

## 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 **January 2013**, 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.

**Mary L. Schapiro served as SEC Chairman  
January 27, 2009 until December 14, 2012**

**Elisse B. Walter as SEC Commissioner  
July 9, 2008 until December 14, 2012**

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

DANIEL M. GALLAGHER, COMMISSIONER

(26 Documents)

*Commissioner Paredes,  
Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68592 / January 4, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15163

In the Matter of  
  
Stephen G. Bennett,  
  
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 Stephen G. Bennett ("Respondent" or "Bennett") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

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

<sup>1</sup> Rule 102(e)(3)(i) provides, in relevant part, that:

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

purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Stephen G. Bennett, age 52, is a resident of Merrimack, New Hampshire. Bennett was an attorney licensed in Utah, but was disbarred on November 20, 2001 for commingling client funds with his personal bank accounts.
2. On December 18, 2012, a final judgment was entered against Stephen G. Bennett, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Copper King Mining Corp., Civil Action Number 2:11-CV-00526 (D. Utah).
3. The Commission's complaint alleged, among other things, that Bennett participated in an unregistered offering of Copper King Mining Corp. ("Copper King") stock by providing false stock tradability opinion letters to allow stock to be issued without the required "restricted" legend. On December 26, 2007, Alexander Lindale, LLC ("Alexander Lindale"), a stock promotion firm, filed a Form D with the Commission indicating that it was going to make a Rule 504 offering pursuant to Regulation D, which allows an exemption from registration if certain requirements are met. Alexander Lindale sold over \$12 million in stock purportedly pursuant to the Rule 504 exemption. Bennett provided Alexander Lindale with a number of stock tradability opinion letters, which represented that Minnesota state securities laws allowed the company to offer and sell unrestricted Rule 504 stock to Alexander Lindale, because Alexander Lindale was an accredited investor and resident of Minnesota. The stock tradability opinion letters misrepresented Bennett's status as an attorney. Bennett knew he had lost his license to practice law. Bennett further knew that Copper King's transfer agent would rely upon Bennett's opinion in effecting stock transfers from Copper King to Alexander Lindale. Without the stock tradability opinion letters, the unregistered offering could not have occurred.

### IV.

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

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

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. 68598 / January 7, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15166

In the Matter of

HI DEF Enterprises, Inc.,  
Hi-Rise Recycling Systems, Inc.,  
Highline Industries, Inc.,  
Hirel Holdings, Inc.,  
Holiday RV Superstores, Inc. (n/k/a  
FreedomRoads RV, Inc.),  
Hooker Enterprises, Inc.,  
Hospital Staffing Services, Inc., and  
Hotelworks.com, Inc.,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents HI DEF Enterprises, Inc., Hi-Rise Recycling Systems, Inc., Highline Industries, Inc., Hirel Holdings, Inc., Holiday RV Superstores, Inc. (n/k/a FreedomRoads RV, Inc.), Hooker Enterprises, Inc., Hospital Staffing Services, Inc., and Hotelworks.com, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. HI DEF Enterprises, Inc. (CIK No. 797422) is a dissolved Florida corporation located in Pompano Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HI DEF is delinquent in its

periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 1995, which reported a net loss of \$300,215 for the prior twelve months.

2. Hi-Rise Recycling Systems, Inc. (CIK No. 906605) is a dissolved Florida corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hi-Rise 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, 2001, which reported a loss of over \$11.4 million for the prior six months. As of October 5, 2012, the company's stock (symbol "HIRI") was traded on the over-the-counter markets.

3. Highline Industries, Inc. (CIK No. 313372) is a permanently revoked Nevada corporation located in Miami Lakes, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Highline 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 October 31, 1993, which reported a net loss of \$837,597 for the prior six months.

4. Hirel Holdings, Inc. (CIK No. 1015115) is a void Delaware corporation located in Pompano Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hirel is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1997, which reported a net loss of over \$3.5 million for the prior nine months.

5. Holiday RV Superstores, Inc. (n/k/a FreedomRoads RV, Inc.) (CIK No. 822076) is a Delaware corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Holiday is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2002, which reported a net loss of over \$19 million for the prior twelve months. On October 20, 2003, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was terminated on February 23, 2009. As of October 5, 2012, the company's stock (symbol "RVEE") was traded on the over-the-counter markets.

6. Hooker Enterprises, Inc. (CIK No. 763364) is a dissolved Tennessee corporation located in Clearwater, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hooker 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 31, 1994, which reported a net loss of \$12,624 for the prior six months.

7. Hospital Staffing Services, Inc. (CIK No. 731625) is a dissolved Florida corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hospital Staffing 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, 1997, which reported a net loss of over \$5 million for the prior nine months.

8. Hotelworks.com, Inc. (CIK No. 911434) is a New York corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hotelworks.com 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, 2001, which reported a net loss of over \$3.1 million for the prior six months. As of October 5, 2012, the company's stock (symbol "HWRK") was traded on the over-the-counter markets.

#### B. DELINQUENT PERIODIC FILINGS

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

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

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

### III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 68597 / January 7, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15165

In the Matter of

Henley Healthcare, Inc.,  
Hightop Capital Corp.,  
Hiko Bell Mining & Oil Co.,  
Horizon Pharmacies, Inc.,  
Horizon Resources Corp., and  
Hudson's Grill of America, 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 Henley Healthcare, Inc., Hightop Capital Corp., Hiko Bell Mining & Oil Co., Horizon Pharmacies, Inc., Horizon Resources Corp., and Hudson's Grill of America, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Henley Healthcare, Inc. (CIK No. 890284) is a Texas corporation located in Sugar Land, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Henley is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2000, which reported a net loss of over \$3.86 million for the prior nine months. On October 19, 2001, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of Texas, which was closed on August

28, 2008. As of October 5, 2012, the company's stock (symbol "HENL") was traded on the over-the-counter markets.

2. Hightop Capital Corp. (CIK No. 1080098) is a dissolved Colorado corporation located in Greenwood Village, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hightop is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of \$2,413 for the prior three months.

3. Hiko Bell Mining & Oil Co. (CIK No. 47431) is an expired Utah corporation located in Vernal, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hiko 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 deficit of over \$3.18 million for the prior three months.

4. Horizon Pharmacies, Inc. (CIK No. 1036260) is a void Delaware corporation located in Denison, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Horizon Pharmacies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of over \$3.4 million for the prior three months.

5. Horizon Resources Corp. (CIK No. 750740) is a dissolved Colorado corporation located in Golden, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Horizon Resources 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, 1994, which reported a net loss of over \$1.7 million for the prior nine months.

6. Hudson's Grill of America, Inc. (CIK No. 729545) is a suspended California corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Hudson's Grill is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1999, which reported a net loss of \$52,593 for the prior three 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

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

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68600 / January 8, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-14863

In the Matter of	:	
	:	
UBS Financial Services Inc. of Puerto Rico	:	ORDER APPOINTING A FUND
	:	ADMINISTRATOR AND APPROVING
Respondent.	:	FUND ADMINISTRATOR BOND
	:	

On May 1, 2012, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against UBS Financial Services Inc. of Puerto Rico ("UBS PR"). Exchange Act Release No. 66893 (May 1, 2012). The Commission ordered the creation of a Fair Fund for a distribution pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, and also ordered that UBS PR pay disgorgement of \$11,500,000.00, prejudgment interest of \$1,109,739.94, and a civil money penalty of \$14,000,000.00 for a total payment of \$26,609,739.94 ("Fair Fund").

The Division of Enforcement ("Division") now seeks the appointment of A.B. Data Ltd. ("A.B. Data") as the fund administrator and the approval of a fund administrator bond in the amount of \$26,609,739.94 that is equal to amount of the Fair Fund. Division staff formed a committee to recommend an appointment of a fund administrator and solicited proposals from candidates, reviewed and evaluated each candidate's proposal and determined that A.B. Data's proposal provided the best value to the Fair Fund for the planned distribution.

Accordingly, pursuant to Rules 1105(a) and 1105(c) of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1105, IT IS HEREBY ORDERED that A.B. Data is appointed as the fund administrator, and A.B. Data shall obtain a bond in the manner prescribed in Rule 1105(c) in the approved amount of \$26,609,739.94.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68601 / January 8, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15167

**In the Matter of**

**China North East Petroleum Holdings Limited,**  
  
**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 North East Petroleum Holdings Limited.

**II.**

After an investigation, the Division of Enforcement alleges that:

A. Respondent China North East Petroleum Holdings Limited ("CNEP" or "Respondent") (CIK No. 0000787251), a Nevada corporation with principal executive offices located in New York, is purportedly engaged in oil exploration, production and drilling in the People's Republic of China ("China"). CNEP's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was listed on the NYSE MKT, LLC ("NYSE"). On July 6, 2012, the NYSE filed a Form 25 delisting the common stock effective on July 16, 2012, and deregistering the common stock from Section 12(b) effective on October 4, 2012. Upon deregistration from Section 12(b), the common stock reverted to its previous registration pursuant to Section 12(g) of the Exchange Act. As of January 7, 2013, CNEP securities were quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. at 19 cents per share, had four market makers, and were not eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. CNEP is delinquent in its reporting obligations under Section 13(a) of the Exchange Act having not filed a periodic report for any period ended after September 30, 2011.

C. 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. Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

D. As a result of the foregoing, Respondent 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 contained in Section II above are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

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

### IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III above 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 may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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



SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33-9367, 34-68140, IA-3498, IC-30256, File No. S7-11-12]

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission is publishing an agenda of its rulemaking actions pursuant to the Regulatory Flexibility Act (RFA) (Pub. L. 96-354, 94 Stat. 1164) (Sept. 19, 1980). Information in the agenda was accurate on November 2, 2012, the day on which the Commission's staff completed compilation of the data. To the extent possible, rulemaking actions by the Commission since that date have been reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

The Commission is now printing in the Federal Register, along with our preamble, only those agenda entries for which we have indicated that preparation of a Regulatory Flexibility Act analysis is required.

The Commission's complete RFA agenda will be available online at www.reginfo.gov.

DATES: Comments should be received on or before February 7, 2013.

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 email to rule-comments@sec.gov. Please include File Number S7-11-12 on the subject line; or
• Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090. All submissions should refer to File No. S7-11-12. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; 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: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The RFA requires each Federal agency, during April and October of each year, to

publish in the Federal Register an agenda identifying rules that the agency expects to consider in the next 12 months that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The RFA specifically provides that publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda and that an agency is not required to consider or act on any matter that is included in the agenda (5 U.S.C. 602(d)). Actions that do not have an estimated date are placed in the long-term category; the Commission may nevertheless act on items in that category within the next 12 months. The agenda includes new entries, entries carried over from prior publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda.

The following abbreviations for the acts administered by the Commission are used in the agenda:

- "Securities Act"—Securities Act of 1933
"Exchange Act"—Securities Exchange Act of 1934
"Investment Company Act"—Investment Company Act of 1940
"Investment Advisers Act"—Investment Advisers Act of 1940
"Dodd-Frank Act"—Dodd-Frank Wall Street Reform and Consumer Protection Act

The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.
Dated: November 2, 2012.
Elizabeth M. Murphy, Secretary.

DIVISION OF CORPORATION FINANCE—PROPOSED RULE STAGE

Table with 3 columns: Sequence No., Title, Regulation Identifier No. Rows include: 533 Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(6) of the Securities Act of 1933, 534 Implementation of Titles V and VI of the JOBS Act, 535 Exemptions for Security-Based Swaps.

DIVISION OF CORPORATION FINANCE—FINAL RULE STAGE

Table with 3 columns: Sequence No., Title, Regulation Identifier No. Rows include: 536 Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, 537 Elimination of Prohibition on General Solicitation in Rule 506 and Rule 144A Offerings, 538 Short-Term Borrowings.

6 of 26

DIVISION OF CORPORATION FINANCE—COMPLETED ACTIONS

Sequence No.	Title	Regulation Identifier No.
539 .....	Conflict Minerals .....	3235-AK84
540 .....	Disclosure of Payments By Resource Extraction Issuers .....	3235-AK85

DIVISION OF INVESTMENT MANAGEMENT—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
541 .....	Purchase of Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption.	3235-AL02

DIVISION OF TRADING AND MARKETS—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
542 .....	Broker-Dealer Reports .....	3235-AK56
543 .....	Transitional Registration as a Municipal Advisor .....	3235-AK69
544 .....	Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934 .....	3235-AL14
545 .....	Rules for Nationally Recognized Statistical Rating Organizations .....	3235-AL15

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

*Division of Corporation Finance*

Proposed Rule Stage

**533. • Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(6) of the Securities Act of 1933**

*Legal Authority:* 15 U.S.C. 77a et seq.; 15 U.S.C. 78a et seq.; Pub. L. 112-108, secs 301 to 305

*Abstract:* The Division is considering recommending that the Commission implement the requirements of title II of the JOBS Act by prescribing rules governing the offer and sale of securities through crowdfunding under new section 4(6) of the Securities Act.

*Timetable:*

Action	Date	FR Cite
NPRM .....	12/00/12	

*Regulatory Flexibility Analysis Required: Yes.*

*Agency Contact:* Sebastian Gomez Abero, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3500, *Email:* gomezalberos@sec.gov. *RIN:* 3235-AL37

**534. • Implementation of Titles V and VI of the Jobs Act**

*Legal Authority:* Pub. L. 112-106

*Abstract:* The Division is considering recommending that the Commission propose rules or amendments to rules to implement titles V (Private Company

Flexibility and Growth) and VI (Capital Expansion) of the JOBS Act.

*Timetable:*

Action	Date	FR Cite
NPRM .....	01/00/13	

*Regulatory Flexibility Analysis Required: Yes.*

*Agency Contact:* Steven G. Hearne, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3430, *Email:* hearnes@sec.gov. *RIN:* 3235-AL40

**535. Exemptions for Security-Based Swaps**

*Legal Authority:* 15 U.S.C. 77s; 15 U.S.C. 77aa; 15 U.S.C. 78l(h); 15 U.S.C. 78w(a); 15 U.S.C. 78mm; 15 U.S.C. 78ddd(d)

*Abstract:* The Commission adopted interim final rules, providing exemptions under the Securities Act, Exchange Act, and Trust Indenture Act of 1939, for those security-based swaps that under previous law were security-based swap agreements and have been defined as "securities" under the Securities Act and the Exchange Act as of July 16, 2011, due solely to the provisions of title VII of the Dodd-Frank Act.

The Division is considering recommending that the Commission propose rules that would enable transactions in security-based swaps to rely on existing exemptions under the Securities Act.

*Timetable:*

Action	Date	FR Cite
Interim Final Rule	07/11/11	76 FR 40605
Interim Final Rule Effective.	07/11/11	
Interim Final Rule Comment Period End.	08/15/11	
NPRM .....	12/00/12	

*Regulatory Flexibility Analysis Required: Yes.*

*Agency Contact:* Amy Starr, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3860.

*RIN:* 3235-AL17

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

*Division of Corporation Finance*

Final Rule Stage

**536. Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings**

*Legal Authority:* 15 U.S.C. 77c(a); 15 U.S.C. 77d; 15 U.S.C. 77s; 15 U.S.C. 77z-3

*Abstract:* The Commission proposed rules to disqualify securities offerings involving certain "bad actors" from eligibility for the exemptions under Rule 506 of Regulation D, in accordance with section 926 of the Dodd-Frank Act.

*Timetable:*

Action	Date	FR Cite
NPRM .....	06/01/11	76 FR 31518
NPRM Comment Period End.	07/14/11	
Final Action .....	12/00/12	

*Regulatory Flexibility Analysis*

*Required: Yes.*

*Agency Contact:* Johanna Vega Losert, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3460, *Email:* losertj@sec.gov.  
*RIN:* 3235-AK97

**537. • Elimination of Prohibition on General Solicitation in Rule 506 and Rule 144a Offerings**

*Legal Authority:* 15 U.S.C. 77a et seq.  
*Abstract:* The Commission proposed rules to eliminate the prohibition against general solicitation and general advertising in securities offerings made pursuant to Rule 506 of Regulation D under the Securities Act and Rule 144A under the Securities Act, as mandated by section 210(a) of the Jumpstart Our Business Startups Act.

*Timetable:*

Action	Date	FR Cite
NPRM .....	09/06/12	77 FR 54469
NPRM Comment Period End.	10/05/12	
Final Action .....	12/00/12	

*Regulatory Flexibility Analysis*

*Required: Yes.*

*Agency Contact:* Ted Yu, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3500.  
Charles Kwon, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3500.  
*RIN:* 3235-AL34

**538. Short-Term Borrowings**

*Legal Authority:* 15 U.S.C. 77a et seq.; 15 U.S.C. 78a et seq.

*Abstract:* The Commission proposed revisions to rules to enhance the disclosure that registrants provide about short-term borrowings.

*Timetable:*

Action	Date	FR Cite
NPRM .....	09/28/10	75 FR 59866
NPRM Comment Period End.	11/29/10	
Final Action .....	03/00/13	

*Regulatory Flexibility Analysis*

*Required: Yes.*

*Agency Contact:* Christina Padden, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3430.  
*RIN:* 3235-AK72

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

*Division of Corporation Finance*

Completed Actions

**539. Conflict Minerals**

*Legal Authority:* 15 U.S.C. 77g; 15 U.S.C. 77j; 15 U.S.C. 77s; 15 U.S.C. 78l; 15 U.S.C. 78m; 15 U.S.C. 78o; 15 U.S.C. 78w; Pub. L. 111-203 sec 1502

*Abstract:* The Commission adopted a new rule pursuant to section 1502 of the Dodd-Frank Act, which added section 13(p) to the Exchange Act. The new rule requires any reporting issuer for which conflict minerals are necessary to the functionality or production of a product manufactured or contracted to be manufactured by that issuer to disclose in a new form whether its conflict minerals originated in the Democratic Republic of the Congo or an adjoining country. If so, the issuer is required to file as an exhibit to this form a separate conflict minerals report.

*Timetable:*

Action	Date	FR Cite
NPRM .....	12/23/10	75 FR 80948
NPRM Comment Period End.	01/31/11	
NPRM Comment Period Extended.	02/03/11	76 FR 6110
NPRM Comment Period Extended End.	03/02/11	
Final Action .....	09/12/12	77 FR 56272
Final Action Effective.	11/13/12	

*Regulatory Flexibility Analysis*

*Required: Yes.*

*Agency Contact:* John Fieldsend, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3430.  
*RIN:* 3235-AK84

**540. Disclosure of Payments by Resource Extraction Issuers**

*Legal Authority:* 15 U.S.C. 78q; Pub. L. 203-111 sec 1504

*Abstract:* The Commission adopted rules pursuant to section 1504 of the Dodd-Frank Act, which added section 13(q) to the Exchange Act. Section 13(q)

requires the Commission to adopt rules requiring resource extraction issuers to disclose in their annual reports filed with the Commission payments made to foreign governments or the U.S. federal government for the purpose of the commercial development of oil, natural gas, or minerals.

*Timetable:*

Action	Date	FR Cite
NPRM .....	12/23/10	75 FR 80978
NPRM Comment Period End.	01/31/11	
NPRM Comment Period Extended.	02/03/11	76 FR 6111
NPRM Comment Period Extended End.	03/02/11	
Final Action .....	09/12/12	77 FR 56365
Final Action Effective.	11/13/12	

*Regulatory Flexibility Analysis*

*Required: Yes.*

*Agency Contact:* Elliot Staffin, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-3243.  
*RIN:* 3235-AK85

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

*Division of Investment Management*

Final Rule Stage

**541. Purchase of Debt Securities by Business and Industrial Development Companies Relying on an Investment Company Act Exemption**

*Legal Authority:* 15 U.S.C. 80a-6(c); 15 U.S.C. 80a-8; 15 U.S.C. 80a-14(a); 15 U.S.C. 80a-29; 15 U.S.C. 80a-30(a); 15 U.S.C. 80a-37; 15 U.S.C. 77e; 15 U.S.C. 77f; 15 U.S.C. 77g; 15 U.S.C. 77j; 15 U.S.C. 77s(a); Pub. L. 111-203, sec 939; Pub. L. 111-203, sec 939A

*Abstract:* The Commission proposed (i) to amend two rules (Rules 2a-7 and 5b-3) and four forms (Forms N-1A, N-2, N-3, and N-MFP) under the Investment Company Act that reference credit ratings and (ii) a new rule under that Act that would set forth a credit quality standard in place of a credit rating removed by the Dodd-Frank Act from section 6(a)(5)(A)(iv)(1) of that Act. These proposals would give effect to provisions of section 939A of the Dodd-Frank Act.

The Commission adopted Rule 6a-5 which sets forth a credit quality standard to replace the one removed from section 6(a)(5)(A)(iv)(1) by the Dodd-Frank Act.

**Timetable:**

Action	Date	FR Cite
NPRM .....	03/09/11	76 FR 12896
NPRM Comment Period End.	04/25/11	
Final Action .....	11/23/12	77 FR 70117
Final Action Effective.	12/24/12	
Final Action .....	03/00/13	

**Regulatory Flexibility Analysis Required: Yes.**

**Agency Contact:** Anu Dubey, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-6792.

*RIN:* 3235-AL02

**SECURITIES AND EXCHANGE COMMISSION (SEC)**

*Division of Trading and Markets*

Final Rule Stage

**542. Broker-Dealer Reports**

**Legal Authority:** 15 U.S.C. 78q

**Abstract:** The Commission proposed amendments to Rule 17a-5 dealing with, among other things, broker-dealer custody of assets.

**Timetable:**

Action	Date	FR Cite
NPRM .....	06/27/11	76 FR 37572
NPRM Comment Period End.	08/26/11	
Final Action .....	12/00/12	

**Regulatory Flexibility Analysis Required: Yes.**

**Agency Contact:** Mark Attar, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-5889, *Email:* attarm@sec.gov.

*RIN:* 3235-AK56

**543. Transitional Registration as a Municipal Advisor**

**Legal Authority:** Pub. L. 111-203, sec 975

**Abstract:** The Commission adopted an interim final temporary rule to require

all municipal advisors to register with it by October 1, 2010, consistent with the Dodd-Frank Act. The rule has been amended and is effective through September 30, 2013.

**Timetable:**

Action	Date	FR Cite
Interim Final Rule	09/08/10	75 FR 54465
Interim Final Rule Effective.	10/01/10	
Interim Final Rule Comment Period End.	10/08/10	
Interim Final Rule Extended.	12/27/11	76 FR 80733
Interim Final Rule Effective Through.	12/31/11	
Interim Final Rule Extended.	09/26/12	77 FR 62185
Interim Final Rule Effective Through.	09/00/13	

**Regulatory Flexibility Analysis Required: Yes.**

**Agency Contact:** Ira Brandriss, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-5681, *Email:* brandrissi@sec.gov.

*RIN:* 3235-AK69

**544. Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934**

**Legal Authority:** Pub. L. 111-203, sec 939A

**Abstract:** Section 939A of the Dodd-Frank Act requires the Commission to remove any references to credit ratings from its regulations and to substitute such standards of creditworthiness as the Commission determines to be appropriate. The Commission proposed to amend certain rules and one form under the Securities Exchange Act applicable to broker-dealer financial responsibility, distributions of securities, and confirmations of transactions. The Commission also requested comment on potential standards of creditworthiness for purposes of Exchange Act sections 3(a)(41) and 3(a)(53), which define the terms "mortgage related security" and

"small business related security," respectively, as the Commission considers how to implement section 939(e) of the Dodd-Frank Act.

**Timetable:**

Action	Date	FR Cite
NPRM .....	05/06/11	76 FR 26550
NPRM Comment Period End.	07/05/11	
Final Action .....	12/00/12	

**Regulatory Flexibility Analysis Required: Yes.**

**Agency Contact:** Rachel Yura, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-5729, *Email:* yurar@sec.gov.

*RIN:* 3235-AL14

**545. Rules for Nationally Recognized Statistical Rating Organizations**

**Legal Authority:** 15 U.S.C. 78o-7; 15 U.S.C. 78q; 15 U.S.C. 78mm; Pub. L. 111-203, secs 936, 938, and 943

**Abstract:** The Commission proposed rules and rule amendments to implement certain provisions of the Dodd-Frank Act concerning nationally recognized statistical rating organizations, providers of third-party due diligence services for asset-backed securities, and issuers and underwriters of asset-backed securities.

**Timetable:**

Action	Date	FR Cite
NPRM .....	06/08/11	76 FR 33420
NPRM Comment Period End.	08/08/11	
Final Action .....	12/00/12	

**Regulatory Flexibility Analysis Required: Yes.**

**Agency Contact:** Timothy Fox, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551-5687, *Email:* foxt@sec.gov.

*RIN:* 3235-AL15

[FR Doc. 2012-31518 Filed 1-7-13; 8:45 am]

BILLING CODE 8011-01-P

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Commissioner Walter  
Commissioner Gallagher  
not participating  
Commissioner Paredes  
Disapproved*

SECURITIES ACT OF 1933  
Release No. 9381 / January 9, 2013

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68610 / January 9, 2013

In the Matter of

JPMORGAN CHASE & CO.

Respondent.

**ORDER UNDER SECTION 27A(b) OF THE  
SECURITIES ACT OF 1933 AND  
SECTION 21E(b) OF THE SECURITIES  
EXCHANGE ACT OF 1934, GRANTING  
WAIVERS OF THE DISQUALIFICATION  
PROVISIONS OF SECTION 27A(b)(1)(A)(ii)  
OF THE SECURITIES ACT OF 1933 AND  
SECTION 21E(b)(1)(A)(ii) OF THE  
SECURITIES EXCHANGE ACT OF 1934 AS  
TO JPMORGAN CHASE & CO. AND ITS  
AFFILIATES**

JPMorgan Chase & Co. ("JPM") has submitted a letter on behalf of itself and its affiliates, dated November 5, 2012, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 (the "Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 (the "Exchange Act") arising from the settlement of a civil injunctive action filed by the Commission against subsidiaries of JPM known as J.P. Morgan Securities LLC (or "JP Morgan"), EMC Mortgage, LLC, Bear Stearns Asset Backed Securities I, LLC, Structured Asset Mortgage Investments II, Inc., SACO I, Inc., and J.P. Morgan Acceptance Corporation I (or "JPMAC"), (collectively "Defendants").

On November 16, 2012, the Commission filed a civil injunctive action in U.S. District Court for the District of Columbia against Defendants for violating the antifraud provisions of the federal securities laws. The complaint alleged that the violations resulted from (a) the undisclosed practices of certain entities affiliated with The Bear Stearns Companies, LLC (collectively "Bear"),<sup>1</sup> in connection with residential mortgage-backed securities offerings, of negotiating cash settlements with mortgage loan originators on loans that violated the representations, warranties, and covenants made to Bear by the originators after the loans were securitized but keeping the consideration received without notifying the trusts that owned the loans, and (b) the inclusion of delinquent loans in a December 2006, \$1.8 billion RMBS offering that was underwritten by JP Morgan and collateralized by loans that JPMAC had purchased. On January 8, 2013, pursuant to Defendants' consent, the U.S. District Court for the District of Columbia entered a Final Judgment

<sup>1</sup> JP Morgan acquired The Bear Stearns Companies, LLC in September 2008.

permanently enjoining Defendants from violating Sections 17(a)(2) and (3) of the Securities Act, and requiring Defendants to pay disgorgement and a penalty.

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

Based on the representations set forth in JPM's letter, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Judgment is appropriate and should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to JPM and its affiliates resulting from the entry of the Final Judgment is hereby granted.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Commissioner Watter  
Commissioner Gallagher  
not participating  
Commissioner Faredes  
Disapproved*

SECURITIES ACT OF 1933  
Release No. 9380 / January 9, 2013

In the Matter of

J.P. MORGAN SECURITIES LLC,  
EMC MORTGAGE, LLC, BEAR  
STEARNS ASSET BACKED  
SECURITIES I, LLC, STRUCTURED  
ASSET MORTGAGE  
INVESTMENTS II, INC., SACO I,  
INC., AND J.P. MORGAN  
ACCEPTANCE CORPORATION I,

Respondents.

ORDER UNDER RULE 602(e) OF THE  
SECURITIES ACT OF 1933 GRANTING A  
WAIVER OF THE RULE 602(b)(4) & 602(c)(2)  
DISQUALIFICATION PROVISIONS

I.

J.P. Morgan Securities LLC (or "JP Morgan"), EMC Mortgage, LLC, Bear Stearns Asset Backed Securities I, LLC, Structured Asset Mortgage Investments II, Inc., SACO I, Inc., and J.P. Morgan Acceptance Corporation I (or "JPMAC"), (collectively "Respondents") have submitted a letter, dated November 2, 2012, requesting a waiver of the Rule 602(b)(4) and 602(c)(2) disqualification from the exemption from registration under Regulation E arising from Respondents' settlement of an injunctive action commenced by the Commission.

II.

On November 16, 2012, the Commission filed a civil injunctive action in the U.S. District Court for the District of Columbia charging Respondents with violating sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"). In its complaint, the Commission alleged that the violations resulted from (a) the undisclosed practices of certain entities affiliated with The Bear Stearns Companies, LLC (collectively "Bear"),<sup>1</sup> in connection with residential mortgage-backed securities offerings, of negotiating cash settlements with mortgage loan originators on loans that violated the representations, warranties, and covenants made to Bear by the originators after the loans were securitized but keeping the consideration received without notifying the trusts that owned the loans, and (b) the inclusion of delinquent loans in a December 2006, \$1.8

<sup>1</sup> JP Morgan acquired The Bear Stearns Companies, LLC in September 2008.

billion RMBS offering that was underwritten by JP Morgan and collateralized by loans that JPMAC had purchased. On January 8, 2013, pursuant to Respondents' consent, the U.S. District Court for the District of Columbia entered a Final Judgment permanently enjoining Respondents from violating Sections 17(a)(2) and (3) of the Securities Act, and requiring Respondents to pay disgorgement and a penalty.

### 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 any of its affiliates is subject to any order, judgment, or decree of a court "temporarily or permanently restraining or enjoining such person from engaging in or continuing any conduct or practice in connection with the purchase or sale of securities," or if, among other things, any investment adviser or underwriter of the securities to be offered is "temporarily or permanently restrained by any court from engaging in or continuing any conduct or practice in connection with the purchase or sale of any security." 17 C.F.R. §§ 230.602 (b)(4) and 230.602(c)(2). Rule 602(e) of the Securities Act provides, however, that the disqualification "shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption be denied." 17 C.F.R. § 230.602(e).

### IV.

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

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provisions of Rules 602(b)(4) and 602(c)(2) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC - 30347; 812-14094]

J.P. Morgan Securities LLC, et al.; Notice of Application and Temporary Order

January 9, 2013

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

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to an injunction entered against J.P. Morgan Securities LLC ("JPMS"), EMC Mortgage, LLC ("EMC"), Bear Stearns Asset Backed Securities I, LLC ("BSABS"), Structured Asset Mortgage Investments II, Inc. ("SAMI"), SACO I Inc. ("SACO") and J.P. Morgan Acceptance Corporation I ("JPMAC") (together, the "Defendants") on January 8, 2013, by the United States District Court for the District of Columbia ("Injunction") until the Commission takes final action on an application for a permanent order. Applicants also have applied for a permanent order.

Applicants: JPMS, EMC, BSABS, SAMI, SACO, JPMAC, Bear Stearns Asset Management Inc. ("BSAM"), Bear Stearns Health Innoventures Management, L.L.C. ("BSHIM"), BSCGP Inc. ("BSGCP"), Constellation Growth Capital LLC ("Constellation"), Constellation Ventures Management II, LLC ("Constellation II"), Highbridge Capital Management, LLC ("Highbridge"), JF International Management Inc. ("JFIMI"), JPMorgan Distribution Services, Inc. ("JPMDS"), J.P. Morgan Institutional Investments, Inc. ("JPMII"), J.P. Morgan Investment Management Inc. ("JPMIM"), J.P. Morgan Partners, LLC ("JPMP"), J.P. Morgan Private Investments Inc. ("JPMPI"), OEP Co-Investors Management II, Ltd. ("OEP II"), OEP Co-Investors Management III, Ltd.

*Commissioner Watter,  
Commissioner Gallagher  
not participating  
Commissioner Paredes,  
Disapproved*

("OEP III," and together with OEP II, the "OEP Entities"), Security Capital Research & Management Incorporated ("Security Capital"), Sixty Wall Street GP Corporation ("Sixty Wall GP") and Sixty Wall Street Management Company, LLC ("Sixty Wall Management") (each an "Applicant" and collectively, the "Applicants").<sup>1</sup>

Filing Date: The application was filed on November 16, 2012, and amended on January 8, 2013.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on February 4, 2013, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: JPMS, BSABS, SAMI, SACO and JPMAC, 383 Madison Avenue, New York, NY 10179; EMC, 2780 Lake Vista Drive, Lewisville, TX 75067; BSAM, BSHIM, BSCGP, Constellation II, JPMII, JPMIM, JPMP, JPMPI, Sixty Wall GP and Sixty Wall Management, 270 Park Avenue, New York, NY 10017; Constellation and Highbridge, 40 West 57<sup>th</sup> Street, 32<sup>nd</sup> Floor, New York, NY 10019; JFIMI, 21<sup>st</sup> Floor, Chater House, 8 Connaught Road Central,

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<sup>1</sup> Applicants request that any relief granted pursuant to the application also apply to any other company of which any Defendant is or may become an affiliated person within the meaning of section 2(a)(3) of the Act (together with the Applicants, the "Covered Persons").

Hong Kong; JPMS, 1111 Polaris Parkway, Columbus, OH 43240; OEP Entities, 320 Park Avenue, 18<sup>th</sup> Floor, New York, NY 10022; and Security Capital, 10 South Dearborn Street, Suite 1400, Chicago, IL 60603.

For Further Information Contact: Jaea F. Hahn, Senior Counsel, at 202-551-6870 or Janet M. Grossnickle, Assistant Director, at 202-551-6821 (Division of Investment Management, Office of Investment Company Regulation).

Supplementary Information: The following is a temporary order and summary of the application. The complete application may be obtained via the Commission's website by searching for the file number, or an applicant using the Company name box, at <http://www.sec.gov/search/search.htm>, or by calling (202) 551-8090.

Applicants' Representations:

1. JPMS, a limited liability company organized under the laws of Delaware, is registered as a broker-dealer under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and is registered as an investment adviser under the Investment Advisers Act of 1940, as amended (the "Advisers Act"). EMC and BSABS are each Delaware limited liability companies; neither is registered as a broker-dealer under the Exchange Act or as an investment adviser under the Advisers Act. SAMI, SACO and JPMAC are each Delaware corporations, none of which is registered as a broker-dealer under the Exchange Act or as an investment adviser under the Advisers Act. The Defendants do not currently serve as investment adviser, sub-adviser, or depositor of any registered investment company, or principal underwriter for any registered open-end investment company, registered unit investment trust ("UIT") or registered face amount certificate company, or investment adviser of any employees' securities company, as defined in section 2(a)(13) of the Act ("ESC") ("Fund Service Activities," and the

Applicants that do serve in such capacities, "Fund Servicing Applicants"). "Funds" refers to the registered investment companies or ESCs for which a Covered Person provides Fund Service Activities.

2. The ultimate parent of each Defendant is J.P. Morgan Chase & Co. ("JPMC"). JPMC is a financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers. JPMC is also the ultimate parent of each of the Fund Servicing Applicants, who, as majority-owned and wholly-owned subsidiaries of the same ultimate parent, are under common control with the Defendants.

3. BSAM is registered as an investment adviser under the Advisers Act and serves as investment adviser or sub-adviser to various Funds, including as a general partner that provides investment advisory services to various ESCs, which provide investment opportunities for highly compensated key employees, officer, directors and current consultants of JPMC and its affiliates.<sup>2</sup> BSHIM, BSCGP, Constellation II and the OEP Entities also serve as general partners that provide investment advisory services to various ESCs. Constellation serves as a sub-adviser to various ESCs. Highbridge, JFIMI, JPMIM, JPMPI, and Security Capital are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to various Funds. JPMP, Sixty Wall GP, Sixty Wall Management are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to ESCs. JPMDS is registered as a broker-dealer under the Exchange Act and serves as principal

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<sup>2</sup> Every Applicant that is a general partner that provides investment advisory services to one or more ESCs believes, for purposes of the application, that it is performing a function that falls within the definition of "investment adviser" in section 2(a)(20) of the Act.

underwriter to various Funds. JPMII is registered as a broker-dealer under the Exchange Act and serves as placement agent to various Funds.<sup>3</sup>

4. On January 8, 2013, the United States District Court for the District of Columbia entered a judgment, which included the Injunction, against the Defendants (“Judgment”) in a matter brought by the Commission.<sup>4</sup> The Commission alleged in the complaint (“Complaint”) that the Defendants violated Sections 17(a)(2) and (3) of the Securities Act of 1933 in connection with alleged false and misleading disclosures involving offerings of certain residential mortgage-backed securities (“RMBS”). Without admitting or denying any of the allegations in the Complaint (other than those relating to the jurisdiction of the District Court over it and the subject matter, solely for purposes of this action), the Defendants consented to the entry of the Injunction and other relief, including disgorgement, prejudgment interest, and civil monetary penalties.

Applicants’ Legal Analysis:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of a security, or in connection with activities as an underwriter, broker or dealer, from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company, registered UIT, or registered face-amount certificate company

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<sup>3</sup> JPMII serves as placement agent to JPMorgan Institutional Trust (“Trust”) with respect to three of its series. The Trust is an open-end investment company registered under the Act, but its shares are not registered under the Securities Act of 1933, as amended. JPMII believes, for purposes of the application, that it is performing a function that falls within the definition of principal underwriter in section 2(a)(29) of the Act.

<sup>4</sup> U.S. Securities and Exchange Commission v. J.P. Morgan Securities LLC, EMC Mortgage, LLC, Bear Stearns Asset Backed Securities I, LLC, Structured Asset Mortgage Investments II, Inc., SACO I Inc., and J.P. Morgan Acceptance Corporation I, Case No. 1:12-cv-01862-RLW (D.D.C. Jan. 8, 2013).

or as investment adviser of an ESC. Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control, with the other person. Applicants state that the Defendants are affiliated persons of each of the other Applicants within the meaning of section 2(a)(3) of the Act. Applicants state that, as a result of the Injunction, they would be subject to the prohibitions of section 9(a) of the Act.

2. Section 9(c) of the Act provides that the Commission shall grant an application for exemption from the disqualification provisions of section 9(a) of the Act if it is established that these provisions, as applied to the Applicants, are unduly or disproportionately severe or that the conduct of the Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a temporary and permanent order exempting them and other Covered Persons from the disqualification provisions of section 9(a).

3. Applicants believe they meet the standard for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of the Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state that the alleged conduct giving rise to the Injunction did not involve any of the Applicants engaging in Fund Service Activities. Applicants also state to the best of their knowledge (i) none of the current directors, officers, or

employees of the Applicants (other than the Defendants) that are involved in providing Fund Service Activities (or any other persons in such roles during the time period covered by the Complaint) participated in the conduct alleged in the Complaint to have constituted the violations that provide a basis for the Injunction; and (ii) the personnel at the Defendants who participated in the conduct alleged in the Complaint to have constituted the violations that provide a basis for the Injunction have had no, and will not have any, involvement in providing Fund Service Activities to the Funds on behalf of the Applicants or other Covered Persons.

5. Applicants state that the inability of the Applicants to engage in Fund Service Activities would result in potentially severe financial hardships for the Funds they serve and the Funds' shareholders or unitholders. Applicants state that they will distribute written materials, including an offer to meet in person to discuss the materials, to the boards of directors of the Funds (excluding for this purpose the ESCs) (the "Boards"), including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Funds, and their independent legal counsel as defined in rule 0-1(a)(6) under the Act, if any, describing the circumstances that led to the Injunction, any impact on the Funds,<sup>5</sup> and the application. Applicants state that they will provide the Boards with the information concerning the Injunction and the application that is necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws.

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<sup>5</sup> Applicants state that several Funds may have owned certain series of the RMBS which are the subject of the Injunction. Applicants further state that these RMBS were acquired from unaffiliated parties, generally in secondary market transactions. To the extent that any of these Funds suffered losses from their investment in the RMBS, the Funds will be able to participate in the Fair Fund to the extent available to any other investor.

6. Applicants also state that, if they were barred from providing Fund Service Activities to registered investment companies and ESCs, the effect on their businesses and employees would be severe. Applicants state that they have committed substantial resources to establish an expertise in providing Fund Service Activities. Applicants further state that prohibiting them from providing Fund Service Activities would not only adversely affect their businesses, but would also adversely affect approximately 940 employees that are involved in those activities. Applicants also state that disqualifying certain Applicants from continuing to provide investment advisory services to ESCs is not in the public interest or in furtherance of the protection of investors. Because the ESCs have been formed for the benefit of key employees, officers and directors of JPMC and its affiliates, it would not be consistent with the purposes of the ESC provisions of the Act or the terms and conditions of the ESC orders to require another entity not affiliated with JPMC to manage the ESCs. In addition, participating employees of JPMC and its affiliates likely subscribed for interests in the ESCs with the expectation that the ESCs would be managed by an affiliate of JPMC.

7. Applicants state that Applicants and certain other affiliated persons of the Applicants have previously received orders under section 9(c) of the Act, as the result of conduct that triggered section 9(a), as described in greater detail in the application.

Applicants' Condition:

Applicants agree that any order granting the requested relief will be subject to the following condition:

Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings

involving or against, Covered Persons, including without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

Temporary Order:

The Commission has considered the matter and finds that the Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the condition in the application, from January 8, 2013, until the Commission takes final action on their application for a permanent order.

By the Commission.

*Kevin M. O'Neill*

Kevin M. O'Neill  
Deputy Secretary

*Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3532 / January 10, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15169

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In the Matter of :  
 :  
KRIS CHELLAM :  
 :  
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 Kris Chellam ("Chellam" 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. Chellam, age 61, resides in Saratoga, California. From 1998 to 2007, Chellam was a senior officer at Xilinx, Inc. ("Xilinx"), including serving as Xilinx's chief financial officer from 1998 to 2005. From approximately May 2007 to April 2009, Chellam was the Co-Managing Partner of the Galleon Special Opportunities Fund, a late-stage venture capital fund affiliated with the hedge fund investment adviser Galleon Management, LP ("Galleon").

2. On October 26, 2012, the Commission filed a civil action against Chellam in Securities and Exchange Commission v. Chellam, Civil Action Number 12-CV-7983, in the United States District Court for the Southern District of New York. On November 7, 2012, the Court entered a final judgment by consent against Chellam, 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.

3. The Commission's complaint alleges that during his employment with Xilinx, Chellam, in breach of an obligation arising from a relationship of trust and confidence and with the expectation of receiving a benefit, conveyed material nonpublic information concerning Xilinx to Galleon founder Raj Rajaratnam, who traded Xilinx securities while in possession of this inside information. The Commission's complaint alleges further that after Chellam joined the Galleon Special Opportunities Fund in 2007, he continued to obtain material nonpublic information about Xilinx and to pass that information to Rajaratnam and other individuals affiliated with Galleon.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Chellam 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.

Elizabeth M. Murphy  
Secretary

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

*Chairman Schapiro  
Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68628 / January 11, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3440 / January 11, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15171

In the Matter of  
  
ERIC ASHMAN, 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 Eric Ashman ("Respondent" or "Ashman") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

II.

<sup>1</sup> 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.

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

### III.

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

1. Ashman, age 45, is and has been a certified public accountant licensed to practice in the State of Massachusetts. He served as Chief Financial Officer of TheStreet, Inc. ("TheStreet") from July 2006 through May 2009.

2. TheStreet was, at all relevant times, a Delaware corporation with its principal place of business in New York, New York. TheStreet is, and at all relevant times was, a digital financial media company providing users, subscribers and advertisers with a variety of content and tools through a range of online channels. At all relevant times, TheStreet's common stock was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ National Market.

