managed accounts other than to complete Question 11 in section 1b of the Form.[331]

These aggregation requirements have been modified from the proposal, which would have required advisers to report aggregated information regarding master-feeder arrangements and parallel managed accounts but separate information regarding parallel funds. One commenter recommended that "the Commissions instead provide managers with flexibility to provide information about private funds in a manner that best represents the activities of their funds and is consistent with their internal reporting procedures, while providing complete information to regulators."[332] We are persuaded that requiring advisers to aggregate or disaggregate funds in a manner inconsistent with

---

[329] *See* Instructions 5 and 6 to Form PF. The aggregation requirements for reporting purposes differ from the aggregation requirements for determining whether the adviser or any fund meets a reporting threshold. *See supra* section II.A.5. A "parallel fund structure" is a structure in which one or more private funds pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as another private fund. *See* Glossary of Terms to Form PF. A "master-feeder arrangement" is an arrangement in which one or more funds ("feeder funds") invest all or substantially all of their assets in a single private fund ("master fund").

[330] *See also supra* note 193 and accompanying text.

[331] *See* Instructions 5 and 6 to Form PF. *See also supra* note 197.

[332] MFA Letter.

their internal recordkeeping and reporting may impose additional burdens and that, so long as the structure of those arrangements is adequately disclosed, a prescriptive approach to aggregation is not necessary.

With respect to parallel managed accounts, commenters encouraged us not to require aggregation for reporting purposes or at least limit the questions that require advisers to aggregate parallel managed accounts for reporting purposes.[333] In particular, these commenters argued that aggregating these funds for reporting purposes would be difficult and "result in inconsistent and misleading data" because their characteristics are often somewhat different from the funds with which they are managed.[334] We are persuaded that including parallel managed accounts in the reporting may reduce the quality of data while imposing additional burdens on advisers. As a result, the instructions have been revised so that advisers are not required to aggregate parallel managed accounts with their private funds for reporting purposes.[335] A question has, however, been added to the Form requiring advisers to report the total amount of parallel managed accounts related to each reporting fund.[336] This will allow FSOC to take into account the greater amount of assets an adviser may be managing using a given strategy for purposes of analyzing the data reported on Form PF.

---

333 *See*, *e.g.*, IAA Letter; TCW Letter. One commenter agreed that the proposal appropriately required reporting on parallel managed accounts. *See* AIMA General Letter. For the reasons discussed below, however, we are persuaded that the better approach is not to require aggregation of these accounts for reporting purposes.

334 IAA Letter. *See also* MFA Letter.

335 *See* Instructions 5 and 6 to Form PF. The approach we are adopting is also similar to the approach used in the FSA Survey, which asks for only limited information regarding "strategy assets." *See* IAA Letter.

336 *See* question 12 of Form PF.

D. Confidentiality of Form PF Data

Form PF elicits non-public information about private funds and their trading strategies, the public disclosure of which could adversely affect the funds and their investors. The SEC does not intend to make public Form PF information identifiable to any particular adviser or private fund, although the SEC may use Form PF information in an enforcement action. The Dodd-Frank Act amends the Advisers Act to preclude the SEC from being compelled to reveal this information except in very limited circumstances.[337] Similarly, the Dodd-Frank Act exempts the CFTC from being compelled under FOIA to disclose to the public any information collected through Form PF and requires that the CFTC maintain the confidentiality of that information consistent with the level of confidentiality established for the SEC in section 204(b) of the Advisers Act.[338] The Commissions will make information collected through Form PF available to FSOC, as the Dodd-Frank Act requires, subject to the confidentiality provisions of the Dodd-Frank Act.[339]

The Dodd-Frank Act contemplates that Form PF data may also be shared with other Federal departments or agencies or with self-regulatory organizations, in addition to the CFTC and FSOC, for purposes within the scope of their jurisdiction.[340] In each case, any such department, agency or self-regulatory organization would be exempt from being

---

337 *See* Proposing Release, *supra* note 12, at n.39.

338 Form PF data is filed with the SEC, and made available to the CFTC, pursuant to section 204(b) of the Advisers Act, making this data subject to the confidentiality protections applicable to data required to be filed under that section.

339 *See* section 204(b) of the Advisers Act.

340 *See* section 204(b)(8)(B)(i) of the Advisers Act.

compelled under FOIA to disclose to the public any information collected through Form PF and must maintain the confidentiality of that information consistent with the level of confidentiality established for the SEC in section 204(b) of the Advisers Act.[341] Prior to sharing any Form PF data, the SEC also intends to require that any such department, agency or self-regulatory organization represent to us that it has in place controls designed to ensure the use and handling of Form PF data in a manner consistent with the protections established in the Dodd-Frank Act.[342]

Certain aspects of the Form PF reporting requirements also help to mitigate the potential risk of inadvertent or improper disclosure. For instance, because data on Form PF generally could not, on its own, be used to identify individual investment positions, the ability of a competitor to use Form PF data to replicate a trading strategy or trade against an adviser is limited.[343] In addition, the deadlines for filing Form PF have, in most cases, been significantly extended from the proposal.[344] Some commenters

---

341 *See* sections 204(b)(9) and (10) of the Advisers Act.

342 This would be consistent with the SEC's current practice of requiring that it receive, prior to sharing nonpublic information with other regulators, "such assurances of confidentiality as the [SEC] deems appropriate." *See* section 24(c) of the Exchange Act and rule 24c-1 thereunder.

343 Questions 26, 30, 35 and 57 on Form PF ask about exposures of the reporting fund but require only that the adviser identify the exposure within broad asset classes, not the individual investment position. Large private equity advisers must identify any financial industry portfolio companies in which the reporting fund has a controlling interest, but these investments are likely to be in private companies whose securities are not widely traded (and, therefore, do not raise the same trading concerns) or in public companies about which information regarding significant beneficial owners is already made public under sections 13(d) and 13(g) of the Exchange Act.

344 *See supra* section II.B.2 of this Release (discussing filing deadlines).

supported these extensions in part because filings will, as a result, generally contain less current, and therefore less sensitive, data.[345]

In addition, our staff is working to design controls and systems for the use and handling of Form PF data in a manner that reflects the sensitivity of this data and is consistent with the confidentiality protections established in the Dodd-Frank Act. As discussed below, this will include programming the Form PF filing system with appropriate confidentiality protections.[346] For instance, SEC staff is studying whether multiple access levels can be established so that SEC employees are allowed only as much access as is reasonably needed in connection with their duties.

Several commenters confirmed that the information collected on Form PF is competitively sensitive or proprietary and emphasized the importance of controls for safekeeping.[347] These commenters also made several recommendations for protecting the data, including: (1) storing identifying information using a code;[348] (2) limiting the ability to transfer Form PF data by email or portable media;[349] (3) limiting access to personnel who "need to know";[350] (4) extending filing deadlines so the data contains less current information;[351] and (5) sharing the data with other regulators only in aggregated and

345 *See infra* note 351 and accompanying text.

346 *See infra* section II.E of this Release.

347 *See, e.g.*, ABA Committees Letter; AIMA General Letter; CPIC Letter; MFA Letter; SIFMA Letter.

348 ABA Committees Letter; Kleinberg General Letter; Seward Letter.

349 ABA Committees Letter.

350 *Id.*

351 AIMA General Letter; Kleinberg General Letter.

anonymous form.[352] As discussed above, the deadlines for filing Form PF have, in most cases, been significantly extended from the proposal.[353] SEC staff is also carefully considering the other recommendations of commenters in designing controls and systems for Form PF.

In advance of the compliance date for Form PF, SEC staff will review the controls and systems in place for the use and handling of Form PF data.[354] Depending on the progress at that time toward the development and deployment of these controls and systems, the SEC will consider whether to delay the compliance date for Form PF.

E. Filing Fees and Format for Reporting

Under Advisers Act rule 204(b)-1(b), Form PF must be filed through an electronic system designated by the SEC for this purpose. On September 30, 2011, the SEC issued notice of its determination that the Financial Industry Regulatory Authority ("FINRA") will develop and maintain the filing system for Form PF as an extension of the existing Investment Adviser Registration Depository ("IARD").[355] This filing system will have certain features, including being programmed to reflect the heightened confidentiality protections created for Form PF filing information under the Dodd-Frank Act and allow for secure access by FSOC and other regulators as permitted under the Dodd-Frank Act.

---

352 AIMA General Letter; Seward Letter.

353 *See supra* notes 344-345 and accompanying text.

354 *See infra* section III of this Release (discussing the compliance date for Form PF).

355 *See Approval of Filing Fees for Exempt Reporting Advisers and Private Fund Advisers*, Investment Advisers Act Release No. IA-3297 (Sept. 30, 2011), 76 FR 62100 (Oct. 6, 2011).

Under the Advisers Act rule 204(b)-1, advisers required to file Form PF must pay to the operator of the Form PF filing system fees that the SEC has approved.[356] The SEC in a separate order has approved filing fees that reflect the costs reasonably associated with these filings and the development and maintenance of the filing system.[357]

We are working with FINRA to allow advisers to file Form PF either through a fillable form on the system website or through a batch filing process utilizing the eXtensible Markup Language ("XML") tagged data format. In connection with the batch filing process, we anticipate publishing a taxonomy of XML data tags in advance of the compliance date for Form PF. We believe that certain advisers may prefer to report in XML format because it allows them to automate aspects of their reporting and thus minimize burdens and generate efficiencies for the adviser.

Commenters who addressed this aspect of the proposal supported having FINRA develop the reporting system as an extension of the IARD platform.[358] Commenters also supported a batch filing capability, with one specifically agreeing that "[a]utomated

---

356 *See* Advisers Act rule 204(b)-1(d); section 204(c) of the Advisers Act.

357 *See Order Approving Filing Fees for Exempt Reporting Advisers and Private Fund Advisers*, Investment Advisers Act Release No. IA-3305 (Oct. 24, 2011).

358 *See* AIMA General Letter (agreeing that using the IARD and FINRA is a "sensible solution."); MFA Letter. We explained in the Form PF Proposing Release that the filing system would need to be programmed with special confidentiality protections designed to ensure the heightened confidentiality protections created for Form PF filing information under the Dodd-Frank Act. *See* Proposing Release, *supra* note 12, at n. 9 and accompanying text and section II.E. These commenters expressed the view that maintaining the confidentiality of Form PF data is an important consideration in developing the filing system. Our staffs are working closely with FINRA in designing controls and systems to ensure that Form PF data is handled and used in a manner consistent with the protections established in the Dodd-Frank Act, and as noted above, we are carefully considering recommendations from commenters in designing controls and systems for the use and handling of Form PF data.

submission of information via the IARD or other electronic system to [utilize] the eXtensible Markup Language (XML) tagged data format or similar format is likely to be an important time saver for a large number of firms."[359]

III. EFFECTIVE AND COMPLIANCE DATES

The effective date for CEA rule 4.27, Advisers Act rule 204(b)-1 and Form PF is March 31, 2012.

The Commissions are adopting a two-stage phase-in period for compliance with Form PF filing requirements. For the following advisers, the compliance date for CEA rule 4.27 and Advisers Act rule 204(b)-1 is June 15, 2012:

- Any adviser having at least $5 billion in assets under management attributable to hedge funds as of the last day of the fiscal quarter most recently completed prior to June 15, 2012;[360]
- Any adviser managing a liquidity fund and having at least $5 billion in combined assets under management attributable to liquidity funds and registered money market funds as of the last day of the fiscal quarter most recently completed prior to June 15, 2012;[361] and

---

359 AIMA General Letter. *See also* Kleinberg General Letter.

360 For this purpose, advisers must calculate the value of assets under management pursuant to the instructions in Form ADV and aggregate assets under management in the same manner as they would when determining whether they satisfy reporting thresholds under Form PF. *See supra* section II.A.5 of this Release.

361 *Id.*

- Any adviser having at least $5 billion in assets under management attributable to private equity funds as of the last day of its first fiscal year to end on or after June 15, 2012.[362]

For instance, an adviser with $5 billion in hedge fund assets under management as of March 31, 2012, must file its first Form PF within 60 days following June 30, 2012.[363] In addition, an adviser having a June 30 fiscal year end and $5 billion in private equity fund assets under management as of June 30, 2012, must file its first Form PF within 120 days following June 30, 2012.[364]

For all other advisers, the compliance date for CEA rule 4.27 and Advisers Act rule 204(b)-1 is December 15, 2012. As a result, most advisers must file their first Form PF based on information as of December 31, 2012.

This timing provides most private fund advisers with a significant amount of time to prepare for filing, requiring only the largest advisers, whose resources and systems should better position them to begin reporting, to report in less than a year following adoption of Form PF. This approach is designed to balance the need for regulators to begin collecting and analyzing data regarding the private fund industry with the ability of advisers to efficiently prepare for filing. We currently anticipate that this timeframe will

---

362 *Id.*

363 This assumes the adviser's fiscal quarters are based on calendar quarters. Of course, if the adviser also exceeds the threshold for liquidity fund advisers, its filing would be due within 15 days.

364 This assumes the adviser does not also exceed the $5 billion threshold for hedge fund or liquidity fund advisers.

also give the SEC sufficient time to create and program a system to accept filings of Form PF.[365]

We are adopting compliance dates that significantly extend the proposed compliance date of December 15, 2011. We are taking this approach, in part, because we are adopting these rules later than originally expected. The revised approach is also intended to respond to commenters who recommended a later compliance date. These commenters argued that the proposed compliance date would have provided advisers insufficient "time to identify the information to be included, establish automated systems and procedures to collect and calculate the information, and develop procedures to review, complete and verify the Form."[366] A majority of these commenters suggested extending compliance to at least nine months after publication of the final Form, though some argued for a year or more.[367] In support of an extended compliance date, commenters emphasized that, without sufficient time to prepare for the initial filing, the reporting process will be manually intensive or require costly system enhancements.[368] As explained above, our revised approach is designed to provide the largest advisers, whose resources and systems should better position them to begin reporting, at least eight

---

365 The SEC is working closely with FINRA to create and program a system for Form PF filings, and FINRA expects to be able to accept Form PF filings in this timeframe.

366 MFA Letter. *See also infra* note 367.

367 *See, e.g.*, AIMA General Letter (nine months); BlackRock Letter (nine months); CPIC Letter (one year); Fidelity Letter (one year); IAA Letter (nine months); Kleinberg General Letter (one year); MFA Letter (nine months); PEGCC Letter (one year); TCW Letter (nine months); Seward Letter (two years); SIFMA Letter (nine months); USCC Letter (270 days).

368 *See* AIMA General Letter; Kleinberg General Letter.

months before they start filing Form PF, and the vast majority of advisers will have over a year before their first Form PF is due.

IV. PAPERWORK REDUCTION ACT

SEC:

Section 204(b) of the Advisers Act directs the SEC to require private fund advisers to file reports containing such information as the SEC deems necessary and appropriate in the public interest and for investor protection or for the assessment of systemic risk. Rule 204(b)-1 and Form PF under the Advisers Act implement this requirement. Form PF contains a new "collection of information" within the meaning of the Paperwork Reduction Act ("PRA").[369] The title for the new collection of information is: "Form PF under the Investment Advisers Act of 1940, reporting by investment advisers to private funds." For purposes of this PRA analysis, the paperwork burden associated with the requirements of rule 204(b)-1 is included in the collection of information burden associated with Form PF and thus does not entail a separate collection of information. The SEC is submitting this collection 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. 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.

Form PF is intended to provide FSOC with information that will assist it in fulfilling its obligations under the Dodd-Frank Act relating to nonbank financial

---

369 44 U.S.C. 3501-3521.

companies and systemic risk monitoring.[370] The SEC may also use the information in connection with its regulatory and examination programs. The respondents to Form PF are private fund advisers.[371] Compliance with Form PF is mandatory for any private fund adviser that had at least $150 million in regulatory assets under management attributable to private funds as of the end of its most recently completed fiscal year.

Specifically, smaller private fund advisers must report annually and provide only basic information regarding their operations and the private funds they advise. Large private equity advisers also must report on an annual basis but are required to provide additional information with respect to the private equity funds they manage. Finally, large hedge fund advisers and large liquidity fund advisers must report on a quarterly basis and provide more information than other private fund advisers.[372] The PRA analysis set forth below takes into account the difference in filing frequencies among different categories of private fund adviser. It also reflects the fact that the additional information Form PF requires large hedge fund advisers to report is more extensive than

---

[370] *See supra* section I.A of this Release; *see also* of the Proposing Release, *supra* note 12, at section II.A.

[371] The requirement to file the Form applies to any investment adviser registered, or required to register, with the SEC that advises one or more private funds and had at least $150 million in regulatory assets under management attributable to private funds as of the end of its most recently completed fiscal year. *See* Advisers Act rule 204(b)-1(a). It does not apply to state-registered investment advisers or exempt reporting advisers.

[372] *See* section II.A of this Release (describing who must file Form PF), section II.B of this Release (discussing the frequency with which private fund advisers must file Form PF), section II.C.2 of this Release (describing the information that large hedge fund advisers must report on Form PF), and sections II.C.3 and II.C.4 of this Release (describing the information that large liquidity and private equity fund advisers must report on Form PF). *See also* Instruction 9 to Form PF (discussing the frequency with which private fund advisers must file Form PF).

the additional information required from large liquidity fund advisers, which in turn is more extensive than that required from large private equity advisers.

As discussed in section II of this Release, the SEC has sought to minimize the reporting burden on private fund advisers to the extent appropriate. In particular, the SEC has taken into account an adviser's size and the types of private funds it manages in designing scaled reporting requirements. In addition, where practical, the SEC has permitted advisers to rely on their existing practices and methodologies to report information on Form PF.[373]

Advisers must file Form PF through the Form PF filing system on the IARD.[374] Responses to the information collections will be kept confidential to the extent permitted by law.[375]

A. Burden Estimates for Annual Reporting by Smaller Private Fund Advisers

In the Implementing Adopting Release, the SEC estimated that there will be approximately 4,270 SEC-registered advisers managing private funds after taking into account recent changes to the Advisers Act and a year of normal growth in the population of registered advisers.[376] The SEC estimates that approximately 700 of these advisers

---

[373] The SEC also believes that private fund advisers already collect or calculate some of the information required on the Form at least as often as they must file the Form. *See supra* note 146.

[374] *See* section II.E of this Release.

[375] *See* section II.D of this Release.

[376] Specifically, the SEC estimated that (1) 3,320 private fund advisers that are currently registered with the SEC will remain registered after certain advisers make the switch to state registration prompted by the Dodd-Frank Act's amendments to section 203A of the Advisers Act, (2) 750 advisers to private funds will register with the Commission as a result of the Dodd-Frank Act's elimination of the private adviser exemption and

will not be required to file Form PF because they have less than $150 million in private fund assets under management.[377] Accordingly, the SEC anticipates that, when advisers begin reporting on Form PF, a total of approximately 3,570 advisers will be required to file all or part of the Form.[378] Out of this total number, the SEC estimates that approximately 3,070 will be smaller private fund advisers, not meeting the thresholds as Large Private Fund Advisers.[379] Commenters did not address the SEC's estimates of the total number of respondents or the number of smaller private fund advisers.[380]

---

(3) 200 additional advisers to private funds will register in the next year. *See* Implementing Adopting Release, *supra* note 11, at n.637 and accompanying text. Estimates of registered private fund advisers are based in part on the number of advisers that reported a fund in Section 7.B of Schedule D to the version of Form ADV in use prior to the date of this release. Because these responses included funds that the adviser's related persons manage as well as those the adviser itself manages, these data may over-estimate the total number of private fund advisers.

[377] Based on IARD data as of October 1, 2011. *See supra* section II.A of this Release for a discussion of the minimum reporting threshold.

[378] 4,270 total private fund advisers – 700 with less than $150 million in private fund assets under management = 3,570 advisers. The SEC notes, however, that if a private fund is advised by both an adviser and one or more subadvisers, only one of these advisers is required to complete Form PF. *See* section II.A.6 of this Release. As a result, it is likely that some portion of these advisers either will not be required to file Form PF or will be subject to a reporting burden lower than is estimated for purposes of this PRA analysis. The SEC has not attempted to adjust the burden estimates downward for this purpose because the SEC does not currently have reliable data with which to estimate the number of funds that have subadvisers.

[379] Based on the estimated total number of registered private fund advisers that would not meet the thresholds to be considered Large Private Fund Advisers. (3,570 estimated registered private fund advisers – 250 large hedge fund advisers – 80 large liquidity fund advisers – 170 large private equity fund advisers = 3,070 smaller private fund advisers.)

[380] The SEC has updated these estimates to reflect: (1) updated data from IARD, (2) the addition of a minimum reporting threshold of $150 million in private fund assets, which reduces the number of advisers subject to the reporting requirements, and (3) the revised estimates of large hedge fund advisers and large private equity advisers discussed in section II.A.4 of this Release. *See supra* section II.A of this Release and notes 88 and 89.

Smaller private fund advisers must complete all or portions of section 1 of Form PF and file on an annual basis. As discussed in greater detail above, section 1 requires basic data regarding the reporting adviser's identity and certain information about the private funds it manages, such as performance, leverage and investor data.[381] If the reporting adviser manages any hedge funds, section 1 also requires basic information regarding those funds, including their investment strategies, counterparty exposures and trading and clearing practices.

The SEC estimates that smaller private fund advisers will require an average of approximately 40 burden hours to compile, review and electronically file the required information in section 1 of Form PF for the initial filing and an average of approximately 15 burden hours for subsequent filings.[382] These estimates reflect an increase compared to the proposal from 10 to 40 hours for the initial filing and from 3 to 15 hours for subsequent filings.

---

381 *See supra* section II.C.1.

382 These estimates are based, in part, on the SEC's understanding that much of the information in sections 1a and 1b of Form PF is currently maintained by most private fund advisers in the ordinary course of business. *See supra* note 146. In addition, the SEC expects the time required to determine the amount of the adviser's assets under management that relate to private funds of various types to be largely included in the approved burden associated with the SEC's Form ADV. As a result, responding to questions on Form PF that relate to assets under management and determining whether an adviser is a Large Private Fund Adviser should impose little or no additional burden on private fund advisers. Of course, not all questions on Form PF impose the same burden, and the burden of responding to questions may vary substantially from adviser to adviser. These estimates are intended to reflect *averages* for compiling, reviewing and filing the Form, do not indicate the time that may be spent on specific questions and may not reflect the time spent by an individual adviser.

The SEC has increased these estimates to reflect comments suggesting that the estimates included in the proposal were too low.[383] Commenters did not provide alternative estimates for these burdens. However, commenters addressing the large hedge fund adviser burdens did provide alternative estimates.[384] As discussed below, the SEC is also increasing its hour burden estimates with respect to large hedge fund advisers based on, among other things, the estimates these commenters provided.[385] In the absence of specific commenter estimates for the smaller adviser reporting burden, the SEC has, therefore, scaled these estimates in proportion to the increases it is making to its burden hour estimates for large hedge fund advisers.

Although the SEC has increased these estimates, it has also taken into account changes from the proposal that it expects, on the whole, to mitigate the burden of reporting the information required in section 1. For instance, we have modified the requirement to report performance by allowing advisers to report monthly and quarterly results only if such results are already calculated for the fund.[386] In addition, we have removed from section 1b a question requiring identification of significant creditors and

---

383 *See, e.g.*, AIMA General Letter; IAA Letter; SIFMA Letter.

384 *See, e.g.*, MFA Letter.

385 *See infra* section IV.B of this Release.

386 Several commenters argued that carrying out valuations to report monthly and quarterly performance for private equity funds would result in significant cost burdens and require significantly more time than was estimated. *See, e.g.*, comment letter of Atlas Holdings (March 9, 2011) ("Atlas Letter"); PEGCC Letter. We have, however, modified the reporting requirements so that advisers only need to provide monthly and quarterly performance results to the extent already calculated. *See supra* notes 198-202 and accompanying text. In other words, because advisers will have always already calculated the required performance data for purposes other than reporting on Form PF, the burden of reporting it on the Form is essentially one of data entry.

substantially reduced the amount of information required with respect to trading and clearing practices in section 1c.[387] We have also made several global changes to the Form that we anticipate will reduce the burden of reporting. These include the removal of the certification, the increased ability of advisers to rely on their existing methodologies and recordkeeping practices and allowing advisers to omit information regarding parallel managed accounts from their responses to the Form.[388] We have also added four new questions in section 1b that will increase the burden of completing that portion of the Form, but the SEC expects the other changes described above to result in a net reduction in the burden of completing the Form relative to the proposal.[389]

Based on the foregoing, the SEC estimates that the amortized average annual

---

[387] One commenter suggested the question we removed would have been "very burdensome." *See* PEGCC Letter.

[388] *See, e.g.*, *supra* section II.C.5 of this Release and notes 183-188 and accompanying text.

[389] *See supra* section II.C.1 of this Release. The SEC originally proposed one of the new questions on Form ADV, and it requires that advisers report the assets and liabilities of each fund broken down using categories that are based on the fair value hierarchy established under GAAP. For advisers obtaining fund audits in accordance with GAAP or a similar international accounting standard, the burden of this question is simply that of entering the data on the Form. In the Implementing Adopting Release, the SEC estimated that approximately 3% of registered advisers have at least one private fund client that may not be audited. *See* Implementing Adopting Release, *supra* note 11, at nn. 634-636 and accompanying text. For this sub-group of advisers, the cost and hour burdens of determining fair values for the funds' assets have already been accounted for in connection with Form ADV because advisers are required to report regulatory assets under management in that form using the fair value of private fund assets. *See* Implementing Adopting Release, *supra* note 11, at section VI and nn. 632-641 and 723 and accompanying text. The question does not require advisers to determine the fair value of liabilities for which they do not already make such determination, so this sub-group of advisers would not incur an incremental cost to fair value liabilities in order to respond to this question. This sub-group of advisers may incur an additional hours burden to determine the categories applicable to the fund's assets and liabilities, and in determining to increase its average hour burden estimates for both smaller private fund advisers and Large Private Fund Advisers, the SEC has taken into account the contribution of this additional hours burden.

burden of periodic filings will be 23 hours per smaller private fund adviser for each of the first three years,[390] and the amortized aggregate annual burden of periodic filings for smaller private fund advisers will be 70,600 hours for each of the first three years.[391]

B. Burden Estimates for Large Hedge Fund Advisers

The SEC estimates that 250 advisers will be classified as large hedge fund advisers.[392] As discussed above, large hedge fund advisers must complete section 1 of the Form and provide additional information regarding the hedge funds they manage in section 2 of the Form. These advisers must report information regarding the hedge funds they manage on a quarterly basis.

Because large hedge fund advisers generally must report more information on Form PF than other private fund advisers, the SEC estimates that these advisers will require, on average, more hours than other Large Private Fund Advisers to configure systems and to compile, review and electronically file the required information. Accordingly, the SEC estimates that large hedge fund advisers will require an average of approximately 300 burden hours for an initial filing and 140 burden hours for each subsequent filing.[393]

---

[390] The SEC estimates that a smaller private fund adviser will make 3 annual filings in three years, for an amortized average annual burden of 23 hours (1 initial filing x 40 hours + 2 subsequent filings x 15 hours = 70 hours; and 70 hours ÷ 3 years = approximately 23 hours). After the first three years, filers generally will not incur the start-up burdens applicable to the first filing.

[391] 23 burden hours on average per year x 3,070 smaller private fund advisers = 70,600 burden hours per year.

[392] *See supra* note 88.

[393] The estimates of hour burdens and costs for large hedge fund advisers provided in the Paperwork Reduction Act and cost-benefit analyses are based, in part, on burden data that advisers provided in response to the FSA Survey and on the experience of SEC staff.

These estimates reflect an increase.compared to the proposal from 75 to 300 hours for the initial filing and from 35 to 140 hours for subsequent filings. The SEC has increased these estimates to reflect comments suggesting that the estimates included in the proposal were too low.[394] One industry group reported that some members attempted to complete the proposed version of Form PF for one or more funds and, "[b]ased on their experience, and recognizing that efficiencies will develop over time, [this group estimated] that large managers on average will expend 150-300 hours to submit the initial Form."[395] The SEC has revised its estimates in this PRA analysis based on the top end of

---

These estimates also assume that some Large Private Fund Advisers will find it efficient to automate some portion of the reporting process, which will increase the burden of the initial filing but reduce the burden of subsequent filings. This efficiency gain is reflected in our burden estimates, which are higher for the first report than subsequent reports, and certain of the anticipated automation costs are accounted for in our cost estimates. *See infra* note 435 and accompanying text. Of course, not all questions on Form PF impose the same burden, and the burden of responding to questions may vary substantially from adviser to adviser. These estimates are intended to reflect *averages* for compiling, reviewing and filing the Form, do not indicate the time that may be spent on specific questions and may not reflect the time spent by an individual adviser.

394 *See, e.g.*, AIMA Letter; IAA Letter; Kleinberg General Letter; MFA Letter; TCW Letter.

395 MFA Letter. This commenter referred to "large managers" generally, but based on the context, this comment appears to relate to large hedge fund advisers specifically. This commenter went on to state that "managers with more complex strategies will expend considerably more time." Other commenters addressing these estimates did not provide alternative estimates, though one indicated that some clients had already exceeded the Proposing Release's estimates in preparing to report on the proposed Form and another commenter, itself one of the largest private fund advisers in the United States, argued that the estimates were understated by "orders of magnitude." *See* BlackRock Letter; *see also* Kleinberg General Letter. In addition, advisers that manage many funds may incur higher costs than advisers that manage fewer funds even if they manage similar amounts of assets. The SEC's estimates are intended to reflect *average* burdens, and it recognizes that particular advisers may, based on their circumstances, incur burdens substantially greater than or less than the estimated averages. In addition, we have based our estimates in part on data that advisers provided in response to the FSA Survey regarding the time required to complete that survey. Although Form PF generally requires more information regarding hedge funds than the FSA Survey, the SEC believes, based on this data and based on the MFA comment letter, that the *average* burden of completing Form PF is very unlikely to be in the thousands or tens of thousands of hours.

this range, which represents a conservative interpretation of this commenter's estimate. This approach appears justified in this case based on other comments suggesting that the hours burden imposed on these advisers could be significantly higher than the SEC estimated in the Proposing Release.[396]

The SEC notes, however, that this commenter's estimates were based on the Form as proposed and we have made a number of changes from the proposal that we expect, on the whole, to mitigate significantly the reporting burden. For example, we have modified a number of questions to reduce the amount of detail required or to allow advisers to rely more on their existing methodologies or recordkeeping practices, including questions regarding trading and clearing practices, interest rate sensitivities, geographical concentrations, turnover, collateral practices, CCP exposures and sensitivities to changes in specified market factors.[397] We have also made several global changes to the Form that we anticipate will reduce the burden of reporting. These include allowing large hedge fund advisers to report only annually on funds that are not hedge funds, the removal of the certification, expanding the ability to disregard funds of funds and allowing advisers to omit information regarding parallel managed accounts from their responses to the Form.[398] We have also added four new questions in section 1b, which will increase the burden of completing that portion of the Form.[399] The SEC believes, however, that the increased burden attributable to these new questions is less than the

---

[396] *See supra* note 394 and accompanying text.

[397] *See supra* section II.C.1 and II.C.2 of this Release.

[398] *See, e.g., supra* sections II.B.1 and II.C.5 of this Release and notes 129 and 183-188 and accompanying text.

[399] *See supra* section II.C.1.

reduced burden attributable to other changes to the Form because the new questions require limited information that, in many cases, will be readily available to advisers while some of the SEC's modifications to reduce the reporting burdens are intended to address areas of the Form that commenters identified as particularly burdensome. In light of these changes, the SEC believes that the commenter estimates, which were based on the proposed Form, likely represent an upper bound of the average burden to large hedge fund advisers.

Based on the foregoing, the SEC estimates that the amortized average annual burden of periodic filings will be 610 hours per large hedge fund adviser for each of the first three years.[400] In the aggregate, the amortized annual burden of periodic filings will then be 153,000 hours for large hedge fund advisers for each of the first three years.[401]

C. Burden Estimates for Large Liquidity Fund Advisers

The SEC estimates that 80 advisers will be classified as large liquidity fund advisers.[402] Commenters did not address this estimate. As discussed above, large liquidity fund advisers must complete section 1 of the Form and provide additional information regarding the liquidity funds they manage in section 3 of the Form. In addition, these advisers must report information regarding the liquidity funds they manage on a quarterly basis.

---

400 The SEC estimates that a large hedge fund adviser will make 12 quarterly filings in three years, for an amortized average annual burden of 610 hours (1 initial filing x 300 hours + 11 subsequent filings x 140 hours = 1,840 hours; and 1,840 hours ÷ 3 years = approximately 610 hours). After the first three years, filers generally will not incur the start-up burdens applicable to the first filing.

401 610 burden hours on average per year x 250 large hedge fund advisers = 153,000 hours.

402 *See supra* note 88.

Large liquidity fund advisers generally must report less information on Form PF than large hedge fund advisers but more information than large private equity advisers and smaller private fund advisers. Accordingly, the SEC estimates that large liquidity fund advisers will require, on average, fewer hours than large hedge fund advisers but more hours than other advisers to configure systems and to compile, review and electronically file the required information. Specifically, the SEC estimates these advisers will require an average of approximately 140 burden hours for an initial filing and 65 burden hours for each subsequent filing.[403]

These estimates reflect an increase compared to the proposal from 35 to 140 hours for the initial filing and from 16 to 65 hours for subsequent filings. The SEC has increased these estimates to reflect comments suggesting that the estimates included in the proposal were too low.[404] Commenters did not provide alternative estimates for these burdens. However, commenters addressing the large hedge fund adviser burdens did

---

403 The estimates of hour burdens and costs for large liquidity fund advisers provided in the Paperwork Reduction Act and cost-benefit analyses are based, in part, on a comparison to the requirements and estimated burden for large hedge fund advisers (which estimates, in turn, are based in part on burden data that advisers provided in response to the FSA Survey) and on the experience of SEC staff. These estimates also assume that some Large Private Fund Advisers will find it efficient to automate some portion of the reporting process, which will increase the burden of the initial filing but reduce the burden of subsequent filings. This efficiency gain is reflected in our burden estimates, which are higher for the first report than subsequent reports, and certain of the anticipated automation costs are accounted for in our cost estimates. *See infra* note 435 and accompanying text. Of course, not all questions on Form PF impose the same burden, and the burden of responding to questions may vary substantially from adviser to adviser. These estimates are intended to reflect *averages* for compiling, reviewing and filing the Form, do not indicate the time that may be spent on specific questions and may not reflect the time spent by an individual adviser.

404 *See, e.g.*, AIMA Letter; IAA Letter; BlackRock Letter. No commenters specifically addressed the burden estimates for liquidity fund advisers, though several commented on the burden estimates generally.

provide alternative estimates.[405] As discussed above, the SEC is also increasing its hour burden estimates with respect to large hedge fund advisers based on, among other things, the estimates these commenters provided.[406] In the absence of specific commenter estimates for the large liquidity fund adviser reporting burden, the SEC has, therefore, scaled these estimates in proportion to the increases it is making to its burden hour estimates for large hedge fund advisers.

Although the SEC has increased these estimates, it has also taken into account changes from the proposal that it expects, on the whole, to mitigate the burden of reporting for large liquidity fund advisers. For instance, we have eliminated from section 1b a question requiring identification of significant creditors.[407] We have also made several global changes that we anticipate will reduce the burden of reporting. These include allowing large liquidity fund advisers to report only annually on funds that are not liquidity funds, removing the certification, expanding the ability to disregard funds of funds, the increased ability of advisers to rely on their existing methodologies and recordkeeping practices and allowing advisers to omit information regarding parallel managed accounts from their responses to the Form.[408] We have also added four new questions in section 1b that will increase the burden of completing that portion of the

---

405 *See, e.g.*, MFA Letter.

406 *See supra* section IV.B of this Release.

407 *See supra* section II.C.1 of this Release. One commenter suggested the question we removed would have been "very burdensome." *See* PEGCC Letter.

408 *See, e.g.*, *supra* sections II.B.1 and II.C.5 of this Release and notes 129 and 183-188 and accompanying text.

Form, but the SEC expects the other changes described above to result in a net reduction in the burden of completing the Form relative to the proposal.[409]

Based on the foregoing, the SEC estimates that the amortized average annual burden of periodic filings will be 290 hours per large liquidity fund adviser for each of the first three years.[410] In the aggregate, the amortized annual burden of periodic filings will then be 23,200 hours for large liquidity fund advisers for each of the first three years.[411]

D. Burden Estimates for Large Private Equity Advisers

The SEC estimates that 170 advisers will be classified as large private equity advisers.[412] As discussed above, large private equity advisers must complete section 1 of the Form and provide additional information regarding the private equity funds they manage in section 4 of the Form. These advisers are only required to report on an annual basis.

Large private equity advisers generally must report less information on Form PF than other Large Private Fund Advisers but more information than smaller private fund advisers. Accordingly, the SEC estimates that large private equity advisers will require, on average, fewer hours than large hedge fund advisers and large liquidity fund advisers

---

409 *See supra* section II.C.1 of this Release.

410 The SEC estimates that a large liquidity fund adviser will make 12 quarterly filings in three years, for an amortized average annual burden of 290 hours (1 initial filing x 140 hours + 11 subsequent filings x 65 hours = 855 hours; and 855 hours ÷ 3 years = approximately 290 hours). After the first three years, filers generally will not incur the start-up burdens applicable to the first filing.

411 290 burden hours on average per year x 80 large hedge fund advisers = 23,200 hours.

412 *See supra* note 89.

but more hours than other advisers to configure systems and to compile, review and electronically file the required information. Specifically, the SEC estimates these advisers will require an average of approximately 100 burden hours for an initial filing and 50 burden hours for each subsequent filing.[413]

These estimates reflect an increase compared to the proposal from 25 to 100 hours for the initial filing and from 12 to 50 hours for subsequent filings. The SEC has increased these estimates to reflect comments suggesting that the estimates included in the proposal were too low.[414] Commenters did not provide alternative estimates for these burdens. However, commenters addressing the large hedge fund adviser burdens did provide alternative estimates.[415] As discussed above, the SEC is also increasing its hour burden estimates with respect to large hedge fund advisers based on, among other things, the estimates these commenters provided.[416] In the absence of specific commenter estimates for the large private equity adviser reporting burden, the SEC has, therefore,

---

413 The estimates of hour burdens and costs for large private equity advisers provided in the Paperwork Reduction Act and cost-benefit analyses are based, in part, on a comparison to the requirements and estimated burden for large hedge fund advisers (which estimates, in turn, are based in part on burden data that advisers provided in response to the FSA Survey) and on the experience of SEC staff. These estimates also assume that some Large Private Fund Advisers will find it efficient to automate some portion of the reporting process, which will increase the burden of the initial filing but reduce the burden of subsequent filings. This efficiency gain is reflected in our burden estimates, which are higher for the first report than subsequent reports, and certain of the anticipated automation costs are accounted for in our cost estimates. *See infra* note 435 and accompanying text. Of course, not all questions on Form PF impose the same burden, and the burden of responding to questions may vary substantially from adviser to adviser. These estimates are intended to reflect *averages* for compiling, reviewing and filing the Form, do not indicate the time that may be spent on specific questions and may not reflect the time spent by an individual adviser.

414 *See, e.g.*, Atlas Letter; PEGCC Letter; USCC Letter.

415 *See, e.g.*, MFA Letter.

416 *See supra* section IV.B of this Release.

scaled these estimates in proportion to the increases it is making to its burden hour estimates for large hedge fund advisers.

Although the SEC has increased these estimates, it has also taken into account changes from the proposal that it expects, on the whole, to mitigate the burden of reporting for large private equity advisers. For instance, we have modified the requirement to report performance by allowing advisers to report monthly and quarterly results only if such results are already calculated for the fund.[417] In addition, we have eliminated from section 1b a question requiring identification of significant creditors and have revised questions in section 4 requiring information regarding portfolio company leverage to align the information required more closely with information available on the balance sheets of those companies.[418] We have also made several global changes to the Form that we anticipate will reduce the burden of reporting. These include requiring only annual (rather than quarterly) reporting, removing the certification, expanding the ability to disregard funds of funds, increasing the ability of advisers to rely on their existing methodologies and recordkeeping practices and allowing advisers to omit information regarding parallel managed accounts from their responses to the Form.[419] We have also added four new questions in section 1b that will increase the burden of completing that

---

417 *See supra* note 386.

418 *See supra* sections II.C.1 and II.C.4 of this Release. One commenter suggested the question we removed would have been "very burdensome." *See* PEGCC Letter.

419 *See, e.g., supra* sections II.B.1 and II.C.5 of this Release and notes 129 and 183-188 and accompanying text.

portion of the Form, but the SEC expects the other changes described above to result in a net reduction in the burden of completing the Form relative to the proposal.[420]

Based on the foregoing, the SEC estimates that the amortized average annual burden of periodic filings will be 67 hours per large private equity adviser for each of the first three years.[421] In the aggregate, the amortized annual burden of periodic filings will then be 11,400 hours for large private equity advisers for each of the first three years.[422]

E. Burden Estimates for Transition Filings, Final Filings and Temporary Hardship Exemption Requests

In addition to periodic filings, a private fund adviser must file very limited information on Form PF in three situations.

First, any adviser that transitions from quarterly to annual filing because it has ceased to be a large hedge fund or large liquidity fund adviser must file a Form PF indicating that it is no longer obligated to report on a quarterly basis. The SEC estimates that approximately 9 percent of quarterly filers will need to make a transition filing each year with a burden of 0.25 hours, or a total of 7 burden hours per year for all private fund advisers.[423] No commenters addressed these estimates. The SEC has not changed its

---

420 *See supra* section II.C.1 of this Release.

421 The SEC estimates that a large private equity adviser will make 3 annual filings in three years, for an amortized average annual burden of 67 hours (1 initial filing x 100 hours + 2 subsequent filings x 50 hours = 200 hours; and 200 hours ÷ 3 years = approximately 67 hours). After the first three years, filers generally will not incur the start-up burdens applicable to the first filing.

422 67 burden hours on average per year x 170 large private equity advisers = 11,400 hours.

423 This estimate is based on IARD data on the frequency of advisers to one or more private funds ceasing to have assets under management sufficient to cause them to be large hedge fund or large liquidity fund advisers. ((80 large liquidity fund advisers + 250 large hedge fund advisers) x 0.09 x 0.25 hours = 7 hours.)

estimates of the rate of transition filings and the burden hours per filing from the proposal, but it has reduced its estimate of the total burden hours per year because fewer filers will be required to report on a quarterly basis.[424]

Second, filers who are no longer subject to Form PF's periodic reporting requirements must file a final report indicating that fact. The SEC estimates that approximately 8 percent of the advisers required to file Form PF will have to file such a report each year with a burden of 0.25 of an hour, or a total of 71 burden hours per year for all private fund advisers.[425] No commenters addressed these estimates. The SEC has not changed its estimates of the rate of final filings and the burden hours per filing from the proposal, but it has reduced its estimate of the total burden hours per year because the addition of a minimum reporting threshold will result in fewer filers reporting on Form PF.[426]

Finally, an adviser experiencing technical difficulties in submitting Form PF may request a temporary hardship exemption by filing portions of Form PF in paper format.[427] The information that must be filed is comparable to the information that Form ADV filers provide on Form ADV-H when requesting a temporary hardship exemption relating to that form. In the case of Form ADV-H, the SEC has estimated that the average burden of

---

424 Under the proposal, large private equity advisers would also have been required to file on a quarterly basis. *See supra* section II.B.1 of this Release.

425 Estimate is based on IARD data on the frequency of advisers to one or more private funds withdrawing from SEC registration. (3,570 private fund advisers x 0.08 x 0.25 hours = 71 hours.)

426 *See supra* section II.A of this Release.

427 *See* Advisers Act rule 204(b)-1(f). The rule requires that the adviser complete and file Item A of Section 1a and Section 5 of Form PF, checking the box in Section 1a indicating that the filing is a request for a temporary hardship exemption.

filing is 1 hour and that approximately 1 in every 1,000 advisers will file annually.[428] Assuming that Form PF filers request hardship exemptions at the same rate and that the applications impose the same burden per filing, the SEC expects approximately 4 filers to request a temporary hardship exemption each year[429] for a total of 4 burden hours.[430] No commenters addressed these estimates, and they remain unchanged from the proposal.

F. Aggregate Hour Burden Estimates

Based on the foregoing, the SEC estimates that Form PF would result in an aggregate of 258,000 burden hours per year for all private fund advisers for each of the first three years, or 72 burden hours per year on average for each private fund adviser over the same period.[431]

G. Cost Burden

In addition to the hour burdens identified above, advisers subject to the Form PF reporting requirements will incur cost burdens. Firms required to file Form PF must also pay filing fees. In a separate order, the SEC has established filing fees for the Form PF filing system of $150 per annual filing and $150 per quarterly filing.[432] We estimate that

---

[428] *See* Implementing Adopting Release, *supra* note 11, at section VI.F.

[429] 3,570 private fund advisers x 1 request per 1,000 advisers = approximately 4 advisers.

[430] 4 advisers x 1 hour per response = 4 hours.

[431] 70,600 hours for periodic filings by smaller advisers + 153,000 hours for periodic filings by large hedge fund advisers + 23,200 hours for periodic filings by large liquidity fund advisers + 11,400 hours for periodic filings by large private equity fund advisers + 7 hours per year for transition filings + 71 hours per year for final filings + 4 hours per year for temporary hardship requests = approximately 258,000 hours per year. 258,000 hours per year ÷ 3,570 total advisers = 72 hours per year on average.

[432] *See supra* section II.E of this Release.

this will result in advisers paying aggregate filing fees of approximately $684,000 per year.[433]

Several commenters suggested that advisers would also need to modify existing systems or deploy new systems to support Form PF reporting.[434] As discussed in the Proposing Release and below, the SEC acknowledges that advisers may incur costs to develop systems and expects that Large Private Fund Advisers, in particular, may find it efficient to automate some portion of the reporting process, which will increase the burden of the initial filing but reduce the burden of subsequent filings.[435] The SEC has assumed that some of the hours that it estimates advisers will spend on preparing their initial filings on Form PF will be attributable to programmers preparing systems for the reporting.[436] The SEC understands that some advisers may outsource all or a portion of these systems requirements to software consultants, vendors, filing agents or other third-party service providers and believes that the emergence of such service providers may serve to make filing on Form PF more efficient than is reflected in its estimates.[437]

---

433 ((3,070 smaller private fund advisers + 170 large private equity advisers) x $150 per annual filing) + ((250 large hedge fund advisers + 80 large private equity advisers) x $150 per quarterly filing x 4 quarterly filings per year) = $684,000 per year.

434 *See, e.g.*, BlackRock Letter; IAA Letter; Kleinberg General Letter; PEGCC Letter; SIFMA Letter.

435 *See infra* section V.B of this Release, especially nn. 511-515; Proposing Release, *supra* note 11, at section V.B.

436 *See infra* notes 511, 513 and 515.

437 The SEC has based its estimates on the use of internal resources, for which some cost data is available, because it believes that an adviser would engage third-party service providers only if the external costs were comparable, or less than, the estimated internal costs of compiling, reviewing and filing the Form PF. As a result, the SEC's estimates of hour and cost burdens in this PRA analysis, and of costs in section V.B of this Release, may overstate the actual burdens and costs that will be incurred once third-party services become available.

Advisers may also incur costs associated with the acquisition or use of hardware needed to perform computations or otherwise process the data required on Form PF.[438] Smaller private fund advisers are unlikely to bear these costs because the information they are required to provide is limited and will, in many cases, already be maintained in the ordinary course of business.[439] Even among Large Private Fund Advisers, these costs are likely to vary significantly. For instance, the cost to any Large Private Fund Adviser may depend on how many funds or the types of funds it manages, the state of its existing systems and the complexity of its business. In addition, large hedge fund and large liquidity fund advisers must file Form PF more frequently, on shorter deadlines and generally with more information than large private equity advisers, increasing the likelihood that filings will compete with other demands for computing resources and that additional resources will be required.

Commenters did not provide estimates for the costs of acquiring or using hardware for purposes of Form PF. SEC staff contacted several organizations, including self-regulatory organizations, prime brokers and fund service providers, to help develop an estimate for these costs. Although these organizations generally were not able to provide such estimates, some expressed the view that the hardware costs would be small relative to the human capital costs and, for Large Private Fund Advisers, software development costs that Form PF imposes.[440] The SEC estimates, based in part on these conversations and the factors discussed above, that these costs will fall across a broad

---

[438] *See supra* note 272.

[439] *See supra* note 382.

[440] *See supra* notes 435-436 and accompanying text.

range for Large Private Fund Advisers. Those who are required to file less information, less frequently and on longer deadlines, who have excess capacity in their existing systems or whose business is relatively simple, may incur no incremental hardware costs.. On the other hand, some Large Private Fund Advisers may need to acquire (or obtain the use of) computing resources equivalent to an additional server, which the SEC estimates would cost approximately $50,000 fully deployed. This suggests an aggregate incremental cost in the first year of reporting between $0 and $25,000,000, though the actual cost is likely to fall in between these two end-points.[441]

CFTC:

As adopted, CEA rule 4.27 does not impose any additional burden upon registered CPOs and CTAs that are dually registered as investment advisers with the SEC. By filing the Form PF with the SEC, these dual registrants would be deemed to have satisfied certain of their filing obligations with the CFTC should the CFTC adopt such requirements, and the CFTC is not imposing any additional burdens herein. Therefore, any burden imposed by Form PF through CEA rule 4.27 on entities registered with both the CFTC and the SEC has been accounted for within the SEC's calculations regarding the impact of this collection of information under the PRA or, to the extent the reporting may relate to commodity pools that are not private funds, the CFTC anticipates that it would account for this burden should it adopt a future rulemaking establishing reporting requirements with respect to those commodity pools.[442]

---

[441] $50,000 x 500 Large Private Fund Advisers = $25,000,000.

[442] 44 U.S.C. 3501-3521.

V. ECONOMIC ANALYSIS

As discussed above, the Dodd-Frank Act amended the Advisers Act to, among other things, authorize the SEC to promulgate reporting requirements for private fund advisers. The Dodd-Frank Act also directs the SEC and CFTC to jointly issue, after consultation with FSOC, rules establishing the form and content of any reports to be filed under this new authority.[443] In enacting Sections 404 and 406 of the Dodd-Frank Act, Congress determined to require that private fund advisers file reports with the SEC and specified certain types of information that should be subject to reporting and/or recordkeeping requirements, but Congress left to the SEC the determination of the specific information to be maintained or reported. When determining the form and content of such reports, the Dodd-Frank Act authorizes the SEC to require that private fund advisers file such information "as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of system risk by [FSOC]."[444]

The SEC is adopting Advisers Act rule 204(b)-1 and Form PF, and the CFTC is adopting CEA rule 4.27 and sections 1 and 2 of Form PF, to implement the private fund adviser reporting requirements that the Dodd-Frank Act directs the Commissions to promulgate. Under these new rules, private fund advisers having at least $150 million in private fund assets under management must file with the SEC information responsive to all or portions of Form PF on a periodic basis. The scope of the required information and the frequency of the reporting is related to the amount of private fund assets that each

---

443 *See* section 211(e) of the Advisers Act.

444 *See* section 204(b)(1)(A) of the Advisers Act.

private fund adviser manages and the types of private fund to which those assets relate.[445] Specifically, smaller private fund advisers must report annually and provide only basic information regarding their operations and the private funds they advise. Large private equity advisers also must report on an annual basis but are required to provide additional information with respect to the private equity funds they manage. Finally, large hedge fund advisers and large liquidity fund advisers must report on a quarterly basis and provide more information than other private fund advisers.

The Advisers Act directs the SEC, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.[446] The Commissions are sensitive to the costs and benefits of their respective rules and have carefully considered the costs and benefits of this rulemaking. The SEC's consideration of the costs and benefits of this rulemaking has included whether this rulemaking will promote efficiency, competition and capital formation. In the proposal, the Commissions identified certain costs and benefits of Advisers Act rule 204(b)-1, CEA rule 4.27 and Form PF and requested comment on all aspects of their cost-benefit analyses. The comments the Commissions received on those analyses are discussed below.

---

445 *See* section II.A of this Release (describing who must file Form PF); *see also* section II.B of this Release (discussing the frequency with which private fund advisers must file Form PF); section II.C of this Release (describing the information that private fund advisers must report on Form PF). *See also* proposed Instruction 9 to Form PF for information regarding the frequency with which private fund advisers must file Form PF.

446 *See* section 202(c) of the Advisers Act.

In considering the benefits and costs of this rulemaking, we have also considered alternatives to the requirements we are adopting. All of these alternatives would require at least some registered private fund advisers to report at least some information because Congress directed the SEC to adopt such reporting requirements. Among the alternatives that we considered were requirements that varied along the following five dimensions: (1) requiring more or less information; (2) requiring more or fewer advisers to complete the Form; (3) allowing advisers to rely more on their existing methodologies and recordkeeping practices in completing the Form (or, alternatively, requiring more standardized responses); (4) requiring more or less frequent reporting; and (5) allowing advisers more or less time to complete and file the Form.

Alternatives along each of these dimensions have advantages and disadvantages. Obtaining more standardized information from more advisers more often and more quickly would likely improve the value of the Form PF data to FSOC and other regulators, and several commenters supported alternatives along one or more of these dimensions.[447] The Commissions are concerned, however, that the costs of such changes may, in general, increase more quickly than the benefits.[448] On the other hand, the Commissions have considered, and are adopting changes from the proposal, that allow advisers more time to file the Form,[449] permit large private equity advisers to file less

---

447 *See, e.g.*, AFL-CIO Letter; AFR Letter. *See also* CII Letter; MSCI Letter.

448 *See, e.g.*, *supra* discussion following notes 101 and 158 and text accompanying note 256. We believe, however, that there are some exceptions, such as the additional information it has determined to request in section 1b of the Form. *See supra* section II.C.1 of this Release.

449 *See supra* section II.B.2 of this Release.

frequently,[450] generally reduce the amount of information required,[451] reduce the number of advisers required to file the Form[452] and allow advisers to rely more on their existing methodologies and recordkeeping practices.[453] A number of commenters supported these changes and, in some cases, would have preferred that we further reduce the reporting burdens.[454] We believe, however, that the approach we are adopting strikes an appropriate balance between the benefits of the information to be collected and the costs to advisers of providing it. These benefits and costs are discussed in greater detail below.

A. Benefits

We believe that Form PF will create two principal classes of benefits. First, the information collected will facilitate FSOC's understanding and monitoring of systemic risk in the private fund industry and assist FSOC in determining whether and how to deploy its regulatory tools with respect to nonbank financial companies. Second, we expect this information to enhance the Commissions' ability to evaluate and develop regulatory policies and improve the efficiency and effectiveness of our efforts to protect investors and maintain fair, orderly and efficient markets.

Congress passed the Dodd-Frank Act in the wake of what some have called "the greatest financial crisis since the Great Depression."[455] The crisis imposed immense

---

450 *See supra* section II.B.1 of this Release.

451 *See supra* section II.C of this Release.

452 *See supra* section II.A of this Release.

453 *See supra* section II.C of this Release.

454 *See, e.g.*, IAA Letter; MFA Letter; PEGCC Letter; SIFMA Letter.

455 *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, FINANCIAL CRISIS INQUIRY COMMISSION (Jan. 2011) ("Financial Crisis Inquiry Report") at xv.

costs on individuals and businesses, with millions of jobs disappearing from the U.S. economy, large numbers of families losing their homes to foreclosure, nearly $11 trillion in household wealth lost, including retirement accounts and life savings, and many businesses, large and small, facing serious challenges.[456] Congress responded to the crisis, in part, by establishing FSOC as the center of a framework intended "to prevent a recurrence or mitigate the impact of financial crises that could cripple financial markets and damage the economy."[457] The goal of this framework, in other words, is the avoidance of significant harm to the U.S. economy from future financial crises.