3. On December 21, 2012, a final judgment was entered against Ashman, permanently enjoining him from violating, directly or indirectly, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14 and 13b2-1 thereunder; and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Eric Ashman, Civil Action Number 12-CV-9189, in the United States District Court for the Southern District of New York. Ashman was also ordered to pay a \$125,000 civil money penalty, ordered to reimburse TheStreet \$34,149 pursuant to Section 304 of the Sarbanes Oxley Act of 2002, and prohibited for 3 years from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

4. The Commission's complaint alleged, among other things, that Ashman aided and abetted a fraud resulting in TheStreet filing materially false and misleading financial statements in the company's annual report on Form 10-K for the fiscal year ended December 31, 2008, and in the company's quarterly reports on Form 10-Q for the first three quarters of fiscal year 2008. The Complaint alleged that Ashman engaged in a number of improper accounting practices that materially increased TheStreet's operating income, or decreased its operating loss, in a departure from generally accepted accounting principles ("GAAP"). These practices included,

among other things: (1) recognizing revenue based on purported contracts for services when Ashman knew or recklessly disregarded that TheStreet had not performed the related services and/or had no basis to believe that such services had been performed; and (2) prematurely recognizing revenue based on services contracts. In addition, the complaint alleged that Ashman made a false statement regarding revenue growth at a subsidiary of TheStreet when he knew or recklessly disregarded that such revenue only increased as a result of accounting improprieties.

#### IV.

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

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

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

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

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his/her practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

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

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

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

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

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to

comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3533 / January 11, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15170**

**In the Matter of**

**I. Joseph Massoud,**

**Respondent.**

**ORDER INSTITUTING**  
**ADMINISTRATIVE PROCEEDINGS**  
**PURSUANT 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 I. Joseph Massoud ("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. Massoud, age 44 and a resident of Westport, Connecticut, is the founder and managing partner of Compass Group Management, LLC ("Compass Group"), an unregistered investment adviser to Compass Diversified Holdings (NYSE: CODI) ("Compass Diversified") and Compass Group Investments, Ltd. ("CGI"). Until he began a leave of absence on February 17, 2011, Massoud was also the chief executive officer and a member of the board of directors of Compass Diversified.

2. On December 12, 2012, a final judgment was entered by consent against Massoud, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Massoud, Civil Action Number 3:12-cv-01691-RNC, in the United States District Court for the District of Connecticut.

3. The Commission's complaint alleged the following facts: Beginning in May 2009, Massoud engaged in insider trading in connection with his purchases of Patriot Capital Funding, Inc. ("Patriot Capital") stock prior to the August 3, 2009 announcement that Patriot Capital was to be acquired by Prospect Capital Corporation. From May through July 2009, while in possession of material non-public information he obtained from Patriot Capital about Patriot Capital's financial condition and also about the value of acquisition proposals submitted to Patriot Capital by other bidders during the bidding process, Massoud bought 322,216 shares of Patriot Capital stock in his personal brokerage account in violation of an agreement, which among other things, included a provision that prohibited him from buying Patriot Capital shares. Following the August 3, 2009 announcement, Patriot Capital's share price increased from \$1.79 per share to close at \$3.53 per share. On August 25, 2009, Massoud sold all 322,216 shares of his Patriot Capital stock, earning over \$676,000 in profits from these transactions.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Massoud 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

*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. 68646 / January 14, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15173

In the Matter of

Imreg, Inc.,  
Innovative Holdings & Technologies, Inc.,  
InnoVet, Inc.,  
Institutional Properties 4,  
Interaction Media Corp., and  
International CRO Holdings 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 Imreg, Inc., Innovative Holdings & Technologies, Inc., InnoVet, Inc., Institutional Properties 4, Interaction Media Corp., and International CRO Holdings Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Imreg, Inc. (CIK No. 730757) is a void Delaware corporation located in New Orleans, Louisiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Imreg 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, 1996, which reported a net loss of \$100,289 for the prior three months.

2. Innovative Holdings & Technologies, Inc. (CIK No. 1066850) is a dissolved Colorado corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Innovative Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended March 31, 2002, which reported a net loss of \$84,455 for the prior three months. As of November 5, 2012, the company's stock (symbol "IHTL") was traded on the over-the-counter markets.

3. InnoVet, Inc. (CIK No. 821243) is a dissolved Florida corporation located in Winter Park, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). InnoVet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of \$6,274 for the prior three months.

4. Institutional Properties 4 (CIK No. 806638) is a California corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Institutional Properties 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, 1994.

5. Interaction Media Corp. (CIK No. 1018145) is a forfeited Delaware corporation located in Coral Gables, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Interaction Media is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 1997, which reported a net loss of \$535,992 for the prior three months.

6. International CRO Holdings Corp. (CIK No. 1417872) is a Delaware corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). International CRO 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 \$11,632 for the prior three 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

*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. 68649 / January 14, 2013**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-15174**

**In the Matter of**

**IMP, Inc.,  
Imperial Credit Industries, Inc.,  
Inco Homes Corp.,  
InfoCast Corp.,  
Infospi.com, Inc. (n/k/a Infospi, Inc.), and  
Instaff International, Inc.,**

**Respondents.**

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

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents IMP, Inc., Imperial Credit Industries, Inc., Inco Homes Corp., InfoCast Corp., Infospi.com, Inc. (n/k/a Infospi, Inc.), and Instaff International, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. IMP, Inc. (CIK No. 812927) is a forfeited Delaware corporation located in Santa Clara, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IMP 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, 2002.

2. Imperial Credit Industries, Inc. (CIK No. 883811) is a suspended California corporation located in Torrance, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Imperial Credit is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2002, which reported a net loss of over \$18.5 million for the prior three months. As of November 5, 2012, the company's stock (symbol "ICII") was traded on the over-the-counter markets.

3. Inco Homes Corp. (CIK No. 897432) is a void Delaware corporation located in Rancho Cucamonga, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Inco Homes 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, 1999. On October 15, 1999, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was closed on July 3, 2002.

4. InfoCast Corp. (CIK No. 1093682) is a permanently revoked Nevada corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). InfoCast 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, 2001, which reported a net loss of over \$2.4 million for the prior three months. As of November 5, 2012, the company's stock (symbol "IFCC") was traded on the over-the-counter markets.

5. Infospi.com, Inc. (n/k/a Infospi, Inc.) (CIK No. 1118345) is a suspended California corporation located in Carlsbad, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infospi.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on May 21, 2001, which reported a net loss of over \$5.3 million for the year ended December 31, 2000.

6. Instaff International, Inc. (CIK No. 850217) is a forfeited Texas corporation located in Phoenix, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Instaff is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended September 30, 1994.

#### 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].

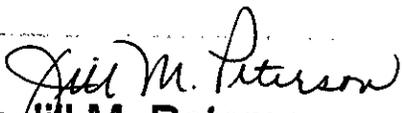
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

  
By: Jill M. Peterson  
Assistant Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

[Release No. 34-68660; File No. S7-08-12]

**RIN 3235-AL12**

**Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule; extension of comment period.

**SUMMARY:** On November 23, 2012, the Securities and Exchange Commission ("Commission") published in the Federal Register a proposed rule for public comment to establish capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants under the Securities Exchange Act of 1934 ("Exchange Act") and amend capital requirements for broker-dealers. The Commission is extending the time period in which to provide the Commission with comments.

**DATES:** Comments should be received on or before February 22, 2013.

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-08-12 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper Comments:

15 of 26

- 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 S7-08-12. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet web site (<http://www.sec.gov/rules/proposed>). Comments will also be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:**

Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Deputy Associate Director, at (202) 551-5521; Randall W. Roy, Assistant Director, at (202) 551-5522; Mark M. Attar, Branch Chief, at (202) 551-5889; Sheila Dombal Swartz, Special Counsel, at (202) 551-5545; Valentina M. Deng, Attorney, at (202) 551-5778; or Teen I. Sheng, Attorney, at 202-551-5511, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-7010.

**SUPPLEMENTARY INFORMATION:**

On November 23, 2012, the Commission issued Release No. 34-68071 soliciting comment on proposed rules and rule amendments establishing capital, margin, and segregation requirements for persons who register with the Commission as security-based swap dealers or major security-based swap participants and amending capital requirements for broker-dealers.<sup>1</sup> The Commission originally requested that comments on this proposal be received by January 22, 2013. The Commission has recently been requested to extend the comment period and believes that extending the comment period is appropriate in

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<sup>1</sup> See Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

order to give the public additional time to comment on the matters addressed by the release.<sup>2</sup> This extension will allow for 91 days of comment which the Commission believes should provide the public with sufficient additional time to consider thoroughly the matters addressed by the release and to submit comprehensive responses to the release which would benefit the Commission in its consideration of the final rules. Therefore, the Commission is extending the public comment period for 31 days until Friday, February 22, 2013.

By the Commission.



Elizabeth M. Murphy  
Secretary

Date: January 15, 2013

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<sup>2</sup> See Letter from Kenneth E. Bentson, Jr., Public Policy and Advocacy Executive Vice President, SIFMA, to Elizabeth M. Murphy, Secretary, Commission, dated Jan. 3, 2013; see also Letter from Richard M. Whiting, Executive Director and General Counsel, Financial Services Roundtable, to Elizabeth M. Murphy, Secretary, Commission, dated Jan. 2, 2013.

*Commissioner Walter  
Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68661 / January 15, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3441 / January 15, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15175

In the Matter of

Kevin A. Howard, CPA

Respondent.

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO RULE 102(e) OF THE  
COMMISSION'S RULES OF PRACTICE,  
MAKING FINDINGS AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Kevin A. Howard ("Respondent" or "Howard") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup>

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to

<sup>1</sup> 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 . . . [p]ermanently 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.

which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Kevin A. Howard, age 49, resides in Houston, Texas. From 1986 until 1998, Howard was a CPA licensed to practice in the State of Texas. Between August 1999 and September 2001, Howard served as Chief Financial Officer and Vice President of Finance for Enron Broadband Services ("EBS"), a subsidiary of Enron Corp. ("Enron"). Howard was terminated by Enron on March 12, 2003.
2. Enron was, at all relevant times, an Oregon corporation with its principal place of business in Houston, Texas. Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based upon reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. Enron also created and traded financial products. At all relevant times, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange.
3. On January 4, 2013, the U.S. District Court for the Southern District of Texas, Houston Division, entered a final judgment by consent against Respondent, permanently enjoining him from violating Section 17(a) of the Securities Act of 1933 ("Securities Act"); permanently enjoining him from violating Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5 and 13b2-1; and permanently enjoining him from aiding and abetting the violation of Sections 13(a) and 13(b)(2)(A) and (B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13, in the civil action entitled Securities and Exchange Commission v. Kevin A. Howard, et al., Civil Action Number H-03-0905 (S.D. Tex.). The final judgment also prohibits Respondent from serving as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act. Respondent was also ordered to pay a \$65,000 civil money penalty.
4. The Commission's First Amended Complaint ("FAC") alleged, among other things, that Respondent engaged in a fraudulent scheme known as "Project Braveheart," which involved the "monetization" of certain assets resulting in the immediate recognition of earnings from a long term agreement with Blockbuster Inc. to develop and provide video-on-demand services. Respondent carried out the scheme by forming a purported joint venture, assigning the Blockbuster agreement to the joint venture, and selling an interest in the joint venture based on the value of future revenues from the Blockbuster agreement to a third party. The FAC further alleged that Project Braveheart was a sham from its inception since it had no economic substance

and was created solely for the purpose of generating earnings. Additionally, the FAC alleged that Respondent was aware that the joint venture partner was an entity that never intended to participate as a partner, and its equity was not at risk because Enron guaranteed the entity a short term take-out at a specified rate of return. The FAC alleged that Respondent did not inform Enron's outside auditor, Arthur Andersen, about the true nature of the transaction, and in meetings and conversations with Andersen made false and misleading statements about the transaction. As a result, EBS recognized \$53 million in earnings in the fourth quarter of 2000 and \$58 million in earnings in the first quarter of 2001, thus enabling EBS to meet its earnings targets.

IV.

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

Accordingly, IT IS HEREBY ORDERED, effective immediately, that:

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**January 16, 2013**

**In the Matter of**

**Eco Global Corporation,  
Execute Sports, Inc.,  
FacePrint Global Solutions, Inc.,  
FinancialContent, Inc., and  
Firstgold 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 Eco Global Corporation because it has not filed any periodic reports since the period ended September 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Execute Sports, 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 FacePrint Global Solutions, Inc. because it has not filed any periodic reports since the period ended June 30, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of FinancialContent, Inc. because it has not filed any periodic reports since the period ended December 31, 2008.

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

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 16, 2013 through 11:59 p.m. EST on January 30, 2013.

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. 68664 / January 16, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15176**

**In the Matter of**

**Eco Global Corporation,  
Execute Sports, Inc.,  
FacePrint Global Solutions, Inc.,  
FinancialContent, Inc., and  
Firstgold 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 the Respondents named in the caption.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Eco Global Corporation ("ECOG")<sup>1</sup> (CIK No. 1362388) is a Nevada corporation located in Spring Valley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ECOG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009, which reported a net loss of \$212,752 for the prior nine months. On May 3, 2010, ECOG filed a Chapter 7 petition in the U.S. Bankruptcy Court for the District of Nevada, which was dismissed on July 17, 2010. As of January 14, 2013, the common stock of ECOG was quoted on (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC

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<sup>1</sup>The short form of each issuer's name is also its stock symbol.

Link”), had seven market makers, and was eligible for the “piggyback” exception of Exchange Act Rule 15c2-11(f)(3).

2. Execute Sports, Inc. (“EXCS”) (CIK No. 1330292) is a revoked Nevada corporation located in San Diego, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EXCS 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 \$6,005,032 for the prior nine months. As of January 14, 2013, the common stock of EXCS was quoted on OTC Link, had five market makers, and was eligible for the “piggyback” exception of Exchange Act Rule 15c2-11(f)(3).

3. FacePrint Global Solutions, Inc. (“FPRN”) (CIK No. 1263764) is an administratively dissolved Wyoming corporation located in Fresno, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FPRN 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 \$343,711 for the prior three months. On January 31, 2008, the United States District Court for the Eastern District of California entered a final judgment of permanent injunction against FPRN which, among other things, enjoined it from future violations of Securities Act of 1933 Sections 5(a) and 5(c). *S.E.C. v. Faceprint Global Solutions, Inc.*, 07-01251 (E.D. Cal. January 31, 2008). As of January 14, 2013, the common stock of FPRN was quoted on OTC Link, had six market makers, and was eligible for the “piggyback” exception of Exchange Act Rule 15c2-11(f)(3).

4. FinancialContent, Inc. (“FCON”) (CIK No. 1100360) is a void Delaware corporation located in Ojai, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FCON 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, 2008. As of January 14, 2013, the common stock of FCON 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. Firstgold Corp. (“FGOCQ”) (CIK No. 878808) is a void Delaware corporation located in Lovelock, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FGOCQ 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 October 31, 2009, which reported a net loss of \$11,980,777 for the prior nine months. On January 27, 2010, FGOCQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Nevada, which was converted to a Chapter 7 petition on April 10, 2012, and was still pending as of January 14, 2013. As of January 14, 2013, the common stock of FGOCQ was quoted on OTC Link, had eight market makers, and was eligible for the “piggyback” exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

6. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file

timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

### III.

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

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

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

### IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Commissioner Paredes,  
Commissioner Gallagher  
not participating*

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68733 / January 25, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-13019

In the Matter of

Gabelli Funds, LLC,

Respondent.

**ORDER AUTHORIZING THE TRANSFER  
OF REMAINING FUNDS AND ANY  
FUTURE FUNDS RETURNED TO THE  
FAIR FUND TO THE U.S. TREASURY,  
TERMINATING THE FAIR FUND, AND  
DISCHARGING THE FUND  
ADMINISTRATOR**

On April 24, 2008, the Commission issued an Order Instituting Administrative and Cease-And-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 based on willful violations of Section 206(2) of the Investment Advisers Act of 1940 and Section 17(d) of the Investment Company Act of 1940 and Rule 17d-1 thereunder, and the willful aiding and abetting and causing violations of Section 12(d)(1)(B)(i) of the Investment Company Act of 1940 ("Order") by Gabelli Funds, LLC ("Gabelli"). Advisers Act Release No. 2727 (April 24, 2008). Pursuant to the Order, Gabelli was: (1) censured; (2) required to cease-and-desist from committing or causing any violations and any future violations of Section 206(2) of the Investment Advisers Act of 1940, Section 17(d) of the Investment Company Act of 1940 and Rule 17d-1 thereunder, and Section 12(d)(1)(B)(i) of the Investment Company Act of 1940; and (3) required to pay disgorgement of \$9.7 million, prejudgment interest of \$1.3 million, and a civil money penalty of \$5 million for a total payment of \$16 million. The Order also established a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002. Gabelli was required to pay all costs and expenses for the distribution.

Gabelli's \$16 million payment pursuant to the Order was used to create a Fair Fund for a distribution to harmed investors ("Fair Fund"). On December 30, 2009, the Commission issued an Order Appointing a Fund Administrator and Waiving Bond. Exchange Act Release No. 61255 (Dec. 30, 2009). Also on December 30, 2009, the Commission issued an Order Approving Distribution Plan (the "Plan"). Exchange Act Release No. 61256 (Dec. 30, 2009). On August 16, 2010, the Commission issued an Order Directing Disbursement of Fair Fund that authorized the disbursement of \$6,199,426.66 based on a staff certification that it received a

validated list of payees from the Independent Distribution Consultant ("IDC"). Exchange Act Release No. 62728 (Aug. 16, 2010). On August 31, 2010, the Commission issued a second Order Directing Disbursement of Fair Fund that authorized the disbursement of \$6,018,207.06 based on a staff certification that it received a second validated list of payees from the IDC. Exchange Act Release No. 62806 (Aug. 31, 2010).

The \$16 million Fair Fund received \$197,486.39 in interest and investment earnings and paid \$67,658.00 in federal taxes, \$800.00 in District of Columbia taxes, and \$174.15 in Plan Administration expenses. Additionally, investment expenses in the amount of \$3,452.99 were paid to the Bureau of Public Debt. Ultimately, \$9,769,110.15 was distributed to 33,292 Gabelli Global Growth Fund investors. Pursuant to Section 1.1 of the Plan, the Gabelli Global Growth Fund also received a distribution. The average payment to investors was \$284.86. The dollar range of distributions was from the *de minimis* \$10.00 up to \$110,419.98. A residual balance of \$6,356,291.10 remains.

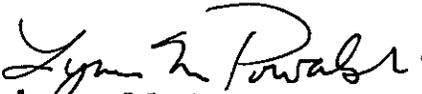
Section 8.19 of the Plan provided that the Fair Fund would be eligible for termination after: (1) the final accounting has been submitted and approved by the Commission; (2) all taxes, fees, and expenses have been paid; and (3) any amount remaining in the Fair Fund has been received by the Commission. A final accounting, which has been submitted to the Commission for approval as required by Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans and as set forth in the Plan, is now approved. Staff has verified that all taxes, fees, and expenses have been paid, and the Commission is in possession of the Fair Fund monies.

Accordingly, IT IS ORDERED that:

1. The remaining Fair Fund balance of \$6,356,291.10 and any future funds returned to the Fair Fund shall be transferred to the U.S. Treasury;
2. The Fair Fund is terminated; and
3. The Fund Administrator is discharged.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

*Commissioner Gallagher  
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 68756 / January 29, 2013**

**INVESTMENT ADVISERS ACT OF 1940  
Release No. 3539 / January 29, 2013**

**ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3443 / January 29, 2013**

**ADMINISTRATIVE PROCEEDING  
File No. 3-15193**

**In the Matter of**

**LISA B. HOVAN, CPA**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO RULE 102(e)  
OF THE COMMISSION'S RULES OF  
PRACTICE 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 Rule 102(e)(3)(i) of the Commission's Rules of Practice<sup>1</sup> and pursuant to Section 203(f) of the

<sup>1</sup> 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

Investment Advisers Act of 1940 ("Advisers Act") against Lisa B. Hovan, CPA ("Respondent" or "Hovan").

## II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, and the findings contained in Section III.3, below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice 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. Respondent, age 45, is a certified public accountant, currently licensed in California and previously licensed in New Jersey and New York. She is a resident of Belvedere, California.
2. From 1999 through 2010, Respondent was a member, indirect owner with her husband, and Chief Financial Officer of Hovan Capital Management, LLC ("HCM"), an investment adviser registered with the Commission. Among HCM's clients, from August 2006 until March 2009, HCM served as a sub-adviser to a Commission-registered investment company that was based in Harrison, New York.
3. On January 14, 2013, a final judgment was entered against Hovan, permanently enjoining her from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, Sections 206(1), 206(2) and 207 of the Advisers Act, in the civil action entitled *Securities and Exchange Commission v. Kurt Hovan, et al.*, Civil Action No. CV-11-4795-RS, in the United States District Court for the Northern District of California. Hovan was also ordered to pay a \$50,000 civil money penalty.
4. The Commission's complaint alleged, among other things, that Hovan, acting with her husband, Kurt Hovan, misused so-called "soft dollars" that HCM had obtained as rebates on commissions paid for securities trades executed in the accounts of HCM's clients. According to the complaint, contrary to assurances to clients and others that HCM would only use soft dollars to pay for a limited category of services that benefitted HCM's clients, Respondent and her husband and HCM used the soft dollars for prohibited purposes, including for HCM's rent, salaries, and for office equipment for HCM. The complaint further alleged that Respondent provided the mutual fund client of HCM's with certifications stating that soft dollars had not been

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the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

used to pay for items other than research that would benefit the client.

#### IV.

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

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

A. Pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, Respondent Hovan is suspended from appearing or practicing before the Commission as an accountant.

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

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in her practice before the Commission will be reviewed either by the independent audit committee of the public company for which she works or in some other acceptable manner, as long as she practices before the Commission in this capacity; or

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

(a) Respondent, or the public accounting firm with which she is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

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

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

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

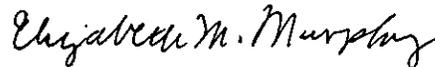
C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that her state CPA license is

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

D. Pursuant to Section 203(f) of the Advisers Act, Respondent Hovan 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.

E. 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 Gallagher  
not participating*

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3540 / January 29, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15194

In the Matter of

KURT S. HOVAN,

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 Kurt S. Hovan ("Respondent" or "Hovan").

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, 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.

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### III.

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

1. Hovan, age 44, is a resident of Belvedere, California. He holds Series 7, 63, and 65 securities licenses issued by FINRA. He is the husband of Lisa Hovan and the brother of Edward Hovan, Jr.

2. Since 1999, Hovan served as member, President, and Chief Investment Officer of Hovan Capital Management, LLC ("HCM"), an investment adviser registered with the Commission. Among HCM's clients, from August 2006 until March 2009, HCM served as a sub-adviser to a Commission-registered investment company that was based in Harrison, New York.

3. On June 20, 2012, a judgment in a criminal case was entered against Hovan, based on his guilty plea to one count of mail fraud, in violation of Title 18, United States Code, Section 1341, in *United States v. Kurt S. Hovan*, Case No. CR-11-0699-RS, in the United States District Court for the Northern District of California. In connection with that plea, Hovan admitted that: (1) he knowingly participated in, devised, or intended to devise a scheme or plan to defraud, or a scheme or plan for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or by the omission of material facts; (2) the statements made or facts omitted as part of the scheme were material; (3) he acted with the intent to defraud; and (4) he used, or caused to be used, the mails to carry out or to attempt to carry out an essential part of the scheme. Hovan further admitted that the scheme involved the misuse of so called "soft dollars," which were rebates on commissions received from directed brokerage business executed for accounts of clients of HCM. Hovan admitted that he directed the use of approximately \$65,000 of the soft dollars to pay for HCM's office rent, contrary to the soft dollar agreements and disclosures to HCM's clients. Hovan also admitted that in January 2010, in response to requests from the Commission's examination staff for research reports purportedly produced by Bolton Research LLC, a company associated with Hovan's brother through which the soft dollars were funneled, Hovan altered and caused to be sent ten due diligence questionnaires to the examiners to make it appear that the reports had been authored by Bolton Research, when they had not.

4. On January 14, 2013, a final judgment was entered against Hovan, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, Sections 204(a), 206(1), 206(2) and 207 of the Advisers Act, Advisers Act Rule 204-2(a)(7), and Section 17(e)(1) of the Investment Company Act of 1940 ("Investment Company Act") in the civil action entitled *Securities and Exchange Commission v. Kurt Hovan, et al.*, Civil Action No. CV-11-4795-RS, in the United States District Court for the Northern District of California. Hovan was also ordered to pay a \$75,000 civil penalty, and to pay \$65,000 in disgorgement, which was deemed satisfied by the order of restitution in the related criminal case.

5. The Commission's complaint alleged, among other things, that Hovan misused so-called "soft dollars" that HCM had obtained as rebates on commissions paid for securities trades executed in the accounts of HCM's clients. According to the complaint, contrary to assurances to clients and others that HCM would only use soft dollars to pay for a limited category of services that benefitted HCM's clients, Respondent directed the use of the soft dollars

for prohibited purposes, including for HCM's rent, salaries, and for office equipment for HCM. The complaint further alleged that, in January 2010, in response to requests for records from the Commission's examination staff, Hovan created and produced phony research reports to the examiners to make it appear that the soft dollars were spent for legitimate research that could benefit clients.

IV.

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

Accordingly, it is hereby ORDERED that:

Pursuant to Section 203(f) of the Advisers Act, Respondent Hovan is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

By the Commission.

  
Elizabeth M. Murphy  
Secretary

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3538 / January 29, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15192

In the Matter of

EDWARD J. HOVAN, JR.,

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 Edward J. Hovan, Jr. ("Respondent" or "Hovan").

**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.

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### III.

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

1. Hovan, age 47, is a resident of Bolton, Connecticut. He is the brother of Kurt Hovan. From at least September 2008 through June 2009, he held the titles of Executive Vice President and Portfolio Manager of Hovan Capital Management, LLC ("HCM"), an investment adviser that was registered with the Commission during that time period. Among HCM's clients during a portion of that period was a Commission-registered investment company, to which HCM served as a sub-adviser.

2. On January 14, 2013, a final judgment was entered against Hovan, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5, Sections 206(1) and 206(2) of the Advisers Act, and Section 17(e)(1) of the Investment Company Act of 1940 ("Investment Company Act"), in the civil action entitled *Securities and Exchange Commission v. Kurt Hovan, et al.*, Civil Action No. CV-11-4795-RS, in the United States District Court for the Northern District of California. Hovan was also ordered liable for \$50,000 in disgorgement, but disgorgement was waived and the court did not order payment of a civil penalty based on representations in his Statement of Financial Condition and supporting material.

3. The Commission's complaint alleged, among other things, that Hovan participated in a scheme to misuse so-called "soft dollars" that HCM had obtained as rebates on commissions paid for securities trades executed in the accounts of HCM's clients. According to the complaint, contrary to assurances to clients and others that HCM would only use soft dollars to pay for a limited category of services that benefitted HCM's clients, HCM used soft dollars to compensate Respondent in the form of a salary. The complaint further alleged that Respondent participated in an arrangement to provide invoices to brokerage firms to make soft dollar payments to an entity described as an independent, third-party research firm, Bolton Research LLC, when, in reality, Bolton Research was simply the conduit for the salary payments to Respondent. The complaint further alleged that Respondent arranged to use soft dollars paid to Bolton Research to pay HCM's office rent, contrary to HCM's representations about how soft dollars were used.

### IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 203(f) of the Advisers Act, Respondent Hovan 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.

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

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3537 / January 29, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15190**

**In the Matter of**

**IMC Asset Management, Inc.,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS  
PURSUANT TO 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 Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against IMC Asset Management, Inc. ("IMCAM" or "Respondent").

**II.**

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

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

IMCAM failed to adopt and implement written policies and procedures that were reasonably designed to prevent violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder ("Compliance Rule"). For fourteen months – from April 2009 through June 2010 – registered investment adviser IMCAM employed a compliance officer who performed virtually no compliance-related functions. In addition, for more than three years – from October 2007 through December 2010 – IMCAM's written policies and procedures addressed primarily activities at its predecessor entity's registered broker-dealer, and were not reasonably designed for the registered adviser. In addition, IMCAM failed to annually review the adequacy of its policies and procedures.

#### Respondent

1. **IMC Asset Management, Inc. ("IMCAM")**, formerly Faxtor, Inc. ("Faxtor"), is a registered investment adviser located in New York, New York. From May 2008 to May 2009, Faxtor was dually registered with the Commission as a broker-dealer and an investment adviser. On March 31, 2009, Faxtor filed a Form BDW to withdraw its registration as a broker-dealer; its withdrawal became effective on May 30, 2009. Faxtor subsequently changed its name to IMC Asset Management, Inc. According to its Form ADV amendment filed on October 16, 2012, IMCAM managed regulatory assets totaling approximately \$108.6 million for two accounts. IMCAM serves as a sub-adviser to the funds that are managed by its foreign parent, IMC Asset Management, B.V. ("IMC BV"), and has no additional clients. During the relevant time, IMCAM provided discretionary investment management services to collateralized debt obligations and two offshore pooled investment vehicles and had approximately ten employees.

#### Background

2. Effective October 5, 2004, Rule 206(4)-7, promulgated under Section 206(4) of the Advisers Act, requires, among other things, that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; and (2) review the adequacy of the written policies and procedures and the effectiveness of their implementation on at least an annual basis.

#### IMCAM Disregarded Its Compliance Responsibilities

3. In April 2009, IMCAM appointed a new Chief Compliance Officer ("CCO"), following the departure of the firm's then-CCO. The new CCO, who had been hired

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<sup>1</sup> 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.

as a Portfolio Manager, had never been a compliance officer previously and had no formal compliance training. Despite his appointment in April 2009, the new CCO performed virtually no compliance-related functions until June 2010.

4. During the period from October 2007 through December 2010, IMCAM did not adopt or implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act or the rules thereunder. During that period, the firm's only written policies and procedures consisted of "Written Supervisory Procedures" ("WSPs") designed primarily to address IMCAM's predecessor's broker-dealer activities, which did not apply to IMCAM's advisory business and, as of May 2009, when Faxtor's withdrawal from registration as a broker-dealer became effective, which no longer applied at all to the firm. The WSPs had been adopted by IMCAM's predecessor, Faxtor, and contained minimal written policies and procedures relating to an advisory business. The policies and procedures that did relate to the firm's investment advisory business did not adequately address all of the material components of the firm's advisory business.

5. In addition, from the time it registered with the Commission in October 2007 until December 2010, IMCAM failed to conduct an annual review of its policies and procedures, as required by the Advisers Act. IMCAM purportedly conducted a "compliance visit" in May 2009, which occurred twenty months after IMCAM registered, but that visit was not adequately documented and was ineffectual. For example, IMCAM's then-CCO, even though he had been appointed in April 2009, did not participate in the 2009 visit, did not recall the visit and was unaware of the results of the visit.

#### Examination and Subsequent Conduct

6. The Commission's examination staff conducted an examination in November 2010 and notified IMCAM of numerous deficiencies regarding its compliance program. The exam staff issued a deficiency letter on March 10, 2011.

7. In November 2010 as a result of the staff's examination, IMCAM performed a compliance review and prepared a "Compliance Review Report" for the period covering July 2009 through December 2010. In December 2010, with the assistance of an outside compliance consultant, IMCAM revised its written compliance policies and procedures to address IMCAM's advisory-related activities. In February and March 2011, IMCAM implemented recommendations contained in the December 2010 Compliance Review Report, including hiring a new CCO and utilizing its outside firm to monitor trading by employees in personal brokerage accounts.

8. In July 2012, however, IMCAM terminated its CCO and hired a new outside compliance consultant to conduct a compliance review. IMCAM also designated a current employee to be the firm's CCO; however, this individual has minimal compliance experience or training.

9. In September 2012, IMCAM formalized an agreement with its new outside compliance consultant to render compliance services on a monthly basis and assist the current CCO in carrying out her compliance duties. The service includes a weekly on site visit by a senior compliance consultant.

### Violations

10. As a result of the conduct described above, IMCAM willfully<sup>2</sup> violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires, among other things, that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; and (2) review at least annually its written policies and procedures and the effectiveness of their implementation.

### Undertakings

Respondent IMCAM has undertaken the following:

11. CCO Training. IMCAM shall require that its current CCO complete by December 31, 2013 comprehensive training concerning the Advisers Act's compliance requirements.

12. Retain Services of Compliance Consultant. IMCAM has retained, and shall continue to retain, at its expense, the services of an outside compliance consultant to render compliance services for a period of at least two years from the entry of this Order. IMCAM shall provide to the Commission staff, within thirty (30) days of the entry of this Order, a copy of the engagement letter detailing the outside compliance consultant's responsibilities, which shall include comprehensive annual compliance reviews. To the extent the outside compliance consultant already has made recommendations for changes in or improvements to IMCAM's policies and procedures and/or disclosure to clients, IMCAM shall adopt and implement all such recommendations

13. Certification of Compliance by Respondent. IMCAM shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and IMCAM agrees to provide such evidence. The certification and supporting material shall be submitted to Valerie A. Szczepanik, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 3 World Financial

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<sup>2</sup> 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)).

Center, Suite 400, New York, New York 10281-1022, or such other address as the Commission staff may provide, 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 Respondent IMCAM's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent IMCAM cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

B. Respondent IMCAM is censured.

C. Respondent IMCAM shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of \$30,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying IMC Asset Management, Inc., as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Bruce Karpati, Chief, Asset Management Unit, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, New York 10281-1022.

D. IMC shall comply with the undertakings enumerated in Section III, paragraphs 11 to 13 above.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR PARTS 230, 240 and 260**

**[Release Nos. 33-9383; 34-68753; 39-2489; File No. S7-26-11]**

**RIN 3235-AL17**

**EXTENSION OF EXEMPTIONS FOR SECURITY-BASED SWAPS**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Interim final rule; extension.

**SUMMARY:** We are adopting amendments to the expiration dates in our interim final rules that provide exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for those security-based swaps that prior to July 16, 2011 were security-based swap agreements and are defined as “securities” under the Securities Act and the Exchange Act as of July 16, 2011 due solely to the provisions of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Under the amendments, the expiration dates in the interim final rules will be extended to February 11, 2014.

**EFFECTIVE DATE:** The amendments are effective [insert date of publication in the Federal Register], and the expiration dates in the interim final rules published July 1, 2011 (76 FR 40605) are extended to February 11, 2014.

**FOR FURTHER INFORMATION CONTACT:** Andrew Schoeffler, Special Counsel, Office of Capital Markets Trends, Division of Corporation Finance, at (202) 551-3860, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

**SUPPLEMENTARY INFORMATION:** We are adopting amendments to the following rules: interim final Rule 240 under the Securities Act of 1933 (“Securities Act”),<sup>1</sup> interim final Rules

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<sup>1</sup> 15 U.S.C. 77a et seq.

Title VII amended the Securities Act and the Exchange Act to include “security-based swaps” in the definition of “security” for purposes of those statutes.<sup>9</sup> As a result, “security-based swaps” became subject to the provisions of the Securities Act and the Exchange Act and the rules and regulations thereunder applicable to “securities.”<sup>10</sup> The interim final rules were intended to allow security-based swap agreements that became security-based swaps on the Title

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issued a no-action letter that addressed the availability of the interim final rules to offers and sales of security-based swaps that are based on or reference only loans or indexes only of loans. See Cleary Gottlieb Steen & Hamilton LLP (Jul. 15, 2011) (“Cleary Gottlieb No-Action Letter”). The Cleary Gottlieb No-Action Letter will remain in effect for so long as the interim final rules remain in effect.

<sup>7</sup> The security-based swap that is exempt must be a security-based swap agreement (as defined prior to the Title VII effective date) and entered into between eligible contract participants (as defined prior to the Title VII effective date). See Rule 240 under the Securities Act [17 CFR 230.240]. See also Interim Final Rules Adopting Release.

<sup>8</sup> The interim final rules currently expire on the later of the compliance dates for final rules we may adopt further defining the terms “security-based swap” and “eligible contract participant,” unless we take further action to modify the expiration dates in the interim final rules. In April 2012, we adopted final rules and interpretations further defining the term “eligible contract participant” and the compliance date of those rules and interpretations was July 23, 2012. In July 2012, we adopted final rules and interpretations further defining the term “security-based swap” and the compliance date of those rules and interpretations is February 11, 2013. See Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps: Security-Based Swap Agreement Recordkeeping, Release No. 33-9338 (Jul. 18, 2012), 77 FR 48208 (Aug. 13, 2012).

<sup>9</sup> See Sections 761(a)(2) and 768(a)(1) of the Dodd-Frank Act (amending Section 3(a)(10) of the Exchange Act [15 U.S.C. 78c(a)(10)] and Section 2(a)(1) of the Securities Act [15 U.S.C. 77b(a)(1)], respectively).

<sup>10</sup> The Securities Act requires that any offer and sale of a security must be either registered under the Securities Act or made pursuant to an exemption from registration. See Section 5 of the Securities Act [15 U.S.C. 77e]. In addition, certain provisions of the Exchange Act relating to the registration of classes of securities and the indenture qualification provisions of the Trust Indenture Act of 1939 (“Trust Indenture Act”) [15 U.S.C. 77aaa *et seq.*] also potentially could apply to security-based swaps. The provisions of Section 12 of the Exchange Act could, without an exemption, require that security-based swaps be registered before a transaction could be effected on a national securities exchange. See Section 12(a) of the Exchange Act [15 U.S.C. 78l(a)]. In addition, registration of a class of security-based swaps under Section 12(g) of the Exchange Act could be required if the security-based swap is considered an equity security and held of record by either 2000 persons or 500 persons who are not accredited investors at the end of a fiscal year. See Section 12(g)(1)(A) of the Exchange Act [15 U.S.C. 78l(g)(1)(A)]. Further, without an exemption, the Trust Indenture Act could require qualification of an indenture for security-based swaps considered to be debt. See 15 U.S.C. 77aaa *et seq.*

platforms to effect security-based swap transactions would continue after the Title VII effective date.<sup>16</sup> We also understood from market participants that if parties continued to engage in the same type of trading activities after the Title VII effective date that they were engaging in prior to the Title VII effective date with respect to security-based swap agreements that became security-based swaps on the Title VII effective date, such activities could raise concerns about the availability of exemptions from the registration requirements of the Securities Act and the Exchange Act.<sup>17</sup> Accordingly, at the time of adoption of the interim final rules in July 2011, we requested comment on various aspects of the interim final rules. In particular, we requested comment on the following:<sup>18</sup> (i) whether security-based swaps are transacted or expected to be transacted following the full implementation of Title VII in a manner that would not permit the parties to rely on existing exemptions under the Securities Act and the Exchange Act; and (ii) whether we should consider additional exemptions under the Securities Act and the Exchange Act for security-based swaps traded on a national securities exchange or through a security-based SEF with eligible contract participants.<sup>19</sup>

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Registration and Regulation of Security-Based Swap Execution Facilities, Release No. 34-63825 (Feb. 2, 2011), 76 FR 10948 (Feb. 28, 2011) (“Security-Based SEF Proposing Release”).

<sup>16</sup> See Interim Final Rules Adopting Release.

<sup>17</sup> Id. We received comments expressing concern regarding the implications of including security-based swaps in the definition of “security.” Commentators indicated that they were still analyzing the full implications of such expansion of the definition of “security,” but that it would take time. Market participants requested temporary relief from certain provisions of the Securities Act and the Exchange Act so that parties could complete their analysis and submit requests for more targeted relief. Id.

<sup>18</sup> Id. We also requested comment on these matters in an earlier proposing release regarding exemptions for security-based swap transactions involving an eligible clearing agency. See Exemptions For Security-Based Swaps Issued By Certain Clearing Agencies, Release No. 33-9222 (Jun. 9, 2011), 76 FR 34920 (Jun. 15, 2011) (“Cleared SBS Exemptions Proposing Release”).

<sup>19</sup> The term “eligible contract participant” is defined in Section 1a(18) of the Commodity Exchange Act [7 U.S.C. 1a(18)]. The definitions of the term “eligible contract participant” in the Securities Act and the Exchange Act both refer to the definition of “eligible contract participant” in the

registration requirements of the Securities Act for security-based swap transactions entered into solely between eligible contract participants due to the operation of security-based swap trading platforms and the publication or distribution of other information regarding security-based swaps.<sup>25</sup> They indicated that certain communications involving security-based swaps, such as the publication or distribution of price quotes, may be available on or through trading platforms on an unrestricted basis, including following the full implementation of Title VII.<sup>26</sup> They also indicated that security-based swap dealers publish and distribute research regarding security-based swap transactions that may be broadly disseminated and could be available on an unrestricted basis.<sup>27</sup> They were concerned that unrestricted access to these communications could affect the availability of exemptions from the registration requirements of the Securities Act, such as the exemption in Section 4(a)(2), for security-based swap transactions entered into solely between eligible contract participants.<sup>28</sup> Based on their concerns regarding the availability of exemptions from the registration requirements of the Securities Act, these commentators requested that we adopt permanent relief from the registration requirements of Section 5 of the Securities Act for offers and sales of security-based swaps<sup>29</sup> solely between eligible contract participants.<sup>30</sup> These commentators also requested relief under the Exchange Act for offers and

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<sup>25</sup> See SIFMA Letter and SIFMA/ISDA Letter.

<sup>26</sup> See SIFMA/ISDA Letter.

<sup>27</sup> See SIFMA Letter.

<sup>28</sup> See SIFMA Letter and SIFMA/ISDA Letter.

<sup>29</sup> The category of security-based swaps that would be covered by this request for relief is broader in some ways than the category of security-based swaps covered by the exemptions provided in the interim final rules. As noted in footnote 6 above, the exemptions provided in the interim final rules apply to security-based swaps that were defined as “security-based swap agreements” prior to the Title VII effective date. That definition of “security-based swap agreement” does not include security-based swaps that are based on or reference only loans and indexes only of loans.

<sup>30</sup> See SIFMA Letter and SIFMA/ISDA Letter. These commentators limited their request for relief to security-based swap transactions not involving an eligible clearing agency. Id. We recently

Exchange Act, and the Trust Indenture Act for security-based swap transactions entered into between eligible contract participants and effected through any trading platform similar to the proposed exemptions for security-based swap transactions involving an eligible clearing agency.<sup>36</sup> The other commentators suggested that we provide exemptions under Section 12(g) of the Exchange Act and the Trust Indenture Act for security-based swap transactions entered into solely between eligible contract participants similar to the proposed exemptions for security-based swap transactions involving an eligible clearing agency.<sup>37</sup> In adopting the exemptions for security-based swap transactions involving an eligible clearing agency, we indicated that these commentator's suggestions were more appropriate to be considered in connection with the interim final rules.<sup>38</sup>

We are carefully considering the comments we have received on the interim final rules as part of our evaluation of the implications for security-based swaps resulting from the inclusion of the term "security-based swap" in the definition of "security" under the Securities Act and the Exchange Act. We also are in the process of implementing the Title VII statutory provisions governing the registration and regulation of security-based SEFs. We have proposed rules to implement these provisions,<sup>39</sup> but the particular characteristics of trading platforms that security-based SEFs will be permitted to operate will not be known until we adopt final rules for security-based SEFs. We currently are evaluating the comments we received regarding these proposed

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<sup>36</sup> See GFI Letter. This commentator did not provide any explanation as to why such exemption was needed, including how security-based swap trading platforms operate, that would enable us to evaluate whether relief is necessary or appropriate. See Cleared SBS Exemptions Adopting Release.