Under the Dodd-Frank Act, FSOC must "monitor emerging risks to U.S. financial stability" and employ its regulatory tools to address those risks.[458] For this purpose, the Dodd-Frank Act granted FSOC the ability to determine that a nonbank financial company will be subject to the supervision of the FRB if the company may pose risks to U.S. financial stability as a result of its activities or in the event of its material financial distress. FSOC may also recommend to the FRB heightened prudential standards for designated nonbank financial companies.[459] In addition, the Dodd-Frank Act authorizes FSOC to issue recommendations to primary financial regulators for more stringent regulation of financial activities that it determines may create or increase systemic risk.[460]

---

[456] *See id.*, at xv-xvi. *See also* Senate Committee Report, *supra* note 5, at 39.

[457] *Id.*

[458] *See id.*, at 2. *See also supra* note 6 and accompanying text.

[459] *See supra* note 7 and accompanying text.

[460] *See supra* note 8 and accompanying text.

Congress recognized that FSOC would need information from private fund advisers to carry out its duties and to determine whether and how to exercise these regulatory authorities. For instance, a Senate committee report noted that "no precise data regarding the size and scope of hedge fund activities are available[, and while] hedge funds are generally not thought to have caused the current financial crisis, information regarding their size, strategies, and positions could be crucial to regulatory attempts to deal with a future crisis."[461] To that end, Congress mandated that the Commissions, as the primary regulators of private fund advisers, gather information from these advisers for FSOC's use. The Commissions have designed Form PF, in consultation with staff representing FSOC's members, to implement this mandate.[462]

Recent releases from FSOC illuminate how Form PF will serve an essential role in FSOC's monitoring of, and exercise of regulatory authority over, the private fund industry. For instance, in one release, FSOC confirmed that the information reported on Form PF is important not only to conducting an assessment of systemic risk among private fund advisers but also to determining how that assessment should be made.[463] Guidance in this FSOC release also suggests the role Form PF data will play in the process of determining whether a private fund adviser or the funds it manages will be subject to FRB supervision.[464] More specifically, the Dodd-Frank Act identifies certain

---

461 *See* Senate Committee Report, *supra* note 5, at 38.

462 *See* section II.C of this Release (describing the information that private fund advisers must report on Form PF).

463 *See supra* note 21 and accompanying text.

464 In the proposed three-stage process for making such determinations, the first and second stages would utilize publicly available data and data that, like Form PF, is collected by

factors that FSOC must consider in making a determination to designate a nonbank financial company for FRB supervision, and FSOC's recent guidance organizes those factors into categories, including size, interconnectedness, use of leverage, liquidity risk and maturity mismatch and concentration.[465] As discussed in detail throughout section II.C of this Release, the information reported on Form PF is designed, in part, to provide FSOC with data to assess these factors in a manner that is relevant to the particular type of fund about which the adviser is reporting.[466] Finally, we expect that FSOC will use Form PF data to supplement the data that it collects regarding other financial market participants and gain a broader view of the financial system than is currently available to regulators.[467] In this manner, we believe that the information collected through Form PF could play an important role in FSOC's monitoring of systemic risk, both in the private fund industry and in the financial markets more broadly.

In addition to the content of the Form, the reporting frequency, filing deadlines and reporting thresholds have been designed to provide FSOC the information it needs to monitor systemic risk across the private fund industry while balancing the burdens these reporting requirements will impose on advisers. For instance, although most advisers will only report annually on Form PF, large hedge fund and large liquidity fund advisers will report quarterly because we understand, based on our staffs' consultations with staff

---

other regulators. A third stage of screening would generally involve OFR collecting additional, targeted information directly from these firms, which FSOC would analyze along with Form PF data and other data used in the first two stages. *See supra* notes 45-46 and accompanying text.

[465] *See* FSOC Second Notice, *supra* note 6.

[466] *See, e.g.*, *supra* notes 192, 228, 266, 282, 284, 298 and 323 and accompanying text.

[467] *See, e.g.*, Proposing Release, *supra* note 12, at n. 120 and accompanying text.

representing FSOC's members, that this will provide FSOC with timely data that it may use to identify emerging trends in systemic risk.[468] The filing deadlines are, similarly, designed to provide FSOC with timely data so that it may understand and monitor systemic risk on a reasonably current basis.[469] Moreover, as discussed above, the reporting thresholds are designed to provide FSOC with a broad picture of the private fund industry while relieving smaller advisers from much of the costs associated with the more detailed reporting.[470] We understand that obtaining this broad picture will help FSOC to contextualize its analysis and assess whether systemic risk may exist across the private fund industry and to identify areas where OFR may want to obtain additional information.[471]

Certain publications from international groups and researchers have suggested that data like that collected on Form PF will be valuable to the regulation of systemic risk. For instance, as discussed above, several international groups have continued working to close information gaps by increasing the disclosures provided to regulators.[472] These groups have emphasized the importance, in their view, of designing and collecting better information to support the identification and modeling of systemic risk.[473] In

---

468 *See supra* section II.B.1 of this Release (discussing reporting frequency and comments on the proposed reporting frequency).

469 *See supra* section II.B.2 of this Release (discussing reporting deadlines and comments on the proposed deadlines).

470 *See supra* section II.A.4.a of this Release (discussing large adviser thresholds and comments on the proposed thresholds). *See also* section II.A of this Release (discussing the minimum reporting thresholds).

471 *Id.*

472 *See supra* notes 28-29 and accompanying text.

473 *Id.*

addition, research papers have suggested that information regarding private funds should play an important role in monitoring systemic risk, and one study argues that more direct measures of systemic risk would be possible with information from the majority of funds in the industry.[474] Another recent research paper argues that expanding the FRB's flow of funds data to include more detailed quarterly information regarding the holding and transfer of financial instruments, including information regarding the portfolios of hedge funds, "would have been of material value to U.S. regulators in ameliorating the recent financial crisis and could be of aid in understanding the potential vulnerabilities of an innovative financial system in the future."[475] Others have commented on hedge fund reporting specifically, stating that "[t]ransparency to regulators can help them measure and manage possible systemic risk and is relatively costless."[476]

Other academics and economists, while supporting regulatory efforts to assess and mitigate systemic risk, have cautioned that achieving the goal of substantially reducing systemic risk may prove difficult. For example, while the authors of one recent work support establishing "early warning indicators" for financial crises, they argue that

---

474 *See, e.g.*, Nicholas Chan, Mila Getmansky, Shane Haas and Andrew Lo, *Systemic Risk and Hedge Funds*, in The Risks of Financial Institutions (Mark Carey and Rene Stulz, eds., 2007) at 238; Monica Billio, Mila Getmansky, Andrew Lo and Loriana Pelizzon, *Econometric Measures of Systemic Risk in the Finance and Insurance Sectors*, NATIONAL BUREAU OF ECONOMIC RESEARCH (July 2010).

475 Leonard Nakamura, *Durable Financial Regulation: Monitoring Financial Instruments as a Counterpart to Regulating Financial Institutions*, NATIONAL BUREAU OF ECONOMIC RESEARCH (May 2011) at 1.

476 Stephen Brown, *et al.*, *Hedge Funds, Mutual Funds, and ETFs*, in REGULATING WALL STREET: THE DODD-FRANK ACT AND THE NEW ARCHITECTURE OF GLOBAL FINANCE 360 (Viral V. Acharya, *et al.*, eds., 2011) (supporting "regular and timely" reporting of asset positions and leverage levels). *See also* Ferran, *supra* note 307, at 28.

the most significant challenge is not the design of a framework for systemic risk analysis but rather:

> the well-entrenched tendency of policy makers and market participants to treat the signals as irrelevant archaic residuals of an outdated framework, assuming that old rules of valuation no longer apply. If the past... is any guide, these signals will be dismissed more often than not.[477]

Accordingly, although collecting information on Form PF will increase the transparency of the private fund industry to regulators (an important prerequisite to understanding and monitoring systemic risk), transparency alone may not be sufficient to address systemic risk.[478]

Some commenters agreed that Form PF data will "facilitate FSOC's ability to promote the soundness of the U.S. financial system."[479] One commenter characterized Form PF as determining the extent to which FSOC and the SEC have access to "data essential to monitoring systemic risks that, as we saw in 2007 and 2008, cause substantial damage to the financial markets and the broader economy when they go unchecked."[480] Another commenter stated that Form PF data could aid in the assessment of "systemic

---

477 Carmen M. Reinhart and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly* (2009) ("Reinhart and Rogoff") at 277, 280 and 281 (after observing this tendency to disregard signals of systemic risk, the authors conclude that this "is why we also need to think about improving institutions," which may be important to reducing this risk).

478 *See also* FSOC 2011 Annual Report, supra note 19, at ii (explaining that identifying and mitigating potential threats to financial stability "is an inherently difficult exercise. No financial crisis emerges in exactly the same way as its predecessors, and the most significant future threats will often be the ones that are hardest to diagnose and preempt" but going on to state that, "[n]onetheless, there is a strong case for improving the quality of information available to the public, supervisors, and regulators about risks in financial institutions and markets.")

479 CII Letter. *See also, e.g.*, AFL-CIO Letter; AFR Letter.

480 AFL-CIO Letter.

risks due to connectivity and contagion."[481] One commenter who expressed reservations regarding specific aspects of the proposal nonetheless supported "the approach proposed by the SEC and CFTC to collect information from registered private fund managers through periodic, confidential reports on Form PF" and agreed that gathering data "from different types of market participants, including investment advisers and the funds they manage, ...is a critical component of effective systemic risk monitoring and regulation."[482]

Some commenters, however, doubted that Form PF would be beneficial for monitoring systemic risk.[483] One commenter, for instance, argued that "Form PF requires firms to calculate and disclose information with uncertain benefits to regulators, and the broad scope of private funds subject to this burden has not been justified."[484] Others argued that particular types of funds, such as private equity funds, should be excluded from the reporting because they do not, in their view, have the potential to pose systemic risk or that certain of the proposed questions on Form PF would not prove beneficial for systemic risk analysis.[485] As discussed above, based on SEC staff's consultation with

---

[481] MSCI Letter (though also noting that they "see less potential benefit from this exercise to track the formation of asset class bubbles" and that certain of the requested information would be difficult to aggregate for purposes of industry-wide analysis; *see* section II.C for a discussion of some of this commenter's observations regarding use of particular data collected on Form PF).

[482] MFA Letter.

[483] *See, e.g.*, Fidelity Letter; PEGCC Letter; TCW Letter; USCC Letter.

[484] CCMR Letter; *see also* USCC Letter (acknowledging, however, that "greater access to comprehensive market and industry information will assist [FSOC] in identifying emerging threats to the stability of the U.S. financial system."); BlackRock Letter; SIFMA Letter.

[485] *See, e.g.*, PEGCC Letter. *See also supra* section II.C of this Release.

staff representing FSOC's members, we continue to believe that targeted information regarding the leverage practices of private equity funds will provide information that FSOC may use to monitor activities and trends in this industry that are of potential systemic importance.[486] In addition, we have made a number of changes from the proposal intended to address the specific concerns of these commenters and believe that Form PF, as adopted, will be an important source of information for FSOC as it carries out its duties as they relate to the private fund industry.[487]

We cannot predict today what the scope of the next financial crisis will be, and Form PF is only one part of a broader framework established under the Dodd-Frank Act to monitor and address systemic risk.[488] Other measures contemplated by the Dodd-Frank Act, including the so-called "Volcker rule," enhanced regulation of swaps and the FRB's oversight of systemically important financial institutions may be critical to identifying and mitigating the next financial crisis. We anticipate, however, that Form PF will improve the information available to regulators as they seek to prevent or mitigate the effects of future financial crises, and if this information helps to avoid even a small portion of the costs of a financial crisis like the most recent one, the benefits of Form PF will be very significant.

Reporting on Form PF will also benefit investors and other market participants by improving the information available to the Commissions regarding the private fund industry and how it interacts with markets. Today, regulators have little reliable data

---

486 *See supra* notes 307-308 and accompanying text.

487 *See supra* section II of this Release (discussing changes from the proposal).

488 *See supra* note 457 and accompanying text.

regarding this rapidly growing sector and frequently have to rely on data from other sources, which when available may be incomplete. The SEC recently adopted amendments to Form ADV that will require the reporting of important information regarding private funds, but this includes little or no information regarding, for instance, performance, leverage or the riskiness of a fund's financial activities.[489] As discussed above, the data collected through Form PF, which will be more reliable than existing data regarding the industry and significantly extend the data available through the revised Form ADV, will assist FSOC in identifying and addressing risks to U.S. financial stability. This may, in turn, protect investors and other market participants from significant losses.

In addition, this data will provide the Commissions with a more complete view of the financial markets in general and the private fund industry in particular. This broader perspective and more reliable data may enhance the Commissions' ability to develop and frame regulatory policies regarding the private fund industry, its advisers and the markets in which they participate, and to more effectively evaluate the outcomes of regulatory policies and programs directed at this sector, including for the protection of private fund investors. For instance, Form PF data may help the Commissions to discern relationships between regulatory actions and private fund results or activities.

---

489 *See* Implementing Adopting Release, *supra* note 11. Information reported on Form ADV is made available to the public, while Form PF data generally will not be. *See supra* section II.D (discussing confidentiality of Form PF data). This has informed the SEC's determination to require certain private fund information on Form ADV and other private fund information on Form PF.

We also expect the Form PF data to improve the efficiency and effectiveness of the Commissions' oversight of private fund advisers by enabling staff to manage and analyze information related to the risks that private funds pose more quickly, more effectively and at a lower cost than is currently possible. This will allow the Commissions to more efficiently and effectively target their examination programs. The Commissions will be able to use Form PF information to generate reports on the industry, its characteristics and trends. We expect that these reports will help the Commissions to anticipate regulatory problems, allocate and reallocate resources, and more fully evaluate and anticipate the implications of various regulatory actions the Commissions may consider taking. This will increase both the efficiency and effectiveness of the Commissions' programs and, thereby, increase investor protection. Form PF data will also help the Commissions better understand the investment activities of private funds and the scope of their potential effect on investors and the markets that the Commissions regulate.

Commenters generally focused on the benefits of Form PF as they relate to systemic risk rather than investor protection. However, one supporter, who represents twelve million workers and sponsors pension and employee benefit plans holding almost half a trillion dollars in assets, agreed that "[c]omprehensive disclosure requirements for private funds will provide important protections for [its] members' retirement savings."[490] On the other hand, some commenters who questioned Form PF's merits expressed skepticism regarding the Form's benefits generally, not just with respect to the

490 AFL-CIO Letter. *See also* AFR Letter.

monitoring of systemic risk.[491] As discussed in detail above, we have made a number of changes from the proposal designed to address commenter concerns regarding certain aspects of the proposed reporting requirements.[492] However, we continue to believe that Form PF, as adopted, will increase the amount and quality of information available regarding a previously opaque area of investment activity and, thereby, enhance the ability of regulators to protect investors and maintain fair, orderly and efficient markets.

The Commissions believe that private fund advisers, investors in private funds and the companies in which private funds may invest will also enjoy certain benefits related to Form PF. For example, we identified above two principal classes of benefits – assistance to FSOC in carrying out its mission and improvements to the ability of regulators to protect investors and oversee markets – in which these groups will share, including indirectly as participants in the U.S. financial system. With respect to hedge fund advisers, for instance, data indicate that the number of funds shut down each year increased significantly during the recent financial crisis, suggesting that these advisers may benefit if a future financial crisis is averted or mitigated.[493] Private fund investors and private fund advisers will also benefit if reporting on Form PF, by requiring advisers to review their fund's portfolios, trading practices and risk profiles, causes advisers to improve their risk management practices or internal controls.

---

491 *See, e.g.*, *supra* note 484.

492 *See supra* section II of this Release (discussing changes from the proposal).

493 *See HedgeFund Intelligence Global Review 2011*, HFI (Spring 2011) ("HFI 2011 Global Review").

Reporting on Form PF may also result in a positive effect on capital formation. Although Form PF data generally will be non-public, Form PF will increase transparency to regulators.[494] The SEC believes that private fund advisers may, as a result, assess more carefully the risks associated with particular investments and, in the aggregate, allocate capital to investments with a higher value to the economy as a whole. To the extent that changes in investment allocations lead to improved economic outcomes in the aggregate, Form PF reporting may result in a positive effect on capital available for investment.

Should the CFTC adopt certain of its proposed systemic risk reporting requirements, the coordination between the CFTC and SEC on this rulemaking would result in significant efficiencies for any private fund adviser that is also registered as a CPO or CTA with the CFTC. This is because, under CEA rule 4.27, filing Form PF would satisfy both SEC and CFTC reporting obligations with respect to commodity pools that are "private funds" and CPOs and CTAs would have the option of reporting on Form PF regarding commodity pools that are not private funds to satisfy certain other CFTC reporting obligations, in each case should the CFTC adopt such reporting obligations.

As discussed in section I.B of this Release, we have also coordinated with foreign financial regulators regarding the reporting of systemic risk information regarding private funds and anticipate that this coordination, as reflected in Form PF, will result in greater efficiencies in private fund reporting, as well as information sharing and private fund

---

494 *See supra* section II.D (discussing confidentiality of Form PF data).

monitoring among foreign financial regulators. Ongoing work among various international organizations has emphasized the importance of filling gaps in the data regarding financial market participants, and one goal of this coordination is to collect comparable information regarding private funds, which will aid in the assessment of systemic risk on a global basis.[495] Several commenters agreed that international coordination in connection with private fund reporting is important and encouraged us to take an approach consistent with international precedents.[496] We have made several changes from the proposal intended to more closely align Form PF with international precedent.[497]

As discussed above, we also believe that private fund advisers already collect or calculate some of the information required on the Form at least as often as they must file the Form, creating efficiencies for, and benefiting, advisers in satisfying their reporting requirements.[498]

B. Costs

Reporting on Form PF will also impose certain costs on private fund advisers and, potentially, other market participants. For the most part, these are the same costs discussed in the PRA analysis above because that analysis must account for the burdens of responding to the Commissions' reporting requirements. In order to minimize these direct costs, the reporting requirements are scaled to the adviser's size, the size of funds

---

495 *See supra* note 29 and accompanying text.

496 *See supra* note 30 and accompanying text.

497 *See supra* note 35 and accompanying text.

498 *See supra* note 382; Proposing Release, *supra* note 12, at n.105; *but see supra* note 146.

and the types of private funds each adviser manages. For instance, smaller private fund advisers and large private equity advisers generally must report less information and less frequently than large hedge fund advisers and large liquidity fund advisers.[499] This scaled approach is intended to provide FSOC with a broad picture of the private fund industry while relieving smaller advisers from much of the costs associated with the more detailed reporting. It is also designed to reflect the different implications for systemic risk that may be presented by different investment strategies, and thus seeks to adjust the costs of the reporting in proportion to the differing potential benefits of the information reported with respect to these strategies.

We expect that the costs Form PF imposes will be most significant for the first report that a private fund adviser is required to file because the adviser will need to familiarize itself with the new reporting form and may need to configure its systems in order to efficiently gather the required information. We also anticipate that the initial report will require more attention from senior personnel, including compliance managers and senior risk management specialists, than will subsequent reports. In addition, we expect that some Large Private Fund Advisers will find it efficient to automate some portion of the reporting process, which will increase the burden of the initial filing but reduce the burden of subsequent filings.

---

499 *See* section II.A of this Release (describing who must file Form PF); section II.B of this Release (discussing the frequency with which private fund advisers must file Form-PF); section II.C of this Release (describing the information that private fund advisers must report on Form PF). *See also* Instruction 9 to Form PF (discussing information regarding the frequency with which private fund advisers must file Form PF).

Several commenters addressed the cost estimates included in the Proposing Release. These commenters generally viewed these estimates as understated and, in several cases, argued that the costs of the initial report, in particular, would be greater than assumed.[500] These commenters offered two common explanations for the higher than estimated costs: (1) "[m]any of the requested items on Form PF are not tracked by advisory firms on the frequency, by the category or on a fund-by-fund basis in the manner requested by the proposed Form," meaning that advisers would need to develop systems for the reporting or engage in a manual process of gathering and compiling data;[501] and (2) completing the Form will require gathering information from many different internal and external parties and systems.[502]

We have carefully considered comments suggesting that the reporting requirements would be more burdensome than estimated in the Proposing Release, and the SEC has substantially increased its estimates of the hour burdens included in this PRA analysis, which flow through to these estimates of costs.[503] We have, however, also taken these comments into consideration in making a number of changes from the proposal that are intended to reduce the burdens of reporting on Form PF. These include global changes to the Form, such as allowing most advisers more time to file following the end of a fiscal period (reducing the likelihood that Form PF will compete with other priorities for advisers' resources or require employment of additional personnel),

---

500 *See, e.g.*, AIMA Letter; IAA Letter; Kleinberg General Letter; MFA Letter; PEGCC Letter; Seward Letter.

501 TCW Letter; but *see also supra* note 146.

502 *See, e.g.*, Kleinberg General Letter; MFA Letter; PEGCC Letter.

503 *See supra* notes 383, 394-395, 404 and 414 and accompanying text.

extending the compliance date, allowing large private equity advisers to report annually rather than quarterly, increasing the threshold for large private equity advisers and permitting greater reliance on advisers' existing methodologies and recordkeeping practices. We have also modified specific questions in response to comments so that responding to the Form is less burdensome.[504] We expect, on the whole, that these changes will mitigate the cost of reporting.[505] In addition, we have added a minimum reporting threshold, which will not reduce the burden to any particular filer of reporting but will reduce the aggregate burden that Form PF imposes because fewer advisers will be required to report.

After filing their initial reports, we anticipate that advisers will incur significantly lower costs because much of the work involved in the initial report is non-recurring and because of efficiencies realized from system configuration and reporting automation efforts accounted for in the initial reporting period. In addition, we estimate that senior personnel will bear less of the reporting burden in subsequent reporting periods, reducing costs though not necessarily reducing the burden hours.

One commenter agreed that efficiencies will be realized over time,[506] but another stated that, at least for private real estate funds, they would not.[507] Having considered

---

504 *See supra* section II.C of this Release.

505 *See supra* notes 388-389, 397-398, 407-409 and 418-420 and accompanying text. We also note that the original cost estimates, as well as the revised estimates included in this Release, include allocations for systems development among Large Private Fund Advisers (who are most likely to find automation cost effective) and assume that information would need to be gathered from many sources, both internal and external. *See supra* note 435 and accompanying text.

506 *See* MFA Letter.

these comments, we continue to believe that, for the average adviser (and particularly for those with more liquid portfolios and greater systems capabilities), efficiencies will be realized over time. We have, however, also increased the cost estimates for subsequent filings in recognition of concerns regarding the overall burden of the reporting and the possibility that efficiencies are not the same for all types of private fund adviser.

Based on the foregoing, we estimate[508] that the periodic filing requirements under Form PF (including configuring systems and compiling, automating, reviewing and electronically filing the report) will impose:

(1) 40 burden hours at a cost of $13,600[509] per smaller private fund adviser for the initial annual report;

(2) 15 burden hours at a cost of $4,200[510] per smaller private fund adviser for each subsequent annual report;

---

507 *See* comment letter of The National Association of Real Estate Investment Managers (Mar. 24, 2011).

508 We understand that some advisers may outsource all or a portion of their Form PF reporting responsibilities to software consultants, vendors, filing agents or other third-party service providers. We have based our estimates on the use of internal resources, for which some cost data is available, because we believe that an adviser would engage third-party service providers only if the external costs were comparable, or less than, the estimated internal costs of compiling, reviewing and filing the Form PF. The hourly wage data used in this Economic Analysis section of the Release is based on the Securities Industry and Financial Markets Association's *Report on Management & Professional Earnings in the Securities Industry 2010* and *Office Salaries in the Securities Industry 2010* ("SIFMA Earnings Reports"). This data has been modified to account for an 1,800-hour work-year and multiplied by 5.35 for management and professional employees and by 2.93 for general and compliance clerks to account for bonuses, firm size, employee benefits and overhead.

509 We expect that for the initial report these activities will most likely be performed equally by a compliance manager at a cost of $273 per hour and a senior risk management specialist at a cost of $409 per hour and that, because of the limited scope of information required from smaller private fund advisers, these advisers generally would not realize significant benefits from or incur significant costs for system configuration or automation. ($273/hour x 0.5 + $409/hour x 0.5) x 40 hours = approximately $13,600.

(3) 100 burden hours at a cost of $31,000[511] per large private equity fund adviser for the initial annual report;

(4) 50 burden hours at a cost of $13,900[512] per large private equity fund adviser for each subsequent annual report;

(5) 300 burden hours at a cost of $93,100[513] per large hedge fund adviser for the initial quarterly report;

---

510 We expect that for subsequent reports senior personnel will bear less of the reporting burden. As a result, we estimate that these activities will most likely be performed equally by a compliance manager at a cost of $273 per hour, a senior compliance examiner at a cost of $235 per hour, a senior risk management specialist at a cost of $409 per hour and a risk management specialist at a cost of $192 per hour. ($273/hour x 0.25 + $235/hour x 0.25 + $409/hour x 0.25 + $192/hour x 0.25) x 15 hours = approximately $4,200.

511 The SEC expects that for the initial report, of a total estimated burden of 100 hours, approximately 60 hours will most likely be performed by compliance professionals and 40 hours will most likely be performed by programmers working on system configuration and reporting automation. Of the work performed by compliance professionals, the SEC anticipates that it will be performed equally by a compliance manager at a cost of $273 per hour and a senior risk management specialist at a cost of $409 per hour. Of the work performed by programmers, the SEC anticipates that it will be performed equally by a senior programmer at a cost of $304 per hour and a programmer analyst at a cost of $224 per hour. ($273/hour x 0.5 + $409/hour x 0.5) x 60 hours + ($304/hour x 0.5 + $224/hour x 0.5) x 40 hours = approximately $31,000.

512 The SEC expects that for subsequent reports senior personnel will bear less of the reporting burden and that significant system configuration and reporting automation costs will not be incurred. As a result, the SEC estimates that these activities will most likely be performed equally by a compliance manager at a cost of $273 per hour, a senior compliance examiner at a cost of $235 per hour, a senior risk management specialist at a cost of $409 per hour and a risk management specialist at a cost of $192 per hour. ($273/hour x 0.25 + $235/hour x 0.25 + $409/hour x 0.25 + $192/hour x 0.25) x 50 hours = approximately $13,900.

513 We expect that for the initial report, of a total estimated burden of 300 hours, approximately 180 hours will most likely be performed by compliance professionals and 120 hours will most likely be performed by programmers working on system configuration and reporting automation. Of the work performed by compliance professionals, we anticipate that it will be performed equally by a compliance manager at a cost of $273 per hour and a senior risk management specialist at a cost of $409 per hour. Of the work performed by programmers, we anticipate that it will be performed equally by a senior programmer at a cost of $304 per hour and a programmer analyst at a

(6) 140 burden hours at a cost of $38,800[514] per large hedge fund adviser for each subsequent quarterly report;

(7) 140 burden hours at a cost of $43,500[515] per large liquidity fund adviser for the initial quarterly report; and

(8) 65 burden hours at a cost of $18,000[516] per large liquidity fund adviser for each subsequent quarterly report.

Assuming that there are 3,070 smaller private fund advisers, 250 large hedge fund advisers, 80 large liquidity fund advisers, and 170 large private equity fund advisers, the

---

cost of $224 per hour. ($273/hour x 0.5 + $409/hour x 0.5) x 180 hours + ($304/hour x 0.5 + $224/hour x 0.5) x 120 hours = approximately $93,100.