<sup>37</sup> See FSR/ISDA/SIFMA Letter. These commentators requested relief under the Exchange Act and the Trust Indenture Act, but did not request relief under the Securities Act. However, two of these commentators subsequently submitted the SIFMA Letter and the SIFMA/ISDA Letter to request relief under the Securities Act. See footnote 30 above and accompanying text.

<sup>38</sup> See Cleared SBS Exemptions Adopting Release.

<sup>39</sup> See Security-Based SEF Proposing Release.

in the security-based swaps market.<sup>41</sup> Thus, while we consider the comments we have received on the interim final rules, the interim final rules are needed to allow market participants that meet the conditions of the interim final rules to continue to enter into security-based swap transactions without concern that such activities may not comply with the registration requirements of the Securities Act applicable to securities transactions, the registration requirements of the Exchange Act applicable to classes of securities, and the indenture provisions of the Trust Indenture Act.

Based on the foregoing, we believe that it is necessary and appropriate in the public interest and consistent with the protection of investors to continue providing the exemptions from all provisions of the Securities Act (other than the Section 17(a) antifraud provisions), the registration requirements of the Exchange Act relating to classes of securities, and the indenture provisions of the Trust Indenture Act for those security-based swaps that prior to the Title VII effective date were security-based swap agreements, provided certain conditions are met.

Accordingly, due to the limited time the interim final rules will be needed, and our consideration of comments we have received on the interim final rules, we have determined that it is necessary and appropriate to extend the expiration dates in the interim final rules to February 11, 2014.<sup>42</sup> If we adopt further rules relating to issues raised by the application of the Securities Act and other federal securities laws to the security-based swaps market before February 11, 2014, we may determine to alter the expiration dates in the interim final rules as part of that rulemaking. We only are extending the expiration dates in the interim final rules; we are not making any other changes to the interim final rules.

## II. CERTAIN ADMINISTRATIVE LAW MATTERS

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<sup>41</sup> Id.

<sup>42</sup> The Cleary Gottlieb No-Action Letter will remain in effect for so long as the interim final rules remain in effect. See footnote 6 above.

qualification provisions of the Trust Indenture Act while we consider the comments we have received on the interim final rules.

As noted above, we sought and received comments on the interim final rules.<sup>47</sup> Although one commentator did not support the interim final rules, this commentator did not provide any explanation for the reason. The other commentators supported the interim final rules and stated their view that the interim final rules were necessary and appropriate steps to prevent disruption of the security-based swaps market and to ensure the orderly implementation of Title VII. These commentators provided detailed responses to our requests for comment on the interim final rules and expressed concerns regarding the treatment of certain communications involving security-based swaps under the Securities Act. These commentators also stated their view that permanent relief was needed for security-based swap transactions and requested that we adopt permanent exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act, similar to the exemptions provided in the interim final rules, for security-based swap transactions entered into solely between eligible contract participants. We also received comments on the proposed exemptions for security-based swap transactions involving an eligible clearing agency that were responsive to the request for comment on the interim final rules.<sup>48</sup> We are carefully considering all of these comments as we evaluate the implications for security-based swaps resulting from the inclusion of the term “security-based swap” in the definition of “security” under the Securities Act and the Exchange Act.

Moreover, we are in the process of implementing the Title VII statutory provisions governing the registration and regulation of security-based SEFs. As noted above, we have proposed rules to implement these provisions, but the particular characteristics of trading

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<sup>47</sup> See footnotes 18 and 20 above and accompanying text.

<sup>48</sup> See footnote 35 above and accompanying text.

the amendments to the interim final rules is impracticable, unnecessary and contrary to the public interest.<sup>49</sup>

### III. ECONOMIC ANALYSIS

In July 2011, we adopted the interim final rules to provide exemptions under the Securities Act, the Exchange Act, and the Trust Indenture Act for those security-based swaps that prior to the Title VII effective date were security-based swap agreements and are defined as “securities” under the Securities Act and the Exchange Act as of the Title VII effective date due solely to the provisions of Title VII. In this release, we are adopting amendments to the interim final rules to extend the expiration dates in the interim final rules. Extending the expiration dates in the interim final rules is intended to minimize disruptions and costs to the security-based swaps market that could occur on the current expiration date of the interim final rules. The interim final rules are needed to allow market participants that meet the conditions of the interim final rules to continue to enter into security-based swap transactions without concern that such activities will be subject to the registration requirements of the Securities Act and the Exchange Act and the indenture qualification provisions of the Trust Indenture Act while we consider the comments we have received on the interim final rules.

We are sensitive to the costs and benefits imposed by our rules. The discussion below attempts to address the amendments to the interim final rules extending the expiration dates in the interim final rules, including the costs and benefits of the amendments as well as the effect of the amendments on efficiency, competition, and capital formation.<sup>50</sup>

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<sup>49</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the rule amendment to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are “impractical, unnecessary or contrary to the public interest,” a rule “shall take effect at such time as the federal agency promulgating the rule determines”).

<sup>50</sup> Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. See 15 U.S.C. 78w(a)(2).

the expiration dates in the interim final rules could cause disruptions in the security-based swaps market. Therefore, we believe that extending the expiration dates in the interim final rules provides important benefits to market participants in the security-based swaps market.

Because the extension of the expiration dates in the interim final rules would maintain the status quo with respect to the ability of market participants to engage in transactions in those security-based swaps that prior to the Title VII effective date were defined as security-based swap agreements, we do not believe that our actions in this release will have an impact on the current state of competition. We also believe that the extension of the expiration dates in the interim final rules will promote efficiency by minimizing disruptions and costs to the security-based swaps market that could occur on the current expiration date of the interim final rules. To the extent that those security-based swaps that prior to the Title VII effective date were defined as security-based swap agreements are used to hedge risks, including those related to the issuance of the referenced securities (as occurs with equity swaps and the issuance of convertible bonds, for example), the extension of the expiration dates in the interim final rules will prevent potential impairment of the capital formation process. For example, if registration of these transactions is required under our existing Securities Act registration scheme, this might result in the issuers of security-based swaps providing disclosure regarding their security-based swap positions that might not otherwise be disclosed to the market. This position disclosure could lead to a decreased use of security-based swaps by these market participants, which could potentially affect capital formation to the extent counterparties might use security-based swaps for hedging their exposure to issuers of referenced securities.

We recognize that a consequence of extending the expiration dates in the interim final rules will be the unavailability of certain remedies under the Securities Act and the Exchange

PRA.<sup>53</sup> We requested comment on whether our conclusion that there are no collections of information is correct, and we did not receive any comment.

## V. REGULATORY FLEXIBILITY ACT CERTIFICATION

We hereby certify pursuant to 5 U.S.C. 605(b) that extending the expiration dates in the interim final rules will not have a significant economic impact on a substantial number of small entities.<sup>54</sup> The interim final rules apply only to counterparties that may engage in security-based swap transactions in reliance on the interim final rule providing an exemption under the Securities Act. The interim final rule under the Securities Act provides that the exemption is available only to security-based swaps that are entered into between eligible contract participants, as that term is defined in Section 1a(12) of the Commodity Exchange Act as in effect prior to the Title VII effective date, and other than with respect to persons determined by the CFTC to be eligible contract participants pursuant to Section 1a(12)(C) of the Commodity Exchange Act. Based on our existing information about the participants in the security-based swaps market, including our existing information about participants in the security-based swaps market, we believe that the interim final rules apply to few, if any, small entities.<sup>55</sup> For this reason, the extension of the expiration dates in the interim final rules should not have a significant economic impact on a substantial number of small entities.

## VI. STATUTORY AUTHORITY AND TEXT OF THE RULES AND AMENDMENTS

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<sup>53</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>54</sup> We certified pursuant to 5 U.S.C. 605(b) that the interim final rules will not have a significant economic impact on a substantial number of small entities. See Interim Final Rules Adopting Release. We received no comments on that certification.

<sup>55</sup> For example, as revealed in a current survey conducted by Office of the Comptroller of the Currency, 100.0% of credit default swap positions held by U.S. commercial banks and trust companies are held by those with assets over \$10 billion. See Office of the Comptroller of the Currency, "Quarterly Report on Bank Trading and Derivatives Activities Third Quarter 2012" (2012).

78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., 12 U.S.C. 5221(e)(3), 15 U.S.C. 8302, and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

**§§ § 240.12a-11 and 240.12h-1 [Amended]**

4. In §240.12a-11(b), in the first sentence, remove the words “the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*” and add, in their place, the words “February 11, 2014”.

5. In §240.12h-1(i), in the second sentence, remove the words “the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*” and add, in their place, the words “February 11, 2014”.

**PART 260 - GENERAL RULES AND REGULATIONS, TRUST INDENTURE ACT OF 1939**

6. The authority citation for Part 260 continues to read as follows:

Authority: 15 U.S.C. 77eee, 77ggg, 77nnn, 77sss, 78ll(d), 80b-3, 80b-4, and 80b-11.

\* \* \* \* \*

**§ 260.4d-12 [Amended]**

7. In §260.4d-12, in the second sentence, remove the words “the compliance date for final rules that the Commission may adopt further defining both the terms *security-based swap* and *eligible contract participant*” and add, in their place, the words “February 11, 2014”.

By the Commission.



Elizabeth M. Murphy  
Secretary

January 29, 2013

Chairman Shapiro  
not participating

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68754 / January 29, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3442 / January 29, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15191

In the Matter of

BRIAN D. FOX,

Respondent.

ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE PROCEEDINGS AND  
IMPOSING TEMPORARY SUSPENSION  
PURSUANT TO RULE 102(e)(3) OF THE  
COMMISSION'S RULES OF PRACTICE

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 Rule 102(e)(3) of the Commission's Rules of Practice against Brian D. Fox ("Respondent" or "Fox").

II.

The Commission finds that:

A. RESPONDENT

1. Brian D. Fox, age 64, served as Powder River Petroleum International, Inc.'s ("Powder River" or the "company") sole director, president and CEO from December 2003 until July 2008, and as its CFO until August 2007. From year-end 2004 through the first-quarter 2008, Fox misled the investing public by fraudulently inflating the revenue and assets and fraudulently omitting major liabilities, of Powder River in the company's Commission filings, and by making other false and misleading public disclosures.

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B. CIVIL INJUNCTION

2. On November 2, 2012, the U.S. District Court for the Northern District of Oklahoma entered judgment against Fox, permanently enjoining him from future violations, direct or indirect, of Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1 and 13b2-2 thereunder. The Judgment further prohibited Fox, pursuant to Exchange Act Section 21(d)(2), from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or required to file reports pursuant to Section 15(d) of the Exchange Act. Securities and Exchange Commission v. Brian D. Fox, Civil Action Number 4:11-CV-0211-CVE-PJC.

3. The Commission's complaint alleged that from year-end 2004 through the first-quarter 2008, Fox misled the investing public by fraudulently inflating the revenue and assets and fraudulently omitting major liabilities, of Powder River in the company's Commission filings, and by making other false and misleading public disclosures. From year-end 2004, Powder River conveyed working interests in oil-and-gas leases to investors in Asia for over \$43 million. Because Powder River promised full repayment of the working interest investors' initial investment, with a 9% guaranteed annual return of principal, these transactions were, in reality, loans. But Powder River, with Fox as chairman, president, CFO and Chief Executive Officer CEO, improperly recognized the loan proceeds as revenue in the company's financial statements. These bogus revenues were incorporated in Powder River's quarterly and annual public filings with the SEC.

III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Brian D. Fox, from violating the Federal securities laws within the meaning of Rule 102(e)(3)(i)(A) of the Commission's Rules of Practice. In view of these findings, the Commission deems it appropriate and in the public interest that Brian D. Fox be temporarily suspended from appearing or practicing before the Commission.

IT IS HEREBY ORDERED that Brian D. Fox be, and hereby is, temporarily suspended from appearing or practicing before the Commission. This Order shall be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Brian D. Fox may within thirty days after service of this Order file a petition with the Commission to lift the temporary suspension. If the Commission within thirty days after service of the Order receives no petition, the suspension shall become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission shall, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a

period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Brian D. Fox personally or by certified mail at his last known address.

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3543 / January 31, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15196

In the Matter of

JEFFREY A. QUAY

Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940  
AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jeffrey A. Quay ("Jeffrey Quay" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From no later than September 1, 2010 to the present, Respondent was associated with Paul-Ellis Investment Associates, an investment adviser registered with the Commission. At various times before September 1, 2010, Respondent has been associated with other brokers, dealers, and investment advisers. Respondent, 45 years old, is a resident of Atlanta, Georgia.

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**B. ENTRY OF THE INJUNCTION**

2. On January 9, 2013, a final judgment was entered against Jeffrey Quay, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. James S. Quay, et al., Civil Action No. 1:12-cv-03429, in the United States District Court for the Northern District of Georgia.

3. The Commission's complaint alleged that from in or around June 2010 to at least January 2012, Jeffrey Quay aided and abetted a fraudulent investment scheme devised by his brother, James Quay, involving a sham limited partnership known as Trinity Charitable Solutions. The complaint further alleged that James Quay convinced two elderly victims to invest at least \$560,000.00 in the scheme, and that Jeffrey Quay and James Quay then dissipated at least \$180,000.00 of the victims' funds on their personal living expenses, including expensive restaurant meals, mortgage payments, and a membership a massage spa.

**III.**

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

**IV.**

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

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

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as

provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

SECURITIES AND EXCHANGE COMMISSION

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 **January 2013**, 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.

**Elisse B. Walter, served as SEC Chairman  
December 14, 2012 to April 10, 2013**

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

DANIEL M. GALLAGHER, COMMISSIONER

(33 Documents)

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Chairman Walter  
Commissioner Paredes  
Commissioner Gallagher  
not participating*

SECURITIES EXCHANGE ACT OF 1934  
Release No. 65941 / December 13, 2011

ADMINISTRATIVE PROCEEDING  
File No. 3-14660

In the Matter of

GARY S. BELL

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Gary S. Bell ("Respondent").

II.

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

*1 of 33*

### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of violations of the locate and close-out requirements of Regulation SHO of the Securities Exchange Act of 1934 ("Reg. SHO") by Respondent Bell and his firm GAS I, LLC ("GAS") who, from December 2006 through April 2007 (as for Bell) and May and June 2007 (as for GAS), violated these requirements and caused large persistent fail to deliver positions in threshold securities.

2. Subject to certain exceptions, Reg. SHO requires market participants seeking to effect a short sale to borrow, arrange to borrow, or have reasonable grounds to believe that a security can be borrowed in time to make delivery when due prior to effecting the short sale. This is known as the "locate requirement." Market makers, who ensure liquidity in the market, are excepted from the locate requirement if they are engaged in bona fide market making activities in the security for which the exception is claimed. Reg. SHO also requires fail-to-deliver positions<sup>2</sup> in certain securities that have persisted for thirteen consecutive settlement days to be immediately closed out.<sup>3</sup> In contrast to the locate requirement, market makers are not excepted from Reg. SHO's close-out requirement.

3. In this case, Bell and GAS improperly relied on the market maker exception from Reg. SHO's locate requirement and engaged in certain transactions that violated the locate and close out requirements. The first type of transaction – known in the industry as a "reverse conversion" or "reversal" – involves selling a put option and buying a call option – a combination that creates what is known as a "synthetic" long position – while selling short the underlying stock. The counterparty on the components of the reverse conversion – which is engaging in a "conversion" – benefits from the transaction because it is able to acquire a long stock position that is perfectly hedged by the synthetic short options position. That party can then loan out the shares of stock and receive fees from the borrowers. Those fees can be quite significant when the stock is

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<sup>1</sup> 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.

<sup>2</sup> Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. The three-day settlement period applies to most securities transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next settlement day following the trade (or T+1).

<sup>3</sup> A "close out" of a fail position involves the purchase of shares of like kind and quantity in the amount of the fail-to-deliver position.

a threshold security, because threshold securities are hard-to-borrow and therefore command large fees in the stock loan market. Consequently, prime brokers created the demand for the reverse conversion to create inventory for stock loans on hard-to-borrow securities, and options market makers like Bell and GAS fed this demand.

4. The second type of transaction, referred to herein as a "reset," is a transaction in which a market participant who has a "fail-to-deliver" position in a threshold security buys shares of that security while simultaneously selling short-term, deep in-the-money<sup>4</sup> call options to, or buying short-term, deep in-the-money put options from, the counterparty to the share purchase. The purchase of shares creates the illusion that the market participant has satisfied the close out obligation of Reg. SHO. However, the shares that are apparently purchased in the reset transactions are never actually delivered to the purchaser because on the day after executing the reset, the option is either exercised (if a call) or assigned (if a put), transferring the shares back to the party that apparently sold them the previous day. This paired transaction allows the market participant with the fail-to-deliver position to effectively borrow the stock for a day, in order to appear to have satisfied the close out requirement of Rule 203(b)(3).

5. By avoiding the cost of borrowing shares and engaging in these reverse conversion and reset transactions, Bell and GAS were able to earn profits while subject to minimal risk. Because Bell and GAS improperly failed to borrow or arrange to borrow securities to make delivery when delivery was due, the short sales were "naked" short sales<sup>5</sup> that violated Reg. SHO.

6. Specifically, from December 2006 through June 2007, Respondent Bell and his firm GAS, both purported options market makers, willfully violated Rule 203(b)(1) of Reg. SHO by improperly claiming the market maker exception to avoid locating shares before effecting short sale transactions in Reg. SHO threshold securities.<sup>6</sup> Bell and GAS also willfully violated Rule 203(b)(3) of Reg. SHO by engaging in a series of sham reset transactions that employed short-term, paired stock and option positions, which enabled both Bell and GAS to circumvent their close out obligations in Reg. SHO threshold securities. Bell and GAS also assisted other options market makers who were executing their own sham reset transactions by acting as a counterparty to the sham transactions and in doing so violated the locate requirement. Respondent Bell, the principal trader at GAS and a part owner of GAS, willfully aided and abetted and caused GAS's violations of Rules 203(b)(1) and 203(b)(3) of Reg. SHO.

<sup>4</sup> An "in-the-money" option is an option that entitles its holder to either buy securities below the current market price for that security (in the case of a call option), or to sell securities above the market price (in the case of a put option). An option that is "deep in-the-money" has a strike price that is far below (in the case of a call option) or far above (in the case of a put) the market price for the given security.

<sup>5</sup> In a "naked" short sale, the seller does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver the securities to the buyer when delivery is due.

<sup>6</sup> A "threshold security" is a security for which there is an aggregate fail-to-deliver position exceeding the size criteria set forth in Rule 203(c)(6) of Regulation SHO for a period of five consecutive settlement days.

### Respondent

7. Gary S. Bell, age 51, is a resident of Naperville, Illinois. Bell, who holds no securities licenses, was a sole-proprietor during the periods January 1, 2005 through May 3, 2006 and from November 30, 2006 through May 1, 2007. Bell was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-35762) until April 30, 2007. On May 1, 2007, Bell began trading through GAS I, L.L.C. During the period from November 30, 2006 through September 25, 2007, Bell was a member of the Chicago Board Options Exchange ("CBOE"). During the period from May 1, 2007 through September 25, 2007, Bell was a part owner of GAS I.

### Other Relevant Entity

8. GAS I, L.L.C., was an Illinois limited liability company with an office in Chicago. GAS was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-35762) from May 1, 2007 to June 20, 2008. Bell was the managing member and a part owner of GAS. From May 1, 2007 through September 25, 2007, GAS was a member of the CBOE registered to conduct market maker business. Effective September 25, 2007, GAS terminated its membership at the CBOE and on September 11, 2009, GAS was dissolved.

### Background

#### **Bell and GAS Failed to Locate Shares Prior to Effecting Short Sales**

9. From December 2006 through June 2007, Bell and GAS engaged in reverse conversions with purchasers of Reg. SHO threshold securities.

10. In these reverse conversions, Bell and GAS sold short shares of Reg. SHO threshold securities while simultaneously creating a synthetic long position in those same securities by purchasing call options from, and selling put options to, the same counterparty to whom Bell and GAS were selling short the shares of the threshold securities. These call and put options had the same strike price and expiration date, and were options to buy (or sell) the same threshold securities that Bell and GAS sold short in the reverse conversion transactions. Through this set of transactions, Bell and GAS eliminated their market risk because the short position was used to hedge the synthetic long position that had been created by purchasing call options and selling put options.

11. The reverse conversion transactions in Reg. SHO securities were profitable for Bell and GAS because the prices of the three separate components of the transactions – the short sale, the sale of the put options, and the purchase of the call options – were interdependent, and were set at levels that created an agreed-upon net profit per share for Bell and GAS. That per-share net profit was the effective price of the conversion, a price that Bell's and GAS's counterparties were willing to pay in order to obtain shares of hard-to-borrow Reg. SHO threshold securities for the

length of time between the original execution of the conversion and the expiration of the option components of the conversion.

12. In executing these reverse conversions, Bell and GAS claimed the market maker exception in Rule 203(b)(1) of Reg. SHO and did not locate shares of the security in question prior to effecting the short sale. This failure to locate shares was improper, however, because Bell and GAS were not engaged in bona fide market making activity in connection with effecting the short sale transactions.

#### **Bell and GAS Failed to Close Out Fail-to-Deliver Positions in Reg. SHO Threshold Securities**

13. Bell's and GAS's short sales resulted in a fail-to-deliver position in the threshold security on the books and records of their clearing firm – i.e. Bell and GAS had not delivered the shares they sold short to their clearing firm so that the clearing firm could settle the trade.

14. Rule 203(b)(3) of Reg. SHO requires clearing firms immediately to close out any fail-to-deliver position in a threshold security that persists for thirteen consecutive settlement days by purchasing securities of a like kind and quantity. Specifically, Rule 203(b)(3) requires a participant of a clearing agency registered with the Commission to take immediate action to close out a fail-to-deliver position in a threshold security in the Continuous Net Settlement system that has persisted for thirteen consecutive settlement days. However, pursuant to Rule 203(b)(3)(vi) of Reg. SHO, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer whose short sale resulted in the position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation for complying with the close out requirement shifts to that broker or dealer.

15. On numerous occasions from December 2006 through June 2007, Bell's and GAS's clearing firm notified them that the clearing firm had allocated to Bell and GAS the obligation to close out fail-to-deliver positions in threshold securities. These notifications informed Bell and GAS that if they did not purchase shares sufficient to satisfy their fail-to-deliver positions, the clearing firm would purchase (or "buy-in") those shares for the Bell and GAS accounts.

16. Bell and GAS did not want their fail-to-deliver positions, which resulted from the short sale portion of the reverse conversion, to be bought-in by the clearing firm because this would result in the clearing firm making large purchases of Reg. SHO threshold securities, at the expense of Bell and GAS, at a price determined by the market. Additionally, the buy-in would have exposed Bell and GAS to market risk on its reverse conversion transaction because it would have eliminated the short position that had been used to hedge the synthetic long position created by the options component of the reverse conversion.

17. To avoid a forced buy-in, Bell, in his own name and later through GAS, entered into a series of sham reset transactions that circumvented his and GAS's obligation under Reg. SHO to close out its fail-to-deliver position. These complex sham transactions gave the appearance that Bell and GAS were closing out their fail-to-deliver positions by purchasing securities of like kind and quantity.

18. Specifically, on numerous occasions, Bell effected short-term in-the-money option transactions in conjunction with stock purchases to circumvent the Reg. SHO close out requirements. Bell "purchased" stock in the Reg. SHO threshold security from another market maker and simultaneously purchased a short-term put option from (or sold a short-term call option to) the same market maker. These combined stock and option transactions were either "married puts" (the purchase of stock in conjunction with the purchase of a put option on the same security) or "buy-writes" (the purchase of stock in conjunction with the sale (or "writing") of call options on the same security).

19. Although married puts and buy-writes can be created using standard options, the option component of the reset transactions used by Bell and GAS were usually established using "FLEX" options. FLEX options are exchange traded options for which the parties can customize certain terms of the options, including the strike price, expiration date, and exercise type (*i.e.*, American or European). Bell and GAS used these FLEX options because they did not intend to actually purchase the shares required to satisfy their close out obligations. Rather, they simply wanted to appear to have satisfied that obligation through a purported purchase of shares. Thus, Bell and GAS structured the reset transactions so that the options component of the transaction would expire very soon after the purported "purchase" of shares had been reflected in Bell's and GAS's account at their clearing firm. Indeed, most of the FLEX options were customized to expire one day after they were purchased.

20. By entering into these reset transactions, Bell and GAS created the false impression that they had satisfied their Reg. SHO close out obligation. Bell and GAS, however, knew that the following day, or shortly thereafter, Bell or GAS would exercise the right to sell the stock back to its counterparty. (In the case of a call option, the option would expire in-the-money, causing the market maker that had purchased that call option to assign an exercise notice to Bell or GAS for Bell or GAS to sell the stock).

21. Moreover, Bell and GAS never actually received the stock they "purchased" from the other market maker because that market maker was selling short the stock without actually having any shares to sell or any intention to borrow shares in time for delivery when due.<sup>7</sup> Accordingly, Bell and GAS never received any shares and so never in fact closed out the "fail-to-deliver" position, as required by Reg. SHO, that was initially established during the reverse conversion transaction. Bell and GAS knew, or had reason to know that the combination of the purchase of shares and the sale of the FLEX option would result in maintenance of the "fail-to-deliver" position.

22. The clearing firm used by Bell and GAS, however, reset Bell's and GAS's Reg. SHO close out obligation to day one, thus giving Bell and GAS another thirteen settlement days in which to close out the short position, based on Bell's and GAS's purported "purchase" of shares and exercise of the option.

<sup>7</sup> These market makers were themselves improperly relying on Reg. SHO's locate exception related to bona fide market making activity because they were not engaged in bona fide market making activity in connection with these short sales.

23. After receiving subsequent buy-in notices from their clearing firm, Bell and GAS continued to engage in these types of transactions until the initial options positions (call options purchase/put options sale) expired or were assigned, thus closing out the short position and eliminating the synthetic long position that the short position had hedged. By engaging in this course of conduct, Bell, in his own name and later through GAS, impermissibly maintained fail-to-deliver positions in numerous Reg. SHO threshold securities for longer than thirteen settlement days. Indeed, on numerous occasions, Bell's repeated use of reset transactions allowed him and GAS to maintain a large fail-to-deliver position in a threshold security for several months.

24. During the relevant period, Bell and GAS engaged in a large number of reverse conversions and reset transactions in numerous threshold securities including, but not limited to: NYSE Group; Chipotle Mexican Grill, Inc.; Novastar Financial, Inc.; and AtheroGenics, Inc. In addition, on numerous occasions, Bell and GAS assisted other purported market makers in evading their close out obligations by acting as the counterparty to reset transactions. Specifically, Bell and GAS sold short shares of Reg. SHO threshold securities so that other market makers could "purchase" the securities to close out their own fail-to-deliver positions, and simultaneously sold deep in-the-money put options or bought deep in-the-money call options, the combination of which allowed the other market makers to circumvent their own Reg. SHO close out obligations. Neither Bell nor GAS located the shares of these threshold securities prior to entering into the short sale component of these reset transactions.

25. As a result of Bell's and GAS's violations of Reg. SHO's locate and close out requirements, they received ill-gotten gains of at least \$1.5 million.

### Violations

#### **Bell Willfully Violated Rule 203(b)(1) of Reg. SHO and Willfully Aided and Abetted and Caused GAS's Violation**

26. Pursuant to the locate requirement of Rule 203(b)(1) of Reg. SHO, a broker or dealer may not effect a short sale in an equity security unless, prior to accepting a short sale order in an equity security from another person, or effecting a short sale in an equity security for its own account, it has "(i) [b]orrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) [r]easonable grounds to believe that the [security can be borrowed so that it can be delivered on the date delivery is due; and (iii) [d]ocumented compliance with [these requirements]."

27. Rule 203(b)(2)(iii) contains an exception to this locate requirement for short sales effected "by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed."

28. At the time Bell, in his own name and later through GAS, placed orders to sell short certain Reg. SHO threshold securities as part of the reverse conversion transactions and reset transactions described above, he failed to locate the securities, claiming the market maker

exception to the locate requirement. The market maker exception was not available to either Bell or GAS, however, because they were not engaging in bona-fide market making activities in these securities.

29. As a result of the conduct described above, Bell willfully violated, and willfully aided and abetted and caused GAS's violations of, Rule 203(b)(1) of Reg. SHO.

### **Bell Willfully Violated Rule 203(b)(3) of Reg. SHO and Willfully Aided and Abetted and Caused GAS's Violation**

30. Rule 203(b)(3) imposes an obligation on clearing firms immediately to close out any fail-to-deliver positions in a threshold security that last for thirteen consecutive settlement days<sup>8</sup> by purchasing securities of like kind and quantity. Pursuant to Rule 203(b)(3)(vi), however, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer for which it clears trades or for which it is responsible for settlement, based on such broker or dealer's short position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation to comply with the mandatory close out requirement shifts to that broker or dealer.

31. Once the fail-to-deliver position is allocated to the broker or dealer, that broker or dealer, in order to satisfy the close out requirement of Rule 203(b)(3) of Reg. SHO, must purchase securities of like kind and quantity. Borrowing securities, or otherwise entering into an arrangement that merely creates the appearance of a purchase, does not satisfy the close out requirement under Rule 203(b)(3) of Reg. SHO.

32. In addition, Rule 203 of Reg. SHO specifically prohibits firms from satisfying their close out obligations through sham transactions that merely give the appearance of closing out a fail-to-deliver position. Specifically, Rule 203(b)(3)(vii) provides that a clearing firm will be deemed not to have satisfied the close out obligation if it enters into an agreement with another person to purchase securities and the clearing firm knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the sham transactions provision of Rule 203(b) applies to that broker or dealer.

33. By selling (or purchasing) deep in-the-money FLEX call (or put) options while simultaneously purporting to "purchase" stock, Bell and GAS engaged in sham transactions that gave the appearance that they were closing out its fail-to-deliver position when, in fact, Bell and GAS knew, or had reason to know that these transactions would result in a fail-to-deliver position.

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<sup>8</sup> In October 2008, the Commission adopted Rule 204T (which was made permanent as Rule 204 effective July 31, 2009). Under Rule 204, clearing firms must close out fails-to-deliver on all equity securities (not just threshold securities) and must do so earlier than under Rule 203(b)(3). Clearing firms must now close out fails-to-deliver by either borrowing or purchasing securities of like kind and quantity no later than the beginning of regular trading hours on the first settlement day after the settlement date. Fails resulting from long sales or attributable to bona fide market making activity have two additional settlement days before they must be closed out.

34. As a result of the conduct described above, Bell willfully violated and willfully aided and abetted and caused GAS's violations of, Rule 203(b)(3) of Reg. SHO.

#### Undertaking

35. Bell has undertaken to provide to the Commission, within thirty (30) days after the end of the nine (9) month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

#### IV.

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

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Exchange Act Rules 203(b)(1) and 203(b)(3).

B. Respondent be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization for a period of nine (9) months, effective on the second Monday following the entry of this Order.

C. Respondent shall, within ten (10) days of the entry of this Order, pay disgorgement of \$1,500,000 and prejudgment interest of \$336,094 and a civil money penalty in the amount of \$250,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and pursuant to 31 U.S.C. 3717. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Securities and Exchange Commission, Office of Financial Management, 100 F St., NE, Stop 6042, Washington, DC 20549; and (D) submitted under cover letter that identifies Gary S. Bell 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 Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, Three World Financial Center, Suite 400, New York, NY 10281.

D. Respondent shall comply with the undertaking enumerated in Section III, paragraph 35 above.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Chairman Walter  
Commissioner Paredes  
Commissioner Gallagher  
not participating*

SECURITIES EXCHANGE ACT OF 1934  
Release No. 66283 / January 31, 2012

ADMINISTRATIVE PROCEEDING  
File No. 3-14726

In the Matter of

JEFFREY A. WOLFSON,  
ROBERT A. WOLFSON,  
AND GOLDEN ANCHOR  
TRADING II, LLC (n/k/a  
BARABINO TRADING,  
LLC)

Respondents.

ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-  
AND-DESIST PROCEEDINGS  
PURSUANT TO SECTIONS 15(b) AND  
21C OF THE SECURITIES  
EXCHANGE ACT OF 1934 AND  
NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Jeffrey A. Wolfson ("J. Wolfson"), Robert A. Wolfson ("R. Wolfson") and Golden Anchor Trading II, LLC ("Golden Anchor") (collectively the "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. These proceedings arise out of violations of the locate and close-out requirements of Regulation SHO of the Securities Exchange Act of 1934 ("Reg. SHO") by the Respondents, who, from July 2006 through July 2007, violated these requirements by taking advantage of an exemption to the locate rules to which they were not entitled and engaged in hundreds of sham transactions that caused large persistent fail to deliver positions in threshold securities generating over \$17 million in unwarranted profits through their violative conduct. The Respondents are: J. Wolfson, his brother R. Wolfson, and the entity R. Wolfson traded through, Golden Anchor.

2. The Commission adopted Reg. SHO in an effort to reduce fails to deliver and to address potentially abusive "naked" short selling. Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. In a "naked" short sale, the seller does not own, and does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver the securities to the buyer when delivery is due.

3. As noted in the Commission's proposing rule release for Reg. SHO, "[n]aked short selling can have a number of negative effects on the market, particularly when the fails to deliver persist for an extended period of time and result in a significantly large unfulfilled delivery obligation at the clearing agency where trades are settled. At times, the amount of fails to deliver may be greater than the total public float. In effect the naked short seller unilaterally converts a securities contract (which should settle in three days after the trade date) into an undated futures-type contract, which the buyer might not have agreed to or that would have been priced differently. The seller's failure to deliver securities may also adversely affect certain rights of the buyer, such as the right to vote. More significantly, naked short sellers enjoy greater leverage than if they were required to borrow securities and deliver within a reasonable time period, and they may use this additional leverage to engage in trading activities that deliberately depress the price of a security." Short Sales, 68 Fed. Reg. 62972, 62975 (Nov. 6, 2003) (footnotes omitted).

4. A "threshold security," as defined in Rule 203(c)(6) of Reg. SHO, is an equity security that has an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency, totaling 10,000 shares or more, and equal to at least 0.5% of the issuer's total shares.

5. Two provisions of Reg. SHO are applicable in this matter. First, Rule 203(b)(1) of Reg. SHO requires, subject to certain exceptions, market participants seeking to effect a short sale to borrow, arrange to borrow, or have reasonable grounds to believe that a security can be borrowed in time for delivery when due prior to effecting the short sale. This is known as the "locate requirement." Reg. SHO contains an exception from this locate requirement for certain market makers, with respect to transactions in connection with bona-fide market making activities in the security for which this exception is claimed (the "Market Maker Exception"). Thus, a market maker can execute a short sale in connection with bona-fide market making without first obtaining a locate.

6. Second, Rule 203(b)(3) requires that if a participant of a registered clearing agency (i.e., a clearing broker) has a fail to deliver position in a threshold security for thirteen settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity (the so-called "close-out")

requirement). This purchase has to be a "bona fide transaction," Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO (December 17, 2004), Question and Answer 5.7 (added May 24, 2005). Also Rule 203(b)(3)(vii) specifically excludes as an effective close-out an arrangement with another person to purchase securities when the participant with the fail to deliver position knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase. A participant of a registered clearing agency may "allocate" a portion of its fail to deliver position to a broker-dealer for which it clears trades based on such broker-dealer's short position, in which case the obligation to close out is shifted to the broker-dealer. This means that even a qualifying market maker who is entitled to avail himself of the Market Maker Exception to the locate requirement when he sells a stock short, has to eventually purchase that stock in a bona fide transaction thirteen days later if his clearing firm has a fail to deliver position in the threshold security for thirteen settlement days and the clearing firm assigns the fail to deliver position to him.

7. The Respondents in this matter, who were not conducting bona-fide market making activities but were instead engaged in "naked" short sale transactions for their personal investment purposes, improperly utilized the Market Maker Exception from Rule 203(b)(1) in order to avoid locating shares before effecting short sales as part of "reverse conversion" and "assist" transactions, as further described below. Because the Respondents failed to borrow or arrange to borrow securities to make delivery when delivery was due, the short sales as part of the reverse conversions and assists were "naked" short sales. These same Respondents also violated Rule 203(b)(3) by repeatedly engaging in a series of sham transactions to ostensibly "reset" the thirteen-day clock for complying with the close-out requirement, but without actually purchasing shares in a bona fide transaction. These sham transactions enabled the Respondents to circumvent Reg. SHO, allowed them to generate millions of dollars in profits because they did not actually borrow or arrange to borrow the securities they were selling short, and caused their clearing broker to have large persistent fail to deliver positions in these threshold securities, thus undermining one important purpose of Reg. SHO.

8. These violations occurred as a result of the Respondents' routine practice of engaging in a combination of three types of transactions in threshold securities. The first type of transaction, known in the industry as a "reverse conversion" or "reversal," involves selling stock short while also selling a put option and buying a call option that each have the exact same expiration date and strike price. The option combination creates what is known as a "synthetic long position" that hedges the short stock sale. All three of these transactions are executed with the same counterparty – which is engaging in a "conversion." The position is "delta neutral" to any change in the underlying stock price because whether the equity price rises or falls, the position remains hedged until the options expire, when one option will expire worthless while the other will be exercised or assigned, causing the stock to be received by the original seller and closing the short position.

9. Reverse conversions are executed to meet a one-sided market demand for hard-to-borrow threshold securities. The buyers of the threshold securities, in this case large prime brokerage firms, engaged in the conversion transaction that allowed them to

acquire a long stock position that is hedged by the synthetic short options position. The brokerage firm could then loan out the shares of the threshold securities and received fees from the borrowers. Those loan fees can be quite significant when the stock is a threshold security, because threshold securities are generally hard to borrow and therefore command large fees in the stock loan market. Indeed, the borrow rate (referred to as a "negative rebate" because it is paid by the borrower to the lender) on a threshold security can be as high as 50% of the stock's market price (on an annualized basis), as compared to a small positive rebate that a financial institution borrowing securities would receive from the lender to compensate for cash collateral it posts to the lender when a security is easy to borrow. In many cases, certain threshold securities could not be borrowed at all. Alternatively, if the shares could be borrowed, the price to borrow was often much higher than the price at which the Respondents were willing and able to transact in reverse conversions because they did not have and did not intend to actually buy or borrow the stock they were selling short.

10. As a result, the Respondents, who did not comply with the "locate" requirements of Rule 203(b)(1) before selling the stock and did not comply with the close out requirements of Rule 203(b)(3), were able to attract the business of prime brokerage firms seeking to create inventory for stock loans on hard to borrow securities.

11. The Respondents could afford to engage in these reverse conversion transactions at a much better price than their competitors who located the stock in compliance with Reg. SHO's requirements and incurred the costs associated with actually borrowing the security as required by Reg. SHO. As J. Wolfson stated in a recorded telephone conversation, "what I sell them is not guaranteed, it never gets delivered, it's funny paper." Thus, the Respondents undercut the price for reverse conversions that was charged by those who did not violate Reg. SHO by engaging in "naked" short selling. As a result, the Respondents made millions of dollars in illicit profit.

12. The second type of transaction the Respondents engaged in – referred to herein as a "reset" – was a transaction in which the Respondents purported to discharge their obligation to "purchase" the security and close out their short position. In reality, it was a sham transaction. In a reset transaction, the Respondent having the close out obligation purportedly "bought" shares of that security while simultaneously buying from the same counterparty a short-term, deep in-the-money<sup>1</sup> put option (a so-called "married put," because the purchase of stock was paired with the put option) or sold a short-term, deep in-the-money call option (a so-called "buy write" because the buyer buys shares and "writes" – or sells – a call option). This ostensible purchase of shares married with the short-term deep in-the-money option created the illusion that the Respondent satisfied the close-out obligation of Reg. SHO Rule 203(b)(3) by "purchasing" shares. But because the purchase was married to a short-term deep in-the-money option that in fact negated the purchase and returned the shares to the counterparty the next day, it was not a bona-fide

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<sup>1</sup> A put option is in-the-money if the stock price is below the strike price of the option. A call option is in-the-money if the stock price is above the strike price of the option.

purchase transaction. Instead, this paired transaction was nothing more than a temporary borrow of stock for a day. The Respondents knew or had reason to know, were reckless in not knowing or should have known that the shares they apparently "purchased" in the reset transactions would be transferred back to the party that apparently "sold" them the day before when the Respondent either exercised the put or was assigned on the call. As J. Wolfson stated in recorded telephone conversations, "every trade you make . . . you know you are not getting delivery" and "nobody in their right minds can expect delivery in any of these Reg. SHO stocks."

13. The reset transaction was virtually always priced at a net cost of \$0.03 per share to the purchaser of the stock, regardless of how much it would actually cost the seller to borrow the stock or how much the seller could make loaning the hard to borrow stock out to a third party if he had it. At times, the \$0.03 was less than a purchaser would have to pay to borrow hard-to-borrow securities in a bona-fide transaction with a counterparty that actually held the stock long. J. Wolfson and R. Wolfson knew or had reason to know, were reckless in not knowing or should have known that their counterparty was selling stock short without purchasing or borrowing to cover the short sale, so no shares would actually be delivered in the transaction. J. Wolfson and R. Wolfson, when "purchasing" the stock knew or had reason to know, were reckless in not knowing or should have known that their counterparty on the reset would not deliver securities in settlement of purchase, there was no actual close out of the fail to deliver position. For all these reasons, J. Wolfson and R. Wolfson also knew that even if there was no failure to deliver, the one-day purchase of stock followed by its return the next day was a sham transaction that simply rolled their short position over for another thirteen settlement days. These transactions violated Rule 203(b)(3) of Reg. SHO.

14. The third type of transaction the Respondents engaged in was simply taking the other side of the reset transaction, referred to as the "assist." Thus, J. Wolfson and R. Wolfson would assist with both their own and others' reset transactions by selling shares short to the resetting party while simultaneously selling to the same counterparty a short-term, deep in-the-money put option or buying a short-term deep in-the-money call option. When each of the Respondents sold short as part of their assist transactions, they did not obtain a locate prior to the short sale, and thus each assist transaction also constituted a separate violation of Rule 203(b)(1). Because these Respondents routinely took both sides of these transactions designed to reset the thirteen day Reg. SHO clock, they understood that no shares ever changed hands. In fact, when engaging in resets, these Respondents traded *with each other* or with Trader A (who received instruction from Wolfson in how to trade threshold securities) at least 47% of the time.

15. J. Wolfson was the key participant in this violative activity and taught his brother, R. Wolfson, and others how to do it. One benefit to J. Wolfson of doing so was to have his brother and others as facilitators by taking the assist on the other side of his reset transactions. J. Wolfson was so concerned about the violative nature of his trading with Trader A that when Trader A's wife, during a recorded telephone call, told J. Wolfson that Trader A wanted to give J. Wolfson some money for all that J. Wolfson had done for Trader A, J. Wolfson said, "we're going to be investigated" by the Commission, Chicago

Board Options Exchange ("CBOE") and American Stock Exchange ("Amex") because they are "into this Reg. SHO thing," and J. Wolfson was adamant that if Trader A gave J. Wolfson or any of his relatives "a penny, [the regulators] can show collusion."

16. In fact, J. Wolfson often did directly collude with Trader A and R. Wolfson to violate Reg. SHO. J. Wolfson even had authority to instruct brokers to place trades into Trader A's and R. Wolfson's accounts. J. Wolfson often called in both sides of his reset transaction and instructed the broker to put assists in either his brother's or Trader A's account (and sometimes both).

17. During the period July 2006 through July 2007, these Respondents routinely engaged in hundreds of "reverse conversion," "reset" and "assist" transactions in numerous threshold securities including, but not limited to Fairfax Financial Holdings Ltd. (then trading on NYSE as "FFH"); NYSE Group (NYSE: NYX); Chipotle Mexican Grill, Inc. (NYSE: CMG); Novastar Financial, Inc. (then trading on NYSE as "NFI"); and AtheroGenics, Inc. (then trading on the NASDAQ as "AGIX").

18. During this period, the Respondents were not engaged in bona fide market making activities in these securities. The Respondents failed to maintain regular and continuous two-sided quotations and did not hold themselves out as being willing to buy and sell options in these securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. The Respondents were not appointed by their Self-Regulatory Organizations ("SROs") as market makers in these threshold securities or in the options of these threshold securities and did not abide by the SRO requirements to be considered market makers in the options of these securities. Moreover, while they sold hundreds of reverse conversions, they rarely purchased a conversion. Once the Respondents sold the reverse conversion, they did not trade out of the position but instead held onto the position (similar to any other investment transaction) until the maturity date of the underlying options, which was often several months. During this time, the Respondents maintained their open short position through routine use of the reset transactions. The Respondents simply had no legitimate claim to avail themselves of the exception from the locate requirement for transactions in connection with bona-fide market making activities in the securities for which this exception was claimed when they sold short either in the reverse conversion or assist transactions.

19. These transactions caused significant amounts of persistent fails to deliver in threshold securities. By engaging in these unlawful transactions during the period July 2006 through July 2007, the Respondents collectively earned at least \$17,375,000 in illicit trading profits.

<b>Respondent</b>	<b>Reverse Conversions</b>	<b>No. of Trades</b>	<b>Assists</b>	<b>No. of Trades</b>	<b>Total</b>
J. Wolfson	\$12,129,000	380	\$3,484,000	486	\$15,613,000
R. Wolfson and Golden Anchor	1,319,000	111	443,000	130	1,762,000
Total	<u>\$13,448,000</u>	<u>491</u>	<u>\$3,927,000</u>	<u>616</u>	<u>\$17,375,000</u>

20. By virtue of their conduct, J. Wolfson willfully violated, aided and abetted and caused; Golden Anchor willfully violated; and R. Wolfson aided and abetted and caused violations of Rules 203(b)(1) and 203(b)(3) of Reg. SHO.

**B. RESPONDENTS**

21. *Jeffrey A. Wolfson*, age 58, is a resident of Northbrook, Illinois. J. Wolfson, a sole-proprietor, holds a Series 7 license and was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-37121) until May 8, 2007, when the assets and liabilities of the sole-proprietorship were transferred to BMR 2, L.L.C. During the period January 1, 2005 through May 8, 2007, J. Wolfson was registered with the Chicago Board Options Exchange ("CBOE") as a market maker for Wol Corporation. J. Wolfson terminated his affiliation with Wol effective May 8, 2007. J. Wolfson is currently a member and the majority owner of Sallerson-Troob, L.L.C. J. Wolfson founded Pax Clearing Corporation which Merrill Lynch Professional Clearing Corp. acquired in April 2005.

22. *Robert A. Wolfson*, age 57, is a resident of West Orange, New Jersey. R. Wolfson, who holds no securities licenses, was employed as a market maker by Golden Anchor from March 21, 2007 through December 31, 2007, where he traded his own account using capital provided by Golden Anchor with an agreement that he receive 50% of the profits generated from his trading.

23. *Golden Anchor Trading II, (n/k/a Barabino Trading, LLC)*, is a New York limited liability company with offices in New York, New York. From November 18, 1997 until May 25, 2009, Golden Anchor was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-50620).

**C. OTHER RELEVANT INDIVIDUAL AND ENTITIES**

24. *BMR 2, L.L.C.*, was an Illinois limited liability company with an office in Chicago. BMR was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-37121) from at least May 8, 2007 until October 10, 2008. On May 8, 2007, BMR assumed all assets and liabilities of Jeffrey A. Wolfson, sole-proprietor. From May 8, 2007 through March 3, 2008, BMR was a member of the CBOE. On September 11, 2009, BMR was dissolved.

25. *Vintage Capital, L.L.C.*, is an Illinois limited liability company with an office in Chicago in the same offices where J. Wolfson traded. Since January 2, 2004, Vintage has been a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-66175).

26. *Sallerson-Troob, L.L.C.*, is an Illinois limited liability company with an office in Chicago in the same offices where J. Wolfson traded. Since August 19, 1997, Sallerson-Troob has been a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-50403). During the period January 1, 2005

through July 31, 2007, Sallerson-Troob was partially owned by J. Wolfson, who is currently the majority owner.

#### **D. ALLEGATIONS**

27. From July 2006 through July 2007, the Respondents engaged in “reverse conversions” and “assist” transactions in which they sold short certain threshold securities without locating the securities subject to the short sales. The Respondents were not entitled to rely on the bona-fide market making exception to justify their failure to locate the threshold securities because these transactions were not part of bona-fide market making, as discussed further below. The Respondents also improperly engaged in a series of sham “reset” transactions that did not satisfy their obligations to close out their fail-to-deliver positions. Through these transactions, the Respondents were able to profit from selling the reverse conversions in threshold securities to prime brokers at prices less than the prevailing rate (then very high) to borrow them. The Respondents were able to keep as profit the entire amount made on the “sale” of the reverse conversion because the Respondents never intended to borrow or buy the securities to close out the short position created by the reverse conversion.

28. We first set out a typical example of the complete trading pattern and then discuss in more detail each Respondent’s repeated violations.

#### **The Violative Trading Pattern**

##### **The Reverse Conversion**

29. The first step in the trading pattern involved a “reverse conversion.” This involves three transactions with the same counterparty including the short sale of a generally large block of stock tied to the sale of a put option and purchase of a call option with identical strike price and expiration dates. The short sale is hedged by the options combination that creates a “synthetic long position” so the entire position is “delta neutral” to changes in the stock price. If the price of the underlying stock increased over the life of the conversion, thereby decreasing the value of the short position, that “loss” would be offset by a corresponding increase in the value of the synthetic long position; conversely, if the price of the underlying stock decreased over the life of the conversion, the decrease in the value of the synthetic long position would be offset by the “gain” on the short position. Below is an example from J. Wolfson’s trading records of a reverse conversion in the securities of iMergent, Inc. (formerly traded on the Amex as “IIG” / options ticker: IIG).

##### **Example 1 – Reverse Conversion**

February 1, 2007	J. Wolfson sold short 35,000 shares of IIG at \$19.45 per share to a counterparty
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- February 1, 2007 J. Wolfson sold 350 (each option contract is for 100 shares of stock) IIG Apr 20 puts at \$3.75 per share to the same counterparty
- February 1, 2007 J. Wolfson bought 350 IIG Apr 20 calls from the same counterparty; 175 at \$2.67 per share and 175 at \$2.68 per share

30. J. Wolfson made a total profit on this reverse conversion of \$18,375, earning \$1.08 on 17,500 shares and \$1.07 on 17,500 shares on the put/call spread (\$3.75-\$2.67 and \$3.75-\$2.68), and losing \$0.55 when the calls he bought as part of the options combination were exercised at the \$20.00 strike price (\$20.00 - \$19.45), for a per share profit of \$0.53 (\$1.08 - \$0.55) on 17,500 shares and \$0.52 (\$1.07-\$0.55) on the other 17,500 shares, or \$18,375, in total for this one transaction. The reverse conversion was a "package" – all three legs would be done with the same counterparty and the price for the reverse conversion would be quoted as the price per share, e.g., \$0.53 to sell the April reverse conversion.

#### **The Reset Transaction**

31. The Respondents' short sale in the reverse-conversion, like the one in Example 1 above, however, resulted in a "fail to deliver" position in the threshold security on the books and records of their clearing firm at the end of the third settlement day (T+3). This was because the Respondents obviously did not own the shares, failed to locate shares prior to effecting their short sales, did not borrow the shares, and did not deliver the shares they sold short on settlement day. In these cases, the clearing firm routinely notified the Respondents that the clearing firm was allocating to them the obligation to close out the fail to deliver positions and that the clearing firm would buy-in those positions if the Respondents did not close them out themselves. Such a notification from a clearing firm is typically referred to in the industry as a "buy-in" notification, *i.e.*, the clearing firm notifies its client that, if the client does not close out the fail to deliver position, the clearing firm will buy shares in the market and recover the cost from the client.

32. The Respondents did not want their fail to deliver position to be bought-in by the clearing firm because such a buy-in would have required the clearing firm to actually make purchases of Reg. SHO threshold securities (which were by definition thinly traded), at the Respondents' expense, at a price determined by the market. Additionally, the buy-in would have exposed the Respondents to market risk on their initial reverse conversion transactions because it would have eliminated the short position leaving only the unhedged synthetic long position created by purchasing call options and selling put options.

33. To avoid being bought-in, the Respondents entered into a reset, in which they bought a married put or executed a buy-write (the purchase of stock in conjunction with the sale, or writing, of call options on the same security) that utilized a particular type of option known as a FLEX option. These are exchange traded options for which the

parties can customize certain terms, including the strike price, expiration date, and exercise type (i.e., American or European). In this case, the option would usually be a one day put option with a deep in-the-money strike price, ensuring that stock "purchased" by the buyer would be "put back" or returned to the seller when exercised the very next day. The following is J. Wolfson's reset of the reverse conversion from Example 1:

#### **Example 2 – Reset Transaction**

- February 23, 2007 J. Wolfson received a Reg. SHO buy-in notification from his clearing firm for 35,000 shares of IIG.
- February 23, 2007 J. Wolfson "purchased" 35,000 shares of IIG at \$18.83 per share from a counterparty who assisted the transaction, thereby seeming to eliminate his fail to deliver position with his clearing firm.
- February 23, 2007 J. Wolfson simultaneously bought from the same counterparty 350 IIG 26 Feb 30 put options (which were deep in-the-money – the stock would have to rise from \$18.83 to \$30, or 59% in one day, for the put to expire worthless) at \$11.20 per share; these one-day FLEX options (February 23 was a Friday) had an expiration date of February 26, 2007.
- February 26, 2007 J. Wolfson exercised the put options resulting in a "sale" back to the seller/counterparty of the 35,000 shares he had "purchased" the day before, thereby re-establishing his original short position. Three days after the exercise of the put, J. Wolfson would fail to deliver on settlement of the "sale" of the 35,000 shares. Nonetheless, the effect of Wolfson's "purchase" on February 23 was to appear to close out the original short position on which he was failing to deliver for thirteen settlement days, and the effect of his exercising the put option was to re-establish the short position for up to another thirteen settlement days even though J. Wolfson never actually received or delivered any IIG shares.

34. The total price paid for the 35,000 shares and the 350 put options was \$30.03 per share (\$18.83 per share for the stock, plus \$11.20 per share for the options). In return, J. Wolfson received the right to sell the shares back one day later at \$30. Thus, Wolfson effectively paid \$0.03 per share, or \$1,050 in total, to circumvent his Reg. SHO obligations. With very little exception, this "reset" transaction cost the purchaser exactly \$0.03 no matter what the underlying stock was. In most cases, these reset transactions

were brokered through a floor broker, who knew a small group of market participants, including the Respondents, willing to take the other side.

35. This reset enabled J. Wolfson to evade the close-out requirement because his clearing firm counted the long purchase component of the reset towards J. Wolfson's "net long" position for the day and reset the clearing firm's calculation of J. Wolfson's close-out obligation. The underlying options on the original reverse conversion expired on April 21, 2007, and J. Wolfson executed at least one additional reset transaction (again at a cost of \$0.03 per share), on March 19, 2007, to maintain a fail to deliver position from February 23 (when the position should have been closed out by the purchase of shares of like kind and quantity) until April 21, when the options from the initial reverse conversion expired. Reverse conversion positions of longer duration required several resets to maintain the original reverse conversion until expiration of the underlying options.

36. Other reset transactions allowed J. Wolfson to maintain his failure to deliver positions for even longer. A reset executed on the thirteenth settlement day of a fail to deliver allowed J. Wolfson to maintain his short position from a reverse conversion for an additional sixteen trading days, as shown in the table below.

S13	T Day 1	T+1 Day 2	T+2 Day 3	T+3 S1 Day 4
S2 Day 5	S3/ Day 6	S4 Day 7	S5 Day 8	S6 Day 9
S7 Day 10	S8 Day 11	S9 Day 12	S10 Day 13	S11 Day 14
S12 Day 15	S13 Day 16			

On settlement day 13 (shown as "S13 in the table above), J. Wolfson did a reset. On the following day (shown as "T" in the table above), the option from the reset was exercised or assigned causing J. Wolfson to sell the shares. When this sale settled on "T+3" it resulted in a fail to deliver, which then could persist for another twelve settlement days until it had to be closed on "S13," the thirteenth settlement day.

#### **Expiration of the Original Reverse Conversion**

37. The reset transactions enabled the Respondents to maintain their short position until the expiry of the underlying options in the original reverse conversion, thereby enabling the Respondents to realize the profits they had essentially locked in at the beginning of the transaction. By the nature of the reverse conversion (which contained puts and calls with the same expiration and strike price) – one option will always expire worthless and the other will always be exercised (or assigned), thus resulting in a "purchase" to the Respondent that would close out the short position put on in the original reverse conversion.

### Example 3 – Expiration of Options from Original Reverse Conversion

- April 20, 2007            The 350 IIG Apr 20 call options J. Wolfson bought on February 1 were in-the-money (the stock was trading at \$25.00) and exercised by J. Wolfson at \$20 resulting in a purchase of 35,000 shares of IIG. These shares closed out J. Wolfson's original IIG fail position
- April 21, 2007            The 350 IIG Apr 20 put options that J. Wolfson purchased on February 1 expired worthless since the market price of IIG was above the strike price (IIG closed at \$25.00 on April 20)

38.     As a result of these reverse conversion and reset transactions in IIG, J. Wolfson made a net profit of \$16,275, equal to the difference of the \$18,375 J. Wolfson made on the reverse conversion, minus the \$2,100 cost of the two reset transactions.

#### J. Wolfson Learns “The Game”

39.     J. Wolfson testified that it was not until after he sold an “assist” transaction in FFH (and more assists after that) that he started asking himself, “What’s the other side of this, why are they doing this, what’s the game[?]” After he “figured out” how he was going to close out by using the reset transaction (which he had been assisting) he “started really selling reversals in threshold securities.” The reset enabled him to avoid the costs associated with borrowing or purchasing sufficient shares to make delivery on the short sale component of the reverse conversion. Thus, actually delivering on the short sale component of the reverse conversion was not part of the Respondents’ strategy. In a recorded October 5, 2006 telephone conversation, J. Wolfson discussed a request for guaranteed delivery of stock on a reverse conversion and admitted that the stock he sold as part of a reverse conversion did not get delivered – “. . . what I sell them is not guaranteed, it never gets delivered, it’s funny paper.”

40.     Moreover, J. Wolfson understood that he was loaning shares, which he did not own or borrow, to prime brokers via his reverse conversions. In a recorded October 4, 2006 telephone conversation, J. Wolfson explained to a representative of a hedge fund how he could lower the hedge fund’s cost of borrowing stock – in this case FFH – to cover its short sales. J. Wolfson explained how a prime brokerage firm was paying him an implied borrow rate of 20% for the long stock it “purchased” from J. Wolfson’s reverse conversion while charging the hedge fund 30% to borrow the stock. To cut out the prime brokerage firm, and make his reverse conversions even more profitable, J. Wolfson proposed that he and the hedge fund could split the 10% the hedge fund could save by doing its conversions with J. Wolfson instead of borrowing the stock from the prime broker.

41.     Typically, in a reverse conversion, the cost to borrow stock is considered a carrying cost to the reverser – the party providing the conversion. However, the Respondents did not have to factor in the cost to borrow stock when they quoted

conversions because they avoided such costs by not complying with Reg. SHO. As a result, the Respondents enjoyed a competitive advantage over others in the market who were complying with Reg. SHO.

42. J. Wolfson's trading records show that he began frequent trading in threshold securities beginning in July 2006 when he did five reverse conversions, one reset and sixteen assists. J. Wolfson's activity in threshold securities peaked in March 2007 when he did eighty-six reverse conversions, thirty resets and seventy-eight assists. Beginning in May 2007, J. Wolfson switched from trading as a sole proprietor to trading through BMR 2, LLC. By executing at least 380 reverse conversions, from July 2006 through July 2007, J. Wolfson generated approximately \$12,129,000 in illicit profits. During the same period, J. Wolfson executed at least 486 assist trades for total profits of approximately \$3,484,000.

#### **J. Wolfson Recruits Trader A and R. Wolfson Into "The Game"**

43. Beginning in late 2006, J. Wolfson began to teach others how to trade reverse conversions in threshold securities as well as resets and assists. J. Wolfson approached Trader A and asked if Trader A wanted to learn how J. Wolfson traded. J. Wolfson and Trader A discussed how to do reverse conversions in threshold securities and J. Wolfson introduced Trader A to the use of reset transactions to close out his Reg. SHO fails.

44. J. Wolfson also shared his threshold securities trading strategies with his brother, R. Wolfson, who began trading in his own account at Golden Anchor in March 2007. All of R. Wolfson's trading in threshold securities was conducted in this account at Golden Anchor and none of Golden Anchor's other trading activity was placed in this account. As the executing broker, it was Golden Anchor's responsibility to obtain locates prior to R. Wolfson's short sales and Golden Anchor's responsibility, once allocated from its clearing firm, to close out the fails to deliver resulting from R. Wolfson's trading in threshold securities. From March 23, 2007 through July 31, 2007, R. Wolfson, trading through Golden Anchor, executed at least 111 reverse conversions in threshold securities that resulted in approximately \$1,319,000 in profits. During the same period, R. Wolfson, trading through Golden Anchor, executed at least 130 assist transactions for total profits of \$443,000.

#### **The Respondents Were Not Bona-Fide Market Makers Under Reg. SHO**

45. The short sales executed by the Respondents in the reverse conversion and the assist transactions were not in connection with bona-fide market making activities in the threshold security, so the Respondents were not eligible for the Market Maker Exception.

46. Section 3(a)(38) of the Exchange Act defines a market maker as a specialist or dealer who "holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a

regular or continuous basis.” The Respondents failed to maintain regular and continuous two-sided quotations and did not hold themselves out as being willing to buy and sell securities or options in the securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. Rather, the Respondents were engaging in reverse conversions and assists for their own investment purposes. J. Wolfson did not regularly or continuously disseminate two-sided quotes in the option classes he used in reverse conversions.

47. The proposing and adopting releases for Reg. SHO provide guidance as to what constitutes “bona-fide” market making activities. The proposing release states that the Market Maker Exception was meant “to facilitate customer orders in a fast moving market without possible delays with complying with the proposed ‘locate’ rule.” Short Sales, 68 Fed. Reg. 62972, 62977 (Nov. 6, 2003). It also notes that “most specialists and market makers seek a net ‘flat’ position in a security at the end of each day and often ‘offset’ short sales with purchases such that they are not required to make delivery under the security settlement system.” Id. The adopting release states that the Commission has specifically noted that bona-fide market making “does not include activity that is related to speculative selling strategies or investment purposes of the broker-dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in that security.” Short Sales, 69 Fed. Reg. 48008, 48015 (Aug. 6, 2004).

48. Market making must be in a security and reverse conversions, as a package of an equity security and two derivatives in that equity security (the put and call options), are not themselves securities. Similarly, assist transactions, as packages of an equity security and a derivative security (the FLEX put or FLEX call option), are not themselves securities.

#### **J. Wolfson**

49. J. Wolfson’s trading activities were not consistent with market making. Rather than engaging in bona-fide market making, J. Wolfson, from July 2006 through May 2007 as an individual and then through BMR 2, LLC (“BMR”), simply executed a trading strategy to sell reverse conversions to other market participants who wanted to use conversions to acquire a long position in the stock. Instead of having a net flat position, J. Wolfson’s trading records show that he maintained extended open short positions in the stocks he sold as part of reverse conversions. J. Wolfson’s reverse conversion and assist trades in certain threshold securities were disproportionate to his other patterns or practices in those securities. For example, on March 2, 2007, J. Wolfson provided an assist to Trader A by selling Trader A 2,220,000 shares of NYX. On the same date, J. Wolfson sold an additional 23,100 shares of NYX in nineteen lots of between 100 and 9,200 shares. Except for the 22,200 one-day FLEX put contracts used in the assist trade, J. Wolfson had no other option transactions in NYX on March 2. On March 9, 2007, J. Wolfson did a reverse conversion with a sale of 100,000 shares of AGIX. On the same date, J. Wolfson sold an additional 57,144 shares of AGIX in forty lots of between 31 and 5,000 shares. Except for the two sets of 500 paired put and call contracts used to offset the short sales in the reverse conversions, J. Wolfson had no other option activity in AGIX on March 9.

50. Indeed, J. Wolfson's clearing firm recognized that J. Wolfson's trading at times was out of proportion with other customers for which it cleared trades. In an email string from March 20-21, 2007, a vice president in the clearing firm's compliance department noted that the largest fail at the firm was 14 million shares in NYX and that J. Wolfson was responsible for approximately 6.8 million shares and Trader A was responsible for approximately 4.5 million shares. The head of compliance noted that the size of these fails was large even when compared to the clearing firm's larger options market makers.

51. J. Wolfson executed his reverse conversion and assist trades through a floor broker, who consistently called soliciting only the reversal. J. Wolfson rarely executed conversions in threshold securities.

52. Recorded telephone conversations with the floor broker concerning assists, where J. Wolfson provides only an offer to sell, together with J. Wolfson's trading records, show that J. Wolfson consistently executed the assist trades at a fixed and predetermined net price – \$0.03 – the profits realized after the sale of the stock, the sale or purchase of the FLEX option, and the exercise or assignment of the FLEX option. This price remained almost constant during the thirteen months during which J. Wolfson provided assists to other market participants, regardless of the equity being traded, and is inconsistent with the varied prices one would expect from bona fide market making activity given the varying costs to actually borrow threshold securities.

#### **Golden Anchor and R. Wolfson**

53. Like J. Wolfson, R. Wolfson's trading strategy, executed through Golden Anchor, was to sell reverse conversions in Golden Anchor's account to other market participants who wanted to use conversions to acquire a long position in the stock. Like J. Wolfson, R. Wolfson maintained extended open short positions in the stocks he sold short as part of reverse conversions. R. Wolfson's reverse conversion and assist trades in certain threshold securities were disproportionate to his other patterns or practices in those securities. For example, on June 6, 2007, R. Wolfson did two reverse conversions in NFI. These reverse conversions involved the sale of 20,000 and 30,000 shares respectively. These were R. Wolfson's only sales of NFI on June 6. On the same date, R. Wolfson purchased a total of 7,400 shares of NFI in fourteen lots of amounts ranging from 100 to 900 shares and a single lot of 2,500 shares. Other than the purchase of ten put contracts and ten call contracts, both with the same strike price, R. Wolfson had no option activity on June 6 in NFI except for the 200 and 300 paired put and call contracts used to offset the short sales in the reverse conversions.

54. R. Wolfson executed his reverse conversion and assist trades through a floor broker, the same floor broker used by J. Wolfson and Trader A, who consistently called soliciting the reversal. R. Wolfson rarely executed conversions in threshold securities.

55. Golden Anchor's trading records for R. Wolfson's account also show that he consistently executed the assist trades at a fixed and predetermined net price – \$0.03 – the profits realized after the sale of the stock, the sale or purchase of the FLEX option, and the exercise or assignment of the FLEX option. The price remained almost constant during the four months during which Golden Anchor provided assists to other market participants, regardless of the equity being traded, and is inconsistent with the varied prices one would expect from bona fide market making activity given the varying costs to actually borrow the threshold securities.

### **The Respondents Were Not Bona-Fide Market Makers Under Relevant Self-Regulatory Organization Rules**

56. In addition to the Reg. SHO requirements for bona-fide market making, the SROs where each of the Respondents traded – the CBOE for J. Wolfson and the Amex for R. Wolfson – had specific rules governing the conduct of market makers, including the requirement to be designated as a market maker in specific securities, executing a specified percentage of trades in person, entering two-sided quotes in certain series of designated options classes in trading systems and executing certain percentages of transactions within these options classes. While compliance with the SRO market maker rules is not dispositive as to whether an options trader was conducting bona-fide market making for the purposes of Reg. SHO, it can be viewed as an additional indicia of bona-fide market making.

#### **J. Wolfson**

57. J. Wolfson was not appointed as a market maker by the CBOE in the securities in which he executed reverse conversions and assists.

#### **Golden Anchor and R. Wolfson**

58. R. Wolfson was registered as an options trader in some of the stocks he sold as part of reverse conversion and assist transactions. However, the Amex reviewed R. Wolfson's 2007 activity and found that he failed to meet the Amex requirements, contained in Rule 958(g) ANTE, for his transactions to be considered registered options trader transactions. In both the first and second quarters of 2007, R. Wolfson failed to meet the in-person and contract volume requirements for trading in option classes to which he was assigned.

59. Since they were not engaged in bona-fide market making for their reverse conversion and assist trades in threshold securities, the Respondents were required to obtain locates pursuant to Rule 203(b)(1) of Reg. SHO, but they failed to do so.

### **The Respondents Evaded Their Close-out Obligation with Resets**

60. The Respondents' short sales in the reverse-conversions resulted in a "fail to deliver" position in the threshold security on the books and records of their clearing firm.

because the Respondents failed to locate shares prior to affecting their short sales, did not borrow shares subsequent to the short sale, made no attempt to acquire long shares and did not deliver to their clearing firm the shares they sold short so that the clearing firm could settle the trade. After receiving subsequent buy-in notices from their clearing firm, the Respondents continued to engage in resets until the expiration day of the original options in the original reverse conversion. By engaging in this course of conduct, the Respondents impermissibly maintained fail to deliver positions in numerous Reg. SHO threshold securities for extended periods of time.

### **J. Wolfson Reset His Fails**

61. J. Wolfson employed numerous reset transactions to evade the close-out requirement for several consecutive 13-day settlement periods. During the period from July 2006 to July 2007, J. Wolfson executed at least 184 reset trades to evade Reg. SHO's close-out requirement. Of these resets, at least ninety-seven, or 53%, were executed with Trader A or Golden Anchor as the counterparty for all or part of the trade.

### **J. Wolfson Also Reset Fails for Vintage Capital, LLC and Sallerson-Troob, LLC**

62. On October 19, 2006, Vintage Capital, LLC ("Vintage"), established a short position in Chipotle Mexican Grill, Inc. (NYSE: CMG/ option ticker: CMG), which was a threshold security, and a long position in another class of the same security – CMGB. J. Wolfson had identified an "arbitrage opportunity" where CMGB shares had ten voting rights and CMG had one voting right. J. Wolfson hedged the position he had in CMGB, acquired by tendering shares of McDonald's as part of its spinoff of CMG, by shorting shares of CMG without locating or borrowing shares. The "naked" short position in CMG, a threshold security, resulted in a failure to deliver position in a threshold security, which Rule 203(b)(3) required to be closed out. Vintage and Sallerson-Troob had similar positions in CMG and the same requirement to close out the failure to deliver.

63. Vintage's trading records show that from November 7, 2006 through July 26, 2007, Vintage executed eleven reset transactions to avoid its Reg. SHO obligation to close out its fail to deliver position in CMG and maintain its short position. Of the eleven CMG resets executed by Vintage during this period, J. Wolfson, Trader A or Golden Anchor were the counterparties on six of the trades.

64. J. Wolfson directed the resets for Vintage and arranged for himself and for Trader A to be on the assist side of Vintage's resets.

65. In a recorded telephone call on March 6, 2007, between J. Wolfson and the floor broker, J. Wolfson placed an order to buy 2,161 CMG for Vintage and said that J. Wolfson would sell it. In a March 28, 2007 instant message exchange, J. Wolfson and Trader A discussed Vintage's call about "a cmg reg sho" for 221,800 shares. J. Wolfson told Trader A that Trader A could sell it and that he should go through the same floor broker. Trading records for both Vintage and Trader A show that Trader A served as the

contraparty to Vintage's reset on March 28, 2007, which allowed Vintage to reset its failure to deliver position of 221,800 shares in CMG.

66. J. Wolfson also directed resets for Sallerson-Troob, LLC ("Sallerson-Troob"). On December 11, 2006, Sallerson-Troob established a short position in CMG of approximately 222,000 shares. From December 28, 2006 through June 15, 2007, Sallerson-Troob executed seven reset transactions to avoid its Reg. SHO obligations and maintain its short position. Of the seven CMG resets executed by Sallerson-Troob during this period, Trader A and Golden Anchor were the counterparties in four of the trades. J. Wolfson admitted to entering the orders for at least some of the seven resets.

#### **R. Wolfson Reset Golden Anchor's Fails**

67. Between March 27, 2007 and August 2, 2007, R. Wolfson executed at least forty-six resets to close out Golden Anchor's fails to deliver in threshold securities. A review of Golden Anchor's trading records and those of the other Respondents and others shows that J. Wolfson and Trader A were the counterparties in at least eleven, or 24%, of Golden Anchor's reset trades.

#### **The Resets Were Not Bona-Fide Purchase Transactions and the Respondents Knew or Had Reason to Know, Were Reckless in Not Knowing or Should Have Known the Resets Would Result in Fails to Deliver.**

68. The resets were not bona-fide purchase transactions. Instead, they were transactions specifically structured to tie the purchase to an option that assured the participants to the transaction that the shares purportedly "purchased" would be returned to the "seller" the very next day. In essence, these transactions were nothing more than a one-day borrow of stock and not bona-fide purchases at all.

69. In addition, the Respondents knew or had reason to know, were reckless in not knowing, or should have known that the purchase of securities in the reset transactions was from a market participant who would not deliver securities in settlement of the purchase.

70. These Respondents had direct knowledge that the reset transaction would not result in delivery of shares at settlement because they often took the assist side (collecting the same \$0.03 they would pay to reset) and knew that they were selling short in that transaction without purchasing or borrowing shares to cover the short sale. In addition, they also knew that they often transacted with each other and knew the others' strategy was also to sell short in the assist transaction without purchasing or borrowing shares to cover the short sale.

71. Additionally, the negative rebate on these hard to borrow securities varied and was often so high a counterparty with long shares that had a high negative rebated could loan the securities out and earn more than three cents. The Respondents knew or had reason to know, were reckless in not knowing, or should have known, that the seller of

shares was short without a borrow to cover, given that the assist was always priced out at net \$0.03.

72. Moreover, the pricing of the reset transactions reveals that they were nothing more than stock loans. The reset transactions consistently sold for a net cost to the resetting party of \$0.03 regardless of the price of the underlying stock or the option premium. As the floor broker noted in an interview with the staff, the stock trade was executed first, followed by the option so that the option premium and strike price could be set to net with the stock price to \$0.03. The reset trade was almost guaranteed to be a losing trade for the resetting party, and the \$0.03 was little more than a fee to borrow the shares for the term of the FLEX option.

**J. Wolfson Knew or Had Reason to Know, Was Reckless in Not Knowing, or Should Have Known That the Reset Would Result in a Fail to Deliver Position**

73. J. Wolfson's knowledge that the purchase legs of his resets would result in fail to deliver positions is also evident from recordings of telephone conversations. In recorded telephone conversations on March 20, 2007, with a high-level CBOE employee, J. Wolfson was informed that "the rule prohibits someone taking on a position where there is not an expectation of delivery," and that the legal position inside and outside the CBOE was that such transactions were prohibited and that he expected a circular from the CBOE to be forthcoming on the issue. J. Wolfson stated that if you are trading Reg. SHO securities on "every trade you make . . . you know you are not getting delivery . . . zero chance." In a recorded telephone conversation on April 2, 2007, with the managing member of Golden Anchor, J. Wolfson commented on the notion that in a close-out you must have reason to believe you are going to get delivery by stating "nobody in their right minds can expect delivery in any of these Reg. SHO stocks . . . especially, and I can name half a dozen, where it's impossible to get delivery." J. Wolfson, in a separate recorded telephone conversation later that same day noted that no one had reason to believe there would be delivery.

74. It was also apparent to the floor broker who handled most of J. Wolfson's trading in threshold securities that Wolfson had a good idea of what Trader A's and R. Wolfson's positions were and that J. Wolfson sometimes called in both sides of a reset and assist trade where Trader A and/or R. Wolfson were on the other side of J. Wolfson's trade.

75. J. Wolfson gave floor brokers orders for both sides of reset trades. During a December 18, 2006 telephone call, J. Wolfson provided a floor broker with an order for a reset transaction in NYX, 1,100 contracts with \$120 strike, and J. Wolfson confirmed that he was the buyer and Trader A was the seller. In the same discussion J. Wolfson submitted an order for a reset in MDTL, another threshold security, for the same parties. On March 14, 2007, J. Wolfson and R. Wolfson had a recorded telephone discussion about R. Wolfson beginning to trade through Golden Anchor. R. Wolfson told J. Wolfson that he wanted to do the other side of J. Wolfson's Reg. SHO trades to which J. Wolfson responded that Trader A did the other side of J. Wolfson's trades and he couldn't just pull all of the trades from Trader A. In a recorded call with a floor broker on April 3, 2007, J.

Wolfson submitted reset and assist trade orders for himself, Trader A and R. Wolfson with all three serving as the only parties on all sides to the trades.

76. During the period from July 2006 through July 2007, J. Wolfson executed at least 486 assist trades for total profits of approximately \$3,484,000.

#### **Golden Anchor and R. Wolfson**

77. Recordings of telephone conversations show that R. Wolfson knew or had reason to know, was reckless in not knowing, or should have known that he was taking the other side of a number of J. Wolfson's resets. On an April 2, 2007 telephone call, J. Wolfson told R. Wolfson to go to a floor broker's booth on the floor of the Amex to execute some trades. In another call just minutes later, the floor broker told J. Wolfson that R. Wolfson was standing right behind him and J. Wolfson gave the floor broker the order details, including a reset for Trader A's account. When the floor broker asked J. Wolfson if he should give most of the trades to R. Wolfson, J. Wolfson said to give all of them to R. Wolfson. Trading records confirm that R. Wolfson executed three assists with J. Wolfson that day. Profits to Golden Anchor from three trades were approximately \$50,000.

78. There were also at least two instances where R. Wolfson forwarded the Reg. SHO buy-in notice from his clearing firm via email to J. Wolfson. Trading records show that, in both instances, J. Wolfson took the other side of Golden Anchors's reset.

79. From March 26, 2007 through July 31, 2007, Golden Anchor executed at least 130 assist transactions for total profits of \$443,000 and J. Wolfson and/or Trader A were counterparties in at least thirty-six, or 28%, of these assists.

#### **E. VIOLATIONS**

##### **J. Wolfson**

80. As a result of the conduct described above, J. Wolfson willfully violated, and willfully aided and abetted and caused BMR's violations of, Rule 203(b)(1) of Reg. SHO, which required a locate to be obtained prior to the short sale of stock.

81. As a result of the conduct described above, J. Wolfson willfully violated, and willfully aided and abetted and caused BMR's, Vintage's and Sallerson-Troob's violations of, Rule 203(b)(3) of Reg. SHO, which prohibits firms from evading their close out obligations through sham transactions that merely give the appearance of closing a fail-to-deliver position.

##### **Golden Anchor and R. Wolfson**

82. As a result of the conduct described above, Golden Anchor willfully violated, and R. Wolfson willfully aided and abetted and caused Golden Anchor's

violations of Rule 203(b)(1) of Reg. SHO, which required a locate to be obtained prior to the short sale of stock.

83. As a result of the conduct described above, Golden Anchor willfully violated and R. Wolfson willfully aided and abetted and caused Golden Anchor's violations of Rule 203(b)(3) of Reg. SHO, which prohibits firms from evading their close out obligations through sham transactions that merely give the appearance of closing a fail-to-deliver position.

### III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act; and

C. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Exchange Act Regulation SHO and Rules 203(b)(1) and 203(b)(3) thereunder, whether Respondents should be ordered to pay disgorgement pursuant to Section 21C(e) of the Exchange Act and civil penalties pursuant to Section 21B(a) of the Exchange Act.

### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

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

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

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

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Chairman Watter  
Commissioner Paredes  
Commissioner Gallagher  
not participating*

SECURITIES EXCHANGE ACT OF 1934  
Release No. 67450 / July 17, 2012

ADMINISTRATIVE PROCEEDING  
File No. 3-14726

In the Matter of

JEFFREY A. WOLFSON,  
ROBERT A. WOLFSON, AND  
GOLDEN ANCHOR  
TRADING II, LLC (n/k/a  
BARABINO TRADING, LLC)

Respondents.

ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER PURSUANT  
TO SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934 AS  
TO ROBERT A. WOLFSON AND GOLDEN  
ANCHOR TRADING II, LLC (n/k/a  
BARABINO TRADING, LLC)

I.

On January 31, 2012, 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 Robert A. Wolfson ("R. Wolfson") and Golden Anchor Trading II, LLC (n/k/a Barabino Trading, LLC) ("Golden Anchor") (together "the Respondents").

II.

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

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### III.

On the basis of this Order and Respondents' Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of violations of the locate and close-out requirements of Regulation SHO of the Securities Exchange Act of 1934 ("Reg. SHO") by the Respondents, who, from March 2007 through July 2007, violated these requirements by taking advantage of an exemption to the locate rules to which they were not entitled and engaged in hundreds of transactions that caused large persistent fail to deliver positions in threshold securities generating over \$1.7 million in illicit trading revenue that, after direct costs, resulted in over \$700,000 in net illicit trading profits through their violative conduct.

2. The Commission adopted Reg. SHO in an effort to reduce fails to deliver and to address potentially abusive "naked" short selling. Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. In a "naked" short sale, the seller does not own, and does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver the securities to the buyer when delivery is due.

3. As stated in the Commission's proposing rule release for Reg. SHO, "[n]aked short selling can have a number of negative effects on the market, particularly when the fails to deliver persist for an extended period of time and result in a significantly large unfulfilled delivery obligation at the clearing agency where trades are settled. At times, the amount of fails to deliver may be greater than the total public float. In effect the naked short seller unilaterally converts a securities contract (which should settle in three days after the trade date) into an undated futures-type contract, which the buyer might not have agreed to or that would have been priced differently. The seller's failure to deliver securities may also adversely affect certain rights of the buyer . . . . More significantly, naked short sellers enjoy greater leverage than if they were required to borrow securities and deliver within a reasonable time period, and they may use this additional leverage to engage in trading activities that deliberately depress the price of a security." Short Sales, 68 Fed. Reg. 62972, 62975 (Nov. 6, 2003) (footnotes omitted).

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

4. A "threshold security," as defined in Rule 203(c)(6) of Reg. SHO, is an equity security that has an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency, totaling 10,000 shares or more, and equal to at least 0.5% of the issuer's total shares, and which is included on a list disseminated to its members by a self-regulatory organization.

5. Two provisions of Reg. SHO are applicable in this matter. First, Rule 203(b)(1) of Reg. SHO requires, subject to certain exceptions, market participants seeking to effect a short sale to borrow, arrange to borrow, or have reasonable grounds to believe that a security can be borrowed in time for delivery when due prior to effecting the short sale. This is known as the "locate requirement." Reg. SHO contains an exception from this locate requirement for certain market makers, with respect to transactions in connection with bona-fide market making activities in the security for which this exception is claimed (the "Market Maker Exception"). Thus, a market maker can execute a short sale in connection with bona-fide market making without first obtaining a locate.

6. Second, Rule 203(b)(3) requires that if a participant of a registered clearing agency (i.e., a clearing broker) has a fail to deliver position at a registered clearing agency in a threshold security for thirteen settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity (the so-called "close-out" requirement). This purchase has to be a "bona fide transaction," Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO (December 17, 2004), Question and Answer 5.7 (added May 24, 2005). Also Rule 203(b)(3)(vii) specifically excludes as an effective close-out an arrangement with another person to purchase securities when the participant with the fail to deliver position knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase.<sup>2</sup> A participant of a registered clearing agency may "allocate" a portion of its fail to deliver position to a broker-dealer for which it clears trades based on such broker-dealer's short position, in which case the obligation to close out is shifted to the broker-dealer. Once the fail to deliver position is allocated to the broker-dealer, all provisions of Rule 203(b)(3) relating to such fail to deliver position apply to that broker-dealer. This means that even a qualifying market maker who is entitled to avail himself of the Market Maker Exception to the locate requirement when he sells a stock short, has to eventually purchase that stock in a bona-fide transaction thirteen days later if his clearing firm has a fail to deliver position in the threshold security for thirteen settlement days and the clearing firm allocates the fail to deliver position to him.

7. The Respondents in this matter, who were not conducting bona-fide market making activities but were instead engaged in "naked" short sale transactions for their own investment purposes, improperly utilized the Market Maker Exception from Rule 203(b)(1) in order to avoid locating shares before effecting short sales as part of "reverse conversion" and "assist" transactions, as further described below. Because the Respondents failed to borrow or arrange to borrow securities to make delivery when delivery was due, the short sales as part of the reverse conversions and assists were "naked" short sales. The Respondents also violated Rule 203(b)(3) by repeatedly engaging in a series of violative transactions to ostensibly "reset" the thirteen-day clock for

<sup>2</sup> During the relevant period, this provision was denominated Rule 203(b)(3)(v).

complying with the close-out requirement, but without actually purchasing shares in a bona-fide transaction. These transactions enabled the Respondents to circumvent Reg. SHO, allowed them to generate hundreds of thousands of dollars in profits because they did not actually borrow or arrange to borrow the securities they were selling short, and caused their clearing broker to have large persistent fail to deliver positions in these threshold securities, thus undermining one important purpose of Reg. SHO.

8. These violations occurred as a result of the Respondents' routine practice of engaging in a combination of three types of transactions in threshold securities. The first type of transaction, known in the industry as a "reverse conversion" or "reversal," involves selling stock short while also selling a put option and buying a call option that each have the exact same expiration date and strike price. The option combination creates what is known as a "synthetic long position" that hedges the short stock sale. All three of these transactions are executed with the same counterparty – which is engaging in a "conversion." The position is "delta neutral" to any change in the underlying stock price because whether the equity price rises or falls, the position remains hedged until the options expire, when one option will expire worthless while the other will be exercised or assigned, causing the stock to be received by the original seller and closing the short position.

9. Reverse conversions are executed to meet a one-sided market demand for hard-to-borrow threshold securities. The buyers of the threshold securities, in this case large prime brokerage firms, engaged in the conversion transaction that allowed them to acquire a long stock position that is hedged by the synthetic short options position. The brokerage firm could then loan out the shares of the threshold securities and receive fees from the borrowers. Those loan fees can be quite significant when the stock is a threshold security, because threshold securities are generally hard to borrow and therefore command large fees in the stock loan market. Indeed, the borrow rate (referred to as a "negative rebate" because it is paid by the borrower to the lender) on a threshold security can be 50% or more of the stock's market price (on an annualized basis), as compared to a small positive rebate that a financial institution borrowing securities would receive from the lender to compensate for cash collateral it posts to the lender when a security is easy to borrow. In many cases, certain threshold securities could not be borrowed at all. Alternatively, if the shares could be borrowed, the price to borrow was often much higher than the price at which the Respondents were willing and able to transact in reverse conversions because they did not have and did not intend to actually buy or borrow the stock they were selling short.

10. As a result, the Respondents, who did not comply with the "locate" requirements of Rule 203(b)(1) before selling the stock and did not comply with the close out requirements of Rule 203(b)(3), were able to attract the business of prime brokerage firms seeking to create inventory for stock loans on hard to borrow securities.

11. The Respondents could afford to engage in these reverse conversion transactions at a much better price than their competitors who located the stock in compliance with Reg. SHO's requirements and incurred the costs associated with actually borrowing the security as required by Reg. SHO. Thus, the Respondents undercut the price for reverse conversions that was charged by

those who did not violate Reg. SHO by engaging in “naked” short selling. As a result, the Respondents made hundreds of thousands of dollars in illicit profit.