514 We expect that for subsequent reports senior personnel will bear less of the reporting burden and that significant system configuration and reporting automation costs will not be incurred. As a result, we estimate that these activities will most likely be performed equally by a compliance manager at a cost of $273 per hour, a senior compliance examiner at a cost of $235 per hour, a senior risk management specialist at a cost of $409 per hour and a risk management specialist at a cost of $192 per hour. ($273/hour x 0.25 + $235/hour x 0.25 + $409/hour x 0.25 + $192/hour x 0.25) x 140 hours = approximately $38,800.

515 The SEC expects that for the initial report, of a total estimated burden of 140 hours, approximately 85 hours will most likely be performed by compliance professionals and 55 hours will most likely be performed by programmers working on system configuration and reporting automation. Of the work performed by compliance professionals, the SEC anticipates that it will be performed equally by a compliance manager at a cost of $273 per hour and a senior risk management specialist at a cost of $409 per hour. Of the work performed by programmers, the SEC anticipates that it will be performed equally by a senior programmer at a cost of $304 per hour and a programmer analyst at a cost of $224 per hour. ($273/hour x 0.5 + $409/hour x 0.5) x 85 hours + ($304/hour x 0.5 + $224/hour x 0.5) x 55 hours = approximately $43,500.

516 The SEC expects that for subsequent reports senior personnel will bear less of the reporting burden and that significant system configuration and reporting automation costs will not be incurred. As a result, the SEC estimates that these activities will most likely be performed equally by a compliance manager at a cost of $273 per hour, a senior compliance examiner at a cost of $235 per hour, a senior risk management specialist at a cost of $409 per hour and a risk management specialist at a cost of $192 per hour. ($273/hour x 0.25 + $235/hour x 0.25 + $409/hour x 0.25 + $192/hour x 0.25) x 65 hours = approximately $18,000.

foregoing estimates suggest an annual cost of $107,000,000[517] for all private fund advisers in the first year of reporting and an annual cost of $59,800,000 in subsequent years.[518]

The cost estimates above assume that risk and compliance personnel (and, in the case of Large Private Fund Advisers filing an initial report, programmers) will carry out the work of reporting on Form PF. Some commenters suggested that employees in portfolio management as well as legal, controller and other back office functions may also be involved in compiling, reviewing and filing Form PF.[519] These commenters did not provide estimates for how the reporting burdens would be allocated among these groups of employees, and we believe the allocation is likely to vary significantly among advisers depending on the size and complexity of their operations. Based on available wage data, we do not believe that variations in the allocation of these responsibilities among the functions that we and commenters identified would result in significantly different aggregate cost estimates.[520]

---

517 (3,070 smaller private fund advisers x $13,600 per initial annual report) + (170 large private equity fund advisers x $31,000 per initial annual report) + (250 large hedge fund advisers x $93,100 per initial quarterly report) + (250 large hedge fund advisers x 3 quarterly reports x $38,800 per subsequent quarterly report) + (80 large liquidity fund advisers x $43,500 per initial quarterly report) + (80 large liquidity fund advisers x 3 quarterly reports x $18,000 per subsequent quarterly report) = approximately $107,000,000.

518 (3,070 smaller private fund advisers x $4,200 per subsequent annual report) + (170 large private equity fund advisers x $13,900 per subsequent annual report) + (250 large hedge fund advisers x 4 quarterly reports x $38,800 per subsequent quarterly report) + (80 large liquidity fund advisers x 4 quarterly reports x $18,000 per subsequent quarterly report) = approximately $59,800,000.

519 *See, e.g.*, Kleinberg General Letter; MFA Letter.

520 For example, our estimates assume that the work is performed by compliance managers at $273 per hour, senior compliance examiners at $235 per hour, senior risk management

In addition, as discussed above, a private fund adviser must file very limited information on Form PF if it needs to transition from quarterly to annual filing, if it is no longer subject to the reporting requirements of Form PF or if it requires a temporary hardship exemption under rule 204(b)-1(f). We estimate that transition and final filings will, collectively, cost private fund advisers as a whole approximately $5,200 per year.[521] We further estimate that hardship exemption requests will cost private fund advisers as a whole approximately $760 per year.[522] No commenters addressed these estimates. The estimate with respect to hardship exemptions is unchanged from the proposal. The estimate with respect to transition and final filings have been reduced because fewer

---

specialists at $409 per hour, risk management specialists at $192 per hour and, in the case of Large Private Fund Advisers filing an initial report, programmers ranging from $304 to $224 per hour. Based on the SIFMA Earnings Reports, indicative costs in the other functions that commenters identified are: $287 per hour for a senior portfolio manager; $211 per hour for an intermediate portfolio manager; $430 per hour for an assistant general counsel; $165 per hour for a fund senior accountant; $194 per hour for an intermediate business analyst; and $154 per hour for an operations specialist. An adviser's chief compliance officer (at a cost of $423 per hour) or controller (at a cost of $433 per hour) may also review the filing, though we would expect that in most cases their involvement would be more limited than that of more junior employees.

521 The SEC estimates that, for the purposes of the PRA, transition filings will impose 7 burden hours per year on private fund advisers in the aggregate and that final filings will impose 71 burden hours per year on private fund advisers in the aggregate. The SEC anticipates that this work will most likely be performed by a compliance clerk at a cost of $67 per hour. (7 burden hours + 71 burden hours) x $67/hour = approximately $5,200.

522 The SEC estimates that, for the purposes of the PRA, requests for temporary hardship exemptions will impose 4 burden hours per year on private fund advisers in the aggregate. The SEC anticipants that five-eighths of this work will most likely be performed by a compliance manager at a cost of $273 per hour and that three-eighths of this work will most likely be performed by a general clerk at a cost of $50 per hour. (($273 per hour x 5/8 of an hour) + ($50 per hour x 3/8 of an hour)) x 4 hours = approximately $760.

filers will be required to report on a quarterly basis and the addition of a minimum reporting threshold means that fewer advisers will report in total.[523]

Advisers may also incur costs related to the modification or deployment of systems to support their reporting obligations under Form PF.[524] As discussed above, certain of the anticipated costs to Large Private Fund Advisers of automating Form PF reporting are accounted for in our cost estimates.[525] In addition, Large Private Fund Advisers may incur costs associated with the acquisition or use of hardware needed to perform computations or otherwise process the data required on Form PF.[526] Commenters did not provide estimates for these costs. However, as discussed above, we estimate that these costs, which are likely to vary significantly among advisers, will range from $0 to $25,000,000 in the aggregate for the first year of reporting, with the actual costs likely to fall in between these two end-points.[527]

Based on the foregoing estimates, we estimate that the aggregate annual costs of Form PF, other than for hardware costs, are approximately $108,000,000 in the first year

---

[523] *See supra* note 424.

[524] *See supra* section IV.G of this Release.

[525] *See supra* note 438 and accompanying text.

[526] *See supra* notes 434-441 and accompanying text.

[527] *Id.*

and $60,500,000 in subsequent years.[528] In addition, we estimate that hardware costs will add between $0 and $25,000,000 in the first year.[529]

Reporting requirements can also impose costs beyond the direct costs associated with compiling and submitting data, and advisers subject to the Form PF reporting requirements may incur costs that are more difficult to quantify. One commenter, for instance, suggested an adviser may incur indirect "costs associated with the risk of disclosure of highly sensitive proprietary information."[530] As discussed above, Form PF elicits non-public information about private funds and their trading strategies, the public disclosure of which could adversely affect the funds and their investors.[531] We are, however, working to establish controls designed to protect this sensitive information from improper or inadvertent disclosure and believe that the risk of such disclosure is low.[532] If an adviser's Form PF data were disclosed despite the controls intended to maintain its confidentiality, there is some risk that a competitor may be able to use an adviser's data to replicate the adviser's trading strategy or trade against the adviser, thereby potentially harming the profitability of the strategy to that adviser. However, because data on Form PF generally could not, on its own, be used to identify individual investment

---

528 $107,000,000 (for periodic reporting in the first year) + $5,200 (for transition and final filings) + $760 (for hardship requests) + $684,000 (for filing fees) = approximately $108,000,000. $59,800,000 (for periodic reporting in subsequent years) + $5,200 (for transition and final filings) + $760 (for hardship requests) + $684,000 (for filing fees) = approximately $60,500,000.

529 *See supra* notes 440-441 and accompanying text.

530 CCMR Letter.

531 *See supra* section II.D of this Release.

532 *See supra* sections II.D and II.E of this Release.

positions, the ability of a competitor to use Form PF data in this manner is limited.[533] In addition, the deadlines for filing Form PF have, in most cases, been significantly extended from the proposal, meaning that the filings will generally contain less current, and therefore less sensitive, data.[534] In the very unlikely event that improper or inadvertent disclosures of Form PF data occurred frequently, the disclosures could discourage advisers from investing the time and other resources required to develop novel strategies, potentially reducing the range of options available to investors and inhibiting financial innovation.

We do not expect this rulemaking to have a significant negative effect on competition because the information generally will be non-public and similar types of SEC-registered advisers will have comparable burdens under the Form.[535] In addition, the SEC does not expect this rulemaking to have a significant negative effect on capital formation, again because the information collected generally will be non-public and, therefore, should not affect private fund advisers' ability to raise capital.

Although Form PF data generally will be non-public, Form PF will increase transparency to regulators.[536] As discussed above, this may result in a positive effect on capital formation because advisers may, as a result, assess more carefully the risks associated with particular investments and, in the aggregate, allocate capital to

---

[533] *See supra* note 343.

[534] *See supra* notes 351 and 344 and accompanying text.

[535] *See supra* section II.D of this Release for a discussion of confidentiality of Form PF data.

[536] *See supra* section II.D of this Release for a discussion of confidentiality of Form PF data.

investments with a higher value to the economy as a whole.[537] However, this increased transparency could also have a negative effect on capital formation if it increases advisers' aversion to risk and, as a result, reduces investment in projects that may be risky but beneficial to the economy as a whole. To the extent that changes in investment allocations lead to reduced economic outcomes in the aggregate, Form PF reporting may result in a negative effect on capital available for investment.

The SEC also recognizes that the direct costs of completing and filing Form PF may reduce the amount of capital that funds have available for investment or, if the costs are passed on to fund investors, reduce the amount of capital investors have available for investment. This could, in turn, affect capital formation.[538] However, the direct costs of reporting on Form PF will, to some extent, only transfer capital from private fund advisers to other market participants, such as employees or service providers paid to complete the Form. Because private fund advisers may have different investment opportunities than these other market participants, this transfer may negatively affect aggregate economic outcomes. However, some of this transferred capital will be invested or spent and will not represent an aggregate loss to the economy. In addition, the direct

---

537 *See supra* note 494 and accompanying text.

538 One commenter expressed concern regarding the possible effects of Form PF reporting on economic growth, investors, investment opportunities, companies, markets, market liquidity and tax revenue as well as "the cost in terms of jobs and capital." Issa Letter. This commenter suggested that these potential negative effects could flow from several sources, including: (1) the possibility that advisers will locate funds outside the United States as a result of, or to avoid, Form PF compliance costs or that these costs will be passed on to investors, causing them to seek investment opportunities outside the United States; and (2) the possibility that advisers will form fewer funds, slow the growth of their funds or shut down existing funds as a result of, or to avoid, Form PF compliance costs. We address these possible sources of indirect costs below.

costs of Form PF are, on average, small compared to other economic incentives that motivate private funds and their advisers to invest and grow.[539]

One commenter expressed concern that this rulemaking could cause advisers, private funds or investors to seek investment opportunities outside the U.S. as a result of, for instance, increased costs.[540] This rulemaking could impose costs on U.S. private fund advisers that non-U.S. private fund advisers would not bear unless they are subject to the Advisers Act and the Form PF reporting requirements. However, advisers generally would not be able to avoid these reporting obligations by simply organizing the fund in a third country because regulatory jurisdiction for Form PF does not depend solely on where the fund is formed.[541] In addition, as noted above, ESMA has proposed a reporting regime similar to Form PF for alternative investment fund managers subject to the EU Directive. If that regime is adopted, we understand most such alternative investment managers would bear reporting costs similar to those that Form PF imposes. Accordingly, we believe the competitive impact of this difference in operating costs will be limited. We also do not expect that private funds will, to any significant extent, seek to avoid these regulatory burdens by foregoing participation in the U.S. capital markets because of the depth and liquidity of these markets and the stability afforded by the legal structures in the U.S.

This commenter also suggested that some fund advisers may determine not to form a new private fund if the costs of Form PF outweigh the marginal benefits the

---

[539] *See infra* notes 545 and 548 and accompanying text.

[540] *See* Issa Letter.

[541] *See supra* note 134 and accompanying text.

adviser expects to obtain by forming the fund.[542] Reduced fund formation could diminish competition and the number of choices available to investors. The SEC does not, however, believe the cost of reporting on Form PF will have a substantial negative effect on fund formation. An adviser with no existing private funds considering whether to form its first fund is likely to face little or no costs as a result of Form PF because it is unlikely to leap past a Large Private Fund Adviser Threshold and may not even exceed the minimum reporting threshold of $150 million in private fund assets under management.[543] For an existing private fund adviser, forming a new private fund would increase the cost of reporting on Form PF, but the adviser would be able to leverage its experience and existing systems, making the incremental reporting more efficient than for an adviser first becoming subject to Form PF reporting requirements.[544] In the case of either an adviser newly managing private funds or an adviser with existing private funds, the SEC believes that Form PF reporting costs are unlikely to discourage the formation of many funds because the costs of either becoming subject to Form PF as a smaller private fund adviser or reporting incrementally more information on Form PF are small when compared to possible management and performance fees. For example, the SEC

---

542 *See* Issa Letter.

543 According to HFI data, even among the top 25 hedge fund launches reported in 2010, the average fund size was approximately $750 million, and existing advisers launched the majority of those funds in any case. This data also shows that, out of 135 total hedge fund launches reported in 2010 exceeding $50 million, at least 110 of them raised under $300 million. HFI does not report in their annual global review hedge fund launches under $50 million. *See* HFI 2011 Global Review, *supra* note 493. *See also supra* sections IV.A and IV.G of this Release (discussing estimates of Form PF reporting costs for smaller private fund advisers).

544 In addition, in the case of large hedge fund advisers, the more detailed information they must file in section 2b of the Form only applies to qualifying hedge funds that have at least $500 million in net assets.

estimates that the cost to smaller private fund advisers of completing and filing Form PF will average less than $14,000 per initial annual filing and $5,000 per subsequent annual filing – or less than 0.01% of assets under management for the smallest adviser subject to Form PF reporting requirements – compared to annual management and performance fees that, at least among hedge fund advisers, average approximately 1.5% of assets under management and 20% of excess returns, respectively.[545]

In addition, this commenter expressed concern that the Large Private Fund Adviser thresholds may encourage some private fund advisers with assets under management near but below the thresholds to attempt to staunch growth in their funds, either by refusing to admit new investors or by managing the investments of the funds, to remain below the thresholds.[546] Similarly, this commenter suggested that some funds may even shut down to avoid Form PF reporting costs.[547] The SEC believes, however, that substantial economic incentives will likely counter such behavior, including private fund performance fees that incentivize the private fund adviser to continue advising its funds and maximize fund appreciation and return. For example, a hedge fund with an initial value of $1.5 billion that experiences a 1% excess return will net $3 million in performance fees, and a 1% growth in assets under management will net an additional $225,000 per year in management fees, compared to an estimated cost of between

---

545 *See* Ibbotson, et al., *supra* note 95, at 15 (finding a management fee of 1.5% of assets under management and a 20% performance fee to be the median fee structure in the TASS hedge fund database). $14,000 / $150,000,000 = approximately 0.009%.

546 *See* Issa Letter.

547 *Id.*

$210,000 and $260,000 in the first year of reporting.[548] In addition, we believe the cost to an adviser of reporting will decline over time as the adviser becomes more familiar with the Form and realizes efficiencies while, at the same time, the adviser will continue to charge management fee and potentially collect performance fees each year. With respect to the large adviser threshold specifically, we anticipate that business relations with investors that may be damaged if the adviser turns away investor assets may also motivate advisers to continue to permit the size of their funds to increase as a result of new investment.

As discussed above, we believe that private fund advisers, investors in private funds and the companies in which private funds may invest will enjoy certain benefits related to Form PF.[549] We recognize, however, that many of Form PF's benefits will be widely distributed across the financial system while its costs will be concentrated. Private fund advisers will bear most of these costs, though they may also pass some of these costs on to fund investors, and to the extent that capital available for investment is reduced, the companies in which private funds would otherwise invest may also bear costs. In addition, the costs of Form PF to an individual adviser will vary depending on factors such as the state of its existing systems and the complexity of its business. As a result, the costs and benefits of Form PF to particular advisers, particular investors,

---

[548] The calculations assume a management fee of 1.5% of assets under management and a 20% performance fee. *See supra* note 545. $93,100 for the initial quarterly report + $38,800 for each subsequent quarterly reporting x 3 quarterly reports = approximately $210,000 for the first year of reporting. *See supra* notes 513-514. In addition, the SEC has estimated that a Large Private Fund Adviser may incur between $0 and $50,000 in costs for the acquisition or use of hardware in the first year of reporting. *See supra* note 441 and accompanying text.

[549] *See supra* section V.A of this Release.

particular companies and individual American citizens will not be evenly distributed. For certain individuals and entities, the costs of Form PF may even exceed the benefits to them. However, we believe that the aggregate benefits of this rulemaking will be substantial. Moreover, the uneven distribution of the benefits and costs of Form PF reflects the potential for an uneven distribution of the costs and benefits of engaging in risky financial activities that may impose negative externalities.[550]

C. CFTC Statutory Findings

Rule 4.27, as finalized, would deem a CPO registered with the CFTC that is dually registered as a private fund adviser with the SEC to have satisfied certain reporting requirements that the CFTC may adopt by filing Form PF with the SEC. The CPOs and CTAs that are dually registered as private fund advisers would be required to provide annually a limited amount of basic information on Form PF about the operations of their private funds. Only large CPOs and CTAs that are also registered as private fund advisers with the SEC would have to submit on a quarterly basis the full complement of

---

[550] *See, e.g.*, Iman Anabtawi and Steven L. Schwarcz, *Regulating Systemic Risk: Towards an Analytical Framework*, 86 NOTRE DAME L. REV. 4, 27 (2011) (arguing that financial market participants will not expend sufficient effort to identify and avoid conditions giving rise to systemic risk and explaining that one factor contributing to this behavior is that "the benefits of exploiting finite capital resources accrue to individual market participants, each of whom is motivated to maximize use of the resource, whereas the costs of exploitation are distributed more widely.... The root of the commons problem in financial markets is the asymmetry in the distribution of gains and losses associated with investment decisions.... In the case of a positive outcome, the firm captures the full benefits of the investment's success. In the case of a negative outcome, however, the firm may not suffer the full consequences of the poor investment. Rather, if the firm fails or merely defaults, those consequences will impact financial market participants that rely on the soundness of the firm's financial condition. Furthermore, if the firm is deemed too systemically significant to fail, its loss may be absorbed by government as a lender of last resort. In either case, the uninternalized costs associated with risk-taking by financial firms leads them to overexploit scarce capital resources in the form of socially excessive risk-taking.").

systemic risk related information required by Form PF.[551] As noted above, the Dodd-Frank Act tasks FSOC with monitoring the financial services marketplace in order to identify potential threats to the financial stability of the United States.[552] The Dodd-Frank Act also requires FSOC to collect information from member agencies – like the SEC and the CFTC – to support its functions.[553] The CFTC and the SEC are jointly adopting sections 1 and 2 of Form PF as a means to collect the information necessary to permit FSOC to fulfill its obligation to monitor private funds, and in order to identify any potential systemic threats arising from their activities. The CFTC and the SEC do not currently collect the information that is covered in proposed sections 1 and 2 of Form PF.

Section 15(a) of the CEA requires that the CFTC, before promulgating a regulation under the Act or issuing an order, consider the costs and benefits of its action. By its terms, CEA Section 15(a) does not require the CFTC to quantify the costs and benefits of a new regulation or determine whether the benefits of the regulation outweigh its costs. Rather, CEA section 15(a) simply requires the CFTC to "consider the costs and benefits" of its action. CEA section 15(a)(2) specifies that costs and benefits shall be evaluated in light of the following considerations: (1) protection of market participants and the public; (2) efficiency, competitiveness and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.[554] Accordingly, the CFTC could, in its discretion, give greater weight to

---

551 See 5 U.S.C. 801(a)(1)(B)(i).

552 See section 112(a)(2)(C) of the Dodd-Frank Act.

553 See section 112(d)(1) of the Dodd-Frank Act.

554 7 U.S.C. 19(a).

any of the five considerations and could, in its discretion, determine that, notwithstanding its costs, a particular regulation was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

Before promulgating these final rules, the CFTC sought public comment on the rules themselves, including the cost-benefit considerations of section 1 and 2 of Form PF.[555] The CFTC also specifically invited commenters to submit "any data or other information that they may have quantifying or qualifying the perceived costs and benefits of this proposed rule with their comment letters."[556] As noted above, the CFTC and the SEC received comments on the cost and benefits of the proposed regulations and the estimates of costs included in the Proposing Release, and they have carefully considered those comments. CEA Rule 4.27 does not impose any additional burdens or costs upon registered CPOs and CTAs that are dually registered as investment advisers with the SEC. By filing Form PF with the SEC, these dual registrants would be deemed to have satisfied certain reporting obligations with the CFTC, should the CFTC adopt such requirements.

1. General Costs and Benefits

With respect to costs, the CFTC has determined that: (1) without the reporting requirements imposed by this rulemaking, FSOC will not have sufficient information to identify and address potential threats to the financial stability of the United States (such as the near collapse of Long Term Capital Management); (2) the reporting requirements,

---

555 *See generally*, CFTC Proposing Release, *supra* note 16, at 76 FR 8068, 8087 (for CFTC's request for comment on the cost-benefit considerations).

556 *See generally*, CFTC Proposing Release, *supra* note 16, at 76 FR 8068, 8087.

once finalized, will provide the CFTC with better information regarding the business operations, creditworthiness, use of leverage, and other material information of certain registered CPOs and CTAs that are also registered as investment advisers with the SEC; and (3) while they are necessary to U.S. financial stability, the reporting requirements will create additional compliance costs for these registrants, as discussed in the foregoing portions of the Economic Analysis as well as in the PRA section of this Release.

The CFTC has determined that the proposed reporting requirements will provide a benefit to all investors and market participants by providing the CFTC and other policy makers with more complete information about these registrants and the potential risk their activities may pose to the U.S. financial system. In turn, this information will enhance the CFTC's ability to appropriately tailor its regulatory policies to the commodity pool industry and its operators and advisors. As mentioned above, the CFTC and the SEC do not have access to this information today and have instead been made to use information from other, less reliable sources.

2. Section 15(a) Determination

As stated above, section 15(a) of the CEA requires the CFTC to consider the costs and benefits of its actions in light of five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.

a. Protection of Market Participants and the Public

Should the CFTC adopt certain of its proposed systemic risk reporting requirements, the coordination between the CFTC and SEC on this rulemaking would

result in significant efficiencies for any private fund adviser that is also registered as a CPO or CTA with the CFTC. This is because, under CEA rule 4.27, filling Form PF would satisfy both SEC and CFTC reporting obligations with respect to commodity pools that are "private funds" and may satisfy CFTC reporting obligations with respect to commodity pools that are not "private funds," in each case should the CFTC adopt such reporting obligations. As noted above, the CFTC has determined that this coordination will protect such participants from duplicative reporting while still providing FSOC with needed information to fulfill its mission to protect the public from potential threats to the financial stability of the United States.

Commodity pools that fall within the definition of private funds and will be filing Form PF represent a sector of collective investment vehicles that have experienced a substantial growth and have been the subject of international concern regarding their size in juxtaposition with the markets as a whole. This concern has led to several countries instituting similar data collection efforts and it is well recognized that the U.S. contingent of these funds represents a sizable portion of all trading by this type of entity. Thus, this combined SEC/CFTC effort will contribute substantially to a better understanding of the impact of private investment vehicles on both the U.S. and international markets and provide the information necessary to intelligently develop regulatory efforts and oversight programs to provide adequate protection of market participants and the public at large.

Finally, the CFTC agrees with the SEC that Form PF, as adopted, will increase the amount and quality of information available regarding a previously opaque area of

investment activity and, thereby, enhance the ability of regulators to protect investors and oversee the markets that they regulate.

b. Efficiency, Competitiveness, and Financial Integrity of Futures Markets

Although the CFTC does not believe this rule relates directly to the efficiency or competitiveness of futures markets, the CFTC does recognize that the interconnectedness of the United States financial system is such that the integrity of futures markets depends on the financial stability of the entire financial system. To the extent that the information collected by Form PF assists the Commissions and FSOC to identify threats that may damage the United States financial system, the regulations herein indirectly protect the integrity of futures markets.

c. Price Discovery

The CFTC has not identified a specific effect on price discovery as a result of Form PF or related regulations.

d. Sound Risk Management

The Dodd-Frank Act tasks FSOC and its member agencies (including both the SEC and the CFTC) with mitigating risks to the financial stability the United States. The CFTC believes these regulations are necessary to fulfill that obligation. Risk management is provided by these regulations in two main ways: (1) assisting FSOC in fulfilling its mission of protecting the systemic financial stability of the United States; and (2) improving the ability of regulators to oversee markets. These benefits are shared by market participants, at least indirectly, as a part of the United States financial system. In addition, CPOs and CTAs that are dually registered as investment advisers will benefit

from these regulations to the extent that reporting on Form PF requires such entities to review their firms' portfolios, trading practices, and risk profiles; thus, the CFTC believes that these regulations may improve the sound risk management practices within their internal risk management systems.

e. Other Public Interest Considerations

The CFTC has not identified other public interest considerations related to the costs and benefits of these regulations.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

SEC:

The SEC has prepared the following Final Regulatory Flexibility Analysis ("FRFA") regarding Advisers Act rule 204(b)-1 in accordance with section 4(a) of the Regulatory Flexibility Act ("RFA").[557] The SEC prepared the Initial Regulatory Flexibility Analysis ("IRFA") in conjunction with the Proposing Release in January 2011.[558]

A. Need for and Objectives of the New Rule

New Advisers Act rule 204(b)-1 and Form PF implement provisions of the Dodd-Frank Act by specifying information that private fund advisers must disclose confidentially to the SEC, which information the SEC will provide to FSOC for systemic risk assessment purposes. Under the new rule, private fund advisers must file information responsive to all or portions of Form PF on a periodic basis. The scope of the required information and the frequency of the reporting is related to the amount of

---

[557] 5 U.S.C. 603(a).

[558] *See* Proposing Release, *supra* note 12, at section VI.

private fund assets that each private fund adviser manages and the type of private fund to which those assets relate. Specifically, smaller private fund advisers and large private equity advisers must report annually, while large hedge fund and liquidity fund advisers must report quarterly and provide additional information regarding the hedge funds and liquidity funds, respectively, that they manage.[559]

B. Significant Issues Raised by Public Comment

In the 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 Advisers Act rule and reporting requirements would apply and the effect on those entities, including whether the effects would be economically significant. None of the comment letters we received addressed the IRFA or the effect of the proposal on small entities, as that term was used in the IRFA.

C. Small Entities Subject to the Rule

Under SEC 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

---

559 *See* section II.A of this Release (describing who must file Form PF), section II.B of this Release (discussing the frequency with which private fund advisers must file Form PF), and section II.C of this Release (describing the information that private fund advisers must report on Form PF). *See also* proposed Instruction 9 to Form PF for information regarding the frequency with which private fund advisers must file Form PF.

natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[560]

Advisers Act rule 204(b)-1 requires an investment adviser registered with the SEC to file certain information on Form PF if it manages one or more private funds and had at least $150 million in regulatory assets under management attributable to private funds as of the end of its most recently completed fiscal year. Under section 203A of the Advisers Act, most advisers qualifying as small entities are prohibited from registering with the SEC and are instead registered with state regulators. Therefore, few small advisers will meet the registration criterion. Fewer still are likely to meet the minimum reporting threshold of $150 million in regulatory assets under management attributable to private funds. By definition, no small entities will, on their own, meet this threshold, which the SEC did not include in the proposal but has added in response to commenter concerns.[561] Advisers are, however, required to determine whether they exceed this threshold by aggregating their private fund assets under management with those of their related persons (other than separately operated related persons), with the result that some small entities may be subject to Form PF reporting requirements.[562] The SEC does not have a precise count of the number of advisers that may satisfy the minimum reporting

---

560 *See* Advisers Act rule 0-7(a).

561 *See supra* note 56-59 and accompanying text.

562 *See supra* section II.A.5 of this Release. The SEC notes that related persons are permitted to file on a single Form PF. As a result, even in the case that a larger related person causes a small entity to exceed the minimum reporting threshold, the small entity may not ultimately bear the reporting burden. *See supra* section II.A.6 of this Release. In addition, under Advisers Act rule 0-7(a)(3), an adviser with affiliates exceeding the other small entity thresholds under that rule would not be regarded as a small entity, suggesting that it may not be possible both to qualify as a small entity under that rule and to satisfy the criteria that would subject an adviser to Form PF reporting obligations.

threshold based on the aggregate private fund assets that it and its related persons manage because such advisers file separate reports on Form ADV. However, because of the new minimum reporting threshold, the group of small entities subject to the rule as adopted will be a subset of the group that would have been subject to the proposed rule. In the Proposing Release, the SEC estimated that approximately 50 small entities were registered with the SEC and advised one or more private funds.[563] Accordingly, the SEC estimates that no more than 50 small entities are likely to become subject to Form PF reporting obligations under the final rule.

D. Projected Reporting, Recordkeeping and other Compliance Requirements

Advisers Act rule 204(b)-1 and Form PF impose certain reporting and compliance requirements on advisers, including small advisers. A small adviser that is subject to the rule must complete all or part of section 1 of the Form. As discussed above, the SEC estimates that completing, reviewing and filing Form PF will cost approximately $13,600 for each small adviser in its first year of reporting and $4,200 per year for each subsequent year.[564] In addition, small entities must pay a filing fee of $150 per annual filing.[565]

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs the SEC to consider significant alternatives that would accomplish the stated objective, while minimizing any significant impact on

---

[563] *See* Proposing Release, *supra* note 12, at n.212 and accompanying text.

[564] *See supra* notes 509-510 and accompanying text.

[565] *See supra* note 432 and accompanying text.

small entities. In connection with the proposed rules and amendments, the SEC considered the following alternatives: (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 standards; and (4) an exemption from coverage of the rule, or any part thereof, for small entities.

Regarding the first and fourth alternatives, the SEC is adopting a minimum reporting threshold of $150 million as well as reporting requirements and timetables that differ for entities of smaller sizes. A small entity adviser that is subject to the rule only needs to file Form PF annually and complete applicable portions of section 1 of the form.[566] Large Private Fund Advisers must file additional information, and large hedge fund or large liquidity fund advisers must file more frequently. In addition, the filing fees that a smaller adviser must pay in a given year are lower than those that a large hedge fund or large liquidity fund advisers must pay over the same period. Regarding the second alternative, the information that a small entity subject to the rule must provide under section 1 of Form PF is much simpler than the information required of large hedge fund or large liquidity fund advisers and is consolidated in one section of the form. Regarding the third alternative, the SEC has, in a number of cases, permitted advisers to rely on their own methodologies in providing the information that the Form requires,

---

566 If the adviser has no hedge fund assets under management, it need not complete section 1.C of the Form. Advisers that manage a significant amount of both registered money market fund and liquidity fund assets must complete section 3 of Form PF, but there are no small entities that manage a registered money market fund.

though the use of performance standards is limited by the need to obtain comparable information from all filers.

CFTC:

Under CEA rule 4.27, the CFTC would not impose any additional burden upon registered CPOs and CTAs that are dually registered as investment advisers with the SEC because such entities are only required to file Form PF with the SEC. Further, certain CPOs registered with the CFTC that are also registered with the SEC would be deemed to have satisfied certain CFTC-related filing requirements, should the CFTC adopt such requirements, by completing and filing the applicable sections of Form PF with the SEC. Therefore, any burden imposed by Form PF through rule 4.27 on small entities registered with both the CFTC and the SEC has been accounted for within the SEC's calculations regarding the impact of this collection of information under the RFA or, to the extent the reporting may relate to commodity pools that are not private funds, the CFTC anticipates that it would account for this burden should it adopt a future rulemaking establishing reporting requirements with respect to those commodity pools. Accordingly, the Chairman, on behalf of the CFTC, hereby certifies pursuant to 5 U.S.C. 605(b) that the rules as adopted will not have a significant impact on a substantial number of small entities.

VII. STATUTORY AUTHORITY

CFTC:

The CFTC is adopting rule 4.27 [17 CFR 4.27] pursuant to its authority set forth in section 4n of the Commodity Exchange Act [7 U.S.C. 6n].

SEC:

The SEC is adopting rule 204(b)-1 [17 CFR 275.204(b)-1] pursuant to its authority set forth in sections 204(b) and 211(e) of the Advisers Act [15 U.S.C. 80b-4 and 15 U.S.C. 80b-11], respectively.

The SEC is adopting rule 279.9 pursuant to its authority set forth in sections 204(b) and 211(e) of the Advisers Act [15 U.S.C. 80b-4 and 15 U.S.C. 80b-11], respectively.

LIST OF SUBJECTS

17 CFR Part 4

Advertising, Brokers, Commodity futures, Commodity pool operators, Commodity trading advisors, Consumer protection, Reporting and recordkeeping requirements.

17 CFR Parts 275 and 279

Reporting and recordkeeping requirements, Securities.

TEXT OF FINAL RULES

Commodity Futures Trading Commission

For the reasons set out in the preamble, the CFTC is amending Title 17, Chapter I of the Code of Federal Regulations as follows:

PART 4—COMMODITY POOL OPERATORS AND COMMODITY TRADING ADVISORS

1. The authority citation for part 4 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 4, 6(c), 6b, 6c, 6l, 6m, 6n, 6o, 12a, and 23.

* * * * *

2. Add §4.27 to read as follows:

§4.27 Additional reporting by advisors of commodity pools.

* * * * *

Investment advisers to private funds. Except as otherwise expressly provided in this section, CPOs and CTAs that are dually registered with the Securities and Exchange Commission and are required to file Form PF pursuant to the rules promulgated under the Investment Advisers Act of 1940, shall file Form PF with the Securities and Exchange Commission in lieu of filing such other reports with respect to private funds as may be required under this section. In addition, except as otherwise expressly provided in this section, CPOs and CTAs that are dually registered with the Securities and Exchange Commission and are required to file Form PF pursuant to the rules promulgated under the Investment Advisers Act of 1940, may file Form PF with the Securities and Exchange Commission in lieu of filing such other reports with respect to commodity pools that are not private funds as may be required under this section. Dually registered CPOs and CTAs that file Form PF with the Securities and Exchange Commission will be deemed to have filed Form PF with the Commission for purposes of any enforcement action regarding any false or misleading statement of a material fact in Form PF.

* * * * *

Securities and Exchange Commission

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

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

3. 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.

* * * * *

4. Section 275.204(b)-1 is added to read as follows:

§ 275.204(b)-1 Reporting by investment advisers to private funds.

(a) *Reporting by investment advisers to private funds on Form PF.* If you are an investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), you act as an investment adviser to one or more private funds and, as of the end of your most recently completed fiscal year, you managed private fund assets of at least $150 million, you must complete and file a report on Form PF (17 CFR 279.9) by following the instructions in the Form, which specify the information that an investment adviser must provide. Your initial report on Form PF is due no later than the last day on which your next update would be timely in accordance with paragraph (e) if you had previously filed the Form; provided that you are not required to file Form PF with respect to any fiscal quarter or fiscal year ending prior to the date on which your registration becomes effective.

(b) *Electronic filing.* You must file Form PF electronically with the Form PF filing system on the Investment Adviser Registration Depository (IARD).

Note to paragraph (b): Information on how to file Form PF is available on the Commission's website at http://www.sec.gov/iard.

(c) *When filed.* Each Form PF is considered filed with the Commission upon acceptance by the Form PF filing system.

(d) *Filing fees.* You must pay the operator of the Form PF filing system a filing fee as required by the instructions to Form PF. The Commission has approved the amount of the filing fee. No portion of the filing fee is refundable. Your completed Form PF will not be accepted by the operator of the Form PF filing system, and thus will not be considered filed with the Commission, until you have paid the filing fee.

(e) *Updates to Form PF.* You must file an updated Form PF:

(1) At least annually, no later than the date specified in the instructions to Form PF; and

(2) More frequently, if required by the instructions to Form PF. You must file all updated reports electronically with the Form PF filing system.

(f) *Temporary hardship exemption.*

(1) If you have unanticipated technical difficulties that prevent you from submitting Form PF on a timely basis through the Form PF filing system, you may request a temporary hardship exemption from the requirements of this section to file electronically.

(2) To request a temporary hardship exemption, you must:

(i) Complete and file in paper format, in accordance with the instructions to Form PF, Item A of Section 1a and Section 5 of Form PF, checking the box in Section 1a indicating that you are requesting a temporary hardship exemption, no later than one business day after the electronic Form PF filing was due; and

(ii) Submit the filing that is the subject of the Form PF paper filing in electronic format with the Form PF filing system no later than seven business days after the filing was due.

(3) The temporary hardship exemption will be granted when you file Item A of Section 1a and Section 5 of Form PF, checking the box in Section 1a indicating that you are requesting a temporary hardship exemption.

(4) The hardship exemptions available under § 275.203-3 do not apply to Form PF.

(g) *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) *Private fund assets* means the investment adviser's assets under management attributable to private funds.

PART 279 – FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

5. The authority citation for Part 279 continues to read as follows:

Authority: 15 U.S.C. 80b-1, *et seq*.

6. Section 279.9 is amended to read as follows:

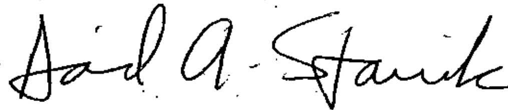
§ 279.9 Form PF, reporting by investment advisers to private funds.

This form shall be filed pursuant to Rule 204(b)-1 (§ 275.204(b)-1 of this chapter) by certain investment advisers registered or required to register under section 203 of the Act (15 U.S.C. 80b-3) that act as an investment adviser to one or more private funds.

Note: The text of the following Form PF will not appear in the Code of Federal Regulations.

[Insert Form PF]

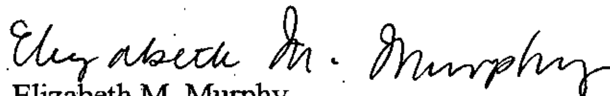
By the Commodity Futures Trading Commission.



David A. Stawick
Secretary

Date: October 31, 2011

By the Securities and Exchange Commission.



Elizabeth M. Murphy
Secretary

Date: October 31, 2011

FORM PF (Paper Version)
Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors

OMB APPROVAL	
OMB Number:	3235-0679
Expires:	[ ]
Estimated average burden hours per response	[ ]

Read these instructions carefully before completing Form PF. Failure to follow these instructions, properly complete Form PF, or pay all required fees may result in your Form PF being delayed or rejected.

In these instructions and in Form PF, "you" means the *private fund adviser* completing or amending this Form PF. If you are a "separately identifiable department or division" (SID) of a bank, "you" means the SID rather than the bank (except as provided in Question 1(a)). Terms that appear in *italics* are defined in the Glossary of Terms to Form PF.

1. Who must complete and file a Form PF?

You must complete and file a Form PF, if:

A. You are registered or required to register with the *SEC* as an investment adviser;

OR

You are registered or required to register with the *CFTC* as a *CPO* or *CTA* and you are also registered or required to register with the *SEC* as an investment adviser;

AND

B. You manage one or more *private funds*.

AND

C. You and your *related persons*, collectively, had at least $150 million in *private fund assets under management* as of the last day of your most recently completed fiscal year.

Many *private fund advisers* meeting these criteria will be required to complete only Section 1 of Form PF and will need to file only on an annual basis. *Large private fund advisers*, however, will be required to provide additional data, and *large hedge fund advisers* and *large liquidity fund advisers* will need to file every quarter. See Instructions 3 and 9 below.

For purposes of determining whether you meet the reporting threshold, you are not required to include the *regulatory assets under management* of any *related person* that is *separately operated*. See Instruction 5 below for more detail.

If your *principal office and place of business* is outside the United States, for purposes of this Form PF 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*.

2. I have a *related person* who is required to file Form PF. May I and my *related person* file a single Form PF?

Related persons may (but are not required to) report on a single Form PF information with respect to all such *related persons* and the *private funds* they advise. You must identify in your response

to Question 1 the *related persons* as to which you are reporting and, where information is requested about you or the *private funds* you advise, respond as though you and such *related persons* were one firm.

3. How is Form PF organized?

Section 1 – All Form PF filers

Section 1a — All *private fund advisers* required to file Form PF must complete Section 1a. Section 1a asks general identifying information about you and the types of *private funds* you advise.

Section 1b — All *private fund advisers* required to file Form PF must complete Section 1b. Section 1b asks for certain information regarding the *private funds* that you advise.

Section 1c — All *private fund advisers* that are required to file Form PF and advise one or more *hedge funds* must complete Section 1c. Section 1c asks for certain information regarding the *hedge funds* that you advise.

Section 2 – *Large hedge fund advisers*

Section 2a — You are required to complete Section 2a if you and your *related persons*, collectively, had at least $1.5 billion in *hedge fund assets under management* as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter. You are not required to include the *regulatory assets under management* of any *related person* that is *separately operated*.

Subject to Instruction 4, Section 2a requires information to be reported on an aggregate basis for all *hedge funds* that you advise.

Section 2b — If you are required to complete Section 2a, you must complete a separate Section 2b with respect to each *qualifying hedge fund* that you advise.

However:

if you are reporting separately on the funds of a *parallel fund structure* that, in the aggregate, comprises a *qualifying hedge fund*, you must complete a separate Section 2b for each *parallel fund* that is part of that *parallel fund structure* (even if that *parallel fund* is not itself a *qualifying hedge fund*); and

if you report answers on an aggregated basis for any *master-feeder arrangement* or *parallel fund structure* in accordance with Instruction 5, you should only complete a separate Section 2b with respect to the *reporting fund* for such *master-feeder arrangement* or *parallel fund structure*.

Section 3 – *Large liquidity fund advisers*

Section 3 — You are required to complete Section 3 if (i) you advise one or more *liquidity funds* and (ii) as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter, you and your *related*

persons, collectively, had at least $1 billion in *combined money market and liquidity fund assets under management*. You are not required to include the *regulatory assets under management* of any *related person* that is *separately operated*.

You must complete a separate Section 3 with respect to each *liquidity fund* that you advise.

However, if you report answers on an aggregated basis for any *master-feeder arrangement* or *parallel fund structure* in accordance with Instruction 5, you should only complete a separate Section 3 with respect to the *reporting fund* for such *master-feeder arrangement* or *parallel fund structure*.

Section 4 – *Large private equity advisers*

Section 4 You are required to complete Section 4 if you and your *related persons*, collectively, had at least $2 billion in *private equity fund assets under management* as of the last day of your most recently completed fiscal year. You are not required to include the *regulatory assets under management* of any *related person* that is *separately operated*.

You must complete a separate Section 4 with respect to each *private equity fund* that you advise.

However, if you report answers on an aggregated basis for any *master-feeder arrangement* or *parallel fund structure* in accordance with Instruction 5, you should only complete a separate Section 4 with respect to the *reporting fund* for such *master-feeder arrangement* or *parallel fund structure*.

Section 5 – Advisers requesting a temporary hardship exemption

Section 5 See Instruction 13 for details.

4. I am a subadviser or engage a subadviser for a *private fund*. Who is responsible for reporting information about that *private fund*?

Only one *private fund adviser* should complete and file Form PF for each *private fund*. If the adviser that filed *Form ADV Section 7.B.1* with respect to any *private fund* is required to file Form PF, the same adviser must also complete and file Form PF for that *private fund*. If the adviser that filed *Form ADV Section 7.B.1* with respect to any *private fund* is not required to file Form PF (e.g., because it is an *exempt reporting adviser*) and one or more other advisers to the fund is required to file Form PF, another adviser must complete and file Form PF for that *private fund*.

Where a question requests aggregate information regarding the *private funds* that you advise, you should only include information regarding the *private funds* for which you are filing Section 1b of Form PF.

5. When am I required to aggregate information regarding *parallel funds*, *parallel managed accounts*, *master-feeder arrangements* and funds managed by *related persons*?

You are required to aggregate related funds and accounts differently depending on the purpose of the aggregation.

Reporting thresholds. For purposes of determining whether you meet any reporting threshold, you must aggregate *parallel funds, dependent parallel managed accounts* and master-feeder funds. In addition, you must treat any *private fund* or *parallel managed account* advised by any of your *related persons* as though it were advised by you. You are not required, however, to aggregate *private funds* or *parallel managed accounts* of any *related person* that is *separately operated.*

Responding to questions. When reporting on individual funds, you may provide information regarding *master-feeder arrangements* or *parallel fund structures* either in the aggregate or separately, provided that you do so consistently throughout the Form. (For example, you may complete either a single Section 1b for all of the funds in a *master-feeder arrangement* or a separate Section 1b for each fund in the arrangement, but you must then take the same approach when completing other applicable sections of the Form.) Where a question requests aggregate information regarding the *private funds* that you advise, you should only include information regarding the *private funds* for which you are filing Section 1b of Form PF. You are not required to report information regarding *parallel managed accounts* (except in Question 11). You should not report information for any *private fund* advised by any of your *related persons* unless you have identified that *related person* in Question 1(b) as a *related person* for which you are filing Form PF.

See the table below for additional details.

For purposes of determining whether a *private fund* is a *qualifying hedge fund*	For purposes of reporting information in Sections 1b, 1c, 2b, 3 and 4
• You must aggregate any *private funds* that are part of the same *master-feeder arrangement* (even if you did not, or were not permitted to, aggregate these *private funds* for purposes of *Form ADV Section 7.B.1*)	• You may, but are not required to, report answers on an aggregated basis for any *private funds* that are part of the same *master-feeder arrangement* (even if you did not, or were not permitted to, aggregate these *private funds* for purposes of *Form ADV Section 7.B.1*)
• You must aggregate any *private funds* that are part of the same *parallel fund structure*	• You may, but are not required to, report answers on an aggregated basis for any *private funds* that are part of the same *parallel fund structure*
• Any *dependent parallel managed account* must be aggregated with the largest *private fund* to which that *dependent parallel managed account* relates	• You are not required to report information regarding *parallel managed accounts* (except in Question 11)

• You must treat any *private fund* or *parallel managed account* advised by any of your *related persons* as though it were advised by you (including *related persons* that you have not identified in Question 1(b) as *related persons* for which you are filing Form PF, though you may exclude *related persons* that are *separately operated*)	• You should not report information for any *private fund* advised by any of your *related persons* unless you have identified that *related person* in Question 1(b) as a *related person* for which you are filing Form PF

6. I am required to aggregate funds or accounts to determine whether I meet a reporting threshold, or I am electing to aggregate funds for reporting purposes. How do I "aggregate" funds or accounts for these purposes?

Where two or more *parallel funds* or master-feeder funds are aggregated in accordance with Instruction 5, you must treat the aggregated funds as if they were all one *private fund*. Investments that a *feeder fund* makes in a *master fund* should be disregarded but other investments of the *feeder fund* should be treated as though they were investments of the aggregated fund.

Where you are aggregating *dependent parallel managed accounts* to determine whether you meet a reporting threshold, assets held in the accounts should be treated as assets of the *private funds* with which they are aggregated.

Example 1. You advise a *master-feeder arrangement* with one *feeder fund*. The *feeder fund* has invested $500 in the *master fund* and holds a *foreign exchange derivative* with a notional value of $100. The *master fund* has used the $500 received from the *feeder fund* to invest in *corporate bonds*. Neither fund has any other assets or liabilities.

For purposes of determining whether the funds comprise a *qualifying hedge fund*, this *master-feeder arrangement* should be treated as a single *private fund* whose only investments are $500 in *corporate bonds* and a *foreign exchange derivative* with a notional value of $100. If you elect to aggregate the *master-feeder arrangement* for reporting purposes, the treatment would be the same.

Example 2. You advise a *parallel fund structure* consisting of two *hedge funds*, named *parallel fund* A and *parallel fund* B. You also advise a related *dependent parallel managed account*. The account and each fund have invested in *corporate bonds* of Company X and have no other assets or liabilities. The value of *parallel fund* A's investment is $400, the value of *parallel fund* B's investment is $300 and the value of the account's investment is $200.

For purposes of determining whether either of the *parallel funds* is a *qualifying hedge fund*, the entire *parallel fund structure* and the related *dependent parallel managed account* should be treated as a single *private fund* whose only asset is $900 of *corporate bonds* issued by Company X.

If you elect to aggregate the *parallel fund structure* for reporting purposes, you would disregard the *dependent parallel managed account*, so the result would be a single *private fund* whose only asset is $700 of *corporate bonds*

issued by Company X.

7. I advise a *private fund* that invests in other *private funds* (e.g., a "fund of funds"). How should I treat these investments for purposes of Form PF?

Investments in other *private funds* generally. For purposes of this Form PF, you may disregard any *private fund's* equity investments in other *private funds*. However, if you disregard these investments, you must do so consistently (e.g., do not include disregarded investments in the *net asset value* used for determining whether the fund is a "hedge fund"). For Question 17, even if you disregard these assets, you may report the performance of the entire fund and are not required to recalculate performance in order to exclude these investments. Do not disregard any liabilities, even if incurred in connection with these investments.

Funds that invest substantially all of their assets in other *private funds*. If you advise a *private fund* that (i) invests substantially all of its assets in the equity of *private funds* for which you are not an adviser and (ii) aside from such *private fund* investments, holds only *cash and cash equivalents* and instruments acquired for the purpose of hedging currency exposure, then you are only required to complete Section 1b for that fund. For all other purposes, you should disregard such fund. For example, where questions request aggregate information regarding the *private funds* you advise, do not include the assets or liabilities of any such fund.

Solely for purposes of this Instruction 7, you 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 *United States persons* but that would be a *private fund* if it had engaged in such an offering or sale.

Notwithstanding the foregoing, you must include disregarded assets in responding to Question 10.

8. I advise a *private fund* that invests in companies that are not *private funds*. How should I treat these investments for purposes of Form PF?

Except as provided in Instruction 7, investments in funds should be included for all purposes under this Form PF. You are not, however, required to "look through" a fund's investments in any other entity unless the Form specifically requests information regarding that entity or the other entity's primary purpose is to hold assets or incur leverage as part of the *reporting fund's* investment activities.

9. When am I required to update Form PF?

You are required to update Form PF at the following times:

Periodic filings (large hedge fund advisers)	Within 60 calendar days after the end of your first, second and third fiscal quarters, you must file a *quarterly update* that updates the answers to all Items in this Form PF relating to the *hedge funds* that you advise.
	Within 60 calendar days after the end of your fourth fiscal quarter, you must file a *quarterly update* that updates the answers to all Items in this Form PF. You may, however, submit an initial filing for the fourth quarter that updates information relating only to the *hedge funds* that you advise so long as you amend your Form PF within 120 calendar days after the end of the quarter to update information relating to any other *private funds* that you

advise. When you file such an amendment, you are not required to update information previously filed for such quarter.

Periodic filings (large liquidity fund advisers)

Within 15 calendar days after the end of your first, second and third fiscal quarters, you must file a *quarterly update* that updates the answers to all Items in this Form PF relating to the *liquidity funds* that you advise.

Within 15 calendar days after the end of your fourth fiscal quarter, you must file a *quarterly update* that updates the answers to all Items in this Form PF. You may, however, submit an initial filing for the fourth quarter that updates information relating only to the *liquidity funds* that you advise so long as you amend your Form PF within 120 calendar days after the end of the quarter to update information relating to any other *private funds* that you advise (subject to the next paragraph). When you file such an amendment, you are not required to update information previously filed for such quarter.

If you are both a *large liquidity fund adviser* and a *large hedge fund adviser*, you must file your *quarterly updates* with respect to the *liquidity funds* that you advise within 15 calendar days and with respect to the *hedge funds* you advise within 60 calendar days.

Periodic filings (all other advisers)

Within 120 calendar days after the end of your fiscal year, you must file an *annual update* that updates the answers to all Items in this Form PF.

Large hedge fund advisers and large liquidity fund advisers are not required to file *annual updates* but instead file *quarterly updates* for the fourth quarter.

Transition filing

If you are transitioning from quarterly to annual filing because you are no longer a *large hedge fund adviser* or *large liquidity fund adviser*, then you must complete and file Item A of Section 1a and check the box in Section 1a indicating that you are making your final quarterly filing. You must file your transition filing no later than the last day on which your next *quarterly update* would be timely.

Final filing

If you are no longer required to file Form PF, then you must complete and file Item A of Section 1a and check the box in Section 1a indicating that you are making your final filing. You must file your final filing no later than the last day on which your next Form PF update would be timely. This applies to all Form PF filers.

Failure to update your Form PF as required by these instructions is a violation of *SEC* and, where applicable, *CFTC* rules and could lead to revocation of your registration.

10. How do I obtain *private fund* identification numbers for my *reporting funds*?

Each *private fund* must have an identification number for purposes of reporting on *Form ADV* and Form PF. *Private fund* identification numbers can only be obtained by filing *Form ADV*.

If you need to obtain a *private fund* identification number and you are required to file a *quarterly update* of Form PF prior to your next annual update of *Form ADV*, then you must acquire the

identification number by filing an other-than-annual amendment to your *Form ADV* and following the instructions on Form ADV for generating a new number. When filing an other-than-annual amendment for this purpose, you must complete and file all of *Form ADV Section 7.B.1* for the new *private fund.*

See Instruction 6 to Part 1A of *Form ADV* for additional information regarding the acquisition and use of *private fund* identification numbers.

11. Who must sign my Form PF or update?

The individual who signs the Form PF 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 limited liability company, a managing member or authorized person.
- For a SID, 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 should be a typed name.

If you and one or more of your *related persons* are filing a single Form PF, then Form PF may be signed by one or more individuals; however, the individual, or the individuals collectively, must have authority, as provided above, to sign both on your behalf and on behalf of all such *related persons.*

12. How do I file my Form PF?

You must file Form PF electronically through the Form PF filing system on the Investment Adviser Registration Depository website (www.iard.com), which contains detailed filing instructions. Questions regarding filing through the Form PF filing system should be addressed to the Financial Industry Regulatory Authority (FINRA) at 240-386-4848.

13. Are there filing fees?

Yes, you must pay a filing fee for your Form PF filings. The Form PF filing fee schedule is published at http://www.sec.gov/iard and http://www.iard.com.

14. What if I am not able to file electronically?

A temporary hardship exemption is available if you encounter unanticipated technical difficulties that prevent you from making a timely filing with the Form PF filing system, 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" (as such term is used in *SEC* rule 204(b)-1(f)).

To request a temporary hardship exemption, you must complete and file on paper Item A of Section 1a and Section 5 of Form PF, checking the box in Section 1a indicating that you are requesting a temporary hardship exemption. Mail one manually signed original and one copy of your exemption filing to: U.S. Securities and Exchange Commission, Branch of Regulations and

Examinations, Mail Stop 0-25, 100 F Street NE, Washington, DC 20549. You must preserve in your records a copy of any temporary hardship exemption filing. Any request for a temporary hardship exemption must be filed no later than one business day after the electronic Form PF filing was due. For more information, see *SEC* rule 204(b)-1(f).