12. The second type of transaction the Respondents engaged in – referred to herein as a “reset” – was a transaction in which the Respondents purported to discharge their obligation to “purchase” the security and close out their short position. In a reset transaction, Golden Anchor had a close out obligation and purportedly “bought” shares of that security while simultaneously buying from the same counterparty a short-term, deep in-the-money<sup>3</sup> put option (a so-called “married put,” because the purchase of stock was paired with the put option) or sold a short-term, deep in-the-money call option (a so-called “buy write” because the buyer buys shares and “writes” – or sells – a call option). The reset transaction was more often than not priced at a net cost of \$0.03 per share to the purchaser of the stock. This ostensible purchase of shares married with the short-term deep in-the-money option created the illusion that Golden Anchor satisfied the close-out obligation of Reg. SHO Rule 203(b)(3) by “purchasing” shares. But because the purchase was married to a short-term deep in-the-money option that in fact negated the purchase and returned the shares to the counterparty the next day, it was not a bona-fide purchase transaction. R. Wolfson, trading with the knowledge of Golden Anchor, knew or had reason to know that the shares he apparently “purchased” in the reset transactions would be transferred back to the party that apparently “sold” them the day before when R. Wolfson either exercised the put or was assigned on the call.

13. R. Wolfson also knew or had reason to know that his counterparty was selling stock short without purchasing or borrowing to cover the short sale, so no shares would actually be delivered in the transaction. R. Wolfson, when “purchasing” the stock knew or had reason to know that because his counterparty on the reset would not deliver securities in settlement of purchase, there was no actual close out of the fail to deliver position. For all these reasons, R. Wolfson also knew that even if there was no failure to deliver, the one-day purchase of stock followed by its return the next day simply rolled Golden Anchor’s short position over for another thirteen settlement days. These transactions violated Rule 203(b)(3) of Reg. SHO.

14. The third type of transaction the Respondents engaged in was simply taking the other side of the reset transaction, referred to as the “assist.” Thus, the Respondents would assist with both their own and others’ reset transactions by selling shares short to the resetting party while simultaneously selling to the same counterparty a short-term, deep in-the-money put option or buying a short-term deep in-the-money call option. When the Respondents sold short as part of their assist transactions, they did not obtain a locate prior to the short sale, and thus each assist transaction also constituted a separate violation of Rule 203(b)(1). Because the Respondents routinely took both sides of these transactions designed to reset the thirteen day Reg. SHO clock, they understood that no shares ever changed hands.

15. During the period March 2007 through July 2007, the Respondents engaged in almost three hundred “reverse conversion,” “reset” and “assist” transactions in numerous threshold securities.

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<sup>3</sup> A put option is in-the-money if the stock price is below the strike price of the option. A call option is in-the-money if the stock price is above the strike price of the option.

16. During this period, R. Wolfson, trading with the knowledge of Golden Anchor, was not engaged in bona-fide market making activities in these securities. R. Wolfson failed to maintain regular or continuous two-sided quotations and did not hold himself out as being willing to buy and sell options in these securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. R. Wolfson did not abide by his Self-Regulatory Organization's ("SRO") requirements to be considered a market maker in the options of these securities. Moreover, while R. Wolfson sold over one hundred reverse conversions, he rarely purchased a conversion. Once R. Wolfson sold the reverse conversion, he did not trade out of the position but instead held onto the position (similar to any other investment transaction) until the maturity date of the underlying options, which was often several months. During this time, R. Wolfson maintained Golden Anchor's open short position through routine use of the reset transactions. The Respondents simply had no legitimate claim to avail themselves of the Market Maker Exception in the securities for which this exception was claimed when they sold short either in the reverse conversion or assist transactions.

17. These transactions caused significant amounts of persistent fails to deliver in threshold securities. By engaging in these unlawful transactions during the period March 2007 through July 2007, the Respondents earned \$1,761,762 in illicit trading revenue from reverse conversions and assists, and incurred \$96,947 in costs from the resets. After direct costs, the Respondents earned \$722,589 in net trading profits.

18. By virtue of its conduct, Golden Anchor willfully violated, and R. Wolfson willfully<sup>4</sup> aided and abetted and caused Golden Anchor's violations of Rules 203(b)(1) and 203(b)(3) of Reg. SHO.

### Respondents

19. *Robert A. Wolfson*, age 57, is a resident of South Egremont, Massachusetts. R. Wolfson was employed as a market maker by Golden Anchor from March 21, 2007 through December 31, 2007, where he traded his own account using capital provided by Golden Anchor with an agreement that he receive 50% of the profits generated from his trading.

20. *Golden Anchor Trading II, (n/k/a Barabino Trading, LLC)*, is a New York limited liability company with offices in New York, New York. From November 18, 1997 until May 25, 2009, Golden Anchor was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-50620).

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<sup>4</sup> 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)).

## Background

21. From March 2007 through July 2007, R. Wolfson, trading through Golden Anchor, engaged in "reverse conversions" and "assist" transactions in which he sold short certain threshold securities without locating the securities subject to the short sales. Golden Anchor was not entitled to rely on the Market Maker Exception to justify its failure to locate the threshold securities because these transactions were not part of bona-fide market making, as discussed further below. The Respondents also improperly engaged in a series of "reset" transactions that did not satisfy Golden Anchor's obligations to close out its fail-to-deliver positions. Through these transactions, the Respondents were able to profit from selling the reverse conversions in threshold securities to prime brokers at prices less than the prevailing rate (then very high) to borrow them. The Respondents were able to keep as profit the entire amount made on the "sale" of the reverse conversion less costs because they never intended to borrow or buy the securities to close out the short position created by the reverse conversion.

22. R. Wolfson learned threshold securities trading strategies from Trader A and began trading his own account at Golden Anchor in March 2007.

### **The Respondents Were Not Bona-Fide Market Makers under Reg. SHO**

23. The short sales executed by Robert Wolfson, with the knowledge of Golden Anchor, in the reverse conversion and the assist transactions were not in connection with bona-fide market making activities in the threshold security, so Golden Anchor was not eligible for the Market Maker Exception.

24. Section 3(a)(38) of the Exchange Act defines a market maker as a specialist or dealer who "holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." R. Wolfson, trading with the knowledge of Golden Anchor, failed to maintain regular or continuous two-sided quotations and did not hold himself out as being willing to buy and sell securities or options in the securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. Rather, the Respondents were engaging in reverse conversions and assists for their own investment purposes. R. Wolfson did not regularly or continuously disseminate two-sided quotes in the option classes he used in reverse conversions.

25. The proposing and adopting releases for Reg. SHO provide guidance as to what constitutes "bona-fide" market making activities. The proposing release states that the Market Maker Exception was meant "to facilitate customer orders in a fast moving market without possible delays with complying with the proposed 'locate' rule." Short Sales, 68 Fed. Reg. 62972, 62977 (Nov. 6, 2003). It also notes that "most specialists and market makers seek a net 'flat' position in a security at the end of each day and often 'offset' short sales with purchases such that they are not required to make delivery under the security settlement system." Id. The adopting release states that the Commission has specifically noted that bona-fide market making "does not include activity that is related to speculative selling strategies or investment purposes of the broker-

dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in that security.” Short Sales, 69 Fed. Reg. 48008, 48015 (Aug. 6, 2004).

26. The Respondents’ trading activities were not consistent with bona-fide market making. Rather than engaging in bona-fide market making, the Respondents, from March 2007 through July 2007, simply executed a trading strategy to sell reverse conversions to other market participants who wanted to use conversions to acquire a long position in the stock. Instead of having a net flat position, Golden Anchor’s trading records show that it maintained extended open short positions in the stocks R. Wolfson sold as part of reverse conversions. The Respondents’ reverse conversion and assist trades in certain threshold securities were disproportionate to their other patterns or practices in those securities.

27. The Respondents executed their reverse conversion and assist trades through a floor broker, who consistently called soliciting only the reversal. The Respondents rarely executed conversions in threshold securities.

28. Golden Anchor’s trading records, show that R. Wolfson consistently executed the violative assist trades at a net price (before related trading costs) of \$0.03, the profits realized after the sale of the stock, the sale or purchase of the FLEX option, and the exercise or assignment of the FLEX option. This price remained almost constant during the five months during which Golden Anchor provided assists to other market participants, regardless of the equity being traded, and is inconsistent with the varied prices one would expect from bona-fide market making activity given the varying costs to actually borrow threshold securities.

29. From March 23, 2007 through July 31, 2007, R. Wolfson, trading through Golden Anchor, executed at least 111 reverse conversions in threshold securities that resulted in approximately \$1,318,896 in revenue, before direct costs. During the same period, R. Wolfson, trading through Golden Anchor, executed at least 130 assist transactions for total revenue of \$442,866.

#### **Robert Wolfson, Trading through Golden Anchor, Was Not a Bona-Fide Market Maker under Relevant Self-Regulatory Organization Rules**

30. In addition to the Reg. SHO requirements for bona-fide market making, the SRO where the Respondents traded – the American Stock Exchange (“Amex”) – had specific rules governing the conduct of market makers, including the requirement to be appointed as a market maker in specific securities, executing a specified percentage of trades in person and executing certain percentages of transactions within these options classes.

31. While compliance with an SRO’s rules governing market makers is not dispositive as to whether R. Wolfson was conducting bona-fide market making for the purposes of Reg. SHO, it can be viewed as additional indicia of bona-fide market making. R. Wolfson was registered as an options trader in some of the stocks he sold as part of reverse conversion and assist transactions. However, the Amex reviewed R. Wolfson’s 2007 activity and found that he failed to meet the Amex requirements, contained in Rule 958(g) ANTE, for his transactions to be considered

registered options trader transactions. In both the first and second quarters of 2007, R. Wolfson failed to meet the in-person and contract volume requirements for trading in option classes to which he was assigned.

32. Since they were not engaged in bona-fide market making for their reverse conversion and assist trades in threshold securities, the Respondents were required to obtain locates pursuant to Rule 203(b)(1) of Reg. SHO, but they failed to do so.

#### **R. Wolfson Evaded Golden Anchor's Close-out Obligation with Resets**

33. Golden Anchor's short sales in the reverse-conversions resulted in a "fail to deliver" position in the threshold security at a registered clearing agency because the Respondents failed to locate shares prior to affecting their short sales, did not borrow shares subsequent to the short sale, made no attempt to acquire long shares and did not deliver to Golden Anchor's clearing firm the shares they sold short so that the clearing firm could settle the trade. After receiving subsequent buy-in notices from Golden Anchor's clearing firm, R. Wolfson continued to engage in resets until the expiration day of the original options in the original reverse conversion. By engaging in this course of conduct, the Respondents impermissibly maintained fail to deliver positions in numerous Reg. SHO threshold securities for extended periods of time.

34. Between March 27, 2007 and July 31, 2007, R. Wolfson executed at least forty-six resets to close out Golden Anchor's fails to deliver in threshold securities at a cost of \$96,947. A review of Golden Anchor's trading records and those of the other options traders shows that Trader A and Trader B were the counterparties in at least eleven, or 24%, of Golden Anchor's reset trades.

#### **The Resets Were Not Bona-Fide Purchase Transactions and the Respondents Knew or Had Reason to Know the Resets Would Result in Fails to Deliver.**

35. The resets were not bona-fide purchase transactions. Instead, they were transactions specifically structured to tie the purchase to an option that assured the participants to the transaction that the shares purportedly "purchased" would be returned to the "seller" the very next day.

36. In addition, R. Wolfson, trading with the knowledge of Golden Anchor, knew or had reason to know that the purchase of securities in the reset transactions was from a market participant who would not deliver securities in settlement of the purchase.

37. Recordings of telephone conversations show that R. Wolfson knew or had reason to know that he was taking the other side of a number of Trader A's resets.

38. Also, the negative rebate on these hard to borrow securities varied and was often so high a counterparty with long shares that had a high negative rebate could loan the securities out and earn more than three cents. The Respondents knew or had reason to know that the seller of shares was short without a borrow to cover, given that the assist was consistently priced out at net \$0.03 (before trading costs).

39. The Respondents knew or had reason to know that the reset transaction would not result in delivery of shares at settlement because they often took the assist side (collecting the same \$0.03 they would pay to reset) and knew that they were selling short in that transaction without purchasing or borrowing shares to cover the short sale. In addition, they also knew that they often transacted with other market participants, including Trader A and Trader B, and knew the others' strategy was also to sell short in the assist transaction without purchasing or borrowing shares to cover the short sale.

40. From March 26, 2007 through July 31, 2007, Golden Anchor executed at least 130 assist transactions and Trader A and/or Trader B were counterparties in at least thirty-six, or 28%, of these assists.

### Violations

#### **Golden Anchor Willfully Violated Rule 203(b)(1) of Reg. SHO and R. Wolfson Willfully Aided and Abetted and Caused Golden Anchor's Violations**

41. Pursuant to the locate requirement of Rule 203(b)(1) of Reg. SHO, a broker or dealer may not effect a short sale in an equity security unless it has "(i) [b]orrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) [r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) [d]ocumented compliance with [these requirements]."

42. Rule 203(b)(2)(iii) contains an exception to this locate requirement for short sales effected "by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed."

43. At the time R. Wolfson, with the knowledge of Golden Anchor, placed orders to sell short certain Reg. SHO threshold securities as part of the reverse conversion transactions and assist transactions described above, he failed to borrow, arrange to borrow, or locate the securities, claiming the Market Maker Exception to the locate requirement. The Market Maker Exception was not available to Golden Anchor, however, because it was not engaging in bona-fide market making activities in these securities.

44. As a result of the conduct described above, Golden Anchor willfully violated, and R. Wolfson willfully aided and abetted and caused Golden Anchor's violations of, Rule 203(b)(1) of Reg. SHO, which required a locate to be obtained prior to the short sale of stock.

**Golden Anchor Willfully Violated Rule 203(b)(3) of Reg. SHO and R. Wolfson Willfully Aided and Abetted and Caused Golden Anchor's Violations**

45. At the relevant time, Rule 203(b)(3) imposed an obligation on clearing firms to immediately close out any fail-to-deliver positions at a registered clearing agency in a threshold security that last for thirteen consecutive settlement days<sup>5</sup> by purchasing securities of like kind and quantity. Pursuant to Rule 203(b)(3)(vi), however, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer whose short sale resulted in the position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation to comply with the mandatory close out requirement shifts to that broker or dealer.

46. Once the fail-to-deliver position is allocated to the broker or dealer, that broker or dealer, in order to satisfy the close out requirement of Rule 203(b)(3) of Reg. SHO, must purchase securities of like kind and quantity. Borrowing securities, or otherwise entering into an arrangement that merely creates the appearance of a purchase, does not satisfy Reg. SHO's close out requirement.<sup>6</sup>

47. In addition, Rule 203 of Reg. SHO specifically prohibits firms from satisfying their close out obligations through transactions that merely give the appearance of closing out a fail-to-deliver position. Specifically, Rule 203(b)(3)(vii) provides that a clearing firm – or a broker or dealer to which the clearing firm allocated a fail-to-deliver position – will be deemed not to have satisfied the close out obligation if it enters into an arrangement with another person to purchase securities and the participant – or a broker or dealer to which the clearing firm allocated a fail-to-deliver position - knows or has reason to know that the other person will not deliver securities in settlement of the purchase.

48. By selling (or purchasing) deep in-the-money FLEX call (or put) options while simultaneously purporting to “purchase” stock, Golden Anchor engaged in transactions that gave the appearance that it was closing out its fail-to-deliver position when, in fact, it did not do so. In addition, Golden Anchor knew, or had reason to know, that the other person would not deliver securities in settlement of the purchase.

49. As a result of the conduct described above, Golden Anchor willfully violated, and R. Wolfson willfully aided and abetted and caused Golden Anchor's violations of, Rule 203(b)(3)

<sup>5</sup> In October 2008, the Commission adopted Rule 204T (which was made permanent as Rule 204 on July 27, 2009). Under Rule 204, clearing firms must close out fails-to-deliver on all securities (not just threshold securities) and must do so earlier than under Rule 203(b)(3). Clearing firms must now close out fail-to-deliver by either borrowing or purchasing sufficient shares before the beginning of trading hours on the first settlement day after the settlement date. Fails relating to long sales or bona-fide market making activity have two additional settlement days before they must be closed out.

<sup>6</sup> See *id.* Fail to deliver positions may be closed out under Rule 204 with either a purchase or a borrow. However, the purchase or borrow must be bona-fide. A clearing firm is not deemed to have fulfilled the close-out requirement where the clearing firm enters into an arrangement with another person to purchase or borrow securities, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow. Rule 204(f).

of Reg. SHO, which prohibits firms from evading their close out obligations through violative transactions that merely give the appearance of closing out a fail-to-deliver position.

#### Undertakings

Respondent R. Wolfson has undertaken to:

50. Provide the Commission, within thirty (30) days after the end of the four (4) month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

#### IV.

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

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

A. Respondents R. Wolfson and Golden Anchor cease and desist from committing or causing any violations and any future violations of Exchange Act Rules 203(b)(1) and 203(b)(3).

B. Respondent R. Wolfson be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in any offering of a penny stock, including acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, for a period of four (4) months, effective on the second Monday following the entry of this Order.

C. Respondents R. Wolfson and Golden Anchor shall together, on a joint and several basis, within ten (10) days of the entry of this Order, pay disgorgement of \$722,589, prejudgment interest of \$177,411 and civil penalties of \$200,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717 from the date of this Order through the date of payment.

Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request. Payment may also be made directly from a bank account or by credit or debit card via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>. Respondents may also pay by certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to: Enterprise Services Center, Accounts Receivable Branch, 6500 South MacArthur Boulevard, Oklahoma City, OK 73169; and shall be accompanied by a letter identifying the file number of these proceedings; Robert A. Wolfson

and/or Golden Anchor Trading II, LLC (n/k/a Barabino Trading, LLC) as a Respondent in these proceedings; and specifying that payment is made pursuant to this Order.

D. Respondent R. Wolfson shall comply with the undertakings enumerated in Section III, above.

E. Respondent Golden Anchor is censured.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

*Chairman Walter  
Commissioner Paredes  
Commissioner Gallagher  
not participating*

SECURITIES EXCHANGE ACT OF 1934  
Release No. 67451 / July 17, 2012

ADMINISTRATIVE PROCEEDING  
File No. 3-14726

In the Matter of

JEFFREY A. WOLFSON,  
ROBERT A. WOLFSON, AND  
GOLDEN ANCHOR  
TRADING II, LLC (n/k/a  
BARABINO TRADING, LLC)

Respondents.

ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER PURSUANT  
TO SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934 AS  
TO JEFFREY A. WOLFSON

I.

On January 31, 2012, 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 Jeffrey A. Wolfson ("Respondent" or "J. Wolfson").

II.

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

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### III.

On the basis of this Order and Respondent's Offer, the Commission finds<sup>1</sup> that:

#### Summary

1. These proceedings arise out of violations of the locate and close-out requirements of Regulation SHO of the Securities Exchange Act of 1934 ("Reg. SHO") by J. Wolfson, who as a sole proprietor, from July 2006 through May 7, 2007, and through his firm BMR 2, LLC ("BMR"), from May 8, 2007 through July 2007, violated these requirements by taking advantage of an exemption to the locate rules to which they were not entitled and engaged in hundreds of violative transactions that caused large persistent fail to deliver positions in threshold securities generating \$15.6 million in illicit trading profits that, after direct transaction costs, resulted in almost \$9 million in net illicit trading profits through his violative conduct.

2. The Commission adopted Reg. SHO in an effort to reduce fails to deliver and to address potentially abusive "naked" short selling. Fails to deliver occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. In a "naked" short sale, the seller does not own, and does not borrow or arrange to borrow the securities in time to make delivery to the buyer within the standard three-day settlement period. As a result, the seller fails to deliver the securities to the buyer when delivery is due.

3. As noted in the Commission's proposing rule release for Reg. SHO, "[n]aked short selling can have a number of negative effects on the market, particularly when the fails to deliver persist for an extended period of time and result in a significantly large unfulfilled delivery obligation at the clearing agency where trades are settled. At times, the amount of fails to deliver may be greater than the total public float. In effect the naked short seller unilaterally converts a securities contract (which should settle in three days after the trade date) into an undated futures-type contract, which the buyer might not have agreed to or that would have been priced differently. The seller's failure to deliver securities may also adversely affect certain rights of the buyer . . . . More significantly, naked short sellers enjoy greater leverage than if they were required to borrow securities and deliver within a reasonable time period, and they may use this additional leverage to engage in trading activities that deliberately depress the price of a security." Short Sales, 68 Fed. Reg. 62972, 62975 (Nov. 6, 2003) (footnotes omitted).

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

4. A "threshold security," as defined in Rule 203(c)(6) of Reg. SHO, is an equity security that has an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency, totaling 10,000 shares or more, equal to at least 0.5% of the issuer's total shares, and which is included on a list disseminated to its members by a self-regulatory organization.

5. Two provisions of Reg. SHO are applicable in this matter. First, Rule 203(b)(1) of Reg. SHO requires, subject to certain exceptions, market participants seeking to effect a short sale to borrow, arrange to borrow, or have reasonable grounds to believe that a security can be borrowed in time for delivery when due prior to effecting the short sale. This is known as the "locate requirement." Reg. SHO contains an exception from this locate requirement for certain market makers, with respect to transactions in connection with bona-fide market making activities in the security for which this exception is claimed (the "Market Maker Exception"). Thus, a market maker can execute a short sale in connection with bona-fide market making without first obtaining a locate.

6. Second, Rule 203(b)(3) requires that if a participant of a registered clearing agency (i.e., a clearing broker) has a fail to deliver position at a registered clearing agency in a threshold security for thirteen settlement days, the participant shall immediately thereafter close out the fail to deliver position by purchasing securities of like kind and quantity (the so-called "close-out" requirement). This purchase has to be a "bona fide transaction," Division of Market Regulation: Responses to Frequently Asked Questions Concerning Regulation SHO (December 17, 2004), Question and Answer 5.7 (added May 24, 2005). Also Rule 203(b)(3)(vii) specifically excludes as an effective close-out an arrangement with another person to purchase securities when the participant with the fail to deliver position knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase.<sup>2</sup> A participant of a registered clearing agency may "allocate" a portion of its fail to deliver position to a broker-dealer for which it clears trades based on such broker-dealer's short position, in which case the obligation to close out is shifted to the broker-dealer. Once the fail to deliver position is allocated to the broker-dealer, all provisions of Rule 203(b)(3) relating to such fail to deliver position apply to that broker-dealer. This means that even a qualifying market maker who is entitled to avail himself of the Market Maker Exception to the locate requirement when he sells a stock short, has to eventually purchase that stock in a bona-fide transaction thirteen days later if his clearing firm has a fail to deliver position in the threshold security for thirteen settlement days and the clearing firm allocates the fail to deliver position to him.

7. J. Wolfson, who was not conducting bona-fide market making activities but was instead engaged in "naked" short sale transactions for his personal investment purposes, improperly utilized the Market Maker Exception from Rule 203(b)(1) in order to avoid locating shares before effecting short sales as part of "reverse conversion" and "assist" transactions, as further described below. Because J. Wolfson failed to borrow or arrange to borrow securities to make delivery when delivery was due, the short sales as part of the reverse conversions and assists were "naked" short sales. J. Wolfson also violated Rule 203(b)(3) by repeatedly engaging in a series of violative transactions to ostensibly "reset" the thirteen-day clock for complying with the close-out

<sup>2</sup> During the relevant period, this provision was denominated Rule 203(b)(3)(v).

requirement, but without actually purchasing shares in a bona-fide transaction. These violative transactions enabled J. Wolfson to circumvent Reg. SHO, allowed him to generate millions of dollars in profits because he did not actually borrow or arrange to borrow the securities he was selling short, and caused his clearing broker to have large persistent fail to deliver positions in these threshold securities, thus undermining one important purpose of Reg. SHO.

8. These violations occurred as a result of J. Wolfson's routine practice of engaging in a combination of three types of transactions in threshold securities. The first type of transaction, known in the industry as a "reverse conversion" or "reversal," involves selling stock short while also selling a put option and buying a call option that each have the exact same expiration date and strike price. The option combination creates what is known as a "synthetic long position" that hedges the short stock sale. All three of these transactions are executed with the same counterparty – which is engaging in a "conversion." The position is "delta neutral" to any change in the underlying stock price because whether the equity price rises or falls, the position remains hedged until the options expire, when one option will expire worthless while the other will be exercised or assigned, causing the stock to be received by the original seller and closing the short position.

9. Reverse conversions are executed to meet a one-sided market demand for hard-to-borrow threshold securities. The buyers of the threshold securities, in this case large prime brokerage firms, engaged in the conversion transaction that allowed them to acquire a long stock position that is hedged by the synthetic short options position. The brokerage firm could then loan out the shares of the threshold securities and receive fees from the borrowers. Those loan fees can be quite significant when the stock is a threshold security, because threshold securities are generally hard to borrow and therefore command large fees in the stock loan market. Indeed, the borrow rate (referred to as a "negative rebate" because it is paid by the borrower to the lender) on a threshold security can be 50% or more of the stock's market price (on an annualized basis), as compared to a small positive rebate that a financial institution borrowing securities would receive from the lender to compensate for cash collateral it posts to the lender when a security is easy to borrow. In many cases, certain threshold securities could not be borrowed at all. Alternatively, if the shares could be borrowed, the price to borrow was often much higher than the price at which J. Wolfson was willing and able to transact in reverse conversions because he did not have and did not intend to actually buy or borrow the stock he was selling short.

10. As a result, J. Wolfson, who did not comply with the "locate" requirements of Rule 203(b)(1) before selling the stock and did not comply with the close out requirements of Rule 203(b)(3), was able to attract the business of prime brokerage firms seeking to create inventory for stock loans on hard to borrow securities.

11. J. Wolfson could afford to engage in these reverse conversion transactions at a much better price than his competitors who located the stock in compliance with Reg. SHO's requirements and incurred the costs associated with actually borrowing the security as required by Reg. SHO. Thus, J. Wolfson undercut the price for reverse conversions that was charged by those who did not violate Reg. SHO by engaging in "naked" short selling. As a result, J. Wolfson made millions of dollars in illicit profit.

12. The second type of transaction J. Wolfson engaged in – referred to herein as a “reset” – was a transaction in which J. Wolfson purported to discharge his obligation to “purchase” the security and close out his short position. In reality, it was a violative transaction. In a reset transaction, J. Wolfson had a close out obligation and purportedly “bought” shares of that security while simultaneously buying from the same counterparty a short-term, deep in-the-money<sup>3</sup> put option (a so-called “married put,” because the purchase of stock was paired with the put option) or sold a short-term, deep in-the-money call option (a so-called “buy write” because the buyer buys shares and “writes” – or sells – a call option). The violative reset transaction was more often than not priced at a net cost of \$0.03 per share to the purchaser of the stock. This ostensible purchase of shares married with the short-term deep in-the-money option created the illusion that J. Wolfson satisfied the close-out obligation of Reg. SHO Rule 203(b)(3) by “purchasing” shares. But because the purchase was married to a short-term deep in-the-money option that in fact negated the purchase and returned the shares to the counterparty the next day, it was not a bona-fide purchase transaction. J. Wolfson knew or had reason to know that the shares he apparently “purchased” in the reset transactions would be transferred back to the party that apparently “sold” them the day before when J. Wolfson either exercised the put or was assigned on the call.

13. J. Wolfson also knew or had reason to know that his counterparty was selling stock short without purchasing or borrowing to cover the short sale, so no shares would actually be delivered in the transaction. J. Wolfson, when “purchasing” the stock knew or had reason to know that because his counterparty on the reset would not deliver securities in settlement of purchase, there was no actual close out of the fail to deliver position. For all these reasons, J. Wolfson also knew that even if there was no failure to deliver, the one-day purchase of stock followed by its return the next day was a violative transaction that simply rolled his short position over for another thirteen settlement days. These transactions violated Rule 203(b)(3) of Reg. SHO.

14. The third type of transaction J. Wolfson engaged in was simply taking the other side of the reset transaction, referred to as the “assist.” Thus, J. Wolfson would assist with both his own and others’ reset transactions by selling shares short to the resetting party while simultaneously selling to the same counterparty a short-term, deep in-the-money put option or buying a short-term deep in-the-money call option. When J. Wolfson sold short as part of his assist transactions, he did not obtain a locate prior to the short sale, and thus each assist transaction also constituted a separate violation of Rule 203(b)(1). Because J. Wolfson routinely took both sides of these transactions designed to reset the thirteen day Reg. SHO clock, he understood that no shares ever changed hands. In fact, when engaging in resets, J. Wolfson traded with Trader A or with Trader B (who received instruction from J. Wolfson in how to trade threshold securities) at least 47% of the time.

15. J. Wolfson was the key participant in this violative activity and taught Trader A, and others how to do it. One benefit to J. Wolfson of doing so was to have Trader A and others as facilitators by taking the assist on the other side of his reset transactions.

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<sup>3</sup> A put option is in-the-money if the stock price is below the strike price of the option. A call option is in-the-money if the stock price is above the strike price of the option.

16. In fact, J. Wolfson often did directly arrange with Trader A and Trader B to violate Reg. SHO. J. Wolfson at times had authority to instruct brokers to place trades into Trader A's and Trader B's accounts. J. Wolfson often called in both sides of his reset transaction and instructed the broker to put assists in either Trader A's or Trader B's account (and sometimes both).

17. During the period July 2006 through July 2007, J. Wolfson routinely engaged in hundreds of "reverse conversion," "reset" and "assist" transactions in numerous threshold securities.

18. During this period, J. Wolfson was not engaged in bona-fide market making activities in these securities. J. Wolfson failed to maintain regular and continuous two-sided quotations and did not hold himself out as being willing to buy and sell options in these securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. J. Wolfson was not appointed by his Self-Regulatory Organization ("SRO") as a market maker in these threshold securities or in the options of these threshold securities and did not abide by the SRO's requirements to be considered a market maker in the options of these securities. Moreover, while J. Wolfson sold hundreds of reverse conversions, he rarely purchased a conversion. Once J. Wolfson sold the reverse conversion, he did not trade out of the position but instead held onto the position (similar to any other investment transaction) until the maturity date of the underlying options, which was often several months. During this time, J. Wolfson maintained his open short position through routine use of the reset transactions. J. Wolfson simply had no legitimate claim to avail himself of the Market Maker Exception activities in the securities for which this exception was claimed when he sold short either in the reverse conversion or assist transactions.

19. These transactions caused significant amounts of persistent fails to deliver in threshold securities. By engaging in these unlawful transactions during the period July 2006 through July 2007, J. Wolfson earned \$15,613,514 in illicit trading profits from reverse conversions and assists, and incurred \$643,962 in costs from the resets. After direct transaction costs, J. Wolfson earned \$8,771,432 in net trading profits.

20. By virtue of his conduct, J. Wolfson willfully<sup>4</sup> violated, aided and abetted and caused violations of Rules 203(b)(1) and 203(b)(3) of Reg. SHO.

#### Respondent

21. *Jeffrey A. Wolfson*, age 59, is a resident of Glencoe, Illinois. J. Wolfson, a sole proprietor, holds a Series 7 license and was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-37121) until May 8, 2007, when the assets and liabilities of the sole proprietorship were transferred to BMR 2, L.L.C. During the period January 1, 2005 through May 8, 2007, J. Wolfson was registered with the Chicago Board Options Exchange ("CBOE") as a market maker for Wol Corporation. J. Wolfson terminated his

<sup>4</sup> 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)).

affiliation with Wol effective May 8, 2007. J. Wolfson is currently a member and the majority owner of Broker-Dealer 1. J. Wolfson founded Pax Clearing Corporation which Merrill Lynch Professional Clearing Corp. acquired in April 2005.

### **Other Relevant Entity**

22. *BMR 2, L.L.C.*, was an Illinois limited liability company with an office in Chicago. BMR was a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act (File No. 8-37121) from at least May 8, 2007 until October 10, 2008. On May 8, 2007, BMR assumed all assets and liabilities of Jeffrey A. Wolfson, sole proprietor. From May 8, 2007 through March 3, 2008, BMR was a member of the CBOE. On September 11, 2009, BMR was dissolved.

### **Background**

23. From July 2006 through July 2007, J. Wolfson, as a sole proprietor and later through BMR, engaged in "reverse conversions" and "assist" transactions in which he sold short certain threshold securities without locating the securities subject to the short sales. J. Wolfson was not entitled to rely on the Market Maker Exception to justify his failure to locate the threshold securities because these transactions were not part of bona-fide market making, as discussed further below. J. Wolfson also improperly engaged in a series of violative "reset" transactions that did not satisfy his obligations to close out his fail-to-deliver positions. Through these transactions, J. Wolfson was able to profit from selling the reverse conversions in threshold securities to prime brokers at prices less than the prevailing rate (then very high) to borrow them. J. Wolfson was able to keep as profit the entire amount made on the "sale" of the reverse conversion because he never intended to borrow or buy the securities to close out the short position created by the reverse conversion.

### **J. Wolfson Begins Frequent Trading in Threshold Securities**

24. It was not until after J. Wolfson sold an "assist" transaction in Company A (and more assists after that) that he learned that others were using reset transactions (which he had been assisting) to close out their fails to deliver and began selling a large number of reversals in threshold securities. The reset enabled him to avoid the costs associated with borrowing or purchasing sufficient shares to make delivery on the short sale component of the reverse conversion. Thus, actually delivering on the short sale component of the reverse conversion was not part of J. Wolfson's strategy.

25. Moreover, J. Wolfson understood that he was making available shares, which he did not own or borrow, to prime brokers to use for loans via his reverse conversions.

26. Typically, in a reverse conversion, the cost to borrow stock is considered a carrying cost to the reverser – the party providing the conversion. However, J. Wolfson did not have to factor in the cost to borrow stock when he quoted conversions because he avoided such costs by not complying with Reg. SHO. As a result, J. Wolfson enjoyed a competitive advantage over others in the market who were complying with Reg. SHO.

27. J. Wolfson's trading records show that he began frequent trading in threshold securities beginning in July 2006 when he did five reverse conversions, one reset and sixteen assists. J. Wolfson's activity in threshold securities peaked in March 2007 when he did eighty-six reverse conversions, thirty resets and seventy-eight assists. Beginning in May 2007, J. Wolfson switched from trading as a sole proprietor to trading through BMR. By executing at least 380 reverse conversions, from July 2006 through July 2007, J. Wolfson generated approximately \$12,129,316 in illicit profits before direct transaction costs. During the same period, J. Wolfson executed at least 486 assist trades for total profits of approximately \$3,484,198, before direct transaction costs.

28. Beginning in late 2006, J. Wolfson began to teach others how to trade reverse conversions in threshold securities as well as resets and assists. J. Wolfson approached Trader B and asked if Trader B wanted to learn how J. Wolfson traded. J. Wolfson and Trader B discussed, among other things, how to do reverse conversions in threshold securities and J. Wolfson introduced Trader B to the use of reset transactions to close out his Reg. SHO fails.

29. J. Wolfson also shared his threshold securities trading strategies with, Trader A, who began trading in his own account at Broker-Dealer 2 in March 2007.

#### **J. Wolfson Was Not a Bona-Fide Market Maker under Reg. SHO**

30. The short sales executed by J. Wolfson in the reverse conversion and the assist transactions were not in connection with bona-fide market making activities in the threshold security, so he was not eligible for the Market Maker Exception.

31. Section 3(a)(38) of the Exchange Act defines a market maker as a specialist or dealer who "holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." J. Wolfson failed to maintain regular and continuous two-sided quotations and did not hold himself out as being willing to buy and sell securities or options in the securities on a regular or continuous basis by entering quotations in an inter-dealer communications system or by any other means. Rather, J. Wolfson was engaging in reverse conversions and assists for his own investment purposes. J. Wolfson did not regularly or continuously disseminate two-sided quotes in the option classes he used in reverse conversions.

32. The proposing and adopting releases for Reg. SHO provide guidance as to what constitutes "bona-fide" market making activities. The proposing release states that the Market Maker Exception was meant "to facilitate customer orders in a fast moving market without possible delays with complying with the proposed 'locate' rule." Short Sales, 68 Fed. Reg. 62972, 62977 (Nov. 6, 2003). It also notes that "most specialists and market makers seek a net 'flat' position in a security at the end of each day and often 'offset' short sales with purchases such that they are not required to make delivery under the security settlement system." Id. The adopting release states that the Commission has specifically noted that bona-fide market making "does not include activity that is related to speculative selling strategies or investment purposes of the broker-

dealer and is disproportionate to the usual market making patterns or practices of the broker-dealer in that security.” Short Sales, 69 Fed. Reg. 48008, 48015 (Aug. 6, 2004).

33. J. Wolfson’s trading activities were not consistent with bona-fide market making. Rather than engaging in bona-fide market making, J. Wolfson, from July 2006 through May 2007 as a sole proprietor and then through BMR, simply executed a trading strategy to sell reverse conversions to other market participants who wanted to use conversions to acquire a long position in the stock. Instead of having a net flat position, J. Wolfson’s trading records show that he maintained extended open short positions in the stocks he sold as part of reverse conversions. J. Wolfson’s reverse conversion and assist trades in certain threshold securities were disproportionate to his other patterns or practices in those securities.

34. J. Wolfson executed his reverse conversion and assist trades through a floor broker, who consistently called soliciting only the reversal. J. Wolfson rarely executed conversions in threshold securities.

35. Recorded telephone conversations with the floor broker concerning assists, together with J. Wolfson’s trading records, show that J. Wolfson consistently executed the violative assist trades at a net price (before related trading costs) of \$0.03, the profits realized after the sale of the stock, the sale or purchase of the FLEX option, and the exercise or assignment of the FLEX option. This price remained almost constant during the thirteen months during which J. Wolfson provided assists to other market participants, regardless of the equity being traded, and is inconsistent with the varied prices one would expect from bona-fide market making activity given the varying costs to actually borrow threshold securities.

#### **J. Wolfson Was Not a Bona-Fide Market Maker under Relevant Self-Regulatory Organization Rules**

36. In addition to the Reg. SHO requirements for bona-fide market making, the SRO where J. Wolfson traded – the CBOE – had specific rules governing the conduct of market makers, including the requirement to be appointed as a market maker in specific securities.

37. J. Wolfson was not appointed as a market maker by the CBOE in the securities in which he executed reverse conversions and assists. While compliance with the CBOE’s market maker rules is not dispositive as to whether J. Wolfson was conducting bona-fide market making for the purposes of Reg. SHO, it can be viewed as an additional indicia of bona-fide market making.

38. Since he was not engaged in bona-fide market making for the reverse conversion and assist trades in threshold securities, J. Wolfson was required to obtain locates pursuant to Rule 203(b)(1) of Reg. SHO, but he failed to do so.

## **J. Wolfson Evaded His Close-out Obligation with Resets**

39. J. Wolfson's short sales in the reverse-conversions resulted in a "fail to deliver" position in the threshold security at a registered clearing agency because he failed to locate shares prior to affecting his short sales, did not borrow shares subsequent to the short sale, made no attempt to acquire long shares and did not deliver to his clearing firm the shares he sold short so that the clearing firm could settle the trade. After receiving subsequent buy-in notices from his clearing firm, J. Wolfson continued to engage in resets until the expiration day of the original options in the original reverse conversion. By engaging in this course of conduct, J. Wolfson impermissibly maintained fail to deliver positions in numerous Reg. SHO threshold securities for extended periods of time.

40. J. Wolfson employed numerous reset transactions to evade the close-out requirement for several consecutive 13-day settlement periods. During the period from July 2006 to July 2007, at a cost of at least \$643,962, J. Wolfson, as a sole proprietor and then through BMR, executed at least 184 reset trades to evade Reg. SHO's close-out requirement. Of these resets, at least ninety-seven, or 53%, were executed with Trader B or Broker-Dealer 2 as the contraparty for all or part of the trade.

## **J. Wolfson Also Reset Fails for Broker-Dealer 3 and Broker-Dealer 1**

41. On October 19, 2006, Broker-Dealer 3, established a short position in Company B. The "naked" short position in Company B, a threshold security, resulted in a failure to deliver position in a threshold security, which Rule 203(b)(3) required to be closed out. Broker-Dealer 3 and Broker-Dealer 1 had similar positions in Company B and the same requirement to close out the failure to deliver.

42. Broker-Dealer 3's trading records show that from November 7, 2006 through July 26, 2007, Broker-Dealer 3 executed eleven reset transactions. J. Wolfson directed the resets for Broker-Dealer 3 and arranged for himself and for Trader B and Broker-Dealer 2 to be on the assist side of six of Broker Dealer 3's resets.

43. J. Wolfson also directed resets for Broker-Dealer 1. On December 11, 2006, Broker-Dealer 1 established a short position in Company B of approximately 222,000 shares. From December 28, 2006 through June 15, 2007, Broker-Dealer 1 executed seven reset transactions to avoid its Reg. SHO obligations and maintain its short position with Trader B and Broker-Dealer 2 as the counterparties in four of the trades. J. Wolfson entered the orders for at least some of the seven resets.

## **The Resets Were Not Bona-Fide Purchase Transactions and J. Wolfson Knew or Had Reason to Know the Resets Would Result in Fails to Deliver.**

44. The resets were not bona-fide purchase transactions. Instead, they were transactions specifically structured to tie the purchase to an option that assured the participants to

the transaction that the shares purportedly "purchased" would be returned to the "seller" the very next day.

45. In addition, J. Wolfson knew or had reason to know that the purchase of securities in the reset transactions was from a market participant who would not deliver securities in settlement of the purchase.

46. J. Wolfson's knowledge that the purchase legs of his resets would result in fail to deliver positions is also evident from recordings of telephone conversations.

47. It was also apparent to the floor broker who handled most of J. Wolfson's trading in threshold securities that J. Wolfson had a good idea of what Trader A's and Trader B's positions were and that J. Wolfson sometimes called in both sides of a reset and assist trade where Trader A and/or Trader B were on the other side of J. Wolfson's trade.

48. Additionally, the negative rebate on these hard to borrow securities varied and was often so high a counterparty with long shares that had a high negative rebate could loan the securities out and earn more than three cents. J. Wolfson knew or had reason to know that the seller of shares was short without a borrow to cover, given that the assist was consistently priced out at net \$0.03 (before trading costs).

49. J. Wolfson had direct knowledge that the reset transaction would not result in delivery of shares at settlement because he often took the assist side (collecting the same \$0.03 he would pay to reset) and knew that he was selling short in that transaction without purchasing or borrowing shares to cover the short sale. In addition, he also knew that he, Trader A and Trader B often transacted with each other and knew the others' strategy was also to sell short in the assist transaction without purchasing or borrowing shares to cover the short sale.

### Violations

#### **J. Wolfson Willfully Violated Rule 203(b)(1) of Reg. SHO and Willfully Aided and Abetted and Caused BMR's Violations**

50. Pursuant to the locate requirement of Rule 203(b)(1) of Reg. SHO, a broker or dealer may not effect a short sale in an equity security unless it has "(i) [b]orrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) [r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) [d]ocumented compliance with [these requirements]."

51. Rule 203(b)(2)(iii) contains an exception to this locate requirement for short sales effected "by a market maker in connection with bona-fide market making activities in the security for which this exception is claimed."

52. At the time J. Wolfson, in his own name and later through BMR, placed orders to sell short certain Reg. SHO threshold securities as part of the reverse conversion transactions and

assist transactions described above, he failed to borrow, arrange to borrow, or locate the securities, claiming the Market Maker Exception to the locate requirement. The Market Maker Exception was not available to either J. Wolfson or BMR, however, because they were not engaging in bona-fide market making activities in these securities.

53. As a result of the conduct described above, J. Wolfson willfully violated, and willfully aided and abetted and caused BMR's violations of, Rule 203(b)(1) of Reg. SHO, which required a locate to be obtained prior to the short sale of stock.