15. May I rely on my own methodologies in responding to Form PF? How should I enter requested information?

You may respond to this Form using your own internal methodologies and the conventions of your service providers, provided the information is consistent with information that you report internally and to current and prospective investors. However, your methodologies must be consistently applied and your responses must be consistent with any instructions or other guidance relating to this Form. You may explain any of your methodologies, including related assumptions, in Question 4.

In responding to Questions on this Form, the following guidelines apply unless otherwise specifically indicated:

- provide the requested information as of the close of business on the *data reporting date*;
- if information is requested for any month or quarter, provide the requested information as of the close of business on the last calendar day of the month or quarter, respectively;
- if a question requests information expressed as a percentage, enter the response as a percentage (not a decimal) and round to the nearest one percent;
- if a question requests a monetary value, provide the information in U.S. dollars as of the *data reporting date*, rounded to the nearest thousand;
- if a question requests a numerical value other than a percentage or a dollar value, provide information rounded to the nearest whole number;
- if a question requests information regarding a "position" or "positions," you should determine whether a set of legal and contractual rights constitutes a "position" in a manner consistent with your internal recordkeeping and risk management procedures (e.g., some advisers may record as a single position two or more partially offsetting legs of a transaction entered into with the same counterparty under the same master agreement, while others may record these as separate positions);
- if a question requires you to distinguish long positions from short positions, classify positions in a manner consistent with your internal recordkeeping and risk management procedures (provided that, for *CDS*, *exotic CDS*, *index CDS*, and *single name CDS*, the protection seller should be viewed as long and the protection buyer should be viewed as short);
- do not net long and short positions;
- for derivatives (other than options), "value" means *gross notional value*; for options, "value" means delta adjusted notional value; for all other investments and for all *borrowings* where the reporting fund is the creditor, "value" means market value or, where there is not a readily available market value, fair value; for *borrowings* where the reporting fund is the debtor, "value" means the value you report internally and to current and prospective investors; and

- for questions 20, 21, 25, 28, 35 and 57, the numerator you use to determine the percentage of *net asset value* should be measured on the same basis as *gross asset value* and may result in responses that total more than 100%.

16. How do I amend Form PF, for example, to make a correction?

If you discover that information you filed on Form PF was not accurate at the time of filing, you may correct the information by re-filing and checking the box in Section 1a indicating that you are amending a previously submitted filing. You are not required to update information that you believe in good faith properly responded to Form PF on the date of filing even if that information is subsequently revised for purposes of your recordkeeping, risk management or investor reporting (such as estimates that are refined after completion of a subsequent audit).

Large hedge fund advisers and *large liquidity fund advisers* that comply with their fourth quarter filing obligations by submitting an initial filing followed by an amendment in accordance with Instruction 9 will not be viewed as affirming responses regarding one fund solely by providing updated information regarding another fund at a later date.

17. How may I preserve on Form PF the anonymity of a *private fund* that I advise?

If you seek to preserve the anonymity of a *private fund* that you advise 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* on Form PF using the same code or designation in place of the fund's name.

18. May I report on Form PF regarding a *commodity pool* that is not a *private fund*? How should I treat the *commodity pool* for purposes of Form PF?

If you are otherwise required to report on Form PF, you may report information regarding any *commodity pool* you advise on Form PF, even if it is not a *private fund*. Properly reporting on Form PF regarding the *commodity pool* will constitute substitute compliance with CFTC reporting requirements to the extent provided in *CEA* rule 4.27.

Commodity pools should be treated as *hedge funds* for purposes of Form PF. If you are reporting on Form PF regarding a *commodity pool* that is not a *private fund*, then treat it as a *private fund* for purposes of Form PF. However, such a *commodity pool* is not required to be included when determining whether you exceed one or more reporting thresholds. If such a *commodity pool* is a *qualifying hedge fund* and you are otherwise required to report information in section 2a of Form PF, then you must report regarding the *commodity pool* in section 2b of Form PF.

Federal Information Law and Requirements for a Collection of Information

Section 204(b) of the *Advisers Act* [15 U.S.C. § 80b-4(b)] authorizes the *SEC* to collect the information that Form PF requires. The information collected on Form PF is designed to facilitate the Financial Stability Oversight Council's ("FSOC") monitoring of systemic risk in the private fund industry and to assist FSOC in determining whether and how to deploy its regulatory tools with respect to nonbank financial companies. The *SEC* and *CFTC* may also use information collected on Form PF in their regulatory programs, including examinations, investigations and investor protection efforts relating to private fund advisers. Filing Form PF is mandatory for advisers that satisfy the criteria described in

Instruction 1 to the Form. *See also* 17 C.F.R. § 275.204(b)-1. The SEC does not intend to make public information reported on Form PF that is identifiable to any particular adviser or *private fund*, although the SEC may use Form PF information in an enforcement action. *See* Section 204(b) of the *Advisers Act*.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507. Any member of the public may direct any comments concerning the accuracy of the burden estimate and any suggestion for reducing this burden to: Secretary, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

Section 1a: Information about you and your *related persons*

Check the box that indicates what you would like to do:

A. If you are not a *large hedge fund adviser* or *large liquidity fund adviser*:

- ☐ Submit your first filing on Form PF
  for the period ended: ______________
- ☐ Submit an *annual update*
  for the period ended: ______________
- ☐ Amend a previously submitted filing
  for the period ended: ______________
- ☐ Submit a final filing
- ☐ Request a temporary hardship exemption

B. If you are a *large hedge fund adviser* or *large liquidity fund adviser*:

- ☐ Submit your first filing on Form PF
  for the [1st, 2nd, 3rd, 4th] quarter, which ended: ____________
- ☐ Submit a *quarterly update* (including fourth quarter updates)
  for the [1st, 2nd, 3rd, 4th] quarter, which ended: ____________
- ☐ Amend a previously submitted filing
  for the [1st, 2nd, 3rd, 4th] quarter, which ended: ____________
- ☐ Transition to annual reporting
- ☐ Submit a final filing
- ☐ Request a temporary hardship exemption

Item A. Information about you

1. (a) Provide your name and the other identifying information requested below.

   (This should be your full legal name. If you are a sole proprietor, this will be your last, first, and middle names. If you are a SID, *enter the full legal name of your bank. Please use the same name that you use in your* Form ADV.*)*

Legal name	SEC 801-Number	NFA ID Number, if any	Large trader ID, if any	Large trader ID suffix, if any

   (b) Provide the following information for each of the *related persons*, if any, with respect to which you are reporting information on this Form PF:

Legal name	SEC 801-Number	NFA ID Number, if any	Large trader ID, if any	Large trader ID suffix, if any

2. Signatures of sole proprietor or authorized representative *(see Instruction 11 to Form PF).*

<u>Signature on behalf of the *firm* and its *related persons*:</u>

I, the undersigned, sign this Form PF on behalf of, and with the authority of, the *firm*. In addition, I sign this Form PF on behalf of, and with the authority of, each of the *related persons* identified in Question 1(b) (other than any *related person* for which another individual has signed this Form PF below).

To the extent that Section 1 or 2 of this Form PF is filed in accordance with a regulatory obligation imposed by *CEA* rule 4.27, the *firm*, each *related person* for which I am signing this Form PF, and I all accept that any false or misleading statement of a material fact therein or material omission therefrom shall constitute a violation of section 6(c)(2) of the *CEA*.

Name of individual:	
Signature:	
Title:	
Email address:	
Telephone contact number (include area code and, if outside the United States, country code):	
Date:	

<u>Signature on behalf of *related persons*:</u>

I, the undersigned, sign this Form PF on behalf of, and with the authority of, the *related person(s)* identified below.

To the extent that Section 1 or 2 of this Form PF is filed in accordance with a regulatory obligation imposed by *CEA* rule 4.27, each *related person* identified below and I all accept that any false or misleading statement of a material fact therein or material omission therefrom shall constitute a violation of section 6(c)(2) of the *CEA*.

Name of each *related person* on behalf of which this individual is signing:	
Name of individual:	
Signature:	
Title:	
Email address:	
Telephone contact number (include area code and, if outside the United States, country code):	
Date:	

Item B. Information about assets of *private funds* that you advise

3. Provide a breakdown of your *regulatory assets under management* and your *net assets*

under management as follows:

(If you are filing a quarterly update *for your first, second or third fiscal quarter, you are only required to update row (a), in the case of a* large hedge fund adviser, *or row (b), in the case of a* large liquidity fund adviser.*)*

	Regulatory assets under management	***Net assets under management***
(a) *Hedge funds*		
(b) *Liquidity funds*		
(c) *Private equity funds*		
(d) *Real estate funds*		
(e) *Securitized asset funds*		
(f) *Venture capital funds*		
(g) *Other private funds*		
(h) Funds and accounts other than *private funds* (i.e., the remainder of your assets under management)		

Item C. Miscellaneous

4. You may use the space below to explain any assumptions that you made in responding to any question in this Form PF. Assumptions must be in addition to, or reasonably follow from, any instructions or other guidance relating to Form PF. If you are aware of any instructions or other guidance that may require a different assumption, provide a citation and explain why that assumption is not appropriate for this purpose.

Question number	**Description**

Section 1b: Information about the *private funds* you advise

Subject to Instruction 5, you must complete a separate Section 1b for each *private fund* that you advise.

Item A. *Reporting fund* identifying information

5. (a) Name of the *reporting fund* .... ☐

   (b) *Private fund* identification number of the *reporting fund* .... ☐

   (c) *NFA* identification number of the *reporting fund*, if applicable .... ☐

   (d) *LEI* of the *reporting fund*, if applicable .... ☐

6. Check "yes" below if the *reporting fund* is the *master fund* of a *master-feeder arrangement* and you are reporting for all of the funds in the *master-feeder arrangement* on an aggregated basis. Otherwise, check "no."

   (See Instruction 5 for information regarding aggregation of master-feeder arrangements. *If you respond "yes," do not complete a separate Section 1b, 1c, 2b, 3 or 4 with respect to any of the* feeder funds.*)*

   ☐ Yes ☐ No

7. (a) Check "yes" below if the *reporting fund* is the largest fund in a *parallel fund structure* and you are reporting for all of the funds in the structure on an aggregated basis. Otherwise, check "no."

   (See Instruction 5 for information regarding aggregation of parallel funds. *If you respond "yes," do not complete a separate Section 1b, 1c, 2b, 3 or 4 with respect to any of the other* parallel funds *in the structure.)*

   ☐ Yes ☐ No

   If you responded "yes" to Question 7(a), complete (b) through (e) below for each other *parallel fund* in the *parallel fund structure.*

   (b) Name of the *parallel fund* .... ☐

   (c) *Private fund* identification number of the *parallel fund* .... ☐

   (d) *NFA* identification number of the *parallel fund*, if applicable .... ☐

   (e) *LEI* of the *parallel fund*, if applicable .... ☐

Item B. Assets, financing and investor concentration

8. *Gross asset value* of *reporting fund* .... ☐

   (This amount may differ from the amount you reported in response to question 11 of Form ADV Section 7.B.1. *For instance, the amounts may not be the same if you are filing Form PF on a quarterly basis, if you are aggregating a* master-feeder arrangement *for purposes of this Form PF and you did not aggregate that* master-feeder arrangement *for purposes of* Form ADV Section 7.B.1. *or if you are aggregating* parallel funds *for purposes of this Form PF.)*

9. *Net asset value* of *reporting fund* .... ☐

10. *Value* of *reporting fund's* investments in equity of other *private funds* .... [ ]

11. *Value* of all *parallel managed accounts* related to the *reporting fund* .... [ ]

    (If any of your parallel managed accounts *relates to more than one of the* private funds *you advise, only report the value of the account once, in connection with the largest* private fund *to which it relates.)*

12. Provide the following information regarding the *value* of the *reporting fund's borrowings* and the types of creditors.

    (You are not required to respond to this question for any reporting fund *with respect to which you are answering Question 43 in Section 2b. Do not net out amounts that the* reporting fund *loans to creditors or the value of collateral pledged to creditors.)*

    (The percentages borrowed from the specified types of creditors should add up to approximately 100%.)

    (a) Dollar amount of total *borrowings*.. [ ]

    (b) Percentage borrowed from *U.S. financial institutions* .... [ ]

    (c) Percentage borrowed from *non-U.S. financial institutions* .... [ ]

    (d) Percentage borrowed from U.S. creditors that are not financial institutions........... [ ]

    (e) Percentage borrowed from non-U.S. creditors that are not financial institutions .... [ ]

13. (a) Does the *reporting fund* have any outstanding derivatives positions?

    ☐ Yes ☐ No

    (b) If you responded "yes" to Question 13(a), provide the aggregate *value* of all derivatives positions of the *reporting fund* .... [ ]

    (You are not required to respond to Question 13 for any reporting fund *with respect to which you are answering Question 44 in Section 2b.)*

14. Provide a summary of the *reporting fund's* assets and liabilities categorized using the hierarchy below. For assets and liabilities that you report internally and to current and prospective investors as representing fair value, or for which you are required to determine fair value in order to report the *reporting fund's* regulatory assets under management on Form ADV, categorize them into the following categories based on the valuation assumptions utilized:

    Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities.

    Level 2 – Other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

    Level 3 – Unobservable inputs, such as your assumptions or the fund's assumptions used to determine the fair value of the asset or liability.

    For any assets and liabilities that you report internally and to current and prospective investors as representing a measurement attribute other than fair value, and for which you are not required to determine fair value in order to report the *reporting fund's* regulatory assets under management on Form ADV, separately report these assets and liabilities in the "cost-based" measurement column.

    (If the fund's financial statements are prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") or another accounting standard that requires the

categorization of assets and liabilities using a fair value hierarchy similar to that established under U.S. GAAP, then respond to this question using the fair value hierarchy established under the applicable accounting standard.)

(This question requires the use of fair values and cost-based measurements, which may be different from the values contemplated by Instruction 15. You are only required to respond to this question if you are filing an annual update *or a* quarterly update *for your fourth fiscal quarter.)*

	Fair value			Cost-based
	Level 1	Level 2	Level 3	
Assets	$ ______	$ ______	$ ______	$ ______
Liabilities	$ ______	$ ______	$ ______	$ ______

15. Specify the approximate percentage of the *reporting fund's* equity that is beneficially owned by the five beneficial owners having the largest equity interests in the *reporting fund.*

(For purposes of this question, if you know that two or more beneficial owners of the reporting fund *are* affiliated *with each other, you should treat them as a single beneficial owner.)*

16. Specify the approximate percentage of the *reporting fund's* equity that is beneficially owned by the following groups of investors.

(Include each investor in only one group. The total should add up to approximately 100%. With respect to beneficial interests outstanding prior to March 31, 2012, that have not been transferred on or after that date, you may respond to this question using good faith estimates based on data currently available to you.)

(a) Individuals that are *United States persons* (including their trusts)

(b) Individuals that are not *United States persons* (including their trusts)

(c) Broker-dealers

(d) Insurance companies

(e) Investment companies registered with the *SEC*

(f) *Private funds*

(g) Non-profits

(h) Pension plans (excluding governmental pension plans)

(i) Banking or thrift institutions (proprietary)

(j) State or municipal *government entities* (excluding governmental pension plans)

(k) State or municipal governmental pension plans

(l) Sovereign wealth funds and foreign official institutions

(m) Investors that are not *United States persons* and about which the foregoing beneficial ownership information is not known and cannot reasonably be obtained because the beneficial interest is held through a chain involving one or more third-party intermediaries

(n) Other

Item C. *Reporting fund* performance

17. Provide the *reporting fund's* gross and net performance, as reported to current and prospective investors (or, if calculated for other purposes but not reported to investors, as so calculated). If the fund reports different performance results to different groups of investors, provide the most representative results. You are required to provide monthly and quarterly performance results only if such results are calculated for the *reporting fund* (whether for purposes of reporting to current or prospective investors or otherwise).

    (If your fiscal year is different from the reporting fund's *fiscal year, then for any portion of the* reporting fund's *fiscal year that has not been completed as of the* data reporting date, *provide the relevant information from that portion of the* reporting fund's *preceding fiscal year.)*

    (Enter your responses as percentages rounded to the nearest one-hundredth of one percent. Performance results for monthly and quarterly periods should not be annualized. If any period precedes the date of the fund's formation, enter "NA". You are not required to include performance results for any period with respect to which you previously provided performance results for the reporting fund *on Form PF.)*

	Last day of fiscal period	Gross performance	Net of management fees and incentive fees and allocations
(a) 1st month of *reporting fund's* fiscal year.......			
(b) 2nd month of *reporting fund's* fiscal year			
(c) 3rd month of *reporting fund's* fiscal year......			
(d) First quarter..			
(e) 4th month of *reporting fund's* fiscal year			
(f) 5th month of *reporting fund's* fiscal year			
(g) 6th month of *reporting fund's* fiscal year			
(h) Second quarter			
(i) 7th month of *reporting fund's* fiscal year			
(j) 8th month of *reporting fund's* fiscal year			
(k) 9th month of *reporting fund's* fiscal year			
(l) Third quarter			
(m) 10th month of *reporting fund's* fiscal year			
(n) 11th month of *reporting fund's* fiscal year			
(o) 12th month of *reporting fund's* fiscal year			
(p) Fourth quarter			
(q) *Reporting fund's* most recently completed fiscal year...			

Section 1c: Information about the *hedge funds* you advise

Subject to Instruction 5, you must complete a separate Section 1c for each *hedge fund* that you advise.

Item A. *Reporting fund* identifying information

18. (a) Name of the *reporting fund* .... ☐

(b) *Private fund* identification number of the *reporting fund*.. ☐

Item B. Certain information regarding the *reporting fund*

19. Does the *reporting fund* have a single primary investment strategy or multiple strategies?

☐ Single primary strategy ☐ Multi-strategy

20. Indicate which of the investment strategies below best describe the *reporting fund's* strategies. For each strategy that you have selected, provide a good faith estimate of the percentage of the *reporting fund's net asset value* represented by that strategy. If, in your view, the *reporting fund's* allocation among strategies is appropriately represented by the percentage of deployed capital, you may also provide that information.

(Select the investment strategies that best describe the reporting fund's strategies, even if the descriptions below do not precisely match your characterization of those strategies; select "other" only if a strategy that the reporting fund *uses is significantly different from any of the strategies identified below. You may refer to the* reporting fund's *use of these strategies as of the* data reporting date *or throughout the* reporting period, *but you must report using the same basis in future filings.)*

(The strategies listed below are mutually exclusive (i.e., do not report the same assets under multiple strategies). If providing percentages of capital, the total should add up to approximately 100%.)

Strategy	% of *NAV* (required)	% of capital (optional)
☐ Equity, Market Neutral		
☐ Equity, Long/Short		
☐ Equity, Short Bias		
☐ Equity, Long Bias		
☐ Macro, Active Trading		
☐ Macro, Commodity		
☐ Macro, Currency		
☐ Macro, Global Macro		
☐ Relative Value, Fixed Income Asset Backed		

☐ Relative Value, Fixed Income Convertible Arbitrage		
☐ Relative Value, Fixed Income Corporate		
☐ Relative Value, Fixed Income Sovereign		
☐ Relative Value, Volatility Arbitrage		
☐ Event Driven, Distressed/Restructuring		
☐ Event Driven, Risk Arbitrage/Merger Arbitrage		
☐ Event Driven, Equity Special Situations		
☐ Credit, Long/Short		
☐ Credit, Asset Based Lending		
☐ Managed Futures/*CTA*, Fundamental		
☐ Managed Futures/*CTA*, Quantitative		
☐ Investment in other funds		
☐ Other: __________		

21. During the *reporting period*, approximately what percentage of the *reporting fund's net asset value* was managed using high-frequency trading strategies?

    (In your response, please do not include strategies using algorithms solely for trade execution. This question concerns strategies that are substantially computer-driven, where decisions to place bids or offers, and to buy or sell, are primarily based on algorithmic responses to intraday price action in equities, futures and options, and where the total number of shares or contracts traded throughout the day is generally significantly larger than the net change in position from one day to the next.)

    ☐ 0% ☐ less than 10% ☐ 10-25% ☐ 26-50%
    ☐ 51-75% ☐ 76-99% ☐ 100% or more

22. Identify the five counterparties to which the *reporting fund* has the greatest mark-to-market net counterparty credit exposure, measured as a percentage of the *reporting fund's net asset value*.

    (For purposes of this question, you should treat affiliated *entities as a single group to the extent exposures may be contractually or legally set-off or netted across those entities and/or one affiliate guarantees or may otherwise be obligated to satisfy the obligations of another.* CCPs *should not be regarded as counterparties for purposes of this question.)*

    (In your response, you should take into account: (i) mark-to-market gains and losses on derivatives; and (ii) any loans or loan commitments.)

    (However, you should not take into account: (i) margin posted by the counterparty; or (ii) holdings of debt or equity securities issued by the counterparty.)

	Legal name of the counterparty (or, if multiple affiliated entities, counterparties)	**Indicate below if the counterparty is affiliated with a major financial institution**	**Exposure (% of *reporting fund's net asset value*)**
(a)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(b)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(c)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(d)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(e)		[drop-down list of counterparty names] Other: _________ [Not applicable]	

23. Identify the five counterparties that have the greatest mark-to-market net counterparty credit exposure to the *reporting fund*, measured in U.S. dollars.

(For purposes of this question, you should treat affiliated *entities as a single group to the extent exposures may be contractually or legally set-off or netted across those entities and/or one affiliate guarantees or may otherwise be obligated to satisfy the obligations of another.* CCPs *should not be regarded as counterparties for purposes of this question.)*

(In your response, you should take into account: (i) mark-to-market gains and losses on derivatives; and (ii) any loans or loan commitments.)

(However, you should not take into account: (i) margin posted to the counterparty; or (ii) holdings of debt or equity securities issued by the counterparty.)

	Legal name of the counterparty (or, if multiple affiliated entities, counterparties)	**Indicate below if the counterparty is affiliated with a major financial institution**	**Exposure (in U.S. dollars)**
(a)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(b)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(c)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(d)		[drop-down list of counterparty names] Other: _________ [Not applicable]	
(e)		[drop-down list of counterparty names]	

	Other: ________ [Not applicable]

24. Provide the following information regarding your use of trading and clearing mechanisms during the *reporting period.*

(Provide good faith estimates of the mode in which instruments were traded and cleared by the reporting fund, *and not the market as a whole. For purposes of this question, a "trade" includes any transaction, whether entered into on a bilateral basis or through an exchange, trading facility or other system and whether long or short. With respect to clearing, transactions for which margin is held in a customer omnibus account at a* CCP *should be considered cleared by a* CCP. *Tri-party* repo *applies where* repo *collateral is held at a custodian (not including a* CCP*) that acts as a third party agent to both the* repo *buyer and the* repo *seller.)*

(The total in each part of this question should add up to 100%. Enter "NA" in each part of this question for which the reporting fund *engaged in no relevant trades.)*

	%
(a) Estimated % (in terms of *value*) of securities (other than derivatives) that were traded by the *reporting fund*:	
On a regulated exchange	
OTC	
(b) Estimated % (in terms of trade volumes) of derivatives that were traded by the *reporting fund*:	
On a regulated exchange or swap execution facility	
OTC	
(c) Estimated % (in terms of trade volumes) of *derivatives* that were traded by the *reporting fund* and:	
Cleared by a *CCP*	
Bilaterally transacted (i.e., not cleared by a *CCP*)	
(d) Estimated % (in terms of *value*) of *repo* trades that were entered into by the *reporting fund* and:	
Cleared by a *CCP*	
Bilaterally transacted (i.e., not cleared by a *CCP*)	
Constitute a tri-party *repo*	

25. What percentage of the *reporting fund's net asset value* relates to transactions that are not described in any of the categories listed in items (a) through (d) of Question 24?

Section 2a: Aggregated information about *hedge funds* that you advise

Item A. Exposure of *hedge fund* assets

26. Aggregate *hedge fund* exposures.

(Give a dollar value *for long and short positions as of the last day in each month of the* reporting period, *by* sub-asset class, *including all exposure whether held physically, synthetically or through derivatives. Enter "NA" in each space for which there are no relevant positions.)*

(Include any closed out and OTC *forward positions that have not yet expired/matured. Do not net positions within* sub-asset classes. *Positions held in side-pockets should be included as positions of the* hedge funds. *Provide the absolute value of short positions. Each position should only be included in a single* sub-asset class.*)*

(Where "duration/WAT/10-year eq." is required, provide at least one of the following with respect to the position and indicate which measure is being used: bond duration, weighted average tenor or 10-year bond equivalent. Duration and weighted average tenor should be entered in terms of years to two decimal places.)

	1st Month		2nd Month		3rd Month	
	LV	*SV*	*LV*	*SV*	*LV*	*SV*
Listed equity						
Issued by financial institutions..................						
Other *listed equity*....................................						
Unlisted equity						
Issued by financial institutions..................						
Other *unlisted equity*................................						
Listed equity derivatives						
Related to financial institutions						
Other *listed equity derivatives*						
Derivative exposures to unlisted equities						
Related to financial institutions						
Other *derivative exposures to unlisted equities*..						
Corporate bonds issued by financial institutions (other than *convertible bonds*)						
Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						

Corporate bonds not issued by financial institutions (other than *convertible bonds*)

Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						

Convertible bonds issued by financial institutions

Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						

Convertible bonds not issued by financial institutions

Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq.						

Sovereign bonds and municipal bonds

U.S. treasury securities						
☐ Duration ☐ WAT ☐ 10-year eq.						
Agency securities						
☐ Duration ☐ WAT ☐ 10-year eq.						
GSE bonds						
☐ Duration ☐ WAT ☐ 10-year eq.						
Sovereign bonds issued by *G10* countries other than the U.S.						
☐ Duration ☐ WAT ☐ 10-year eq.						
Other *sovereign bonds* (including supranational bonds)						
☐ Duration ☐ WAT ☐ 10-year eq.						
U.S. state and local bonds						
☐ Duration ☐ WAT ☐ 10-year eq.						

Loans

Leveraged loans						

☐ Duration ☐ WAT ☐ 10-year eq..						
Other loans (not including *repos*).............						
☐ Duration ☐ WAT ☐ 10-year eq..						

Repos						
☐ Duration ☐ WAT ☐ 10-year eq.						

ABS/structured products

MBS..						
☐ Duration ☐ WAT ☐ 10-year eq..						
ABCP						
☐ Duration ☐ WAT ☐ 10-year eq..						
CDO/CLO						
☐ Duration ☐ WAT ☐ 10-year eq..						
Other ABS						
☐ Duration ☐ WAT ☐ 10-year eq..						
Other structured products						

Credit derivatives

Single name CDS						
Index CDS						
Exotic CDS..						

Foreign exchange derivatives (investment).....						
Foreign exchange derivatives (hedging)..........						
Non-U.S. currency holdings............................						

Interest rate derivatives.................................						

Commodities (derivatives)

Crude oil..						
Natural gas						
Gold						
Power..						
Other commodities..................................						

Commodities (physical)

Crude oil..						
Natural gas						

Gold						
Power						
Other commodities						

Other derivatives						

Physical real estate						

Investments in internal private funds						
Investments in external private funds						
Investments in registered investment companies						

Cash and cash equivalents

Certificates of deposit						
☐ Duration ☐ WAT ☐ 10-year eq.						
Other deposits						
Money market funds						
Other *cash and cash equivalents* (excluding government securities)						
Investments in funds for cash management purposes (other than *money market funds*)						
Investments in other sub-asset classes						

27. For each month of the *reporting period*, provide the *value* of turnover during the month in each of the asset classes listed below for the *hedge funds* that you advise.

(The value *of turnover should be the sum of the absolute* values *of transactions in the relevant asset class during the period.)*

	1st Month	**2nd Month**	**3rd Month**
Listed equity			
Corporate bonds (other than *convertible bonds*)			
Convertible bonds			

Sovereign bonds and municipal bonds

	1st Month	**2nd Month**	**3rd Month**
U.S. treasury securities			
Agency securities			
GSE bonds			
Sovereign bonds issued by *G10* countries other than the U.S.			
Other *sovereign bonds* (including supranational bonds)			

U.S. state and local bonds			
Futures			

28. (a) Provide a geographical breakdown of the investments held by the *hedge funds* that you advise (by percentage of the total *net asset value* of these *hedge funds*).