**J. Wolfson Willfully Violated Rule 203(b)(3) of Reg. SHO and Willfully Aided and Abetted and Caused BMR's, Broker-Dealer 2's and Broker-Dealer 3's Violations**

54. At the relevant time, Rule 203(b)(3) imposed an obligation on clearing firms to immediately close out any fail-to-deliver positions at a registered clearing agency in a threshold security that last for thirteen consecutive settlement days<sup>5</sup> by purchasing securities of like kind and quantity. Pursuant to Rule 203(b)(3)(vi), however, a clearing firm is permitted reasonably to allocate a fail-to-deliver position to a broker or dealer whose short sale resulted in the position. Once the clearing firm has allocated the fail-to-deliver position to another broker or dealer, the obligation to comply with the mandatory close out requirement shifts to that broker or dealer.

55. Once the fail-to-deliver position is allocated to the broker or dealer, that broker or dealer, in order to satisfy the close out requirement of Rule 203(b)(3) of Reg. SHO, must purchase securities of like kind and quantity. Borrowing securities, or otherwise entering into an arrangement that merely creates the appearance of a purchase, does not satisfy Reg. SHO's close out requirement.<sup>6</sup>

56. In addition, Rule 203 of Reg. SHO specifically prohibits firms from satisfying their close out obligations through violative transactions that merely give the appearance of closing out a fail-to-deliver position. Specifically, Rule 203(b)(3)(vii) provides that a clearing firm – or a broker or dealer to which the clearing firm allocated a fail-to-deliver position – will be deemed not to have satisfied the close out obligation if it enters into an arrangement with another person to purchase securities and the participant – or a broker or dealer to which the clearing firm allocated a fail-to-deliver position – knows, or has reason to know, that the other person will not deliver securities in settlement of the purchase.

<sup>5</sup> In October 2008, the Commission adopted Rule 204T (which was made permanent as Rule 204 on July 27, 2009). Under Rule 204, clearing firms must close out fails-to-deliver on all securities (not just threshold securities) and must do so earlier than under Rule 203(b)(3). Clearing firms must now close out fail-to-deliver by either borrowing or purchasing sufficient shares before the beginning of trading hours on the first settlement day after the settlement date. Fails relating to long sales or bona-fide market making activity have two additional settlement days before they must be closed out.

<sup>6</sup> See *id.* Fail to deliver positions may be closed out under Rule 204 with either a purchase or a borrow. However, the purchase or borrow must be bona-fide. A clearing firm is not deemed to have fulfilled the close-out requirement where the clearing firm enters into an arrangement with another person to purchase or borrow securities, and the participant knows or has reason to know that the other person will not deliver securities in settlement of the purchase or borrow. Rule 204(f).

57. By selling (or purchasing) deep in-the-money FLEX call (or put) options while simultaneously purporting to "purchase" stock, J. Wolfson, BMR, Broker-Dealer 1 and Broker-Dealer 3 engaged in violative transactions that gave the appearance that they were closing out their fail-to-deliver position when, in fact, they did not do so. In addition, J. Wolfson, BMR, Broker-Dealer 1 and Broker-Dealer 3 knew, or had reason to know, that the other person would not deliver securities in settlement of the purchase.

58. As a result of the conduct described above, J. Wolfson willfully violated, and willfully aided and abetted and caused BMR's, Broker-Dealer 1's and Broker-Dealer 3's violations of, Rule 203(b)(3) of Reg. SHO, which prohibits firms from evading their close out obligations through violative transactions that merely give the appearance of closing out a fail-to-deliver position.

#### Undertakings

Respondent has undertaken to:

59. Provide the Commission, within thirty (30) days after the end of the twelve (12) month suspension period described below, an affidavit that he has complied fully with the sanctions described in Section IV below.

60. Cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Respondent has undertaken:

- a. To produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Commission's staff;
- b. To be interviewed by the Commission's staff at such times as the staff reasonably may request and to appear and testify without service of a notice or subpoena in such investigations, litigations, hearings or trials as may be requested by the Commission's staff; and
- c. That in connection with any testimony of the Respondent to be conducted at deposition, hearing or trial pursuant to a notice or subpoena, agree that any such notice or subpoena for Respondent's appearance and testimony may be served by regular mail on: Ira Lee Sorkin, Esq., Lowenstein Sandler PC, 1251 Avenue of the Americas, New York, NY 10020.

#### IV.

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

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

A. Respondent cease and desist from committing or causing any violations and any future violations of Exchange Act Rules 203(b)(1) and 203(b)(3).

B. Respondent be, and hereby is suspended, from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and from participating in any offering of a penny stock, including acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, for a period of twelve (12) months, effective on the second Monday following the entry of this Order.

C. Respondent shall pay disgorgement of \$8,771,432, prejudgment interest of \$2,153,568 and civil penalties of \$2,500,000 to the United States Treasury. Payment shall be made in the following installments:

1. \$3,000,000 within 10 days of the entry of this Order;
2. \$1,325,000 within 30 days of the entry of this Order;
3. \$3,100,000 within 90 days of the entry of this Order;
4. \$2,000,000 within 180 days of the entry of this Order;
5. \$2,000,000 within 270 days of the entry of this Order;
6. \$2,000,000 within 360 days of the 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 disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717 from the date of this Order through the date of payment, shall be due and payable immediately, without further application.

Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request. Payment may also be made directly from a bank account or by credit or debit card via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>. Respondent may also pay by certified check, bank cashier's check, or United States postal money order payable to the Securities and Exchange Commission, which shall be delivered or mailed to: Enterprise Services Center, Accounts Receivable Branch, 6500 South MacArthur Boulevard, Oklahoma City, OK 73169; and shall be

accompanied by a letter identifying the file number of these proceedings; Jeffrey A. Wolfson as a Respondent in these proceedings; and specifying that payment is made pursuant to this Order.

D. Respondent shall comply with the undertaking enumerated in paragraph 59, above.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 68605 / January 9, 2013**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3436 / January 9, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15168**

\_\_\_\_\_ :  
**In the Matter of** :

**JOHN J. AESOPH, CPA, and** :  
**DARREN M. BENNETT, CPA** :

**Respondents.** :  
\_\_\_\_\_ :

**ORDER INSTITUTING PUBLIC**  
**ADMINISTRATIVE PROCEEDINGS**  
**PURSUANT TO SECTION 4C OF**  
**THE SECURITIES EXCHANGE**  
**ACT OF 1934 AND RULE 102(e) OF**  
**THE COMMISSION'S RULES OF**  
**PRACTICE**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against John J. Aesoph, CPA ("Aesoph") and Darren M. Bennett, CPA ("Bennett") pursuant to Section 4C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice to determine whether Aesoph and Bennett engaged in improper professional conduct.

**II.**

After an investigation, the Division of Enforcement and the Office of the Chief Accountant allege that:

**A. Summary**

1. Aesoph and Bennett (collectively, "the auditors") repeatedly engaged in improper professional conduct during their year-end 2008 audit of TierOne Corporation, a holding company for TierOne Bank (collectively "TierOne"). They did so by failing to subject TierOne's loan loss estimates – one of the highest risk areas of the audit – to appropriate scrutiny. Aesoph served as the audit partner and Bennett served as the senior manager on the engagement; they each had significant responsibility for the audit decisions, the inadequately designed and

implemented audit programs, the review of audit work papers, and the failures to follow audit standards that are the subject of this proceeding.

2. TierOne's loan losses were a critical audit area that warranted heightened scrutiny. Up to and during 2008, as a result of the financial crisis and related real estate market crash, TierOne had been experiencing a dramatic increase in the number of its troubled real estate loans. TierOne estimated its loan losses for a key component of its troubled loan portfolio – large, unique loans accounted for under Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 114 ("FAS 114") – by using the value of the collateral underlying these loans. Rather than get updated appraisals to value the collateral of the loans that TierOne evaluated for impairment under FAS 114 (called here "the bank's FAS 114 loans"<sup>1</sup>), TierOne frequently relied on stale, dated appraisals to which the bank's management sometimes applied a discount. TierOne's determination of the discount amounts, and its decisions not to apply a discount, were not documented, nor were they supported by reliable facts or evidence.

3. Aesoph and Bennett violated numerous Public Company Accounting Oversight Board ("PCAOB") audit standards in both their audit of internal control over financial reporting and their audit of the financial statements. The auditors correctly identified TierOne's loan losses as presenting a fraud risk and a significant risk of material misstatement. The actual audit test work in this area, however, was inadequate considering the associated audit risk and materiality. For example, the internal controls identified and tested by the audit engagement team relating to the allowance for loan and lease losses ("ALLL") did not effectively address one of the most important and riskiest components of the bank's loan loss calculations: management's use of stale and inadequate appraisals to value the collateral underlying the bank's FAS 114 loans. Based on this test work, Aesoph and Bennett had no reasonable basis to conclude that TierOne maintained, in all material respects, effective internal control over financial reporting. Moreover, the auditors failed to adequately identify and evaluate defects in the design and operating effectiveness of controls over collateral valuation that would have been important to the auditors' conclusion about whether TierOne's controls sufficiently addressed the assessed risk of misstatement. The auditors violated PCAOB standards, including specifically Auditing Standard No. 5 ("AS No. 5"), in their audit of internal control over financial reporting.

4. Compounding these flaws in the audit of internal control over financial reporting were Aesoph and Bennett's failures to comply with PCAOB standards in their substantive audit procedures over the bank's FAS 114 loans. The relevant audit work on these loans consisted of checking management's basic math, confirming that appraisals (no matter how stale) existed, reviewing a sample of appraisals, and relying on management's uncorroborated representations concerning property-specific issues, including whether stale appraisals required adjustment. These procedures fell short of the requirements of a number of PCAOB standards, including specifically AU Sections 328 and 342, which address auditing fair value and accounting estimates, respectively. In short, the auditors failed to subject management's estimates to appropriate scrutiny.

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<sup>1</sup> The specific loans at issue in this proceeding are listed on 2008 audit work papers L-22.2F, L-22.2H, L-32.1, L-32.2, and L-32.3.

5. Aesoph and Bennett failed to obtain sufficient, competent evidential matter to provide assurances that management's estimates were reasonable. They further failed to act with due professional care or appropriate professional skepticism.

6. These failures, along with others detailed below, demonstrate a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in which Aesoph and Bennett knew, or should have known, heightened scrutiny was warranted; and repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

#### **B. Respondents**

7. **John J. Aesoph**, CPA, age 40, is a resident of Omaha, Nebraska. Aesoph has been an auditor at KPMG, LLP ("KPMG") since 2001 and a partner at the firm since 2005. He was on the TierOne audit engagement from 2002 through KPMG's resignation in 2010, and was the engagement partner for the 2008 audit. Aesoph is currently licensed as a CPA in Nebraska and North Dakota. He has previously been licensed as a CPA in Idaho, Indiana, Iowa, Kansas, and South Dakota.

8. **Darren M. Bennett**, CPA, age 35, is a resident of Elkhorn, Nebraska. Bennett has been an auditor at KPMG since 2001. He worked on the TierOne audit each year from 2003 through KPMG's resignation in 2010, with the exception of one year. Bennett was the senior manager for the 2008 TierOne audit. Bennett was also a member of KPMG's financial services practice and served as manager or senior manager on at least four financial services audits in addition to TierOne. Bennett is licensed as a CPA in Nebraska, North Dakota, and South Dakota.

#### **C. Other Relevant Parties**

9. **TierOne Corporation**, a Wisconsin corporation, was, during the relevant time period, a holding company for TierOne Bank, a federally-chartered savings bank headquartered in Lincoln, Nebraska. TierOne's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act; that registration was revoked by consent on June 4, 2012. Prior to May 7, 2010, TierOne's shares were listed on the NasdaqGS exchange under the stock symbol "TONE." TierOne's common stock was thereafter quoted on OTC Pink, which is operated by OTC Markets Group Inc. On June 4, 2010, TierOne Bank was closed by its primary regulator, the United States Office of Thrift Supervision ("OTS"). The Federal Deposit Insurance Corporation ("FDIC") was named receiver and another bank took over TierOne's assets and deposit accounts. TierOne subsequently filed for Chapter 7 bankruptcy protection on June 24, 2010.

10. **KPMG LLP** is a limited liability partnership headquartered in New York, New York, engaged in the business of providing accounting and auditing services. KPMG audited TierOne's 2008 financial statements and internal control over financial reporting as of December 31, 2008 and issued unqualified opinions. KPMG also performed quarterly reviews for TierOne during the relevant time period.

#### **D. TierOne's Risky Problem Loan Portfolio**

11. TierOne was a century-old thrift bank that had historically focused on residential and agricultural loans in the Nebraska/Iowa/Kansas region. Beginning in about 2004, however, TierOne expanded into high-risk types of lending in regions such as Las Vegas, Florida, and Arizona, which were experiencing unusual, rapid escalation in market values. This strategy made the bank particularly vulnerable to the fallout from the financial crisis, as these areas were hardest hit by the precipitous fall in real estate prices, which began in late 2006 and early 2007.

12. Throughout 2008, TierOne was experiencing a dramatic rise in high-risk problem loans including land and land development and residential construction. Certain of these problem loans – typically larger and non-homogenous (*i.e.*, not car or residential mortgage loans) – were deemed “impaired” pursuant to FAS 114, meaning it was probable the bank would not recover all amounts as contractually due. TierOne’s reported FAS 114 impaired loan balance had increased from less than \$4 million as of December 31, 2006 to nearly \$186 million as of December 31, 2008.

13. In June 2008, the OTS conducted a “risk-focused examination” of the bank that focused on asset quality, credit administration, management, earnings, and the adequacy of ALLL. As a result of that examination, the OTS downgraded the bank’s composite CAMELS rating from a one (indicating a financial institution that was “sound in every respect”) to a four (indicating a financial institution with “serious financial or managerial deficiencies” that require close supervisory attention). The OTS provided the bank with a report that deemed the institution to be in troubled condition and board and management performance to be exceptionally poor. OTS concluded that TierOne had experienced a significant deterioration in asset quality due to eroding real estate values in Nevada and Florida, and that poor board and management oversight had exacerbated the problem. The OTS cited data demonstrating that real estate values were declining at unprecedented rates in states and markets where the bank had a concentration of loans. The OTS also directed TierOne to maintain higher minimum capital ratios. Failure to correct the problems identified by the OTS or to meet the heightened capital requirements would result in additional OTS enforcement action.

14. The bank’s FAS 114 loans had a negative effect on TierOne’s ability to meet the heightened capital requirements mandated by the OTS. Under Generally Accepted Accounting Principles (“GAAP”), TierOne was required to assess probable losses associated with its impaired loans and record those losses in its ALLL. GAAP permits the impairment to be measured using the fair value of the underlying collateral if the loan is collateral dependent, which is the method that was typically utilized by TierOne on its FAS 114 loans. As loan losses increased, the bank’s capital was further eroded, directly impacting the OTS capital requirements.

15. In order to assess loan losses for the bank’s FAS 114 loans, TierOne prepared loan-by-loan spreadsheets that contained estimates of collateral values and loan impairment determinations. TierOne generally based the valuation on the most recent appraisal in its loan files. If the appraisal was aged, as it typically was, TierOne would sometimes apply a discount to the appraised value. These discounts were determined by an informal committee at the bank. The

rationale for applying any particular discount – or for not discounting an appraisal at all – was not documented.

16. In the summer of 2009, when the OTS began its annual exam, the bank was forced to get a significant number of updated appraisals and to use those appraisals in its loan loss calculations. In the fall of 2009, TierOne disclosed over \$130 million in additional loan loss provisions. TierOne was shut down by bank regulators on June 4, 2010 and filed for bankruptcy later that month.

17. In April 2010, KPMG resigned as TierOne's auditor. KPMG withdrew its audit opinion relating to TierOne's 2008 financial statements on the basis that they were materially misstated with respect to certain out-of-period adjustments for loan loss reserves. KPMG also withdrew its opinion relating to TierOne's internal control over financial reporting as of the year-end 2008 due to a material weakness in internal control over financial reporting related to the material misstatements.

#### **E. The Auditors Recognized the Risks in TierOne's Problem Loan Portfolio**

18. Prior to and during their 2008 audit of TierOne, Aesoph and Bennett were aware of the risk and significance of the bank's loan loss provisions, and of the loan loss component related to the bank's FAS 114 loans specifically.

##### **1. The Auditors Identified ALLL Risks**

19. The bank's ALLL had two primary components: an allowance for loans impaired under FAS 114 and an allowance for loans impaired under Statement of Financial Accounting Standards No. 5 ("FAS 5"). The portion of the ALLL allocable to loans that TierOne evaluated for impairment under FAS 114 was individually material to the financial statements and presented a significant risk of material misstatement.

20. The audit planning document – reviewed and approved by both Aesoph and Bennett – identified the ALLL as a risk that could result in a material misstatement of TierOne's financial statements. Specifically, the audit plan noted that the ALLL presented a significant risk of material misstatement, both with respect to inherent risk and control risk, including the risk of fraud.

##### **2. Numerous Red Flags Further Underscored the Risks**

21. Compounding the identified risks were numerous red flags and other irregularities that should have triggered Aesoph and Bennett's professional skepticism and led them to investigate further.

###### **a. OTS Identified a Significant Understatement of the ALLL**

22. In connection with its June 2008 examination, the OTS identified a deficiency in TierOne's ALLL as of March 31, 2008 of between \$17 million and \$22 million, representing an approximate 25% increase over the previously reported ALLL. Aesoph and Bennett were aware of this deficiency: Bennett directly identified it in a memo he authored – and Aesoph reviewed –

that discussed the OTS report. Further, the June 2008 OTS report, discussed above in paragraph 13, was provided to KPMG and included in the auditors' work papers.

**b. Third-Party Market Data Showed Significant Declines in Real Estate Values That Were Not Reflected in TierOne's Valuations of its FAS 114 Loans**

23. As another red flag, TierOne's valuation adjustments on the collateral underlying the bank's FAS 114 loans were inconsistent with independent market data. Third-party market data indicated that real estate values were declining precipitously in many of the markets where the bank's FAS 114 collateral was located, including Las Vegas, Nevada and Phoenix, Arizona. At year-end 2008, TierOne had prepared spreadsheets analyzing more than fifty borrower relationships, totaling approximately \$255 million in loans, for evaluation for impairment under FAS 114. Approximately \$186 million of these loans were actually deemed impaired by the bank. The majority of the loans that the bank evaluated for impairment under FAS 114 were collateralized by property with appraisals more than a year old; over half of those stale appraisals were not discounted. Critically, when management did discount appraisals, those discounts were typically inconsistent with – and more favorable to the bank than – the declines indicated by the independent market data.

**c. Management Typically Did Not Get Updated Appraisals**

24. Further, despite the market declines, TierOne management often did not get updated appraisals on the collateral underlying the bank's FAS 114 loans. This failure came despite the fact that the OTS and members of the audit engagement team noted stale appraisals and recommended that appraisals be updated.

**d. New Appraisals Obtained Throughout 2008 Indicated Management Overestimated Collateral Values and Understated Loss Provisions**

25. In the limited instances where TierOne did get updated appraisals or valuations on the bank's FAS 114 loans during 2008, the collateral value typically showed a significant decline from the amount used by management in the immediately preceding quarter. Appraisals received throughout 2008 showed that management's estimates were inflated by twenty to almost fifty percent in the prior quarter. The magnitude of the quarter-to-quarter declines could not be explained by market conditions alone.<sup>2</sup> In addition to the updated appraisals showing differences in value from the immediately-preceding quarter, some of those appraisals revealed tremendous drops in the value TierOne had used at year end 2007.<sup>3</sup>

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<sup>2</sup> New appraisals or valuations were received on several of the bank's FAS 114 loans, including: Storybook Homes; Rising Sun; Grand Teton; Quarter 10; Stetson Ridge; La Madre 48; Rome 24; Clearwater Estates; Equestrian Meadow; HD Tbella; and HDB, LLC.

<sup>3</sup> TierOne received new appraisals on several loans that had been booked as FAS 114 loans at year-end 2007, including: Storybook Homes, Clearwater Estates, Grand Teton, and Rising Sun.

26. When considered in conjunction with management's reluctance to obtain new appraisals, these sharp declines in collateral values should have raised significant questions about management's motivations.

**e. Stale Appraisals Were Not Discounted Despite TierOne's Internal Policy**

27. During the 2008 audit, the auditors reviewed a memorandum that was prepared by TierOne and annotated by the audit engagement team that assessed the adequacy of the fourth quarter 2008 ALLL balance. That memorandum stated that, for Nevada land and residential construction loans, TierOne "tries to estimate collateral value declines in real estate by discounting appraised values, which are older than six months." Despite this stated policy, TierOne often failed to discount Nevada appraisals that were more than six months old.

**f. TierOne's Unallocated Loan Loss Reserve Decreased at Year End**

28. TierOne designated a portion of its ALLL as an "unallocated" reserve which was intended to cover loan losses inherent in TierOne's loan portfolio, including particularly loans in Nevada. However, despite the fact that market conditions continued to deteriorate throughout 2008, TierOne's unallocated reserve decreased significantly at year end. The unallocated reserve dropped from approximately \$7 million in the second and third quarters to approximately \$4 million at year end. This decrease was particularly troubling given that during its year end audit, the audit engagement team relied on the unallocated reserve to absorb potential errors in TierOne's calculation of its ALLL or to justify not performing additional audit work. These conclusions by the audit engagement team were reviewed by Aesoph and Bennett.

**g. Management Failed to Document Their Discounting Decisions**

29. As a final red flag to the auditors, TierOne did not document the rationale and basis for management's assumptions regarding valuation of the collateral underlying the bank's FAS 114 loans, despite the guidance in Financial Reporting Release ("FRR") No. 28. *See also* Staff Accounting Bulletin No. 102 ("SAB 102").

**3. TierOne's FAS 114 Loans Were Material**

30. In addition to these red flags, the portion of the ALLL related to the bank's FAS 114 loans was material. PCAOB auditing standards recognize that financial statements are materially misstated when they contain misstatements whose effect, individually or in the aggregate, is important enough to cause the financial statements not to be presented fairly, in all material respects, in conformity with generally accepted accounting principles. AU § 312, ¶ 4.

31. The portion of the ALLL related to the bank's FAS 114 loans was material to the financial statements taken as a whole. It far exceeded the \$1.9 million materiality threshold established for the 2008 audit. It was reasonably possible that even a relatively small change in the value of the bank's FAS 114 loans would cause a material error in the financial statements.

32. The portion of the ALLL related to the bank's FAS 114 loans was material for additional reasons. For example:

a. Any additional loan losses discovered by the audit engagement team would have pushed the bank closer to falling below the OTS-mandated 8.5% core capital ratio and 11% risk-based capital ratio. TierOne's core and risk-based capital ratios at December 31, 2008 were 8.9% and 11.6%, respectively.

b. The bank's loan losses factored significantly into TierOne's overall operating results and profitability. The bank's net interest income after provision for loan losses was only \$2.9 million at year end 2008, meaning a small increase in loan losses would change a reported net income to a reported net loss. Further, the trend in this net interest income figure was in precipitous decline, decreasing from \$119.8 million at year end 2006 to \$48 million at year end 2007 to \$2.9 million at year end 2008.

c. TierOne itself acknowledged the importance of its ALLL, including its FAS 114 loans, devoting several pages in its 2008 Form 10-K to a discussion of problem loans and the ALLL. Indeed, the 10-K expressly stated that "[a]n inadequate allowance for loan losses could adversely affect our results of operations."

33. Given the risk and materiality of the ALLL related to the bank's FAS 114 loans, and the many red flags, Aesoph and Bennett had heightened responsibilities in auditing this area, and were required to apply professional skepticism in obtaining sufficient competent evidential matter to support their opinions. They failed in these responsibilities.

#### **F. Aesoph and Bennett's Improper Professional Conduct**

34. The Commission's Rules allow the Commission to censure or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way certain professionals who violate "applicable professional standards." 17 C.F.R. § 201.102(e). For auditors of issuers such as TierOne, the applicable professional standards include standards issued by the PCAOB.

##### **1. General Standards**

35. The PCAOB's three general standards of auditing require that an auditor (1) have adequate technical training and proficiency, (2) maintain an independent mental attitude, and (3) act with due professional care in the performance of the audit. AU § 150, ¶ 2. The three basic standards of field work require the auditor to (1) adequately plan and properly supervise the audit, (2) obtain a sufficient understanding of internal control to plan the audit, and (3) obtain sufficient competent evidential matter to afford a reasonable basis for an opinion. AU § 150, ¶ 2.

36. "Due professional care imposes a responsibility upon each professional within an independent auditor's organization to observe the standards of field work and reporting." AU § 230, ¶ 2. The concept of due professional care includes acting with reasonable diligence. AU § 230, ¶ 3. It also includes exercising professional skepticism. AU § 230, ¶ 7. "Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence." AU § 230, ¶ 7. "The auditor neither assumes that management is dishonest nor assumes unquestioned honesty. In exercising professional skepticism, the auditor should not be satisfied with less than persuasive evidence because of a belief that management is honest." AU § 230, ¶ 9.

37. Auditors are required to obtain “sufficient competent evidential matter” to afford a reasonable basis for the auditor’s opinions. AU § 326, ¶ 1; *see also* AU § 230, ¶ 11 (“The independent auditor’s objective is to obtain sufficient competent evidential matter to provide him or her with a reasonable basis for forming an opinion.”). “Gathering and objectively evaluating audit evidence requires the auditor to consider the competency and sufficiency of the evidence.” AU § 230, ¶ 8. PCAOB standards attach greater validity to evidential matter obtained directly by the auditors, and to evidential matter obtained from independent sources outside an entity. AU § 326, ¶ 21. Representations from management, while part of the evidential matter the auditor obtains, “are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit.” AU § 333, ¶ 2.

38. Further, audit procedures, and the amount and persuasiveness of evidence auditors are required to obtain, are driven by risk. “Audit risk and materiality, among other matters, need to be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.” AU § 312, ¶ 1; *see also* AU § 312, ¶ 12 (“The auditor should consider audit risk and materiality both in (a) planning the audit and designing auditing procedures and (b) evaluating whether the financial statements taken as a whole are presented fairly, in all material respects, in conformity with generally accepted accounting principles. The auditor should consider audit risk and materiality in the first circumstance to obtain sufficient competent evidential matter on which to properly evaluate the financial statements in the second circumstance.”). When auditors identify a significant risk of material misstatement, as they did here, that fact is relevant to the nature and extent of the audit procedures to be applied. AU § 312, ¶ 17. “Higher risk may cause the auditor to expand the extent of procedures applied, apply procedures closer to or as of year-end, particularly in critical audit areas, or modify the nature of procedures to obtain more persuasive evidence.” AU § 312, ¶ 17.

39. Aesoph, as the engagement partner, was responsible for the audit engagement and its performance, for proper supervision of the work of the engagement team members, and for compliance with PCAOB standards. Aesoph sought and received the assistance of Bennett, who was the senior manager on the 2008 TierOne audit, in fulfilling his responsibilities as engagement partner.

40. Bennett contributed significantly to the planning of the audit, the design of tests of controls, and the design and implementation of substantive procedures. Additionally, Bennett was responsible for executing the audit, including directing the audit engagement team on how to conduct the audit. Bennett reviewed the audit work papers and was responsible for on-site supervision of the audit engagement team. Bennett also played a significant role in gathering and evaluating evidential matter to support the audit of ALLL, and specifically the valuation of collateral underlying the bank’s FAS 114 loans. Bennett, like Aesoph, was responsible for compliance with PCAOB standards with respect to the supervisory responsibilities that were assigned to him.<sup>4</sup>

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<sup>4</sup> *See, e.g., In the Matter of Robert M. Harbrecht, CPA and Brian R. Spires, CPA*, Rel. No. 34-56469, AAE Rel. No. 2720 (Sept. 19, 2007) (experienced senior manager who was responsible,

41. At the completion of the audit, both Aesoph and Bennett signed off that “all necessary auditing procedures were completed,” that “support for conclusions was obtained,” and that “sufficient appropriate audit evidence was obtained.” Further, Aesoph specifically signed off on the audit checklist’s requirement that the audit engagement team had “performed and documented its work in compliance with . . . applicable auditing standards . . . , and the working papers demonstrate this compliance.”

42. As detailed below, Aesoph and Bennett’s conduct in planning, supervising, and implementing KPMG’s audit of TierOne’s 2008 financial statements – and specifically the portions of the audit relating to the bank’s FAS 114 loans – violated numerous PCAOB standards. Most prominently, the auditors violated the requirements of AS No. 5 regarding audits of internal control over financial reporting, and AU Sections 328 (auditing fair value measurements) and 342 (auditing accounting estimates) related to the substantive audit procedures. Aesoph and Bennett also violated: the third general audit standard (due professional care), *see* AU § 150, ¶ 2; and the third standard of field work (obtaining sufficient competent evidential matter), *see* AU § 150, ¶ 2; AS No. 3; and AU §§ 230, 312, 316, 319, 326, 333, and 561.

## **2. The Audit of TierOne’s Internal Controls Violated Professional Standards**

43. KPMG performed an integrated audit of TierOne, meaning that the audit of TierOne’s internal control over financial reporting was integrated with the audit of TierOne’s financial statements. When an auditor assesses control risk below the maximum level, as the auditors did here, he or she should obtain sufficient evidential matter to support that assessed level. AU § 319, ¶¶ 80, 90. Moreover, if one or more material weaknesses exist, the company’s internal control over financial reporting cannot be considered effective. AS No. 5, ¶ 2. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company’s annual or interim financial statements will not be prevented or detected on a timely basis. AS No. 5, Appendix A, ¶ A7.

44. AS No. 5 provides specific requirements for auditing internal control over financial reporting in an integrated audit, including that the auditors should understand likely sources of potential misstatements and focus more of their attention on the areas of highest risk. But the key ALLL control that the audit engagement team identified (the bank’s Asset Classification Committee) did not effectively address the riskiest component of the ALLL: the bank’s valuation of collateral for the bank’s FAS 114 loans with stale appraisals. In addition, the audit engagement team failed to identify or test any effective internal controls to determine whether TierOne was complying with its own policies for updating appraisals. The auditors therefore violated AS No. 5, and further lacked a reasonable basis for KPMG’s conclusion that there were no material weaknesses in TierOne’s internal control over financial reporting.

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along with partner, for planning and executing audit sanctioned pursuant to Rule 102(e) for violations of PCAOB standards).

**a. Relevant PCAOB Standards**

45. In an integrated audit, an auditor should design tests of controls to obtain sufficient evidence both to support his or her opinion on internal control over financial reporting and to support his or her control risk assessments for the purpose of the audit of the financial statements. AS No. 5, ¶ 7.

46. Auditors also should determine and understand the likely sources of potential misstatements. One of the ways to do so is “by asking himself or herself ‘what could go wrong?’ within a given significant account or disclosure.” AS No. 5, ¶¶ 28-31.

47. To further understand the likely sources of potential misstatements, and as part of selecting the controls to test, the auditor should understand the flow of transactions related to the relevant assertions, identify points within the company’s processes at which a misstatement could arise that would be material, and identify the controls that management has implemented to address these potential misstatements. AS No. 5, ¶ 34.

48. Performing a “walkthrough” is often the most effective way to understand likely sources of potential misstatements and identify the appropriate controls to test. AS No. 5, ¶ 37. Walkthroughs require the auditor to “follow[ ] a transaction from origination through the company’s processes . . . until it is reflected in the company’s financial records, using the same documents and information technology that company personnel use.” AS No. 5, ¶ 37.

49. The selection of the controls to test, and the evidence needed to evaluate a given control, are driven by the auditors’ risk assessment. AS No. 5, ¶ 10. “The auditor should focus more of his or her attention on the areas of highest risk,” taking into consideration the risks such as the risk of fraud with respect to significant management estimates. AS No. 5, ¶¶ 11, 14. Further, the level of evidence needed increases as the risk associated with the control increases. AS No. 5, ¶¶ 46-47.

50. Some types of tests, by their nature, produce greater evidence of the effectiveness of controls than other tests. AS No. 5, ¶ 50. PCAOB standards include a hierarchy of tests. Inquiry, which ordinarily produces the lowest level of evidence, is never alone sufficient to support a conclusion about the effectiveness of a control. AS No. 5, ¶¶ 45, 50.

51. If there are deficiencies in a company’s internal control over financial reporting that, individually or in combination, result in one or more material weaknesses, the auditor “must express an adverse opinion on the company’s internal control over financial reporting, unless there is a restriction on the scope of the engagement.” AS No. 5, ¶ 90.

52. Aesoph and Bennett’s internal control test work did not comply with the foregoing PCAOB standards.

**b. Failure to Identify Effective Controls over the Valuation of the Collateral for the Bank’s FAS 114 Loans**

53. Aesoph and Bennett both reviewed and approved key audit work papers involving the evaluation and testing of TierOne’s internal controls over the ALLL. These work papers

identified seventeen key controls over TierOne's loan process. The audit engagement team used the work of TierOne's internal audit department to provide evidence on many of these controls, but determined to independently test five key controls "due to the fraud risk and/or the high risk of failure associated with the controls." Each of these five controls purported to address some aspect of TierOne's problem loans. None, however, effectively addressed TierOne's valuation of the collateral underlying the bank's FAS 114 loans.

54. The key control identified for prevention of a material misstatement of the ALLL was TierOne's Asset Classification Committee review. However, while the audit work papers do identify that the Asset Classification Committee had general responsibility for the ALLL, there is no reference to whether or how the Committee assessed the value of the collateral underlying individual loans evaluated under FAS 114, including any necessary adjustments to appraised values. The Asset Classification Committee meeting minutes included in the work papers contain no discussion about discounting stale appraisals or otherwise estimating the value of collateral.

55. The Asset Classification Committee was not an effective control over valuation of the collateral underlying the bank's FAS 114 loans. The Committee did not generate or review written documentation to support TierOne's calculations, including, specifically, documentation of the rationale and basis for management's assumptions regarding valuation of collateral. Without such documentation, there was insufficient evidence upon which to conclude that the bank's internal controls related to valuation of collateral were effective. *See* FRR No. 28; *see also* SAB 102.

56. The other controls independently tested during the audit also failed to address TierOne's valuation of collateral underlying the bank's FAS 114 loans. Further, the "walkthrough" described in the audit work papers, which was specifically reviewed by Bennett, was insufficient to provide a sufficient understanding of the valuation process or to identify important points at which a necessary control in the process was missing or was not designed effectively. *See* AS No. 5, ¶¶ 37, 38.

**c. Failure to Identify or Test Controls Relating to Compliance with TierOne's Appraisal Policies**

57. TierOne's written lending policy required all loans to be supported by "current appraisals or evaluations." The policy noted that "[i]n a rapidly escalating or deteriorating market, a value may be valid for only a few months." The policy also stated that new appraisals should be obtained when a loan was renewed, extended, or refinanced if market deterioration indicated that the collateral may no longer fully protect the loan.

58. While TierOne's lending policy may have been sound, it was not in and of itself a control. The auditors failed to identify any control to ensure compliance with this policy. In fact, TierOne frequently ignored or violated this policy, continuing to rely on stale appraisals in significantly deteriorated markets. TierOne also failed to obtain new appraisals on loans that had been modified.

**d. The Absence of These Controls Was a Material Weakness**

59. PCAOB audit standards define a material weakness as a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. AS No. 5, Appx. A, ¶ 7. Whether a deficiency or combination of deficiencies rises to the level of a material weakness depends on the severity of the deficiencies. AS No. 5, ¶¶ 62-63. The absence of effective controls over the valuation of collateral underlying the bank's FAS 114 loans and over compliance with TierOne's appraisal renewal policy, individually or in combination, represented a material weakness in TierOne's internal control over financial reporting as of December 31, 2008. Because of the material weakness in internal control, KPMG should have issued an adverse opinion on the bank's internal control over financial reporting. Further, the auditors' inappropriate conclusion that controls were effective led to an unsupported – and incorrect – conclusion that, for purposes of the financial statement audit, the risk of significant misstatement with respect to the ALLL was only moderate.

**3. Substantive Testing of the Bank's FAS 114 Loans Violated Professional Standards**

60. Adding to the failures in connection with auditing TierOne's internal control over ALLL were Aesoph and Bennett's deficient substantive audit procedures. Specifically, the audit engagement team failed to follow PCAOB standards in reviewing the reasonableness of management's estimates of the value of the collateral underlying the bank's FAS 114 loans – one of the riskiest and most critical elements of the bank's FAS 114 loss estimate calculation. The audit engagement team relied principally on the most recent (and often stale) appraisals given them and on management's uncorroborated representations of current value. The audit engagement team relied on these representations despite evidence that management's estimates were biased and inconsistent with independent market data. Bennett was directly involved in the audit engagement team's FAS 114 test work. Specifically: Bennett initially reviewed the individual spreadsheets prepared by TierOne that purported to justify the valuation of the underlying collateral of the bank's FAS 114 loans; Bennett supervised the audit test work and collection of evidential matter, including meeting directly with management to discuss management's estimates of the value of collateral; and Bennett approved the audit engagement team's FAS 114 test work prior to passing it to Aesoph. Aesoph reviewed the FAS 114 test work prior to signing the audit opinion. By failing to subject management's estimates to appropriate scrutiny, the auditors violated PCAOB standards, including particularly AU Sections 328 and 342, which address auditing fair value and accounting estimates, respectively. The auditors failed to obtain sufficient, competent evidential matter to provide assurances that management's estimates were reasonable. They further failed to act with due professional care or appropriate professional skepticism.

**a. Relevant PCAOB Standards**

61. TierOne's calculation of the appropriate loss reserve on the bank's FAS 114 loans, which was based largely on an assessment of the value of the underlying collateral, was an estimate. As such, the auditors' responsibility was to obtain sufficient competent evidence to

provide reasonable assurance that the estimates were reasonable and presented in conformity with the relevant accounting principles. AU §§ 328, ¶ 3; 342, ¶ 7.

62. In evaluating reasonableness, the auditor should obtain an understanding of how management developed the estimate. Based on that understanding, the auditor should use one or a combination of the following approaches: (1) review and test the process used by management to develop the estimate; (2) develop an independent expectation of the estimate to corroborate the reasonableness of management's estimate; or (3) review subsequent events or transactions occurring prior to the date of the auditor's report. AU § 342, ¶ 10; *see also* AU 328, ¶ 23.

63. Where management's estimate is based on a valuation, such as an appraisal, that was made prior to the financial reporting date, the following is an example of a consideration in the development of audit procedures: "obtain[ing] evidence that management has taken into account the effect of events, transactions, and changes in circumstances occurring between the date of the fair value measurement and the reporting date." AU § 328, ¶ 25; *see also* AU § 313, ¶ 3 ("Applying principal substantive tests to the details of an asset or liability account as of an interim date rather than as of the balance-sheet date potentially increases the risk that misstatements that may exist at the balance-sheet date will not be detected by the auditor."), ¶ 6 ("The auditor should consider whether there are rapidly changing business conditions or circumstances that might predispose management to misstate financial statements in the remaining period. If such conditions or circumstances are present, the auditor might conclude that the substantive tests to cover the remaining period would not be effective in controlling the incremental audit risk associated with them. In those situations, the asset and liability accounts affected should ordinarily be examined as of the balance-sheet date.").

64. Importantly, because estimates were involved, the auditors were required to be particularly attuned to management bias – intentional or not. Among other things, auditors normally should consider "the historical experience of the entity in making past estimates." AU § 342, ¶ 9. "Even when management's estimation process involves competent personnel using relevant and reliable data, there is potential for bias in the subjective factors. Accordingly, when planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both the subjective and objective factors" management used in making the estimates. AU § 342, ¶ 4.

65. Further, as the auditors had correctly identified TierOne's ALLL as presenting a risk of fraud and a high risk of error, the auditors had a heightened responsibility over this area. AU § 312, ¶ 17 ("Higher risk may cause the auditor to expand the extent of procedures applied, apply procedures closer to or as of year end, particularly in critical audit areas, or modify the nature of procedures to obtain more persuasive evidence."); AU § 316, ¶ 2 ("[T]he auditor's response to the risks of material misstatement due to fraud involves the application of professional skepticism when gathering and evaluating audit evidence.").

Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risk of material misstatement due to fraud. Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. In exercising professional skepticism in gathering and evaluating evidence, the auditor should not be satisfied with less-than-persuasive evidence because of a belief that management is honest.

AU § 316, ¶ 13.

66. The risk of material misstatement generally increases where, as here, the relevant account is an estimate. AU § 312, ¶ 36. While estimates may differ, an unreasonable estimate should be considered a likely misstatement. AU § 312, ¶ 36. The auditor should also consider whether differences in management's estimates and estimates best supported by the audit evidence suggest possible management bias. AU § 312, ¶ 36.

67. While representations from management are a part of the audit evidence, "they are not a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit." AU § 333, ¶ 2. This is particularly true in an area, like the ALLL, involving estimates. AU § 316, ¶ 54 ("In addressing an identified risk of material misstatement due to fraud involving accounting estimates, the auditor may want to supplement the audit evidence otherwise obtained ...."). It is even more critical where the audit area involves a risk of fraud. AU § 316, ¶ 46 ("Examples of the application of professional skepticism in response to the risks of material misstatement due to fraud are ... obtaining additional corroboration of management's explanations or representations concerning material matters, such as through third-party confirmation, the use of a specialist, analytical procedures, examination of documentation from independent sources, or inquiries of others within or outside the entity."); AU 316 ¶ 53 (example of modification of procedures in response to identified risks of material misstatement due to fraud include "[i]nterviewing personnel involved in activities in areas where a risk of material misstatement due to fraud has been identified to obtain their insights about the risk and how controls address the risk"); AU § 326, ¶ 21 ("When evidential matter can be obtained from independent sources outside an entity, it provides greater assurance of reliability for the purposes of an independent audit than that secured solely within the entity .... The independent auditor's direct personal knowledge, obtained through physical examination, observation, computation, and inspection, is more persuasive than information obtained indirectly.").

68. The auditor should be thorough in his or her search for evidential matter and unbiased in its evaluation. AU § 326, ¶ 25; *see also id.* ("In developing his or her opinion, the auditor should consider relevant evidential matter regardless of whether it appears to corroborate or to contradict the assertions in the financial statements."). The inability to obtain sufficient

competent evidential matter may require the auditor to qualify his or her opinion or to disclaim an opinion. See AU § 508, ¶ 22.

69. Finally, auditors are required to clearly document the work they perform. See AS No. 3. "Audit documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached." AS No. 3, ¶ 4. "The auditor must document the procedures performed, evidence obtained, and conclusions reached with respect to relevant financial statement assertions." AS No. 3, ¶ 6. "Audit documentation must clearly demonstrate that the work was in fact performed." AS No. 3, ¶ 6. "Because audit documentation is the written record that provides the support for the representations in the auditor's report, it should," among other things, "[d]emonstrate that the engagement complied with the standards of the PCAOB." AS No. 3, ¶ 5.

70. Aesoph and Bennett's substantive audit procedures fell short of these standards.

**b. Improper Professional Conduct**

71. TierOne estimated the value of the collateral underlying the bank's FAS 114 loans on a loan-by-loan basis because the bank's FAS 114 portfolio was made up of large, non-homogenous loans. Therefore, the audit engagement team performed a loan-by-loan review of the bank's FAS 114 loan portfolio to test whether management's estimates of value were reasonable. However, the substantive audit procedures and the evidence obtained from those procedures were insufficient to meet PCAOB standards.

**i. Failure to Test Management's Estimates of Collateral Value**

72. The audit engagement team obtained and reviewed each of the more than fifty FAS 114 spreadsheets prepared by the bank. Most of the audit work was simply "ticking and tying": recalculating figures, agreeing charge off amounts, and tying reported appraisal values to the actual appraisals.