(See Instruction 15 for information on calculating the numerator for purposes of this Question.)

	Region	% of *NAV*
(i)	Africa	
(ii)	Asia and Pacific (other than the Middle East)	
(iii)	Europe (*EEA*)	
(iv)	Europe (other than *EEA*)	
(v)	Middle East	
(vi)	North America	
(vii)	South America	
(viii)	Supranational	

(b) Provide the value of investments in the following countries held by the *hedge funds* that you advise (by percentage of the total *net asset value* of these *hedge funds*).

(See Instruction 15 for information on calculating the numerator for purposes of this Question.)

	Country	% of *NAV*
(i)	Brazil	
(ii)	China (including Hong Kong)	
(iii)	India	
(iv)	Japan	
(v)	Russia	
(vi)	United States	

Section 2b: Information about *qualifying hedge funds* that you advise.

You must complete a separate Section 2b for each *qualifying hedge fund* that you advise. However, with respect to *master-feeder arrangements* and *parallel fund structures* that collectively comprise *qualifying hedge funds,* you may report collectively or separately about the component funds as provided in the General Instructions.

Item A. *Reporting fund* identifying information

29. (a) Name of the *reporting fund*.. ☐

(b) *Private fund* identification number of the *reporting fund*.. ☐

Item B. *Reporting fund* exposures and trading

Check this box if you advise only one *hedge fund*. If you check this box, you may skip Question 30.
☐

30. *Reporting fund* exposures.

(Give a dollar value *for long and short positions as of the last day in each month of the* reporting period, *by* sub-asset class, *including all exposure whether held physically, synthetically or through derivatives. Enter "NA" in each space for which there are no relevant positions.)*

(Include any closed out and OTC *forward positions that have not yet expired/matured. Do not net positions within* sub-asset classes. *Positions held in side-pockets should be included as positions of the* hedge funds. *Provide the absolute value of short positions. Each position should only be included in a single* sub-asset class.*)*

(Where "duration/WAT/10-year eq." is required, provide at least one of the following with respect to the position and indicate which measure is being used: bond duration, weighted average tenor or 10-year bond equivalent. Duration and weighted average tenor should be entered in terms of years to two decimal places.)

	1st Month		2nd Month		3rd Month	
	LV	*SV*	*LV*	*SV*	*LV*	*SV*
Listed equity						
Issued by financial institutions..................						
Other *listed equity*....................................						
Unlisted equity						
Issued by financial institutions..................						
Other *unlisted equity*................................						
Listed equity derivatives						

Related to financial institutions						
Other *listed equity derivatives*						
Derivative exposures to unlisted equities						
Related to financial institutions						
Other *derivative exposures to unlisted equities*						
Corporate bonds issued by financial institutions (other than *convertible bonds*)						
Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Corporate bonds not issued by financial institutions (other than *convertible bonds*)						
Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Convertible bonds issued by financial institutions						
Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Convertible bonds not issued by financial institutions						
Investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Non-investment grade						
☐ Duration ☐ WAT ☐ 10-year eq..						
Sovereign bonds and municipal bonds						
U.S. treasury securities.............................						
☐ Duration ☐ WAT ☐ 10-year eq..						
Agency securities						
☐ Duration ☐ WAT ☐ 10-year eq..						

GSE bonds ....

☐ Duration ☐ WAT ☐ 10-year eq..

Sovereign bonds issued by *G10* countries other than the U.S. ....

☐ Duration ☐ WAT ☐ 10-year eq..

Other *sovereign bonds* (including supranational bonds) ....

☐ Duration ☐ WAT ☐ 10-year eq..

U.S. state and local bonds ....

☐ Duration ☐ WAT ☐ 10-year eq..

Loans

Leveraged loans ....

☐ Duration ☐ WAT ☐ 10-year eq..

Other loans (not including *repos*) ....

☐ Duration ☐ WAT ☐ 10-year eq..

Repos ....

☐ Duration ☐ WAT ☐ 10-year eq. ....

ABS/structured products

MBS ....

☐ Duration ☐ WAT ☐ 10-year eq..

ABCP ....

☐ Duration ☐ WAT ☐ 10-year eq..

CDO/CLO ....

☐ Duration ☐ WAT ☐ 10-year eq..

Other ABS ....

☐ Duration ☐ WAT ☐ 10-year eq..

Other structured products ....

Credit derivatives

Single name CDS ....

Index CDS ....

Exotic CDS ....

Foreign exchange derivatives (investment) .....

Foreign exchange derivatives (hedging) ....

Non-U.S. currency holdings ....

Interest rate derivatives						
Commodities (derivatives)						
Crude oil						
Natural gas						
Gold						
Power						
Other commodities						
Commodities (physical)						
Crude oil						
Natural gas						
Gold						
Power						
Other commodities						
Other derivatives						
Physical real estate						
Investments in internal private funds						
Investments in external private funds						
Investments in registered investment companies						
Cash and cash equivalents						
Certificates of deposit						
☐ Duration ☐ WAT ☐ 10-year eq..						
Other deposits						
Money market funds						
Other *cash and cash equivalents* (excluding government securities)						
Investments in funds for cash management purposes (other than *money market funds*)						
Investments in other sub-asset classes						

31. What is the *reporting fund's* base currency?

    [drop-down of currencies]

    Other: ____________

32. Provide the following information regarding the liquidity of the *reporting fund's* portfolio.

(Specify the percentage by value *of the* reporting fund's *positions that may be liquidated within each of the periods specified below. Each investment should be assigned to only one period and such assignment should be based on the shortest period during which you believe that such position could reasonably be liquidated at or near its carrying value. Use good faith estimates for liquidity based on market conditions over the* reporting period *and assuming no fire-sale discounting. In the event that individual positions are important contingent parts of the same trade, group all those positions under the liquidity period of the least liquid part (so, for example, in a convertible bond arbitrage trade, the liquidity of the short should be the same as the* convertible bond*). Exclude* cash and cash equivalents.*)*

(The total should add up to approximately 100%.)

	% of portfolio capable of being liquidated within
1 day or less	
2 days – 7 days	
8 days – 30 days	
31 days – 90 days	
91 days – 180 days	
181 days – 365 days	
Longer than 365 days	

		1st Month	**2nd Month**	**3rd Month**
33.	*Value* of *reporting fund's unencumbered cash*			
34.	Total number of open positions (approximate), determined on the basis of each position and not the issuer or counterparty			

35. For each open position of the *reporting fund* that represents 5% or more of the *reporting fund's net asset value*, provide the information requested below.

	% of *net asset value*	***Sub-asset class***
(a) First month of the *reporting period*		
(i) Position		[drop-down of asset classes]
(ii) Position		[drop-down of asset classes]
(b) Second month of the *reporting period*		
(i) Position		[drop-down of asset classes]
(ii) Position		[drop-down of asset classes]
(c) Third month of the *reporting period*		

(i) Position .... [ ] [drop-down of asset classes]

(ii) Position .... [ ] [drop-down of asset classes]

36. For each of the top five counterparties listed in your response to Question 22 with respect to the *reporting fund*, provide the following information regarding the collateral and other credit support that the counterparty has posted to the *reporting fund*.

(For purposes of Questions 36, 37 and 38, include as collateral assets purchased in connection with repos *and collateral posted under an arrangement pursuant to which the secured party has loaned securities to the pledgor.* Repos *and* reverse-repos *with the same counterparty may be netted to the extent secured by the same type of collateral.)*

(a) Counterparty [1, 2, 3, 4, 5]:

(i) *value* of collateral posted in the form of *cash and cash equivalents*...... [ ]

(ii) *value* of collateral posted in the form of securities (other than *cash and cash equivalent* instruments).. [ ]

(iii) *value* of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support) .... [ ]

37. For each of the top five counterparties listed in your response to Question 23 with respect to the *reporting fund*, provide the following information regarding the collateral and other credit support that the *reporting fund* has posted to the counterparty.

(a) Counterparty [1, 2, 3, 4, 5]:

(i) *value* of collateral posted in the form of *cash and cash equivalents*...... [ ]

(ii) *value* of collateral posted in the form of securities (other than *cash and cash equivalent* instruments).. [ ]

(iii) *value* of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support) .... [ ]

38. (a) Of the total amount of collateral and other credit support that counterparties have posted to the *reporting fund*, what percentage:

(i) may be rehypothecated? [ ]

(ii) has the *reporting fund* rehypothecated? [ ]

(b) Of the total amount of collateral and other credit support that the *reporting fund* has posted to counterparties, what percentage may be rehypothecated? [ ]

39. During the *reporting period*, did the *reporting fund* clear any transactions directly through a *CCP*?

☐ Yes ☐ No

Item C. *Reporting fund* risk metrics

40. (a) During the *reporting period*, did you regularly calculate the *VaR* of the *reporting fund*? *(Please respond without regard to whether you reported the result of this calculation internally or to investors.)*

☐ Yes ☐ No

(b) If you responded "yes" to Question 40(a), provide the following information.

(If you regularly calculate the VaR *of the* reporting fund *using multiple combinations of confidence interval, horizon and historical observation period, complete a separate response to this Question 40(b) for each such combination.)*

(i) Confidence interval used (e.g., 100%-alpha%) *(as a percentage)*.......... ☐

(ii) Time horizon used *(in number of days)* .... ☐

(iii) What weighting method was used to calculate *VaR*?

☐ None ☐ Exponential ☐ Other: ___________

(iv) If you responded "exponential" to Question 40(b)(iii), provide the weighting factor used *(as a decimal to two places)*............................. ☐

(v) What method was used to calculate *VaR*?

☐ Historical simulation ☐ Monte Carlo simulation

☐ Parametric ☐ Other: ____________

(vi) Historical lookback period used *(in number of years; enter "NA" if none used)*.. ☐

(vii) *VaR* at the end of the 1st month of the *reporting period* *(as a % of NAV)* .... ☐

(viii) *VaR* at the end of the 2nd month of the *reporting period* *(as a % of NAV)* .... ☐

(ix) *VaR* at the end of the 3rd month of the *reporting period* *(as a % of NAV)* .... ☐

41. Are there any risk metrics other than (or in addition to) *VaR* that you consider to be important to the *reporting fund's* risk management?

(Select all that you consider relevant. Please respond without regard to whether you reported the metric internally or to investors. If none, "None.")

[drop-down of risk metrics]

Other: ______________

42. For each of the market factors identified below, determine the effect of the specified changes on the *reporting fund's* portfolio and provide the results.

(You may omit a response to any market factor that you do not regularly consider in formal testing in connection with the reporting fund's *risk management. If you omit any market factor, check either the box in the first column indicating that you believe that this market*

factor is not relevant to the reporting fund's *portfolio or the box in the second column indicating that this market factor is relevant but not formally tested. For this purpose, "formal testing" means that the adviser has models or other systems capable of simulating the effect of a market factor on the fund's portfolio, not that the specific assumptions outlined in the question were used in testing.)*

(For each market factor, separate the effect on your portfolio into long and short components where (i) the long component represents the aggregate result of all positions whose valuation changes in the same direction as the market factor under a given stress scenario and (ii) the short component represents the aggregate result of all positions whose valuation changes in the opposite direction from the market factor under a given stress scenario.)

(Assume that changes in a market factor occur instantaneously and that all other factors are held constant. If the specified change in any market factor would make that factor less than zero, use zero instead.)

(Please note the following regarding the market factors identified below:

(i) A change in "equity prices" means that the prices of all equities move up or down by the specified amount, without regard to whether the equities are listed on any exchange or included in any index;

(ii) "Risk free interest rates" means rates of interest accruing on sovereign bonds *issued by governments having the highest credit quality, such as* U.S. treasury securities*;*

(iii) A change in "credit spreads" means that all spreads against risk free interest rates change by the specified amount;

(iv) A change in "currency rates" means that the values of all currencies move up or down by the specified amount relative to the reporting fund's *base currency;*

(v) A change in "commodity prices" means that the prices of all physical commodities move up or down by the specified amount;

(vi) A change in "option implied volatilities" means that the implied volatilities of all the options that the reporting fund *holds increase or decrease by the specified number of percentage points; and*

(vii) A change in "default rates" means that the rate at which debtors default on all instruments of the specified type increases or decreases by the specified number of percentage points.)

Not relevant	**Relevant/not formally tested**	**Market factor – changes in market factor**	**Effect on long components of portfolio (as % of *NAV*)**	**Effect on short components of portfolio (as % of *NAV*)**
☐	☐	Equity prices:		
		Equity prices increase 5%		
		Equity prices decrease 5%		
		Equity prices increase 20%		
		Equity prices decrease 20%		

☐	☐	Risk free interest rates (changes represent a parallel shift in the yield curve):		
		Risk free interest rates increase 25*bp*		
		Risk free interest rates decrease 25*bp*		
		Risk free interest rates increase 75*bp*		
		Risk free interest rates decrease 75*bp*		
☐	☐	Credit spreads:		
		Credit spreads increase 50*bp*		
		Credit spreads decrease 50*bp*		
		Credit spreads increase 250*bp*		
		Credit spreads decrease 250*bp*		
☐	☐	Currency rates:		
		Currency rates increase 5%		
		Currency rates decrease 5%		
		Currency rates increase 20%		
		Currency rates decrease 20%		
☐	☐	Commodity prices:		
		Commodity prices increase 10%		
		Commodity prices decrease 10%		
		Commodity prices increase 40%		
		Commodity prices decrease 40%		
☐	☐	Option implied volatilities:		
		Implied volatilities increase 4 percentage points		
		Implied volatilities decrease 4 percentage points.....		
		Implied volatilities increase 10 percentage points ...		
		Implied volatilities decrease 10 percentage points...		
☐	☐	Default rates (*ABS*):		
		Default rates increase 1 percentage point................		
		Default rates decrease 1 percentage point		
		Default rates increase 5 percentage points		
		Default rates decrease 5 percentage points..............		
☐	☐	Default rates (*corporate bonds* and *CDS*):		
		Default rates increase 1 percentage point................		
		Default rates decrease 1 percentage point		

		Default rates increase 5 percentage points		
		Default rates decrease 5 percentage points..............		

Item D. Financing information

43. For each month of the *reporting period*, provide the following information regarding the *value* of the *reporting fund's borrowings*, the types of creditors and the collateral posted to secure its *borrowings*.

(For each type of borrowing, *information is requested regarding the percentage borrowed from specified types of creditors. In each case, the total percentages allocated among these types of creditors should add up to 100%.)*

(Do not net out amounts that the reporting fund *loans to creditors or the value of collateral pledged to creditors.)*

	1st Month	**2nd Month**	**3rd Month**
(a) Dollar amount of *unsecured borrowing*			
(i) Percentage borrowed from *U.S. financial institutions*......			
(ii) Percentage borrowed from *non-U.S. financial institutions*			
(iii) Percentage borrowed from U.S. creditors that are not financial institutions			
(iv) Percentage borrowed from non-U.S. creditors that are not financial institutions			

(b) *Secured borrowing.*

(Classify secured borrowing *according to the legal agreement governing the borrowing (e.g., Global Master Repurchase Agreement for* reverse repo *and Prime Brokerage Agreement for prime brokerage). Please note that for* reverse repo borrowings, *the amount should be the net amount of cash borrowed (after taking into account any initial margin/independent amount, 'haircut' and repayments). Positions under a Global Master Repurchase Agreement should not be netted.)*

(i) Dollar amount via prime brokerage................................			
(A) *value* of collateral posted in the form of *cash and cash equivalents*			
(B) *value* of collateral posted in the form of securities (other than *cash and cash equivalent* instruments) ..			
(C) *value* of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support)............................			

(D) percentage borrowed from *U.S. financial institutions*			
(E) percentage borrowed from *non-U.S. financial institutions*			
(F) percentage borrowed from U.S. creditors that are not financial institutions			
(G) percentage borrowed from non-U.S. creditors that are not financial institutions			
(ii) Dollar amount via *reverse repo (for purposes of items (A) through (D) below, include as collateral any assets sold in connection with the* reverse repo *as well as any variation margin)*			
(A) *value* of collateral posted in the form of *cash and cash equivalents*			
(B) *value* of collateral posted in the form of securities (other than *cash and cash equivalent* instruments)			
(C) *value* of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support)			

(D) percentage borrowed from *U.S. financial institutions*			
(E) percentage borrowed from *non-U.S. financial institutions*			
(F) percentage borrowed from U.S. creditors that are not financial institutions			
(G) percentage borrowed from non-U.S. creditors that are not financial institutions			
(iii) Dollar amount of other *secured borrowings*			
(A) *value* of collateral posted in the form of *cash and cash equivalents*			
(B) *value* of collateral posted in the form of securities (other than *cash and cash equivalent* instruments)			
(C) *value* of other collateral and credit support posted (including face amount of letters of credit and similar third party credit support)			

(D) percentage borrowed from *U.S. financial institutions*			
(E) percentage borrowed from *non-U.S. financial*			

institutions			
(F) percentage borrowed from U.S. creditors that are not financial institutions			
(G) percentage borrowed from non-U.S. creditors that are not financial institutions			

	1st Month	2nd Month	3rd Month
44. For each month of the *reporting period*, provide the aggregate *value* of all derivatives positions of the *reporting fund (enter "NA" if no outstanding derivatives positions at the end of the relevant period)*....			

45. For each month of the *reporting period*, provide the following information regarding the *reporting fund's* derivative positions that were not cleared by a *CCP* and the collateral posted to secure those positions.

(If the reporting fund *is a net receiver of collateral, provide the collateral value as a negative number.)*

	1st Month	2nd Month	3rd Month
(a) Aggregate net mark-to-market value of all derivatives positions of the *reporting fund* that were not cleared by a *CCP (enter "NA" if no relevant derivatives positions outstanding at the end of the relevant period)*			
(b) Net *value* of collateral posted by or to the *reporting fund* in respect of these positions in the form of *cash and cash equivalents*			
(c) Net *value* of collateral posted by or to the *reporting fund* in respect of these positions in the form of securities (other than *cash and cash equivalent* instruments)......................................			
(d) Net *value* of other collateral and credit support posted by or to the *reporting fund* in respect of these positions (including face amount of letters of credit and similar third party credit support)			

46. Financing liquidity:

(a) Provide the aggregate dollar amount of *borrowing* by and cash financing available to the *reporting fund* (including all drawn and undrawn, committed and uncommitted lines of credit as well as any term financing)	

(b) Divide the amount reported in response to Question 46(a) among the periods specified below depending on the longest period for which the creditor is contractually committed to provide such financing.

(If a creditor (or syndicate or administrative/collateral agent) is permitted to vary unilaterally

the economic terms of the financing or to revalue posted collateral in its own discretion and demand additional collateral, then the financing should be deemed uncommitted for purposes of this question. Uncommitted financing should be included under "1 day or less.")

(The total should add up to 100%.)

	% of total financing
1 day or less	
2 days – 7 days	
8 days – 30 days	
31 days – 90 days	
91 days – 180 days	
181 days – 365 days	
Longer than 365 days	

47. Identify each creditor, if any, to which the *reporting fund* owed an amount in respect of *borrowings* equal to or greater than 5% of the *reporting fund's net asset value* as of the *data reporting date*. For each such creditor, provide the amount owed to that creditor.

(This question does not require the precise legal name of the creditor; if the creditor belongs to an affiliated *group that is included in the list below, select that group and do not enter the creditor's name in the space for "other.")*

Name of creditor	Dollar amount owed to each creditor
[drop-down list of creditor/counterparty names] Other: ________________________	
[repeat drop-down list of creditor/counterparty names] Other: _______	
[repeat drop-down list of creditor/counterparty names] Other: _______	

Item E. Investor information

48. (a) As of the *data reporting date*, what percentage of the *reporting fund's net asset value*, if any, is subject to a "side-pocket" arrangement?

(This question relates to whether assets are currently in a side-pocket and not the potential for assets to be moved to a side-pocket.)

(b) Have additional assets been placed in a side-pocket since the end of the prior

reporting period?

(Check "NA" if you reported no assets under Question 48(a) in the current period and/or the prior period.)

☐ Yes ☐ No ☐ NA

49. Provide the following information regarding the *reporting fund's* restrictions on investor withdrawals and redemptions.

(For Questions 49 and 50, please note that the standards for imposing suspensions and restrictions on withdrawals/redemptions may vary among funds. Make a good faith determination of the provisions that would likely be triggered during conditions that you view as significant market stress.)

(a) Does the *reporting fund* provide investors with withdrawal/redemption rights in the ordinary course?

☐ Yes ☐ No

(If you responded "yes" to Question 49(a), then you must respond to Questions 49(b)-(e).)

As of the *data reporting date*, what percentage of the *reporting fund's net asset value*, if any:

(b) May be subjected to a suspension of investor withdrawals/redemptions by an adviser or fund governing body *(this question relates to an adviser's or governing body's right to suspend and not just whether a suspension is currently effective)*	
(c) May be subjected to material restrictions on investor withdrawals/ redemptions (e.g., "gates") by an adviser or fund governing body *(this question relates to an adviser's or governing body's right to impose a restriction and not just whether a restriction has been imposed)*	
(d) Is subject to a suspension of investor withdrawals/redemptions *(this question relates to whether a suspension is currently effective and not just an adviser's or governing body's right to suspend)*	
(e) Is subject to a material restriction on investor withdrawals/redemptions (e.g., a "gate") *(this question relates to whether a restriction has been imposed and not just an adviser's or governing body's right to impose a restriction)*	

50. Investor liquidity (as a % of *net asset value*):

(Divide the reporting fund's net asset value *among the periods specified below depending on the shortest period within which investors are entitled, under the fund documents, to withdraw invested funds or receive redemption payments, as applicable. Assume that you would impose gates where applicable but that you would not completely suspend withdrawals/redemptions and that there are no redemption fees. Please base on the notice period before the valuation date rather than the date proceeds would be paid to investors.)*

(The total should add up to approximately 100%.)

% of *NAV* locked for

1 day or less	
2 days – 7 days	
8 days – 30 days	
31 days – 90 days	
91 days – 180 days	
181 days – 365 days	
Longer than 365 days	

Section 3: Information about *liquidity funds* that you advise.

You must complete a separate Section 3 for each *liquidity fund* that you advise. However, with respect to *master-feeder arrangements* and *parallel fund structures*, you may report collectively or separately about the component funds as provided in the General Instructions.

Item A. *Reporting fund* identifying and operational information

51. (a) Name of the *reporting fund*.. ☐

    (b) *Private fund* identification number of the *reporting fund*............................ ☐

52. Does the *reporting fund* use the amortized cost method of valuation in computing its *net asset value*?

    ☐ Yes ☐ No

53. Does the *reporting fund* use the penny rounding method of pricing in computing its *net asset value*?

    ☐ Yes ☐ No

54. (a) Does the *reporting fund* have a policy of complying with the *risk limiting conditions* of *rule 2a-7*?

    ☐ Yes ☐ No

    (b) If you responded "no" to Question 54(a) above, does the *reporting fund* have a policy of complying with the following provisions of *rule 2a-7*:

    (i) the diversification conditions? ☐ Yes ☐ No

    (ii) the credit quality conditions? ☐ Yes ☐ No

    (iii) the liquidity conditions? ☐ Yes ☐ No

    (iv) the maturity conditions? ☐ Yes ☐ No

Item B. *Reporting fund* assets

55. Provide the following information for each month of the *reporting period*.

	1st Month	2nd Month	3rd Month
(a) Net asset value of *reporting fund* as reported to current and prospective investors........			
(b) Net asset value per share of *reporting fund* as reported to current and prospective investors *(to the nearest hundredth of a cent)*........			
(c) *Net asset value per share* of *reporting fund (to the nearest hundredth of a cent; exclude the value of any capital support agreement or similar arrangement)*........			

(d)	*WAM* of *reporting fund (in days)*			
(e)	*WAL* of *reporting fund (in days)*			
(f)	*7-day gross yield* of *reporting fund (to the nearest hundredth of one percent)*			
(g)	Dollar amount of the *reporting fund's* assets that are *daily liquid assets*			
(h)	Dollar amount of the *reporting fund's* assets that are *weekly liquid assets*			
(i)	Dollar amount of the *reporting fund's* assets that have a *maturity* greater than 397 days			

56. Selected product exposures by *maturity* for *liquidity fund assets under management*.

(Give the value *of the* reporting fund's *positions as of the* data reporting date *in each of the following asset classes, divided by* maturity.*)*

(Include all exposure whether held physically, synthetically or through derivatives. Include any closed out and OTC *forward positions that have not yet expired/matured. Do not net positions within asset classes. Assets held in side-pockets should be included as assets of the* reporting fund. *Each asset should only be included in a single asset class.)*

	Maturity				
	1 day or less	**2 days to 7 days**	**8 days to 30 days**	**31 days to 397 days**	**Greater than 397 days**
***Sovereign bonds* and municipal bonds**					
U.S. treasury securities					
Agency securities					
GSE bonds					
Sovereign bonds issued by *G10* countries other than the U.S.					
Other *sovereign bonds* (including supranational bonds)					
U.S. state and local bonds					
Instruments issued by *U.S. financial institutions*					
Unsecured commercial paper					
ABCP					
ABS and *structured products* other than *ABCP*					
Certificates of deposit					
Floating rate notes					
Repos					
Where assets purchased are *U.S. treasury securities* or *agency securities*					

Where assets purchased are *corporate bonds* that are *investment grade*					
Where other assets are purchased					

Instruments issued by companies organized in the U.S. (other than *U.S. financial institutions*)

Unsecured commercial paper					
Corporate bonds (other than unsecured commercial paper), loans, *ABS*, *structured products* and *repos*, combined					

Instruments issued by *non-U.S. financial institutions*

Unsecured commercial paper					
ABCP					
ABS and *structured products* other than *ABCP*					
Certificates of deposit					
Floating rate notes					
Repos					
Where assets purchased are *U.S. treasury securities* or *agency securities*					
Where assets purchased are *corporate bonds* that are *investment grade*					
Where other assets are purchased					

Instruments issued by companies organized outside the U.S. (other than *non-U.S. financial institutions*)

Unsecured commercial paper					
Corporate bonds (other than unsecured commercial paper), loans, *ABS*, *structured products* and *repos*, combined					

Other instruments

Investments in *money market funds*					
Investments in *liquidity funds*					
Cash and cash equivalents (other than instruments covered by another category above)					

57. For each open position of the *reporting fund* that represents 5% or more of the *reporting fund's net asset value*, provide the information requested below.

	% of *net asset value*	*Sub-asset class*
(a) First month of the *reporting period*		
(i) Position		[drop-down of asset classes]
(ii) Position		[drop-down of asset classes]
(b) Second month of the *reporting period*		
(i) Position		[drop-down of asset classes]
(ii) Position		[drop-down of asset classes]
(c) Third month of the *reporting period*		
(i) Position		[drop-down of asset classes]
(ii) Position		[drop-down of asset classes]

Item C. Financing information

58. (a) Is the amount of total *borrowing* reported in response to Question 12 equal to or greater than 5% of the *reporting fund's net asset value*?

☐ Yes ☐ No

(b) If you responded "yes" to Question 58(a) above, divide the dollar amount of total *borrowing* reported in response to Question 12 among the periods specified below depending on the type of *borrowing*, the type of creditor and the latest date on which the reporting fund may repay the principal amount of the *borrowing* without defaulting or incurring penalties or additional fees.

(If a creditor (or syndicate or administrative/collateral agent) is permitted to vary unilaterally the economic terms of the financing or to revalue posted collateral in its own discretion and demand additional collateral, then the borrowing *should be deemed to have a maturity of 1 day or less for purposes of this question. For amortizing loans, each amortization payment should be treated separately and grouped with other* borrowings *based on its payment date.)*

(The total amount of borrowings *reported below should equal approximately the total amount of* borrowing *reported in response to Question 12.)*

	1 day or less	2 days to 7 days	8 days to 30 days	31 days to 397 days	Greater than 397 days
(i) *Unsecured borrowing*					
(A) *U.S. financial institutions*					
(B) *Non-U.S. financial institutions*					
(C) Other U.S. creditors					
(D) Other non-U.S. creditors					
(ii) *Secured borrowing*					
(A) *U.S. financial institutions*					

(B) *Non-U.S. financial institutions*					
(C) Other U.S. creditors					
(D) Other non-U.S. creditors					

59. (a) Does the *reporting fund* have in place one or more committed liquidity facilities?

☐ Yes ☐ No

(b) If you responded "yes" to Question 59(a), provide the aggregate dollar amount of commitments under the liquidity facilities ☐

Item D. Investor information

60. Specify the number of outstanding shares or units of the *reporting fund's* stock or similar securities ☐

61. Provide the following information regarding investor concentration.

(For purposes of this question, if you know that two or more beneficial owners of the reporting fund *are* affiliated *with each other, you should treat them as a single beneficial owner.)*

(a) Specify the percentage of the *reporting fund's* equity that is beneficially owned by the beneficial owner having the largest equity interest in the *reporting fund* ☐

(b) How many investors beneficially own 5% or more of the *reporting fund's* equity? ☐

62. Provide a good faith estimate, as of the *data reporting date*, of the percentage of the *reporting fund's* outstanding equity that was purchased using *securities lending collateral* ☐

63. Provide the following information regarding the restrictions on withdrawals and redemptions by investors in the *reporting fund*.

(For Questions 63 and 64, please note that the standards for imposing suspensions and restrictions on withdrawals/redemptions may vary among funds. Make a good faith determination of the provisions that would likely be triggered during conditions that you view as significant market stress.)

As of the *data reporting date*, what percentage of the *reporting fund's net asset value*, if any:

(a) May be subjected to a suspension of investor withdrawals/redemptions by an adviser or fund governing body *(this question relates to an adviser's or governing body's right to suspend and not just whether a suspension is currently effective)* ☐

(b) May be subjected to material restrictions on investor withdrawals/ redemptions (e.g., "gates") by an adviser or fund governing body *(this question relates to an adviser's or governing body's right to impose a restriction and not just whether a restriction has been imposed)* ☐

(c) Is subject to a suspension of investor withdrawals/redemptions *(this question relates to whether a suspension is currently effective and not just an adviser's or governing body's right to suspend)* .... ☐

(d) Is subject to a material restriction on investor withdrawals/redemptions (e.g., a "gate") *(this question relates to whether a restriction has been imposed and not just an adviser's or governing body's right to impose a restriction)* .... ☐

64. Investor liquidity (as a % of *net asset value*):

(Divide the reporting fund's net asset value *among the periods specified below depending on the shortest period within which investors are entitled, under the fund documents, to withdraw invested funds or receive redemption payments, as applicable. Assume that you would impose gates where applicable but that you would not completely suspend withdrawals/redemptions and that there are no redemption fees. Please base on the notice period before the valuation date rather than the date proceeds would be paid to investors. The total should add up to 100%.)*

	% of *NAV* locked for
1 day or less	
2 days – 7 days	
8 days – 30 days	
31 days – 90 days	
91 days – 180 days	
181 days – 365 days	
Longer than 365 days	

Section 4: Information about *private equity funds* that you advise.

You must complete a separate Section 4 for each *private equity fund* that you advise. However, with respect to *master-feeder arrangements* and *parallel fund structures*, you may report collectively or separately about the component funds as provided in the General Instructions.

Item A. *Reporting fund* identifying information

65. (a) Name of the *reporting fund* ....

    (b) *Private fund* identification number of the *reporting fund* ....

Item B. *Reporting fund* financing and investments

66. (a) Do you or any of your *related persons* guarantee, or are you or any of your *related persons* otherwise obligated to satisfy, the obligations of any portfolio company in which the *reporting fund* invests?

    (You are not required to respond "yes" simply because a portfolio company is a primary obligor and is also your related person.*)*

    ☐ Yes ☐ No

    (b) If you responded "yes" to Question 66(a) above, report the total dollar *value* of all such guarantees and other obligations..

67. What is the weighted average debt-to-equity ratio of the *controlled portfolio companies* in which the *reporting fund* invests *(expressed as a decimal to the tenths place)*?

    (Weighting should be based on gross assets of each controlled portfolio company *as a percentage of the aggregate gross assets of the* reporting fund's controlled portfolio companies.*)*

68. What is the highest debt-to-equity ratio of any *controlled portfolio company* in which the reporting fund invests *(expressed as a decimal to the tenths place)*?

69. What is the lowest debt-to-equity ratio of any *controlled portfolio company* in which the reporting fund invests *(expressed as a decimal to the tenths place)*?

70. What is the aggregate gross asset value of the *reporting fund's controlled portfolio companies*?

71. What is the aggregate principal amount of *borrowings* categorized as current liabilities on the most recent balance sheets of the *reporting fund's controlled portfolio companies*?

72. What is the aggregate principal amount of *borrowings* categorized as long-term liabilities on the most recent balance sheets of the *reporting fund's controlled portfolio companies*?

73. What percentage of the aggregate *borrowings* of the *reporting fund's controlled portfolio companies* is payment-in-kind (PIK) or zero-coupon debt? ☐

74. During the *reporting period*, did the *reporting fund* or any of its *controlled portfolio companies* experience an event of default under any of its indentures, loan agreements or other instruments evidencing obligations for borrowed money?

    (Do not include a potential event of default (i.e., an event that would constitute an event of default with the giving of notice, the passage of time or otherwise) unless it has become an event of default.)

    ☐ Yes ☐ No

75. (a) Does any *controlled portfolio company* of the *reporting fund* have in place one or more bridge loans or commitments (subject to customary conditions) for a bridge loan?

    ☐ Yes ☐ No

    (b) If you responded "yes" to Question 75(a), identify each *person* that has provided all or part of any bridge loan or commitment to the relevant *controlled portfolio company*. For each such *person*, provide the applicable outstanding amount or commitment amount.

Name	Outstanding amount of financing, if drawn	Amount of commitment, if undrawn
[repeat drop-down list of creditor/counterparty names] Other: ________		
[repeat drop-down list of creditor/counterparty names] Other: ________		
[repeat drop-down list of creditor/counterparty names] Other: ________		

76. (a) Is any of the *reporting fund's controlled portfolio companies* a *financial industry portfolio company*?

    ☐ Yes ☐ No

    (b) If you responded "yes" to Question 76(a), then for each of the *reporting fund's controlled portfolio companies* that constitutes a *financial industry portfolio company*, provide the following information.

Legal Name	Address of principal office (include city, state and country)	*NAICS code*	*LEI*, if any	Debt-to-equity ratio of portfolio company	Gross asset value of portfolio company	% of *reporting fund's* gross assets invested in this portfolio company	% of portfolio company beneficially owned by the *reporting fund*

77. Provide a breakdown of the *reporting fund's* investments in portfolio companies by industry, based on the *NAICS codes* of the companies.

(The total should add up to 100%.)

NAICS code	**% of *reporting fund's* total portfolio company investments**

78. (a) Provide a geographical breakdown of the gross value of the *reporting fund's* investments in portfolio companies (by percentage of the total gross value of the *reporting fund's* investments in portfolio companies).

(The total should add up to approximately 100%.)

	Region	**%**
(i)	Africa	
(ii)	Asia and Pacific (other than the Middle East)	
(iii)	Europe (*EEA*)	
(iv)	Europe (other than *EEA*)	
(v)	Middle East	
(vi)	North America	
(vii)	South America	
(viii)	Supranational	

(b) Provide the gross value of the *reporting fund's* investments in portfolio companies in the following countries (by percentage of the total gross value of the *reporting fund's* investments in portfolio companies).

(The total may not add up to 100%.)

	Country	**%**
(i)	Brazil	
(ii)	China (including Hong Kong)	
(iii)	India	
(iv)	Japan	
(v)	Russia	
(vi)	United States	

79. If you or any of your *related persons* (other than the *reporting fund*) invest in any companies that are portfolio companies of the *reporting fund*, provide the aggregate dollar amount of these investments.

Section 5: Request for temporary hardship exemption.

You must complete Section 5 if you are requesting a temporary hardship exemption pursuant to *SEC* rule 204(b)-1(f).

A. For which type of Form PF filing are you requesting a temporary hardship exemption?

1. If you are not a *large hedge fund adviser* or *large liquidity fund adviser*:
   - ☐ Initial filing
   - ☐ *Annual update*
   - ☐ Final filing
2. If you are a *large hedge fund adviser* or *large liquidity fund adviser*:
   - ☐ Initial filing
   - ☐ *Quarterly update*
   - ☐ Filing to transition to annual reporting
   - ☐ Final filing

B. Provide the following information regarding your request for a temporary hardship exemption (attach a separate page if additional space is needed).

1. Describe the nature and extent of the temporary technical difficulties when you attempt to submit the filing to the Form PF filing system on the IARD:

2. Describe 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. Describe the burden and expense of employing alternative means (e.g., a service provider) to submit the filing in electronic format in a timely manner:

4. Provide any other reasons that a temporary hardship exemption is warranted:

GLOSSARY OF TERMS

ABCP — Asset backed commercial paper, including (but not limited to) structured investment vehicles, single-seller conduits and multi-seller conduit programs.

Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).

ABS — Securities derived from the pooling and repackaging of cash flow producing financial assets.

Advisers Act — U.S. Investment Advisers Act of 1940, as amended.

Affiliate — With respect to any *person*, any other *person* that directly or indirectly *controls*, is *controlled* by or is under common *control* with such person. The term *affiliated* means that two or more *persons* are *affiliates*.

Agency securities — Any security issued by a *person* controlled or supervised by and acting as an instrumentality of the government of the United States pursuant to authority granted by the Congress of the United States and guaranteed as to principal or interest by the United States.

Include bond derivatives.

Annual update — An update of this Form PF with respect to any fiscal year.

Borrowings — *Secured borrowings* and *unsecured borrowings*, collectively.

bp — Basis points.

Cash and cash equivalents — Cash (including U.S. and non-U.S. currencies), cash equivalents and government securities. For purposes of this definition:

- cash equivalents are: (i) bank deposits, certificates of deposit, bankers acceptances and similar bank instruments held for investment purposes; (ii) the net cash surrender value of an insurance policy; and (iii) investments in *money market funds*; and
- government securities are: (i) *U.S. treasury securities*; (ii) *agency securities*; and (iii) any certificate of deposit for any of the foregoing.

CCP — Central clearing counterparties (or central clearing houses) (for example, CME Clearing, The Depository Trust & Clearing Corporation, Fedwire and LCH Clearnet Limited).

CDO/CLO — Collateralized debt obligations and collateralized loan obligations (including, in each case, cash flow and synthetic) other than *MBS*.

Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).

CDS — Credit default swaps, including any *LCDS*.

CEA — U.S. Commodity Exchange Act, as amended.

CFTC — U.S. Commodity Futures Trading Commission.

Combined money market and liquidity fund assets under management — With respect to any adviser, the sum of: (i) such adviser's *liquidity fund assets under management*; and (ii) such adviser's *regulatory assets under management* that are attributable to *money market funds* that it advises.

Committed capital	Any commitment pursuant to which a *person* is obligated to acquire an interest in, or make capital contributions to, the *private fund*.
Commodities	Has the meaning provided in the *CEA*. Include *ETFs* that hold commodities. For questions regarding *commodity* derivatives, provide the *value* of all exposure to *commodities* that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
Commodity pool	A "commodity pool," as defined in section 1a(10) of the *CEA*.
Control	Has the meaning provided in *Form ADV*. The term *controlled* has a corresponding meaning.
Controlled portfolio company	With respect to any *private equity fund*, a portfolio company that is *controlled* by the *private equity fund*, either alone or together with the *private equity fund's affiliates* or other *persons* that are, as of the *data reporting date*, part of a club or consortium including the *private equity fund*.
Convertible bonds	Convertible *corporate bonds* (not yet converted into shares or cash). Include bond derivatives, but <u>do not</u> include any positions held via *CDS* (these should be recorded in the *CDS* category).
Corporate bonds	Bonds, debentures and notes, including commercial paper, issued by corporations and other non-governmental entities. <u>Do not</u> include preferred equities. Include bond derivatives, but <u>do not</u> include any positions held via *CDS* (these should be recorded in the *CDS* category).
CPO	A "commodity pool operator," as defined in section 1a(11) of the *CEA*.
Credit derivatives	*Single name CDS*, *index CDS* and *exotic CDS*.
Crude oil	For questions regarding crude oil derivatives, provide the *value* of all exposure to crude oil that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
CTA	A "commodity trading advisor," as defined in section 1a(12) of the *CEA*.
Daily liquid assets	Has the meaning provided in *rule 2a-7*.
Data reporting date	In the case of an initial filing, the *data reporting date* is the last calendar day of your most recently completed fiscal year (or, if you are a *large hedge fund adviser* or *large liquidity fund adviser*, your most recently completed fiscal quarter). In the case of an *annual update*, the *data reporting date* is the last calendar day of your most recently completed fiscal year. In the case of a *quarterly update*, the *data reporting date* is the last calendar day of your most recently completed fiscal quarter.
Dependent parallel managed account	With respect to any *private fund*, any related *parallel managed account* <u>other than</u> a *parallel managed account* that individually (or together with other *parallel managed accounts* that pursue substantially the same investment objective and strategy and invest side by side in substantially the same positions) has a *gross asset value* greater than the *gross asset value* of such *private fund* (or, if such *private fund* is a *parallel fund*, the *gross asset value* of the *parallel fund structure* of which it is a part).
Derivative	All synthetic or derivative exposures to equities, including preferred equities, that

exposures to unlisted equities	are not listed on a regulated exchange. Include single stock futures, equity index futures, dividend swaps, total return swaps (contracts for difference), warrants and rights.
EEA	The European Economic Area. As of the effective date of this Form PF, the *EEA* is comprised of: (i) the European Union member states, which are Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom; and (ii) Iceland, Liechtenstein and Norway.
ETF	Exchange-traded fund.
Exempt reporting adviser	Has the meaning provided in *Form ADV*.
Exotic CDS	*CDS*s referencing bespoke baskets or tranches of *CDOs*, *CLOs* and other structured investment vehicles, including credit default tranches.
Feeder fund	See *master-feeder arrangement*.
Financial industry portfolio company	Any of the following: (i) a nonbank financial company, as defined in the Financial Stability Act of 2010; or (ii) any bank, savings association, bank holding company, financial holding company, savings and loan holding company, credit union or other similar company regulated by a federal, state or foreign banking regulator, including the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the National Credit Union Administration or the Farm Credit Administration.
Firm	The *private fund adviser* completing or amending this Form PF.
Foreign exchange derivative	Any derivative whose underlying asset is a currency other than U.S. dollars or is an exchange rate. Cross-currency interest rate swaps should be included in *foreign exchange derivatives* and excluded from *interest rate derivatives*. Only one currency side of every transaction should be counted.
Form ADV	Form ADV, as promulgated and amended by the *SEC*.
Form ADV Section 7.B.1	Section 7.B.1 of Schedule D to *Form ADV*.
G10	The Group of Ten. As of the effective date of this Form PF, the *G10* is comprised of: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States.
Gold	For questions regarding gold derivatives, provide the *value* of all exposure to gold that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
Government entity	Has the meaning provided in *Form ADV*.
Gross asset value	Value of gross assets, calculated in accordance with Part 1A, Instruction 6.e(3) of *Form ADV*.
Gross notional value	The gross nominal or notional value of all transactions that have been entered into but not yet settled as of the *data reporting date*. For contracts with variable

nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the *data reporting date*.

GSE bonds

Notes, bonds and debentures issued by private entities sponsored by the U.S. federal government but not guaranteed as to principal and interest by the U.S. federal government.

Include bond derivatives, but do not include any positions held via *CDS* (these should be recorded in the *CDS* category).

Hedge fund

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).

Solely for purposes of this Form PF, any *commodity pool* about which you are reporting or required to report on Form PF is categorized as a *hedge fund*.

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.

Hedge fund assets under management

With respect to any adviser, *hedge fund assets under management* are the portion of such adviser's *regulatory assets under management* that are attributable to *hedge funds* that it advises.

Index CDS

CDSs referencing a standardized basket of credit entities, including *CDS* indices and indices referencing leveraged loans.

Investment grade

A security is *investment grade* if it is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk.

Interest rate derivative

Any derivative whose underlying asset is the obligation to pay or the right to receive a given amount of money accruing interest at a given rate. Cross-currency interest rate swaps should be included in *foreign exchange derivatives* and excluded from *interest rate derivatives*.

This information must be presented in terms of 10-year bond-equivalents.

Investments in external private funds

Investments in *private funds* that neither you nor your *related persons* advise (other than cash management funds).

Investments in internal private funds

Investments in *private funds* that you or any of your *related persons* advise (other than cash management funds).

Investments in other

Any investment not included in another *sub-asset class*.

sub-asset classes	
Investments in registered investment companies	Investments in registered investment companies (other than cash management funds, such as money market funds, and *ETFs*). *ETFs* should be categorized based on the assets that the fund holds and should not be included in this category.
Large hedge fund adviser	Any *private fund adviser* that is required to file Section 2a of Form PF. See Instruction 3 to determine whether you are required to file this section.
Large liquidity fund adviser	Any *private fund adviser* that is required to file Section 3 of Form PF. See Instruction 3 to determine whether you are required to file this section.
Large private equity adviser	Any *private fund adviser* that is required to file Section 4 of Form PF. See Instruction 3 to determine whether you are required to file this section.
Large private fund adviser	Any *large hedge fund adviser, large liquidity fund adviser* or *large private equity adviser*.
LEI	With respect to any company, the "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. In the case of a financial institution, if a "legal entity identifier" has not been assigned, then provide the RSSD ID assigned by the National Information Center of the Board of Governors of the Federal Reserve System, if any.
LCDS	Loan credit default swaps.
Leveraged loans	Loans that are made to entities whose senior unsecured long term indebtedness is *non-investment grade*. This may include loans made in connection with the financing structure of a leveraged buyout. Do not include any positions held via *LCDS* (these should be recorded in the *CDS* category).
Liquidity fund	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.
Liquidity fund assets under management	With respect to any adviser, *liquidity fund assets under management* are the portion of such adviser's *regulatory assets under management* that are attributable to *liquidity funds* it advises (including *liquidity funds* that are also *hedge funds*).
Listed equity	Direct beneficial ownership of equities, including preferred equities, listed on a regulated exchange. Do not include synthetic or derivative exposures to equities. *ETFs* should be categorized based on the assets that the fund holds and should only be included in *listed equities* if the fund holds *listed equities* (e.g., a commodities *ETF* should be categorized based on the commodities it holds).
Listed equity derivatives	All synthetic or derivative exposures to equities, including preferred equities, listed on a regulated exchange. Include single stock futures, equity index futures, dividend swaps, total return swaps (contracts for difference), warrants and rights.

LV	*Value* of long positions, measured as specified in Instruction 15.
Master fund	See *master-feeder arrangement.*
Master-feeder arrangement	An arrangement in which one or more funds (*"feeder funds"*) invest all or substantially all of their assets in a single *private fund* (*"master fund"*). A fund would also be a *feeder fund* investing in a *master fund* for purposes of this definition 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.*
Maturity	The maturity of the relevant asset, determined without reference to the maturity shortening provisions contained in paragraph (d) of *rule 2a-7* regarding interest rate readjustments.
MBS	Mortgage backed securities, including residential, commercial and agency. Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).
Money market fund	Has the meaning provided in *rule 2a-7.*
NAICS code	With respect to any company, the six-digit North American Industry Classification System code that best describes the company's primary business activity and principal source of revenue. If the company reports a business activity code to the U.S. Internal Revenue Service, you may rely on that code for this purpose.
Natural gas	For questions regarding natural gas derivatives, provide the *value* of all exposure to natural gas that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
Net assets under management	*Net assets under management* are your *regulatory assets under management* minus any outstanding indebtedness or other accrued but unpaid liabilities.
Net asset value or *NAV*	With respect to any *reporting fund*, the gross assets reported in response to Question 8 minus any outstanding indebtedness or other accrued but unpaid liabilities.
NFA	The National Futures Association.
Non-investment grade	A security is *non-investment grade* if it is not an *investment grade* security.
Non-U.S. financial institution	Any of the following: (i) a financial institution chartered outside the United States; (ii) a financial institution that is separately incorporated or otherwise organized outside the United States but has a parent that is a financial institution chartered in the United States; or (iii) a branch or agency that resides in the United States but has a parent that is a financial institution chartered outside the United States.
OTC	With respect to any instrument, the trading of that instrument over the counter.
Other ABS	*ABS* products that are not covered by another *sub-asset class.* Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).
Other commodities	*Commodities* other than *crude oil, natural gas, gold* and *power.* All types of oil and energy products (aside from *crude oil* and *natural gas*), including (but not

	limited to) ethanol, heating oil propane and gasoline, should be included in this category. For questions regarding *other commodity* derivatives, provide the *value* of all exposure to *other commodities* that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
Other derivatives	Any derivative not included in another *sub-asset class.*
Other loans	All loans other than *leveraged loans. Other loans* includes (but is not limited to) bilateral or syndicated loans to corporate entities. Do not include any positions held via *LCDS* (these should be recorded in the *CDS* category) or certificates of deposit.
Other private fund	Any *private fund* that is not a *hedge fund, liquidity fund, private equity fund, real estate fund, securitized asset fund* or *venture capital fund.*
Other structured products	Any *structured products* not included in another *sub-asset class.* Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).
Parallel fund	See *parallel fund structure.*
Parallel fund structure	A structure in which one or more *private funds* (each, a "*parallel fund*") pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as another *private fund.*
Parallel managed account	With respect to any *private fund*, a *parallel managed account* is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified *private fund.*
Person	Has the meaning provided in *Form ADV.*
Power	For questions regarding power derivatives, provide the *value* of all exposure to power that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled).
Principal office and place of business	Has the meaning provided in *Form ADV.*
Private equity fund	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.
Private equity fund assets under management	With respect to any adviser, *private equity fund assets under management* are the portion of such adviser's *regulatory assets under management* that are attributable to *private equity funds* it advises.
Private fund	Any 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. 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.* 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.

Private fund adviser	Any investment adviser that (i) is registered or required to register with the *SEC* (including any investment adviser that is also registered or required to register with the *CFTC* as a *CPO* or *CTA*) and (ii) advises one or more *private funds*.
Private fund assets under management	With respect to any adviser, *private fund assets under management* are the portion of such adviser's *regulatory assets under management* that are attributable to *private funds* it advises.
Qualifying hedge fund	Any *hedge fund* that has a *net asset value* (individually or in combination with any *feeder funds, parallel funds* and/or *dependent parallel managed accounts*) of at least $500 million as of the last day of any month in the fiscal quarter immediately preceding your most recently completed fiscal quarter.
Quarterly update	An update of this Form PF with respect to any fiscal quarter.
Real estate fund	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.
Regulatory assets under management	Regulatory assets under management, calculated in accordance with Part 1A, Instruction 5.b of *Form ADV*.
Related person	Has the meaning provided in *Form ADV*.
Repo	Any purchase of securities coupled with an agreement to sell the same (or similar) securities at a later date at an agreed upon price. Do not include any positions held via *CDS* (these should be recorded in the *CDS* category).
Reporting period	With respect to an *annual update*, the twelve month period ending on the *data reporting date*. With respect to a *quarterly update*, the three month period ending on the *data reporting date*.
Reporting fund	A *private fund* as to which you must report information on Form PF. Typically, each *private fund* is a *reporting fund*. However, if you are reporting aggregate information for any *master-feeder arrangement* or *parallel fund structure*, only the *master fund* or the largest *parallel fund* in the structure (as applicable) should be identified as a *reporting fund*. See Instructions 3 and 5.
Reverse repo	Any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed upon price.
Risk limiting conditions	The conditions specified in paragraphs (c)(2) (maturity), (c)(3) (quality), (c)(4) (diversification), and (c)(5) (liquidity) of *rule 2a-7*.
Rule 2a-7	Rule 2a-7 promulgated by the *SEC* under the Investment Company Act of 1940.
SEC	U.S. Securities and Exchange Commission.
Secured borrowing	Obligations for borrowed money in respect of which the borrower has posted collateral or other credit support. For purposes of this definition, *reverse repos* are *secured borrowings*.
Securities lending collateral	Cash pledged to the *reporting fund's* beneficial owners as collateral in respect of securities lending arrangements.
Securitized asset	Any *private fund* whose primary purpose is to issue asset backed securities and

fund	whose investors are primarily debt-holders.
Separately operated	For purposes of this Form, a *related person* is *separately operated* if you are not required to complete Section 7.A. of Schedule D to *Form ADV* with respect to that *related person*.
7-day gross yield	Based on the 7 days ended on the *data reporting date*, calculate the *liquidity fund*'s yield by determining the net change, exclusive of capital changes and income other than investment income, in the value of a hypothetical pre-existing account having a balance of one share at the beginning of the period and dividing the difference by the value of the account at the beginning of the base period to obtain the base period return, and then multiplying the base period return by (365/7) with the resulting yield figure carried to the nearest hundredth of one percent. The 7-day gross yield should not reflect a deduction of shareholders fees and fund operating expenses.
Single name CDS	*CDSs* referencing a single entity.
Sovereign bonds	Any notes, bonds and debentures issued by a national government (including central governments, other governments and central banks but excluding U.S. state and local governments), whether denominated in a local or foreign currency. Include bond derivatives, but <u>do not</u> include any positions held via *CDS* (these should be recorded in the *CDS* category).
Structured products	Pre-packaged investment products, typically based on derivatives and including structured notes.
Sub-asset class	Each sub-asset class identified in Questions 26 and 30.
SV	*Value* of short positions, measured as specified in Instruction 15.
Unlisted equity	Direct beneficial ownership of equities, including preferred equities, that are not listed on a regulated exchange. <u>Do not</u> include synthetic or derivative exposures to equities.
U.S. financial institution	Any of the following: (i) a financial institution chartered in the United States (whether federally-chartered or state-chartered); (ii) a financial institution that is separately incorporated or otherwise organized in the United States but has a parent that is a financial institution chartered outside the United States; or (iii) a branch or agency that resides outside the United States but has a parent that is a financial institution chartered in the United States.
U.S. treasury securities	Direct obligations of the U.S. Government. Include *U.S. treasury security* derivatives.
Unencumbered cash	The fund's *cash and cash equivalents* <u>plus</u> the *value* of overnight *repos* used for liquidity management where the assets purchased are *U.S. treasury securities* or *agency securities* <u>minus</u> the sum of the following (without duplication): (i) *cash and cash equivalents* transferred to a collateral taker pursuant to a title transfer arrangement; and (ii) *cash and cash equivalents* subject to a security interest, lien or other encumbrance (this could include *cash and cash equivalents* in an account subject to a control agreement).
Unfunded commitments	*Committed capital* that has not yet been contributed to the *private equity fund* by investors.

United States person	Has the meaning provided in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States.
Unsecured borrowing	Obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support.
Value	See Instruction 15.
VaR	For a given portfolio, the loss over a target horizon that will not be exceeded at some specified confidence level.
Venture capital fund	Any *private fund* meeting the definition of venture capital fund in rule 203(l)-1 of the *Advisers Act.*
WAL	Weighted average portfolio maturity of a *liquidity fund* calculated taking into account the maturity shortening provisions contained in paragraph (d) of *rule 2a-7*, but determined without reference to the exceptions in paragraph (d) of *rule 2a-7* regarding interest rate readjustments.
WAM	Weighted average portfolio maturity of a *liquidity fund* calculated taking into account the maturity shortening provisions contained in paragraph (d) of *rule 2a-7.*
Weekly liquid assets	Has the meaning provided in *rule 2a-7.*