73. The audit engagement team did, however, obtain a sample of original appraisals from management for additional testing. Specifically, the audit engagement team assumed that appraisals less than a year old were "current" (regardless of the market). For appraisals older than a year, they inquired whether a discount was applied to the appraised value, and if not, they inquired why TierOne didn't think it was necessary or appropriate. In addition, Bennett and members of the audit engagement team discussed with management a sample of FAS 114 calculations and recent trends, and "leveraged" information from certain loan reviews.<sup>5</sup> Following this test work, Bennett also reviewed and discussed the bank's FAS 114 spreadsheets with Aesoph to ensure that Aesoph was satisfied with the audit engagement team's conclusions. Based on the entirety of these procedures, the auditors concluded that "the FAS 114 calculations

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<sup>5</sup> Although the auditors may have "leveraged" the aspects of the loan reviews that arguably supported their conclusions as to the reasonableness of management's valuations of certain of the bank's FAS 114 loans, they ignored information in those same loan reviews that contradicted management's valuation assessment.

appear to be properly prepared and adequately supported at 12/31/08." Aesoph and Bennett lacked a reasonable basis for this conclusion.

74. Aesoph and Bennett relied on an unsupported – and unsupported – assumption that appraisals less than a year old were “current,” without regard to the property’s location or stage of development, and that market conditions had not materially deteriorated throughout the year. Many of the markets in which TierOne’s collateral was located were seeing significant continuing quarterly declines in the value of real estate. In addition, many of the properties that served as collateral were under development and in varying stages of completion. TierOne’s lending policy cautioned against relying on aged appraisals in these markets. According to the policy, “[i]n a rapidly escalating or deteriorating market, a[n appraisal] value may be valid for only a few months.” Despite this policy, Aesoph and Bennett arbitrarily assumed that only appraisals older than a year potentially needed adjusting.

75. This assumption that appraisals up to a year old were current was unsupported by any evidence and particularly troubling in the Nevada market. As noted above, TierOne’s memorandum prepared to support its ALLL balance – a memo annotated by the audit engagement team, included in the audit work papers, and reviewed by Aesoph and Bennett – noted that the bank would estimate collateral for Nevada real estate by discounting appraisals older than six months, acknowledging that six month old appraisals in that market were not reflective of current market conditions. Even so, the bank failed to discount many Nevada appraisals that were more than six months old and Aesoph and Bennett failed to reconcile the inconsistency between the bank’s stated practice and its actual practice.

76. In addition, the test work over management’s valuation estimates was insufficient. Again, according to its audit program, the audit engagement team would “inquire” of management whether discounts had been applied to older appraisals, and if not, why not. But uncorroborated management representations are not sufficient evidence in a high risk audit area.

77. Further calling into question the auditors’ work, the auditors relied on management’s uncorroborated representations even though independent evidence indicated that management’s estimating and discounting decisions were biased. As noted above, earlier in 2008, the OTS had determined that TierOne had underreported its ALLL by nearly 25%. And the few times TierOne obtained a new appraisal on an impaired loan throughout 2008, that new appraisal typically showed that TierOne’s valuation in the immediately preceding quarter was seriously deficient. In addition, TierOne’s discount decisions and amounts were often significantly different on properties in the same market, and were typically inconsistent with third-party market information. Further, the rationale for TierOne’s discounting decisions was not documented. Despite these red flags, the auditors continued to rely on management’s representations regarding management’s appraisal discounting decisions, without performing any additional test work or obtaining independent corroboration of management’s representations.

78. Auditors are required to document their work, including the procedures performed and the evidence obtained. Based upon the documentation in the audit work papers, including the audit programs, memoranda, and individual FAS 114 loan analyses, the audit engagement team obtained little if any reliable or persuasive evidence with respect to management’s adjustments (or lack thereof) to stale appraised values. The little that is documented shows that

Bennett and the audit engagement team made various inquiries of management and accepted management's representations. There is little to no documentation of management's representations with respect to specific properties, or of the auditors performing any rigorous testing or independent corroboration of management's discounting decisions. The audit documentation does not demonstrate that the engagement complied with the standards of the PCAOB.

**ii. Failure to Corroborate Additional Information**

79. In addition to appraisal information, TierOne's FAS 114 worksheets sporadically contained references to other information in support of management's estimates of the fair value of the collateral. This information included, for example, asking prices, borrower development plans and status, estimated costs to complete, offers to purchase, and other information. The auditors failed to obtain independent corroboration of any of this information.

**4. The Auditors' Failure to Recognize Bias in Management's Estimates Violated Professional Standards**

80. Exacerbating Aesoph and Bennett's failures surrounding the reasonableness of management's loan loss estimates on its FAS 114 loans was their failure to recognize bias in those same estimates.

**a. Relevant PCAOB Standards**

81. As noted above, auditors normally should consider "the historical experience of the entity in making past estimates." AU § 342, ¶ 9. Relatedly, "[t]he auditor also should perform a retrospective review of significant accounting estimates reflected in the financial statements of the prior year to determine whether management judgments and assumptions relating to the estimates indicate a possible bias on the part of management." AU § 316, ¶ 64. "With the benefit of hindsight, a retrospective review should provide the auditor with additional information about whether there may be a possible bias on the part of management in making the current-year estimates." AU § 316, ¶ 64.

**b. Improper Professional Conduct**

82. Consistent with PCAOB standards, KPMG's audit program required the auditors to assess management bias. The auditors claimed to do so, noting in the audit completion document that

[t]he Company's historical ability to reliably develop significant estimates has been adequate. We have considered current events as they relate to prior quarters and years during our audit procedures and noted there was no indication of bias on management's part in developing their estimates.

83. This conclusion was inconsistent with the OTS' findings in June 2008 about management's numerous failures to develop reliable estimates. It was also inconsistent with evidence of management bias that surfaced throughout 2008. As discussed above, Aesoph and Bennett knew that the OTS identified a deficiency in TierOne's ALLL that represented

approximately 25% of the ALLL balance at the time. Further, as discussed above, Aesoph and Bennett knew, or should have known, that the limited instances in which the bank actually obtained new appraisals on impaired loans resulted in significant declines in the value of the collateral both compared to the previous quarter and, in some cases, compared to the values used in the prior year. In many cases, these new appraisals resulted in significant increases in the loan loss provisions associated with these loans. Despite this evidence, the auditors improperly concluded that the bank's estimation process was "adequate" and that there was "no indication of bias on management's part."

**5. The Failure to Investigate Subsequent Discovery of Facts Violated Professional Standards**

84. Finally, the auditors failed to investigate facts discovered after the date of their report on the 2008 financial statements that may have affected the 2008 financial statements.

**a. Relevant PCAOB Standards**

85. PCAOB audit standards set out a number of steps that should be taken by an auditor who, "subsequent to the date of the report upon audited financial statements, becomes aware that facts may have existed at that date which might have affected the report had he or she then been aware of such facts." AU § 561, ¶ 1. As an initial matter, "[w]hen the auditor becomes aware of information which relates to financial statements previously reported on by him, but which was not known to him at the date of his report, and which is of such a nature and from such a source that he would have investigated it had it come to his attention during the course of his audit, he should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of his report." AU § 561, ¶ 4. If in fact the information is reliable and existed at the date of the report, other steps may be required. AU § 561, ¶¶ 5-8. "Subsequent events affecting the realization of assets . . . ordinarily will require adjustment of the financial statements . . ." AU § 560, ¶ 7.

**b. Improper Professional Conduct**

86. During KPMG's 2009 quarterly reviews, the engagement team learned of several borrower relationships that had new appraisals or valuations that likely existed at the date of KPMG's 2008 audit report, issued on March 12, 2009. In each case, that new valuation showed a significant decline from management's estimate at year end.<sup>6</sup>

87. Despite learning that there were new appraisals and valuation assessments which were dated prior to the issuance of the 2008 audit report, Aesoph and Bennett failed to perform the procedures required by AU § 561. Rather, Aesoph and Bennett assumed they had no reason to investigate because, they claim, they received representations from management shortly before issuing their audit opinion that no new appraisals had been received that impacted the 2008 financial statements. This is, however, precisely what should have triggered AU § 561: new

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<sup>6</sup> The specific loans included: Celebrate 50, MME, Ashley Turner, Stratton Group, Blake Home Builders, and Den Mark Construction.

information came to light after the audit report was issued that was inconsistent with previous information and, for that matter, management's purported representations that all new appraisals had been given to KPMG. Aesoph and Bennett had an obligation to investigate, but failed to do so.

#### **G. Violations**

88. As described in detail above, Aesoph and Bennett violated numerous PCAOB audit standards, failed to obtain sufficient competent evidential matter to support their audit conclusions, and failed to exercise due professional care and appropriate professional skepticism.

89. Specifically, Aesoph and Bennett violated: the third general audit standard (due professional care), *see* AU § 150, ¶ 2; the third standard of field work (competent evidential matter), *see* AU § 150, ¶ 2; AS Nos. 3 and 5; and AU §§ 230, 312, 316, 319, 326, 328, 333, 342, and 561.

90. Aesoph and Bennett engaged in improper professional conduct, as defined in Section 4C of the Exchange Act and Rule 102(e)(1)(ii), in that their conduct constituted negligent conduct consisting of (1) a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards in which Aesoph and Bennett knew, or should have known, that heightened scrutiny was warranted, or (2) repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

### **III.**

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

A. Whether the allegations set forth in Section II hereof are true and to afford Respondents Aesoph and Bennett an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate against Respondents Aesoph and Bennett pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, including, but not limited to, censure or denying, temporarily or permanently, the privilege of appearing or practicing before the Commission.

### **IV.**

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

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

If Respondents Aesoph or Bennett fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against the Respondents 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 upon the Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68591 / January 4, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3435 / January 4, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-13977

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In the Matter of  
Kenneth J. Abod, CPA

: ORDER GRANTING APPLICATION FOR  
: REINSTATEMENT TO APPEAR AND PRACTICE  
: BEFORE THE COMMISSION AS AN ACCOUNTANT  
: RESPONSIBLE FOR THE PREPARATION OR  
: REVIEW OF FINANCIAL STATEMENTS REQUIRED  
: TO BE FILED WITH THE COMMISSION

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On July 23, 2010, Kenneth J. Abod, CPA ("Abod") 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 Abod pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.<sup>1</sup> This order is issued in response to Abod's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission found that Abod failed to comply with Generally Accepted Accounting Principles ("GAAP") while serving as Sunrise Senior Living, Inc.'s ("Sunrise" or the "Company") treasurer for the year-end 2004 and the first fiscal quarter of 2005. Abod helped determine the amount of Sunrise's 2004 year-end bonus accrual and was aware that the company was planning to pay \$1 million in 2004 bonuses in 2005 but had failed to accrue for them at 2004 fiscal year-end. Abod also instructed Sunrise employees to make an adjustment to eliminate the corporate bonus accrual account for the first quarter of 2005, ended on March 31, 2005. Sunrise would not have met previously issued earnings per share forecasts if it had properly accrued for bonuses at year end 2004 and the first fiscal quarter of 2005. The accounting for the corporate bonus accrual account failed to comply with GAAP, because it was probable that Sunrise would pay bonuses and could reasonably estimate the bonus payment amounts. Consequently, Abod caused Sunrise to issue an annual report for fiscal year 2004 and a quarterly report for the first

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<sup>1</sup> See Accounting and Auditing Enforcement Release No. 3158 dated July 23, 2010. Abod was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

quarter of 2005 that failed to comply with GAAP. As a result of this conduct, the Commission found that Abod willfully violated Section 13(b)(5) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 13b2-1 thereunder and caused and willfully aided and abetted Sunrise's violations of Exchange Act Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) and Rule 12b-20, 13a-1, and 13a-13 thereunder.

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, Abod attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Abod is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Abod's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Abod, it appears that he has complied with the terms of the July 23, 2010 order suspending him from appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct, or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Abod, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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<sup>2</sup> 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 Kenneth J. Abod, CPA is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68611 / January 9, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3438 / January 9, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-13555

\_\_\_\_\_ : ORDER GRANTING APPLICATION FOR  
In the Matter of : REINSTATEMENT TO APPEAR AND PRACTICE  
: BEFORE THE COMMISSION AS AN ACCOUNTANT  
Jimmie Dean Jones, CPA : RESPONSIBLE FOR THE PREPARATION OR  
: REVIEW OF FINANCIAL STATEMENTS REQUIRED  
\_\_\_\_\_ : TO BE FILED WITH THE COMMISSION

On July 17, 2009, Jimmie Dean Jones, CPA ("Jones") 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 Jones pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice.<sup>1</sup> Jones consented to the entry of that order without admitting or denying the findings therein. This Order is issued in response to Jones' application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

At all times relevant to the 2009 Order, Jones was a certified public accountant who was licensed to practice in the state of Oklahoma, and served as the Chief Accounting Officer for LSB Industries, Inc. ("LSB"). The Commission found that during the first three quarters of fiscal year 2004 and the full fiscal year 2004, LSB failed to comply with the disclosure and restatement requirements of Accounting Principles Board Opinion No. 20, "Accounting Changes" ("APB 20"). Rather than comply with APB 20's restatement and disclosure requirements, Jones directed his subordinates to bleed down LSB's reserve relating to its last in, first out inventory pricing method ("LIFO") during 2004. Jones also failed to comply with LSB's requirement that he alert the company's CFO to items with a financial statement impact exceeding \$100,000. Moreover, Jones was responsible for LSB's false disclosures in its Forms 10-Q for the first and second quarters of 2004 that it maintained LIFO inventory. Jones knew

<sup>1</sup> See Accounting and Auditing Enforcement Release No. 3015, dated July 17, 2009. Jones was permitted, pursuant to the order, to apply for reinstatement after two years upon making certain showings.

that LSB's Forms 10-Q for the first three quarters of fiscal year 2004 and Form 10-K for the year ended December 31, 2004 materially overstated LSB's reported net income. Jones also knew that LSB's Form 10-Q for the quarter ended March 31, 2004 failed to comply with APB 20. Finally, Jones knew or should have known that LSB's Forms 10-Q for the quarters ended March 31, 2004 and June 30, 2004 contained false disclosures that LSB maintained inventory using the LIFO pricing methodology. As a result of this conduct, Jones willfully violated Exchange Act Section 13(b)(5) and Rule 13b2-1 and caused and willfully aided and abetted LSB's violations of Exchange Act Sections 13(a) and 13(b)(2)(A), and Rules 13a-1 and 13a-13.

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, Jones attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Jones is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original order in this regard. Therefore, the denial of Jones' privilege of appearing or practicing before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Jones, it appears that he has complied with the terms of the July 17, 2009 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 Jones, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Jimmie Dean Jones, CPA is hereby reinstated to appear and practice before the Commission as

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<sup>2</sup> 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).

an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68621; File No. SR-NSCC-2012-810)

January 10, 2013

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice to Eliminate the Offset of Its Obligations with Institutional Delivery Transactions that Settle at The Depository Trust Company for the Purpose of Calculating Its Clearing Fund Under Procedure XV of Its Rules & Procedures

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> thereunder, notice is hereby given that on December 18, 2012, the National Securities Clearing Corporation ("NSCC") filed with the Securities and Exchange Commission ("Commission") the advance notice described in Items I, II and III below, which Items have been prepared primarily by NSCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

NSCC proposes to modify its Rules & Procedures ("Rules") to eliminate the offset of NSCC obligations with institutional delivery ("ID") transactions that settle at the Depository Trust Company ("DTC") for the purpose of calculating the NSCC clearing fund ("Clearing Fund") under Procedure XV of the Rules.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. NSCC

<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(i).

has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.<sup>3</sup>

(A) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

*Background*

A primary objective of NSCC's Clearing Fund is to have on deposit from each applicable clearing member ("Member") assets sufficient to satisfy losses that may otherwise be incurred by NSCC as the result of the default of the Member and the resultant close out of that Member's unsettled positions under NSCC's trade guaranty. Each Member's Clearing Fund required deposit is calculated daily pursuant to a formula set forth in Procedure XV of the Rules designed to provide sufficient funds to cover this risk of loss. The Clearing Fund formula accounts for a variety of risk factors through the application of a number of components, each described in Procedure XV.<sup>4</sup>

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<sup>3</sup> The Commission has modified the text of the summaries prepared by NSCC.

<sup>4</sup> In addition to those described in this filing, Clearing Fund components also include (i) a mark-to-market component which, with certain exclusions, takes into account any difference between the contract price and market price for net positions of each security in a Member's portfolio through settlement; (ii) a "special charge" in view of price fluctuations in or volatility or lack of liquidity of any security; (iii) an additional charge relating to a Member's outstanding fail positions; (iv) a "specified activity charge" for transactions scheduled to settle on a shortened settlement cycle (i.e., less than T+3 or T+3 for "as-of" transactions); (v) an additional charge that NSCC may require of Members on surveillance status; and (vi) an "Excess Capital Premium" that takes into account the degree to which a Member's collateral requirement compares to the Member's excess net capital by applying a charge if a Member's Required Deposit, minus any amount applied from the charges described in (ii) and (iii) above, is above its required capital.

The Value-at-Risk component, or "VaR," is a core component of this formula and is designed to calculate the amount of money that may be lost on a portfolio over a given period of time assumed necessary to liquidate the portfolio, within a given level of confidence.<sup>5</sup> The Market Maker Domination component, or "MMDOM," is charged to Market Makers,<sup>6</sup> or firms that clear for them. In calculating the MMDOM, if the sum of the absolute values of net unsettled positions in a security for which the firm in question makes a market is greater than that firm's excess net capital, NSCC may then charge the firm an amount equal to such excess or the sum of each of the absolute values of the affected net unsettled positions, or a combination of both. MMDOM operates to identify concentration within a given CUSIP.

Pursuant to Procedure XV of the Rules, NSCC may calculate the VaR and MMDOM components of a Member's Clearing Fund requirement after taking into account any offsetting pending (i.e., non-fail) ID transactions that have been confirmed and/or affirmed through an institutional delivery system acceptable to NSCC (typically Omgeo LLC ("Omgeo"), a joint venture of the Depository Trust and Clearing Corporation and Thomson Reuters) ("ID Offset").<sup>7</sup>

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<sup>5</sup> NSCC's equity VaR model assumes a 99% confidence interval, uses a 150-day historical look-back period, and assumes a three-day liquidation period. In effect, NSCC assumes the market conditions observed over the past 150 days are predictive of the market conditions expected over the course of the next three business days. Pursuant to Procedure XV, NSCC may exclude from the VaR charge "Net Unsettled Positions in classes of securities whose volatility is (x) less amenable to statistical analysis, such as OTC Bulletin Board or Pink Sheet issues or issues trading below a designated dollar threshold, or (y) amenable to generally accepted statistical analysis in a complex manner, such as municipal or corporate bonds." The charge for such positions is determined by multiplying the absolute value of the positions by a pre-determined percentage.

<sup>6</sup> As used in Procedure XV, the term Market Maker means a firm that is registered by FINRA as a Market Maker.

<sup>7</sup> The changes proposed by this advance notice will not impact NSCC's ID Net Service.

NSCC is proposing to eliminate the ID Offset from its Clearing Fund calculations in order to eliminate the market risk that, in the event NSCC ceases to act for a Member with pending ID transactions, it may be unable to complete those pending ID transactions in the time frame contemplated by its current Clearing Fund calculations and, as a result, may have insufficient margin in its Clearing Fund.

#### *ID Transactions*

The parties involved in an institutional trade include the institutional investor (such as mutual funds, insurance companies, hedge funds, bank trust departments, and pension funds), the investment manager (who enters trade orders on behalf of institutional investors), the buying broker and the selling broker, and custodian banks.<sup>8</sup> Trades between the buying broker and the selling broker are typically settled through NSCC's Continuous Net Settlement system ("CNS").<sup>9</sup>

Before ID trades are sent to DTC, where they settle delivery versus payment, the trade allocation details are matched between the executing broker and the institutional investor. After an executing broker has provided a final notice of execution associated with the client's order, most institutional clients will provide trade allocation details to the executing broker using a service provided by Omgeo. When the executing broker accepts and processes the trade

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<sup>8</sup> Prime broker ID transactions settling at NSCC are not included in the ID Offset, as they are included in the Member's NSCC activity once such transactions are affirmed, and, therefore, are not addressed in this filing. The ID transactions included in the ID Offset and described in this advance notice are activity that is held in custody at a bank.

<sup>9</sup> CNS is NSCC's core netting and allotting system, where all eligible compared and recorded transactions for a particular settlement date are netted by issue into one net long (buy) or net short (sell) position, and NSCC becomes the contra-party for settlement purposes, assuming the obligation of its Members that are receiving securities to receive and pay for those securities, and the obligation of Members that are delivering securities to make the delivery.

allocations, an electronic confirmation is provided through Omgeo's TradeSuite service to the institutional investor or its agent (typically the institutional client's custodian bank) for affirmation. Omgeo links with the various parties to institutional trades to provide real-time central matching capabilities, electronically comparing trade details and notifying parties of any exceptions. After the trade allocation details are affirmed, the trade is considered matched and institutional delivery details are sent to DTC for settlement.

Completion of the money and securities settlement of institutional trades occurs at DTC. Because investment managers are not participants of and do not have direct accounts at DTC, their securities are held in custodial accounts with banks who are participants at DTC. Therefore, when the institutional delivery details for confirmed and affirmed ID trades are sent to DTC from Omgeo, the delivering investment manager's custodian bank or broker, as the case may be, must authorize the delivery, generating a deliver order that will settle in accordance with DTC's rules.

NSCC Risk Management receives a daily feed from Omgeo, including both ID trades that have only been confirmed as well as those that have also been affirmed. For purposes of the ID Offset, NSCC includes ID trades that are confirmed and/or affirmed on trade date (T) and those ID trades which have been affirmed on T+1 and remain affirmed through settlement date (SD).

#### *ID Offset*

Procedure XV currently allows for a Member's net unsettled NSCC position in a particular CUSIP to be compared to any pending ID transactions settling at DTC for potential offset for purposes of calculating the VaR and the MMDOM components of a Member's Clearing Fund requirement, defined as the ID Offset. The ID Offset is based on the assumption that, in the event of a Member insolvency, NSCC will be able to close out any trades for which

there is a corresponding ID transaction settling at DTC by completing that ID transaction. Therefore, the VaR and the MMDOM components are calculated after taking into account any offsetting pending (i.e., non-fail) ID transactions that have been confirmed and/or affirmed, reducing the Clearing Fund requirement for those Members with ID transactions. ID transactions are included in the ID Offset only if they are on the opposite side of the market from the Member's net NSCC position (i.e., only if they reduce that net position).

*Potential Inability to Complete ID Transactions*

Generally, when NSCC ceases to act for a Member, it is obligated, for those transactions to which the trade guaranty has attached, to pay for deliveries made by non-defaulting Members that are due, through CNS, to the failed Member on the day of insolvency and the days following. As described above, the current calculation of the VaR and MMDOM components of NSCC's Clearing Fund are based on the assumption that, in the event of a Member default, NSCC will be able to complete the pending ID transactions that were used to offset that Member's unsettled NSCC position. If NSCC is unable to complete the ID transactions as contemplated by this calculation, then NSCC may need to liquidate a portfolio that could be substantially different than the portfolio that NSCC collected Clearing Fund for, leaving NSCC potentially under collateralized and exposed to market risk, because when it calculated the Clearing Fund requirement, NSCC assumed, under its current rules, a portfolio that included Member positions to be offset by ID transactions.

There are a number of reasons why NSCC may not be able to complete an insolvent Member's open ID transactions. First, NSCC does not guarantee ID transactions and completion of these transactions by the counterparty of the ID transaction, which is not a Member of NSCC, is voluntary. Further, the institutional customer is not a Member of NSCC, is not bound by

NSCC's Rules, and is not party to any legally binding contract with NSCC that requires the institutional customer or its custodian to complete the transaction. Finally, based on news that a Member may be in distress or insolvent, the institutional customer or its investment advisor may feel compelled to take immediate market action with respect to the institutional buy or sell transaction, in order to reduce its market risk; this effectively eliminates the option for NSCC to complete these transactions, either entirely or on the timetable assumed by the Clearing Fund calculation.

While NSCC's Risk Management systems net ID transactions by CUSIP across all settlement days for the purposes of the ID Offset, ID transactions settle trade by trade between the executing broker and the custodian. As a result, the netted ID position used to offset the NSCC position could potentially be comprised of thousands of individual trades with hundreds of different counterparties. It would be time consuming for NSCC to contact each counterparty individually to get their agreement to complete ID transactions, which would delay the determination of the portfolio requiring liquidation in the event of a cease to act, and thus hold up the prompt close out of the defaulter's open positions, exposing NSCC to additional market risk not covered by the margin collected.

#### *Implementation Time Frame*

Following Commission approval, in order to mitigate the impact of this advance notice, NSCC proposes to implement the changes set forth in this filing on over an 18-month period. On a date no earlier than 10 days following notice to Members by Important Notice ("Initial Implementation Date"), NSCC proposes to eliminate the ID Offset from ID transactions that have only been confirmed, but have not yet been affirmed. At this time, NSCC will continue to apply the ID Offset to ID transactions that have been affirmed. During the 12-month period

following the Initial Implementation Date, NSCC will discuss with Members, whose business will be affected by the elimination of the ID Offset, mechanisms to mitigate this impact.

Beginning on a date approximately 12 months from the Initial Implementation Date, and no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate from the ID Offset all affirmed ID transactions that have reached settlement date at the time the Clearing Fund calculations are run. Three months later, or approximately 15 months following the Initial Implementation Date, and on a date no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate from the ID Offset all affirmed ID transactions that have reached either settlement date or the day prior to settlement date. Finally, on a date approximately 18 months following the Initial Implementation Date, and no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate the ID Offset entirely for all ID transactions. Members will be advised of each proposed implementation date through issuance of NSCC Important Notices, which are publically available at [www.dtcc.com](http://www.dtcc.com).

The table below illustrates this proposed implementation schedule:

**Proposed Implementation Schedule for Elimination of ID Offsets**

<u>Action</u>	<u>Scheduled Implementation</u>
Eliminate from ID Offset those ID transactions that have <u>only</u> been confirmed, but have not yet been affirmed	Following approval of rule filing, and on a date no earlier than 10 days following notice to Members by Important Notice ("Initial Implementation Date")
Eliminate from ID Offset all affirmed ID transactions that have reached Settlement Date ("SD")	12 months following the Initial Implementation Date, and on a date no earlier than 10 days following notice to Members by Important Notice
Eliminate from ID Offset all affirmed ID transactions that have reached SD and the day prior to SD (SD-1)	15 months following the Initial Implementation Date, and on a date no earlier than 10 days following

	notice to Members by Important Notice
Eliminate from ID Offset all ID transactions	18 months following the Initial Implementation Date , and on a date no earlier than 10 days following notice to Members by Important Notice

*Proposed Rule Changes*

NSCC proposes to amend Procedure XV to eliminate the ID Offset from calculation of the VaR and MMDOM components of a Member's Clearing Fund requirement as currently provided for in, with respect to CNS transactions, Section I(A)(1)(a)(i) and Section I(A)(1)(d), and, with respect to Balance Order transactions, Section I(A)(2)(a)(i) and Section I(A)(2)(c).

*Anticipated Effect on and Management of Risk*

As a central counterparty, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions and thereby reducing the risk faced by participants and contributing to global financial stability. In this role, however, NSCC is necessarily subject to certain risks in the event of the default or failure of a Member.

NSCC reviews its risk management processes against federal securities laws and rulemaking promulgated by the Commission, and applicable regulatory and industry guidelines, including but not limited to the Principles for Financial Market Infrastructures ("PFMI") of the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("CPSS-IOSCO").<sup>10</sup> In accordance with

<sup>10</sup> CPSS-IOSCO PFMI (April 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

Commission rules,<sup>11</sup> specifically Rule 17Ad-22(b)(1) addressing measurement and management of credit exposures, Rule 17Ad-22(b)(2) addressing margin requirements, and Rule 17Ad-22(d)(11) addressing default procedures, and also in accordance with the PFMI, this advance notice should enhance NSCC's ability to more effectively manage its credit exposures to participants, help ensure that it is able to cover its credit exposures to its participants for all products through an effective, risk-based margin system, limit NSCC's exposures and losses, and enhance protections against market risk that may arise when NSCC ceases to act for a Member with open ID transaction activity.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

While written comments relating to the advance notice have not yet been solicited, NSCC has received a letter on behalf of certain Members seeking further review of the impact of the proposed changes contained in the advance notice and consideration of alternatives. NSCC notified the Commission of the contents of the letter and promptly delivered a response to those Members addressing their concerns. A Member working group has been established to discuss mechanisms for impacted Members to mitigate the potential impact of the rule changes described in this filing.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The clearing agency may implement the proposed change pursuant to Section 806(e)(1)(G) of the Clearing Supervision Act<sup>12</sup> if it has not received an objection to the

<sup>11</sup> Securities and Exchange Commission Release No. 34-68080 (October 22, 2012), 77 FR 66219 (November 2, 2012; File No. S7-08-11 (available at <http://www.sec.gov/rules/final/2012/34-68080.pdf>), effective on January 2, 2013.

<sup>12</sup> 12 U.S.C. 5465(e)(1)(G).

proposed change within 60 days of the later of (i) the date that the Commission received the advance notice or (ii) the date the Commission receives any further information it requested for consideration of the notice. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date of receipt of the advance notice, or the date the Commission receives any further information it requested, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission. The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.<sup>13</sup>

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<sup>13</sup> NSCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Act and Rule 19b-4 thereunder. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. Pursuant to Section 19(b)(2) of the Act, within 45 days of the date of publication of the proposed rule change in the Federal Register or within such longer period up to 90 days if the Commission designates or the self-regulatory organization consents the Commission will either: (i) by order approve or disapprove the proposed rule change or (ii) institute proceedings to determine whether the proposed rule change should be disapproved. 17 U.S.C. 78s(b)(2)(A). See Release No. 34-68549 (December 28, 2012), 78 FR 792 (January 4, 2013).

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NSCC-2012-810 on the subject line.

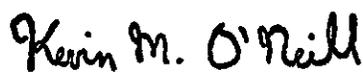
##### Paper Comments:

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

All submissions should refer to File Number SR-NSCC-2012-810. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of NSCC and on NSCC's website at

[http://dtcc.com/downloads/legal/rule\\_filings/2012/nscc/SR-NSCC-2012-10.pdf](http://dtcc.com/downloads/legal/rule_filings/2012/nscc/SR-NSCC-2012-10.pdf). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NSCC-2012-810 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.



Kevin M. O'Neill  
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68618; File No. SR-OCC-2012-801)

January 10, 2013

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice, as Modified by Amendment No. 1 Thereto, in Connection with a Proposed Change to Enter into an Unsecured, Committed Credit Agreement

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i),<sup>2</sup> notice is hereby given that on December 18, 2012, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice described below. On December 21, 2012, OCC filed Amendment No. 1 to the advance notice.<sup>3</sup> The advance notice as amended by Amendment No. 1 is described in Items I, II, and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the advance notice and Amendment No. 1 from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

OCC is filing this advance notice in connection with a change to its operations (the “Change”) in the form of entering into an unsecured, committed credit agreement (the “Agreement” or the “Facility”). The Facility would provide OCC with access to additional liquidity for working capital needs and general corporate purposes. The Facility would also help

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(i).

<sup>3</sup> Amendment No. 1 corrects Item 2 of OCC’s Form 19b-4 to indicate that “[t]he proposed change was approved by the Board of Directors of OCC at a meeting held on July 24, 2012,” rather than September 25, 2012.

satisfy the liquidity requirement of the Commodity Futures Trading Commission's ("CFTC") regulation Section 39.11(e)(2).

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>4</sup>

(A) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

**Description of Change**

The proposed Change would provide OCC with access to an unsecured, committed credit facility in an aggregate principal amount not to exceed \$25 million. The Facility would be designed to provide OCC with access to additional liquidity for working capital needs and general corporate purposes. The Facility will also satisfy the liquidity requirement of CFTC regulation Section 39.11(e)(2).<sup>5</sup> OCC also does not expect any need to draw funds against the Facility. OCC's principal reason for entering into the Facility is to provide OCC additional

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<sup>4</sup> The Commission has modified the text of the summaries prepared by OCC.

<sup>5</sup> For clarity concerning the scope of the proposed Change, OCC notes that the Commission recently published a notice of no objection to an OCC advance notice filing through which OCC replaced a separate credit facility that is maintained for the purpose of meeting obligations that may arise out of the default or suspension of an OCC clearing member or the failure of a bank or securities or commodities clearing organization to perform its obligations due to bankruptcy, insolvency, receivership, or suspension of operations. Securities Exchange Act Release No. 34-68002 (October 5, 2012); 77 FR 62308 (October 12, 2012).

flexibility in managing its liquid assets while ensuring continued compliance with the liquidity requirements of the CFTC regulations cited above.

Among other things, CFTC regulation Section 39.11(a)(2) requires a derivatives clearing organization (“DCO”) to hold an amount of financial resources that, at a minimum, exceeds the total amount that would enable the DCO to cover its operating costs for a period of at least one year, calculated on a rolling basis.<sup>6</sup> In turn, CFTC regulation Section 39.11(e)(2) provides that these financial resources must include unencumbered, liquid financial assets (i.e., cash and/or highly liquid securities), equal to at least six months’ operating costs and that if any portion of such financial resources is not sufficiently liquid, the DCO may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.<sup>7</sup> Accordingly, under the proposed Change, OCC would enter into a credit agreement for the Facility with BMO Harris Bank N.A. (“Lender”) having a maximum aggregate principal loan amount not to exceed \$25 million.

One of the conditions of OCC’s access to the Facility is the execution of credit agreement documents between OCC and the Lender. OCC anticipates that the parties will finalize the forms of the credit agreement documents in early 2013. Ongoing conditions governing OCC’s ability to access the Facility would include that no default or event of default by OCC may exist before or during an extension of credit by the Lender to OCC through the Facility and that certain representations of OCC must remain true and correct. Events of default would include, but not be limited to, failure to pay any interest, principal, fees or other amounts when due, default under any covenant or agreement in any loan document, materially inaccurate or false

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<sup>6</sup> 17 CFR 39.11(a)(2).

<sup>7</sup> 17 CFR 39.11(e)(2).

representations or warranties, cross default with other material debt agreements, insolvency, bankruptcy, dissolution or termination of the existence of OCC, and unsatisfied judgments.

The Facility would be available to OCC on a revolving basis for a 364-day term. Upon notice by OCC to the Lender of a request for funds, whether in writing or by telephone, the Lender would disburse loaned funds to OCC in U.S. dollars. The date of any loan would be required to be a business day, and the loans would be unsecured and made and evidenced by a promissory note provided by OCC. Under the terms of OCC's Agreement with the Lender, any loan proceeds would be required to be used by OCC to finance its working capital needs or for OCC's general corporate purposes. OCC's ability to draw against the Facility, even though no such draw is actually made, would contribute to OCC's compliance with the liquidity requirements prescribed by CFTC regulation Section 39.11(e)(2).

OCC would have the ability to terminate the Facility at any time. Termination within the first six months of the Facility would trigger a termination fee. After six months from the date of entering the Agreement with the Lender to establish the terms of the Facility, OCC would be permitted to cancel the Facility with no termination fee. Upon five days written notice during the term of the Facility, OCC would also be permitted to reduce the overall size of the Facility at any time. Any such reductions would be required to be made in an initial amount of at least \$2.5 million. Thereafter, reductions would be able to be made in multiples of \$1 million. In no event, however, would OCC be permitted to reduce the size of the Facility to an amount that is less than the greater of either its aggregate principal amount of indebtedness outstanding with respect to loans from the Facility or \$15 million.<sup>8</sup>

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<sup>8</sup> In the event that OCC seeks to terminate or reduce the overall size of the Facility, OCC will first file an advance notice with the Commission.

The outstanding principal balance of all loans made to OCC through the Facility will accrue interest equal to a base rate (generally equal to a Prime Rate, a Federal Funds Rate, or a LIBOR rate), as in effect from time to time, plus a certain applicable margin. Regardless of which method applies to a particular portion of OCC's total outstanding loan balance, in an event of a default the calculation of the amount of interest would be subject a 2.00% increase above the otherwise applicable rate.

The Facility would involve a variety of customary fees payable by OCC to the Lender, including, but not limited to: (1) a one-time upfront fee payable at closing to the Lender calculated as a percentage of the total commitment amount of the Facility; (2) commitment fees payable quarterly in arrears on the average daily unused amount of the Facility; (3) reasonable out-of-pocket costs and expenses of the Lender in connection with the negotiation, preparation, execution, and delivery of the Facility and loan documentation, and costs and expenses in connection with any default, event of default, or enforcement of the Facility; and (4) termination fees if OCC elects to terminate the Facility prior to six months from the date of the credit agreement underlying the Facility.

#### **Anticipated Effect on and Management of Risk**

OCC believes that any impact of the Facility on the risks presented by OCC would be to reduce such risks by providing an additional source of liquidity for the protection of OCC, its clearing members, and the options market in general. OCC also believes it would provide OCC with additional liquidity for working capital needs and general corporate purposes and thereby assist OCC in satisfying the CFTC's requirements with respect to liquidity under CFTC regulation Section 39.11.

Like any lending arrangement, OCC notes there is a risk that the Lender would fail to fund when OCC requests a loan, because of the Lender's insolvency, operational deficiencies, or otherwise. Even if OCC were to draw on the Facility for liquidity purposes, which it does not anticipate, OCC believes that the potential funding risk associated with the Facility is mitigated in several ways. First, the Lender is a national banking association that is subject to oversight by prudential banking regulators with respect to its safety and soundness and its ability to meet its lending obligations. Furthermore, the \$25 million size of the Facility would be relatively small when compared to the total resources available to OCC. Therefore, if the Facility proved unavailable to OCC for any reason, OCC believes that it readily would be able to access, or arrange for access, to other sources of liquidity if necessary.

According to OCC, a second risk associated with the Facility is the risk that OCC would default on its obligation to make timely payment of principal or interest. OCC believes the benefits of the Facility outweigh this risk. Finally, because the Facility would be an unsecured lending arrangement, OCC would not be at risk in an event of default of the Lender potentially liquidating OCC assets that are used to secure loaned funds.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

Written comments were not and are not intended to be solicited with respect to the advance notice and none have been received.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The clearing agency may implement the proposed change pursuant to Section 806(e)(1)(G) of the Clearing Supervision Act<sup>9</sup> if it has not received an objection to the proposed

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<sup>9</sup> 12 U.S.C. 5465.

change within 60 days of the later of (i) the date that the Commission received the advance notice or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency shall not implement the proposed changes contained in the advance notice if the Commission objects to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date of receipt of the advance notice, or the date the Commission receives any further information it requested, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed. The clearing agency shall post notice on its website of proposed changes that are implemented.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

##### Electronic Comments:

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

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2012-801 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 SR-OCC-2012-801. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of OCC and on OCC's website at <http://www.theocc.com/about/publications/bylaws.jsp>

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2012-801 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

*Kevin M. O'Neill*

Kevin O'Neill  
Deputy Secretary

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 232, 239, 249, 269, 274**

**[Release Nos. 33-9382; 34-68644; 39-2488; IC-30348]**

**Adoption of Updated EDGAR Filer Manual**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual and related rules to reflect updates to the EDGAR system. The revisions are being made primarily to introduce the new EDGARLink Online submission type IRANNOTICE; and support PDF as an official filing format for submission types 497AD, 40-17G, 40-17G/A, 40-17GCS, 40-17GCS/A, 40-24B2, and 40-24B2/A. The EDGAR system is scheduled to be upgraded to support this functionality on January 14, 2013.

**EFFECTIVE DATE:** [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** In the Division of Corporation Finance, for questions on submission type IRANNOTICE, contact Jeffrey Thomas at (202) 551-3600; in the Division of Investment Management for questions concerning submission types 497AD, 40-17G, 40-17G/A, 40-17GCS, 40-17GCS/A, 40-24B2, and 40-24B2/A, contact Heather Fernandez at (202) 551-6708; and in the Office of Information Technology, contact Vanessa Anderson at (202) 551-8800.

**SUPPLEMENTARY INFORMATION:** We are adopting an updated EDGAR Filer Manual, Volume II. The Filer Manual describes the technical formatting requirements for the preparation

and submission of electronic filings through the EDGAR system.<sup>1</sup> It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website.

The revisions to the Filer Manual reflect changes within Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 22 (January 2013). The updated manual will be incorporated by reference into the Code of Federal Regulations.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.<sup>2</sup> Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.<sup>3</sup>

The EDGAR system will be upgraded to Release 13.0 on January 14, 2013 and will introduce the following changes: EDGAR will be updated to introduce a new submission type, IRANNOTICE, on EDGAR Filing Website for filers to submit notices of disclosure filed in Exchange Act quarterly and annual reports under Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012<sup>4</sup> and new section 13(r) of the Securities Exchange Act of 1934.<sup>5</sup> Filers may access this submission type from the 'EDGARLink Online Form Submission' link on

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<sup>1</sup> We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on Oct. 4, 2012. See Release No. 33-9364 (October 15, 2012) [77 FR 62431]

<sup>2</sup> See Rule 301 of Regulation S-T (17 CFR 232.301).

<sup>3</sup> See Release No. 33-9364 (October 15, 2012) [77 FR 62431] in which we implemented EDGAR Release 12.2. For additional history of Filer Manual rules, please see the cites therein.

<sup>4</sup> Pub. L. No. 112-158.

<sup>5</sup> 15 USC 78m(r).

the EDGAR Filing Website. Additionally, filers may construct XML submissions for this submission type by following the EDGARLink Online Technical Specification document.

EDGAR will be updated to allow filers to submit, on a voluntary basis, submission types 497AD, 40-17G, 40-17G/A, 40-17GCS, 40-17GCS/A, 40-24B2, and 40-24B2/A in Portable Document Format (PDF) as an official filing format. EDGAR will continue to accept ASCII and HTML as official filing formats for these submissions.

The new online version of Form N-SAR deployment has been delayed to April 2013. The specific deployment date will be announced on the Commission's public web site's "Information for EDGAR Filers" page (<http://www.sec.gov/info/edgar.shtml>). Filers should continue to use the EDGAR Filer Manual, Volume III: N-SAR Supplement to file their N-SAR submissions. When the online version of Form N-SAR is deployed, EDGAR Filer Manual, Volume III: N-SAR Supplement will be retired. Instructions to file the online version of Form N-SAR addressed in Chapter 9 of EDGAR Filer Manual, Volume II: EDGAR Filing should then be followed.

Along with the adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.<sup>6</sup>

You may obtain paper copies of the updated Filer Manual at the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. We

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<sup>6</sup> We also are making a technical correction to the instructions of Form ID (referenced in 17 CFR 239.63, 249.446, 269.7 and 274.402) to conform them with a recent change we made to Rules 10 (17 CFR 232.10) and 101 (17 CFR 232.101) of Regulation S-T and the EDGAR Filer Manual relating to the use of PDF files in connection with the Form ID authentication process. See Release No. 33-9353 (Aug. 29, 2012).

will post electronic format copies on the Commission's website; the address for the Filer Manual is <http://www.sec.gov/info/edgar.shtml>.

Since the Filer Manual and the corresponding rule changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).<sup>7</sup> It follows that the requirements of the Regulatory Flexibility Act<sup>8</sup> do not apply.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,<sup>9</sup> we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 13.0 is scheduled to become available on January 14, 2013. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

#### Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,<sup>10</sup> Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,<sup>11</sup> Section 319 of the Trust Indenture Act of 1939,<sup>12</sup> and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.<sup>13</sup>

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<sup>7</sup> 5 U.S.C. 553(b).

<sup>8</sup> 5 U.S.C. 601- 612.

<sup>9</sup> 5 U.S.C. 553(d)(3).

<sup>10</sup> 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

<sup>11</sup> 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

**PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS**

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

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2. Section 232.301 is revised to read as follows:

**§232.301 EDGAR Filer Manual.**

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the EDGAR Filer Manual, Volume I: “General Information,” Version 14 (October 2012). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: “EDGAR Filing,” Version 22 (January 2013). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved

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<sup>12</sup> 15 U.S.C. 77sss.

<sup>13</sup> 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

You must comply with these requirements in order for documents to be timely received and accepted. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Room 1543, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Electronic copies are available on the Commission's website. The address for the Filer Manual is <http://www.sec.gov/info/edgar.shtml>. You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202-741-6030, or go to:

[http://www.archives.gov/federal\\_register/code\\_of\\_federal\\_regulations/ibr\\_locations.html](http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html).

#### **PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933**

3. The authority citation for Part 239, continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, 80a-37, and Pub. L. No. 111-203, §939A, 124 Stat. 1376, (2010) unless otherwise noted.

\* \* \* \* \*

#### **PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934**

4. The authority citation for Part 249 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 78a et seq., and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

#### **PART 269 – FORMS PRESCRIBED UNDER THE TRUST INDENTURE ACT OF 1939**

5. The authority citation for Part 269 continues to read as follows:

**Authority:** 15 U.S.C. 77ddd(c), 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77sss, and 78ll(d), unless otherwise noted.

\* \* \* \* \*

**PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT  
OF 1940**

6. The authority citation for Part 274 continues to read, in part, as follows:

**Authority:** 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

\* \* \* \* \*

7. Form ID (referenced in §§239.63, 249.446, 269.7 and 274.402 of this chapter) is amended by revising the fourth paragraph of the section entitled “Using and Preparing Form ID” of the Form ID General Instructions, to read as follows.

[The revised Form ID will not appear in the Code of Federal Regulations]

OMB Approval

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OMB Number: 3235-0328  
Expires: November 30, 2013  
Estimated average burden  
Hours per response: 0.15

U.S. Securities and Exchange Commission

Washington, DC 20549

FORM ID

UNIFORM APPLICATION FOR ACCESS CODES TO FILE ON EDGAR

\* \* \* \* \*

FORM ID

GENERAL INSTRUCTIONS  
USING AND PREPARING FORM ID

\* \* \* \* \*

The Form ID application must include a notarized authentication document in PDF format. The application can include other attachments such as a cover letter or Power of Attorney. To assemble the Form ID submission (i.e., associate any attachments with your Form ID application), you must upload them to EDGAR. The PDF document attachment must not contain active content (Actions, embedded JavaScript, etc.), external references (Destinations, Hyperlinks, etc.), and passwords or document security controls.

\* \* \* \* \*

By the Commission.



Elizabeth M. Murphy  
Secretary

January 14, 2013

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68651 / January 14, 2013

Admin. Proc. File No. 3-14390

In the Matter of  
RICHARD L. GOBLE

ORDER DISMISSING PROCEEDING

I.

Richard L. Goble, the founder of North American Clearing, Inc., formerly a broker-dealer registered with the Commission,<sup>1</sup> appeals from an initial decision of an administrative law judge.<sup>2</sup> Pursuant to Exchange Act §§ 15(b)(4)(C) and 15(b)(6)(A)(iii), we may impose sanctions against a person who is permanently enjoined "from engaging in any conduct or practice in connection with [activities as a broker-dealer]" and "in connection with the purchase and sale of securities."<sup>3</sup> The United States District Court for the Middle District of Florida enjoined Goble from violating the antifraud,<sup>4</sup> customer protection,<sup>5</sup> and books-and-records<sup>6</sup> provisions of the federal securities laws,

<sup>1</sup> In addition to being North American's founder, Goble was the sole trustee of the trust that owned 100 percent of the shares of the firm.

<sup>2</sup> *Richard L. Goble*, Initial Decision Release No. 435, 2011 SEC LEXIS 3492 (Oct. 5, 2011).

<sup>3</sup> 15 U.S.C. §§ 78o(b)(4)(C) and 78o(b)(6)(A)(iii), respectively.

<sup>4</sup> 15 U.S.C. § 78j(b) and 17 C.F.R. § 240.10b-5. Exchange Act § 10(b) and Rule 10b-5 thereunder prohibit the employment of fraudulent schemes or the making of material misrepresentations and omissions in connection with an offer, purchase, or sale of securities. *See, e.g., Gregory O. Trautman*, Exchange Act Release No. 61167, 2009 SEC LEXIS 4173, at \*52 (Dec. 15, 2009).

<sup>5</sup> 15 U.S.C. § 78o(c)(3) and 17 C.F.R. § 240.15c3-3(e). Exchange Act § 15(c)(3) requires that broker-dealers observe Commission rules prescribed to provide safeguards for the broker-dealer's financial responsibility and related practices when effecting the purchase or sale of securities. Exchange Act Rule 15c3-3(e) requires, among other things, that a broker-dealer establish and maintain a customer reserve account and sets forth a formula for calculating the required balance to be maintained in the reserve account. *See Exhibit A to Rule 15c3-3.*

<sup>6</sup> 15 U.S.C. § 78q(3) and 17 C.F.R. § 240.17a-3, respectively. The books-and-records provisions "require that broker-dealers registered with the Commission make and keep current, for prescribed periods, certain books and records." *Joseph John VanCook*, Exchange Act Release No. 61039, 2009 SEC LEXIS 3872, at \*54 (Nov. 20, 2009), *petition denied*, 653 F.3d 130 (2d Cir. 2011). Those provisions include the requirement that the records be accurate. *See Anthony A. Adonnino*, Exchange Act Release No. 48618, 2003 SEC LEXIS 2411, at \*24-25 (Oct. 9, 2003), *aff'd*, 111 F. App'x 46 (2d Cir. 2004).

and from obtaining or seeking to obtain a securities license.<sup>7</sup> On the basis of this injunction, and on consideration of the public interest, the law judge barred Goble from associating with any broker, dealer, investment adviser, municipal securities dealer, transfer agent, or nationally recognized statistical rating organization.<sup>8</sup>

On November 8, 2011, Goble filed his petition for Commission review of the initial decision. On May 29, 2012, while Goble's appeal to the Commission was pending, the United States Court of Appeals for the Eleventh Circuit issued an opinion vacating the injunction the district court imposed.<sup>9</sup> As a result, the parties were asked to file additional briefs on the question of whether we should dismiss the proceeding against Goble because the injunction that served as the basis for the Order Instituting Proceedings has now been vacated.

## II.

### A. Both parties agree that the proceeding should be dismissed, differing only about whether it should be dismissed with or without prejudice.

The parties agree it is appropriate to dismiss this administrative proceeding, but disagree as to whether it should be with or without prejudice. In its response to the additional briefing order, the Division of Enforcement acknowledges that we have dismissed proceedings under similar circumstances in the past.<sup>10</sup> The Division, however, asks that the dismissal of the proceeding be without prejudice "because it is likely the District Court will enter a new injunction based on the Eleventh Circuit's remand," which "would be a basis for the Commission to re-institute these proceedings."<sup>11</sup>

Goble requests that the proceeding be dismissed with prejudice. Goble contends that the law judge's decision to bar Goble was based solely on the district court's finding that Goble had violated the antifraud provisions, which the court of appeals reversed. According to Goble, the district court's

<sup>7</sup> *SEC v. N. Am. Clearing, Inc., et al.*, Docket No. 6:08-cv-00829-MSS-KRS (M. D. Fla. Apr. 27, 2011) (unpublished).

<sup>8</sup> The law judge did not bar Goble from association with a municipal advisor, as the Division of Enforcement sought.

<sup>9</sup> The Eleventh Circuit affirmed the district court's findings that Goble had violated the customer protection and books-and-records provisions of the federal securities laws, but reversed the district court's finding that he had violated the antifraud provisions. The Eleventh Circuit remanded the case to the district court to reconsider the appropriateness of the lifetime bar from the securities business it imposed on Goble, and also to re-write the injunction against violations of the customer protection and books-and-records provisions in a way "that allows Goble to understand his obligations under the injunction." *SEC v. Goble*, 682 F.3d 934, 952-53 (11th Cir. 2012).

<sup>10</sup> See, e.g., *Evelyn Litwok*, Investment Advisers Act Release No. 3438, 2012 SEC LEXIS 2328, at \*3-4 (July 25, 2012) (dismissing a follow-on administrative proceeding after the court of appeals reversed tax evasion convictions for two tax years and vacated and remanded tax evasion and mail fraud convictions for another year, all of which served as the basis of the proceeding); *John M. Lucarelli*, Exchange Act Release No. 56075, 2007 SEC LEXIS 1548, at \*6 (July 13, 2007) (dismissing a proceeding based on a jury verdict after the district court judge entered judgment of acquittal notwithstanding the verdict).

<sup>11</sup> Division's Resp. to Comm'n's Order Directing the Filing of Additional Briefs at 2.

finding that Goble had also violated the customer protection and books-and-records provisions, which the court of appeals affirmed, "were not considered relevant in the Administrative Judge's decision."<sup>12</sup>

**B. It is appropriate to dismiss the proceeding.**

As a result of the Eleventh Circuit's decision vacating the district court's injunction, there is currently no basis for continuing a proceeding against Goble pursuant to Exchange Act § 15(b) on the record before us. Therefore, it is appropriate to dismiss the proceeding.

Our Rules of Practice, however, do not distinguish between dismissing proceedings with or without prejudice.<sup>13</sup> Given the state of the proceeding before us, we can determine only that there is no basis for continuing it. As noted, the Eleventh Circuit directed the district court, on remand, to draft a new injunction against Goble for his violations of the customer protection and books-and-records provisions. We do not suggest any view regarding the institution of any later proceedings against Goble arising from these or any other facts.

Accordingly, it is ORDERED that the proceeding against Richard L. Goble is dismissed.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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<sup>12</sup> Goble's Add'l Briefing on the Question of Whether the Comm'n Should Dismiss this Proceeding at 2.

<sup>13</sup> *Lucarelli*, 2007 SEC LEXIS 1548, at \*5.

*Commissioner Gallagher  
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 68669 / January 16, 2013**

**INVESTMENT ADVISERS ACT OF 1940  
Release No. 3534 / January 16, 2013**

**INVESTMENT COMPANY ACT OF 1940  
Release No. 30351 / January 16, 2013**

**ADMINISTRATIVE PROCEEDING  
File No. 3-14993**

**In the Matter of**

**MIDDLECOVE  
CAPITAL, LLC, AND  
NOAH L. MYERS,**

**Respondents.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS  
AND A CEASE-AND-DESIST ORDER  
PURSUANT TO SECTIONS 15(b) AND 21C  
OF THE SECURITIES EXCHANGE ACT  
OF 1934, SECTIONS 203(e), 203(f), AND  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940, AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT OF 1940**

**I.**

On August 22, 2012, the United States Securities and Exchange Commission (the "Commission") instituted administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against MiddleCove Capital, LLC ("MiddleCove") and Noah L. Myers ("Myers") (collectively, "the Respondents").

**II.**

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 a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f), and 203(k) of the Investment

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Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 (“Order”) as set forth below.

### III.

On the basis of this Order and Respondents’ Offers, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. From approximately October 2008 to February 2011 (the “relevant period”), Noah Myers, the sole owner of MiddleCove Capital, LLC (“MiddleCove”), engaged in fraudulent trade allocation – “cherry-picking” – at MiddleCove. During the relevant period, MiddleCove was a registered investment adviser. Myers executed his cherry-picking scheme by unfairly allocating trades that had appreciated in value during the course of the day to his personal and business accounts and allocating trades that had depreciated in value during the day to the accounts of his advisory clients. He did this by purchasing securities in an omnibus account and delaying allocation of the purchases until later in the day (and sometimes the next day), after he saw whether the securities appreciated in value. When a security appreciated in value on the day of purchase, Myers would often sell the security and disproportionately allocate the purchase and the realized day-trading profit to his own accounts or accounts benefiting himself or his family members. In contrast, for securities that did not appreciate on the day of purchase, Myers would disproportionately allocate these purchases to his clients’ accounts and his clients would hold the position for more than one day. Myers carried out his cherry-picking scheme with regard to several securities, but was most active with an inverse and leveraged exchange traded fund (ETF). Myers finally ceased these practices in February 2011 when one of his employees threatened to contact the Commission. As a result of his fraud, Myers realized ill-gotten gains of approximately \$460,000. Myers’s cherry-picking scheme also resulted in more than \$2 million in client losses from his trading in the inverse and leveraged ETF. Neither MiddleCove nor Myers disclosed to clients that they were engaged in cherry-picking and that they would favor Myers’s accounts in the allocation of appreciated securities. In addition, Myers and MiddleCove failed to follow the policies stated in MiddleCove’s ADV concerning trade allocation.

2. By virtue of their conduct, the Respondents willfully violated Section 10(b) of the Exchange Act [15 U.S.C. §§78j(b)] and Rule 10b-5 [17 C.F.R. §§240.10b-5] promulgated thereunder, and Sections 206(1) [15 U.S.C. §80b-6(1)], 206(2) [15 U.S.C. §80b-6(2)] and 207 [15 U.S.C. §80b-7] of the Advisers Act.

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<sup>1</sup> The findings herein are made pursuant to Respondents’ Offers and are not binding on any other person or entity in this or any other proceeding.

## RESPONDENTS

3. **MiddleCove Capital, LLC** (SEC File No. 801-68677), is a Connecticut limited liability company with its principal place of business in Centerbrook, Connecticut. It has been registered with the Commission as an investment adviser since 2008 when Myers formed MiddleCove. At its peak in 2011, when MiddleCove had two portfolio managers including Myers, MiddleCove managed approximately \$129 million in client assets. MiddleCove is wholly owned and controlled by Myers. In mid-2011, one of MiddleCove's portfolio managers left the firm after being there for approximately one year. As a result of his departure, MiddleCove's assets under management declined by approximately one-half. MiddleCove currently has no employees other than Myers. As of September 31, 2011, MiddleCove managed approximately 350 client accounts and had approximately \$53,000,000 under management. MiddleCove's clients are individuals and families.

4. **Noah L. Myers**, age 41, resides in Lyme, Connecticut. Myers is the principal, chief investment officer, and sole owner of MiddleCove. Myers formed MiddleCove in early 2008 after a fourteen-year career at Citigroup Global Markets Inc. ("Citigroup"). During the relevant time period, Myers was also a registered representative of Purshe Kaplan Sterling Investments, Inc. ("Purshe Kaplan"), a registered broker-dealer located in Albany, New York.

## OTHER RELEVANT ENTITY

5. **Purshe Kaplan Sterling Investments, Inc.** (SEC File No. 8-46844), is a New York corporation with its principal place of business in Albany, New York. Purshe Kaplan has been registered with the Commission as a broker-dealer since 1994. Myers was a registered representative of Purshe Kaplan during the relevant time period.

## RESPONDENTS' CONDUCT

### **The cherry-picking scheme.**

6. Myers formed MiddleCove in February 2008, and, in April 2008, Myers began using an omnibus account ("master account") at Charles Schwab & Co., Inc. ("Charles Schwab"), the custodian for all of MiddleCove's accounts, to place orders for his personal and client transactions. When he used the master account to purchase securities, Myers would place a block trade in the master account and then allocate the shares to his personal and client accounts.

7. Prior to October 2008, Myers was relatively inactive in his own accounts as compared to his client accounts. However, Myers began day-trading his own accounts in October 2008 and actively traded his own accounts over the next two years. From October 2008 to February 2011, Myers allocated approximately \$60 million in securities purchased in the master account to his personal and business accounts, compared to approximately \$200 million in securities purchased in the master account and allocated to MiddleCove's clients. Myers's personal trading activity, including his day-trading, slowed considerably after a MiddleCove employee confronted Myers in late 2010 about his cherry-picking scheme.

8. From October 2008 to February 2011, Myers engaged in a cherry-picking scheme to misappropriate profitable transactions to his personal and business accounts. Myers made block purchases of securities in the master account sometime during the trading day before the 4 P.M. close of the U.S. stock market. After making a purchase, Myers delayed allocating it until he knew whether there was a gain or loss on the trade on the day of purchase. During the relevant time period, approximately 65% of the purchases that Myers allocated to his clients were not allocated until after 4 P.M. on the day of the purchase. On some occasions, Myers would even wait until the next day to allocate a purchase and then mark the allocated trade "As Of" the day it was purchased in the market. This timing difference made it possible for Myers to selectively allocate profitable trades to his own accounts. If the security increased in price on the day of purchase, Myers would often sell the security on the same day he purchased it (a "day trade") and disproportionately allocate the day-trade profit to his personal and business accounts. However, if the security's price did not increase on the day of purchase, Myers disproportionately allocated the purchase to his clients' accounts.

9. Myers's scheme often involved purchasing a security in the master account for consecutive days over several weeks, or even months, and then allocating the security depending on its performance. If it increased in value on the day of purchase, he disproportionately allocated the security to his own accounts. If the security decreased in value on the day of purchase, Myers disproportionately allocated it to his clients' accounts. Thus, the securities on which Myers was disproportionately making money were the same securities on which his clients were disproportionately losing money. In fact, during the relevant time period, when Myers allocated a trade to his own accounts, he had almost always allocated the same security to his clients' accounts on a different trading day within one month of the allocation to his own accounts. The only consistent difference in whether Myers allocated a security to his own accounts or his clients' accounts was whether the security appreciated in value on the day it was purchased.

**The scheme is identified.**

10. Charles Schwab had an internal program that flagged Myers's accounts as potentially receiving favorable allocation of profitable day trades. A MiddleCove employee investigated Myers's trading patterns after he received a call from an employee of Charles Schwab in November 2010. The Schwab employee indicated that Schwab had flagged the allocation of MiddleCove's block trades as potentially giving profitable trades to an account that benefited Myers. As a result of the call, the MiddleCove employee analyzed Myers's trade allocation for a stock (Research in Motion or RIMM) and a leveraged ETF (ProShares UltraShort Financials or SKF). From his analysis of Myers's trade allocation of these two securities, the employee suspected that Myers was cherry-picking trades in favor of his own account at the expense of his clients. Specifically, the employee believed, based on his review of Myers's trade allocation, that Myers was allocating trades that lost money at the end of the day to clients instead of himself and that the performance for Myers's accounts was much more profitable than his clients' accounts.

11. Following the MiddleCove employee's analysis of Myers's cherry-picking scheme, all four of MiddleCove's employees confronted Myers about his trade allocation in mid-December, 2010. As a result of the confrontation, Myers agreed to use a trading method that

required Myers to place all of his client trades through a certain Charles Schwab trade application, and to use a different method for his own trades.

12. On February 18, 2011, the same MiddleCove employee who had analyzed Myers's trading in November noticed Myers had allocated a day trade profit to himself using the Charles Schwab trade application that Myers had agreed to only use for clients' trades. The employee confronted Myers and threatened to report Myers to the Commission if he did not re-allocate the trade, and Myers agreed to re-allocate the trade to a client. After this confrontation, Myers stopped cherry-picking and did relatively little trading in his own accounts.

13. Commission examination staff interviewed Myers in November 2011 about his own securities trading. Myers admitted that he had a day-trading strategy in one of his personal accounts that was profitable about 95% of the time, but he did not offer a plausible explanation for his stellar day-trading performance.

#### **Myers profited at his clients' expense.**

14. During the relevant time period, trades that Myers made in his own accounts increased in value by an average of approximately 67 basis points (or .67 of one-percent) on the day that Myers purchased the security. This 67 basis-point increase resulted in approximately \$408,000 in first-day profits for Myers's own accounts. In contrast, during the relevant time period, trades that Myers allocated to his clients' accounts *decreased* by approximately 32 basis points on the day that Myers purchased the security. This difference in return is highly statistically significant – the likelihood of Myers experiencing his first-day return (approximately 67 basis points) compared to the average first-day return for all of his and his clients' purchases (approximately negative 32 basis points for his clients' purchases and negative 9 basis points for his and his clients' purchases combined) from a "lucky" allocation of trades is less than one in ten million. Similarly, approximately 74% of Myers's trades had a profit on the first day compared to approximately 52% of his clients' trades – the likelihood of observing a difference in profitability this large by chance is less than one in one trillion.

15. Myers realized approximately \$138,000 in profits on his trades of SKF (the leveraged and inverse ETF discussed above) while his clients realized a net loss of approximately \$2.2 million on their SKF trades. These losses were spread out among approximately 120 clients.

16. Myers's cherry-picking scheme also resulted in significant investment losses for MiddleCove clients to whom Myers allocated shares of SKF. Many of the clients did not know what SKF was or that they had invested in a leveraged ETF, even when their investment in SKF was a significant part of their account value and they experienced significant losses because of it. Many of these clients were retired and/or were using their MiddleCove account as their source of funds for retirement and had limited willingness or ability to accept significant investment risk.

17. Leveraged and inverse ETFs like SKF are generally not designed to be held for more than one day. In June 2009, Financial Industry Regulatory Authority ("FINRA") issued Notice to Members 09-31 reminding firms of their sales practice obligations relating to leveraged and inverse ETFs. SKF is a leveraged and inverse ETF designed to achieve daily investment

results corresponding to twice the inverse (opposite) of the daily performance of the Dow Jones U.S. Financials Index. The FINRA notice described how leveraged and inverse ETFs are designed to achieve their stated objectives on a daily basis, and, “[d]ue to the effect of compounding, their performance over longer periods of time can differ significantly from the performance (or inverse of the performance) of the underlying index or benchmark during the same period of time. . . This effect can be magnified in volatile markets.” With an inverse or a leveraged ETF, if the relevant benchmark moves 100 points in one direction on day one and returns to the original level on day two, an investment in the ETF held for both days will be negative even though the benchmark is flat. (If, on the other hand, the benchmark moved in the same direction on both days, an investor in the ETF would have even better performance than shorting the index or investing in the index on margin.) If the ETF is an inverse and leveraged ETF, as is the case with SKF, the loss would be more significant. For these and other reasons, the FINRA notice concluded that “While the customer-specific suitability analysis depends on the investor’s particular circumstances, inverse and leveraged ETFs typically are not suitable for retail investors who plan to hold them for more than one trading session, particularly in volatile markets.”

18. During the period of his cherry-picking scheme, approximately one-third of Myers’s one-day profits were from SKF trades. These profits came at the expense of approximately \$2 million in client losses because Myers exposed his clients to the downside of this volatile security so that he could reap the rewards when SKF rose in value on the day of purchase. This scheme meant that Myers held SKF for more than one day in the accounts of several clients for whom such an investment was inappropriate. Moreover, at times, SKF was a considerable proportion of the holdings of his clients, further magnifying their investment risk. For example, Myers’s decision to use SKF as his tool for his cherry-picking scheme extended to:

- Investor A, age 84 and retired, invested all of her savings with MiddleCove. She described herself as conservative investor. Nonetheless, in September 2009, Myers established a \$89,727.74 SKF position for this investor, which was 34.3% of her month-end account balance. The investor lost a net of \$14,543 on SKF, and she had no idea what this security was.
- Investor B, age 77 and retired, had his retirement savings completely with MiddleCove. He viewed himself as “moderate risk” investor. In September 2009, Myers established a \$251,196.95 SKF position for this investor in his only account, representing about 28% of the account. The investor lost a net of \$59,483 on SKF.
- Investor C, age 70 and retired, was a client who described himself as unsophisticated. In September 2009, Investor C had approximately \$239,288.89 of SKF, or approximately 87.7% of the account’s month end value. The investor had no knowledge of what SKF was, and he lost a net of \$83,264 on SKF.

**The scheme was contrary to MiddleCove’s Form ADV.**

19. During the relevant time period, MiddleCove filed its Form ADV, Part II on April 29, 2009, and March 29, 2010. Items 12A, 12B, and 13A of the Form ADV, Part II stated, in pertinent part:

Transactions for each client generally will be effected independently, unless the Adviser decides to purchase or sell the same securities for several clients at approximately the same time. The Adviser may (but is not obligated to) combine or "batch" such orders to obtain best execution, to negotiate more favorable commission rates, or to allocate equitably among the Adviser's clients differences in prices and commissions or other transaction costs that might have been obtained had such orders been placed independently. Under this procedure, transactions will generally be averaged as to price and allocated among the Adviser's clients pro rata to the purchase and sale orders placed for each client on any given day. To the extent that the Adviser determines to aggregate client orders for the purchase or sale of securities, including securities in which the Adviser's Advisory Affiliate(s) may invest, the Adviser shall generally do so in accordance with applicable rules promulgated under the Advisers Act and no-action guidance provided by the staff of the U.S. Securities and Exchange Commission. The Adviser shall not receive any additional compensation or remuneration as a result of the aggregation.

The same items in the ADV went on to list specific circumstances in which allocations may not be *pro rata* among accounts, none of which applied to the relevant trades. These statements, taken as a whole, were misleading because the statements conveyed the impression that batched trades would be allocated fairly and not unduly favor Myers or MiddleCove, and, when trades included securities in which the "Adviser's Advisory Affiliate(s) may invest," there would be extra layer of protection provided by a regulatory framework.

#### VIOLATIONS

20. As a result of the conduct described above, Myers and MiddleCove willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities, by knowingly or recklessly allocating profitable trades to Myers's personal and business accounts at the expense of advisory clients. In addition, through this cherry-picking scheme and by failing to disclose the scheme, Myers and MiddleCove willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser with respect to advisory clients or prospective clients.

21. As a result of the conduct described above, MiddleCove willfully violated Section 207 of the Advisers Act by filing misleading Forms ADV that willfully made material misstatements concerning MiddleCove's trade allocation policies and procedures. By signing and causing to be filed on behalf of MiddleCove these misleading Forms ADV, Myers also willfully violated Section 207 of the Advisers Act.

#### IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents MiddleCove and Myers cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 207 of the Advisers Act.

B. The registration of MiddleCove as an investment adviser is hereby revoked.

C. Respondent Myers 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;

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; and

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Any reapplication for association by Respondent Myers 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 Respondent Myers, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondents shall, within 10 days of the entry of this Order, pay disgorgement of \$462,022 and prejudgment interest of \$26,096 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondents are jointly and severally liable for all payments required to be made by this paragraph. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will

provide detailed ACH transfer/Fedwire instructions upon request;<sup>2</sup>

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MiddleCove Capital, LLC and Noah L. Myers as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

F. Respondents shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$300,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Respondents are jointly and severally liable for all payments required to be made by this paragraph. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MiddleCove Capital, LLC and Noah L. Myers as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

<sup>2</sup> The minimum threshold for transmission of payment electronically is \$50,000.00 as of April 1, 2012. This threshold will be increased to \$1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

G. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund 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' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that 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 either of the Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

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. 68673 / January 16, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15178**

**In the Matter of**

**LARRY LEE ADAIR, Esq.,**

**Respondent.**

**ORDER INSTITUTING PUBLIC  
ADMINISTRATIVE PROCEEDINGS AND  
IMPOSING TEMPORARY SUSPENSION  
PURSUANT TO RULE 102(e)(3)(i)(A) OF  
THE COMMISSION'S RULES OF  
PRACTICE**

**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 Larry Lee Adair, Esq. ("Respondent" or "Adair") pursuant to Rule 102(e)(3)(i)(A)<sup>1</sup> of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(3)(i)(A)].

**II.**

The Commission finds that:

1. Adair was, at all relevant times, an attorney licensed in Florida. From approximately December 2001 until at least December 2003, Adair was president of Syndicated Gold Depository, Inc. ("SGD"), one of a group of companies used to facilitate a multi-national, \$300 million Ponzi scheme that involved more than 3,000 U.S. and Canadian investors. Adair continued to act as an agent for SGD through at least March 2004. Adair was also a director of Merendon Mining Corp. Ltd. ("Merendon"), another company used in the Ponzi scheme. SGD held itself out to investors as a business engaged in supplying capital to Merendon. It solicited those investments by making false statements about Merendon's involvement in gold mining

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<sup>1</sup> 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, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (A) [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating . . . any provision of the Federal securities laws or of the rules and regulations thereunder . . . .

operations, including false statements about Merendon's generation of revenue to repay loans it received from SGD. Adair personally solicited investors in SGD and personally directed others in the solicitation of SGD investors. Adair made false and misleading statements to investors about, among other things, the rate of return paid by SGD securities, the use of investors' funds, the security of the investment, and the independence of the various companies involved in the investment. As part of the Ponzi scheme, Adair used a variety of attorney trust accounts under his control to take payments from investors, make payments to investors, and make payments to others involved in the Ponzi scheme. In total, Adair received and disbursed over \$168 million of investor funds through accounts under his control.

2. On June 10, 2010, the Commission filed a complaint against Adair and others in the United States District Court for the Western District of Washington, charging him with violating Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, together with Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, by his participation in the Ponzi scheme. That lawsuit sought a permanent injunction, disgorgement of unlawful proceeds plus pre-judgment and post-judgment interest, a financial penalty, and an order prohibiting Adair from acting as an officer or director of any public company. *SEC v. Merendon Mining (Nevada) Inc., et al.*, Civil Action Number 2:10-cv-00955-RAJ.

3. On October 30, 2012, the Court entered a final judgment against Adair, which permanently enjoins him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act, as well as Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### III.

Based upon the foregoing, the Commission finds that a court of competent jurisdiction has permanently enjoined Adair, by reason of his misconduct in an action brought by the Commission, from violating provisions of the securities laws or of the rules and regulations thereunder. In view of this finding, the Commission deems it appropriate and in the public interest that Adair be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Adair be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an attorney. This Order will be effective upon service on the Respondent.

IT IS FURTHER ORDERED that Adair may, within thirty days after service of this Order, file a petition with the Commission to lift the temporary suspension. If the Commission receives no petition within thirty days after service of the Order, the suspension will become permanent pursuant to Rule 102(e)(3)(ii).

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If

a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Adair personally or by certified mail at his last known address.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**[Release No. 34-68668; File No. S7-11-11]**

**RIN: 3235-AL11**

**Lost Securityholders and Unresponsive Payees**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission ("Commission") is adopting amendments to Rule 17Ad-17 to implement the requirements of Section 929W of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). That Section added to Section 17A of the Securities Exchange Act of 1934 ("Exchange Act") subsection (g), "Due Diligence for the Delivery of Dividends, Interest, and Other Valuable Property Rights," which directs the Commission to revise Exchange Act Rule 17Ad-17, "Transfer Agents' Obligation to Search for Lost Securityholders" to: extend the requirements of Rule 17Ad-17 to search for lost securityholders from only recordkeeping transfer agents to brokers and dealers as well; add a requirement that "paying agents" notify "unresponsive payees" that a paying agent has sent a securityholder a check that has not yet been negotiated; and add certain other provisions. The Commission also is adopting a proposed conforming amendment to Rule 17Ad-7(i) and new Rule 15b1-6, a technical rule to help ensure that brokers and dealers have notice of their new obligations with respect to lost securityholders and unresponsive payees.

**EFFECTIVE DATES:** The amendments will become effective on [insert 60 days after the date of publication of the release in the Federal Register]. The compliance date will be [twelve months after the date of publication of the release in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Thomas C. Etter, Jr., Special Counsel, at (202) 551-5710, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-7010.

## **SUPPLEMENTARY INFORMATION**

### **I. Introduction**

On July 21, 2010, the President signed the Dodd-Frank Act into law.<sup>1</sup> This legislation was enacted to, among other things, promote the financial stability of the United States by improving accountability and transparency in the financial system.<sup>2</sup> Title IX of the Dodd-Frank Act provides the Commission with new tools to protect investors and to improve the regulation of securities.<sup>3</sup>

Section 929W of the Dodd-Frank Act added to Section 17A of the Exchange Act subsection (g), which requires the Commission to revise Exchange Act Rule 17Ad-17<sup>4</sup> to extend to brokers and dealers the rule's requirement that recordkeeping transfer agents search for "lost securityholders".<sup>5</sup>

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

<sup>2</sup> *Id.* at Preamble.

<sup>3</sup> *Id.* § 901 ("This section may be cited as the 'Investor Protection and Securities Reform Act of 2010'."); Title IX ("Investor Protections and Improvements to the Regulation of Securities").

<sup>4</sup> 17 CFR 240.17Ad-17.

<sup>5</sup> Rule 17Ad-17(b)(2), as amended herein, defines a "lost securityholder" to mean "a securityholder: (i) To whom an item of correspondence that was sent to the securityholder at the address contained in the transfer agent's master securityholder file or in the customer security account record of the broker or dealer has been returned as undeliverable; provided, however, that if such item is re-sent within one month to the lost securityholder, the transfer agent, broker, or dealer may deem the securityholder to be a lost securityholder as of the day the re-sent item is returned as undeliverable; and (ii) For whom the transfer agent, broker, or dealer has not received information regarding the securityholder's new address."

Subsection (g) of Section 17A of the Exchange Act further directs the Commission to revise Rule 17Ad-17 to include “a requirement that the paying agent provide a single written notification to each missing security holder that the missing security holder has been sent a check that has not yet been negotiated.”<sup>6</sup> Such written notification must be sent to a missing securityholder no later than seven months after the sending of the not yet negotiated check and may be sent along with a check or other mailing subsequently sent to the missing securityholder.

Section 17A(g)(1)(D)(i) of the Exchange Act provides that “a security holder shall be considered a ‘missing security holder’ if a check is sent to the security holder and the check is not negotiated before the earlier of the paying agent sending the next regularly scheduled check or the elapsing of six months after the sending of the not yet negotiated check.”<sup>7</sup> Section 17A(g)(1)(D)(ii) of the Exchange Act defines the term “paying agent” to include “any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security.”<sup>8</sup>

Exchange Act Section 17A(g)(1)(B) and (C) also require that the revisions to Rule 17Ad-17: (1) provide an exclusion for paying agents from the notification requirements when the

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<sup>6</sup> Section 17A(g)(1)(A), 15 U.S.C. 78q-1(g)(1)(A). We note that in drafting Exchange Act Section 17A(g), Congress used a two-word formulation of the term “security holder.” Currently, in Rule 17Ad-17, however, there is a one-word formulation of the term “securityholder.” We do not believe that Congress intended for the term “security holder” to have a different meaning than the term “securityholder.” Thus, for the sake of consistency within Rule 17Ad-17, we use the term “missing securityholder” to discuss the statutory provision and the amendments to Rule 17Ad-17. In addition, as discussed further in Section II.B.2 below, in response to comments, we use the term “unresponsive payee” in the rule text and throughout this release in place of the statutory term “missing securityholder.”

<sup>7</sup> Section 17A(g)(1)(D)(i), 15 U.S.C. 78q-1(g)(1)(D)(i).

<sup>8</sup> Section 17A(g)(1)(D)(ii), 15 U.S.C. 78q-1(g)(1)(D)(ii).

value of the not yet negotiated check is less than \$25;<sup>9</sup> and (2) add a provision to make clear that the notification requirements imposed on paying agents shall have no effect on state escheatment laws.<sup>10</sup>

Exchange Act Section 17A(g)(2) requires the Commission to adopt rules, regulations, or orders necessary to implement the provisions of Section 17A(g)(1).<sup>11</sup> Section 17A(g)(2) further requires the Commission to seek to minimize disruptions to the current systems used by or on behalf of paying agents to process payments to account holders and to avoid requiring multiple paying agents to send written notification to a missing security holder regarding the same not yet negotiated check.<sup>12</sup>

On March 18, 2011, the Commission issued a release proposing for comment amendments to Exchange Act Rules 17Ad-17 and 17Ad-7 (“Proposing Release”).<sup>13</sup> The amendments were designed to implement Section 929W of the Dodd-Frank Act.

The Commission received fourteen comment letters on the proposed rule amendments, including six letters from trade associations.<sup>14</sup> Five commenters generally expressed support for

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<sup>9</sup> Section 17A(g)(1)(B), 15 U.S.C. 78q-1(g)(1)(B).

<sup>10</sup> Section 17A(g)(1)(C), 15 U.S.C. 78q-1(g)(1)(C).

<sup>11</sup> Section 17A(g)(2), 15 U.S.C. 78q-1(g)(2).

<sup>12</sup> *Id.*

<sup>13</sup> 17 CFR 240.17Ad-17 and 240.17Ad-7; Securities Exchange Act Release No. 64099 (March 18, 2011), 76 FR 16707 (Mar. 25, 2011) (“Proposing Release”).

<sup>14</sup> The Commission received comment letters from six trade associations (representing transfer agents, investment companies, insurance products, the securities industry, the banking industry, and the securities bar), two transfer agents, one broker-dealer, one law firm, and four individuals.

Letters were received from: Mary Pitman, author, *The Little Book of Missing Money* (March 25, 2011); Kara Follis (April 6, 2011); B.J. Luis (April 7, 2011); Chris Barnard (May 2, 2011); Charles V. Rossi, President, The Security Transfer Association, Inc. (“STA”) (May 5, 2011); Tamara K. Salmon, Senior Associate Counsel, Investment

the amendments,<sup>15</sup> and one commenter expressed disapproval.<sup>16</sup> Twelve commenters offered suggestions for modification or requests for clarification with respect to specific provisions of the proposal.<sup>17</sup> As discussed below, we are adopting the proposed amendments to Rule 17Ad-17 with certain modifications based on the comments we received, and we are adopting an amendment to Rule 17Ad-7(i) as proposed. We also are adopting a new rule, Rule 15b1-6, to ensure that brokers and dealers have notice of their new obligations with respect to lost securityholders and unresponsive payees.

## II. Final Rule

### A. Background

The Commission originally adopted Rule 17Ad-17 in 1997 to address situations where recordkeeping transfer agents have lost contact with securityholders.<sup>18</sup> The rule requires such transfer agents to exercise reasonable care to ascertain the correct addresses of these “lost

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Company Institute (“ICI”) (May 9, 2011); Laura Stevenson, Compliance Officer, Computershare Trust Company of Canada/Computershare Investor Services Inc. (“Computershare”) (May 9, 2011); Ronald C. Long, Director of Regulatory Services, Wells Fargo Advisors (“WFA”) (May 9, 2011); Prescott Lovern, President, R & L Associates Law LLC (May 9, 2011); Holly H. Smith and Clifford E. Kirsch, Sutherland Asbill & Brennan, LLP on behalf of its client, The Committee on Annuity Insurers (“Annuity Committee”) (May 9, 2011); Thomas F. Price, Managing Director, SIFMA (May 9, 2011); Anthony Thalman, Managing Director, BNY Mellon Shareholder Services (“BNY Mellon”) (May 17, 2011); Phoebe A. Papageorgiou, Senior Counsel, American Bankers Association (“American Bankers”) (May 23, 2011); and Jeffrey W. Rubin, Chair, Federal Regulation of Securities Committee, Business Law Section, American Bar Association (“ABA”) (May 26, 2011).

<sup>15</sup> Kara Folis, Chris Barnard, STA, ICI, and SIFMA, supra note 14.

<sup>16</sup> Prescott Lovern, supra note 14.

<sup>17</sup> Chris Barnard, STA, ICI, Computershare, WFA, SIFMA, Prescott Lovern, Annuity Committee, SIFMA, BNY Mellon, American Bankers, and ABA, supra note 14.

<sup>18</sup> Securities Exchange Act Release No. 39176 (Oct. 1, 1997), 62 FR 52229 (Oct. 7, 1997) (“Rule 17Ad-17 Adopting Release”). A “recordkeeping transfer agent” is a registered transfer agent that maintains and updates the master securityholder file. See Rule 17Ad-9(h).

securityholders” and to conduct certain database searches for them.<sup>19</sup> As the Commission noted at that time, such loss of contact can be harmful to securityholders because they no longer receive corporate communications or the interest and dividend payments to which they may be entitled.<sup>20</sup> Additionally, the securities and any related interest and dividend payments to which the securityholders may be entitled are often placed at risk of being deemed abandoned under operation of state escheatment laws.<sup>21</sup> This loss of contact has various causes, but it most frequently results from: (1) failure of a securityholder to notify the transfer agent of his correct address after relocating; or (2) failure of the estate of a deceased securityholder to notify the transfer agent of the death of the securityholder and the name and address of the trustee/administrator for the estate.<sup>22</sup>

## **B. Discussion**

### **1. Application of Rule 17Ad-17 to Brokers and Dealers**

The amendments to Rule 17Ad-17 implement the statutory directive of Section 17A(g)(1) of the Exchange Act to extend the application of that rule to brokers and dealers. Specifically, the Commission is adopting the changes to Rule 17Ad-17 implementing this extension largely as proposed, principally by revising paragraph (a) of Rule 17Ad-17 to extend its requirements to “every broker or dealer that has customer security accounts that include accounts of lost

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<sup>19</sup> Rule 17Ad-17, 17 CFR 240.17Ad-17.

<sup>20</sup> Rule 17Ad-17 Adopting Release, supra note 18.

<sup>21</sup> Id. Generally, after expiration of a certain period of time, which varies from state to state but is usually three to seven years, an issuer or its transfer agent will remit abandoned property (e.g., securities and funds of lost securityholders) to a state’s unclaimed property administrator pursuant to the state’s escheatment laws.

<sup>22</sup> Securities Exchange Act Release No. 37595 (Aug. 22, 1996), 61 FR 44249 (Aug. 28, 1996).

securityholders”.<sup>23</sup> As a result, each such broker or dealer will, like recordkeeping transfer agents, be required to exercise reasonable care to ascertain the correct addresses of “lost securityholders”, as that term is defined in paragraph (b)(2)(i) of Rule 17Ad-17, and to conduct certain database searches for them.<sup>24</sup> The database searches will be conducted by taxpayer identification number (“TIN”), or by name if a search based on TIN is not likely to locate the securityholder, the same procedure that has existed under Rule 17Ad-17 since its adoption in 1997 with respect to lost securityholder searches by transfer agents.<sup>25</sup>

**a. Definition of “Broker” and “Dealer”**

As adopted, Rule 17Ad-17(a) will now apply to all “brokers” and “dealers”. Two commenters<sup>26</sup> argued that extension of the rule’s lost securityholder requirements to brokers and dealers as directed by the statute<sup>27</sup> should be interpreted in paragraph (a) of Rule 17Ad-17 to mean only those brokers and dealers that carry securities for customers (*i.e.*, “carrying firms”). As explained by one of these commenters, carrying firms by contract accept the obligation to hold customer funds and securities, and without a limitation to carrying firms, the rule could be overbroad and could apply to insurance underwriters and firms selling annuities that do not hold

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<sup>23</sup> While the Commission is adopting Rule 17Ad-17(a) largely as proposed, we are clarifying that the requirements apply only to brokers or dealers that have customer security accounts “that include accounts of lost securityholders”. The additional language parallels the language applicable to recordkeeping transfer agents and eliminates ambiguity in the proposed rule as to what obligations would be incurred by a broker or dealer that has no customer security accounts of lost securityholders. Letter from ABA, *supra* note 14.

<sup>24</sup> For the amended definition of “lost securityholder,” *see supra* note 5.

<sup>25</sup> *See* Rule 17Ad-17 Adopting Release, *supra* note 18.

<sup>26</sup> Letters from Mr. Bernard and Annuity Committee, *supra* note 14.

<sup>27</sup> Exchange Act, Section 17A(g)(1), 15 U.S.C. 78q-1(g)(1).

securities for the accounts of customers.<sup>28</sup> A third commenter<sup>29</sup> suggested that the Proposing Release overstated the carrying firm's role in handling customers' accounts and stated that while the carrying firm does carry customer accounts for introducing firms, in many cases it is the introducing firm that has the primary relationship with the customers. The commenter further suggested that the obligations of Rule 17Ad-17 be allocable among introducing and carrying firms such that the broker or dealer that has the primary relationship with the particular customer, which in many cases would be an introducing firm rather than a carrying firm, would bear the responsibility for complying with those obligations. A fourth commenter<sup>30</sup> asserted that it is unclear whether Congress intended to extend the rule's coverage to all brokers and dealers and suggested that the Commission could use its exemptive authority under Section 36 of the Exchange Act<sup>31</sup> to narrow the term's scope and apply the rule only to a subset of brokers and dealers, such as those having customer accounts that contain securities registered under Section 12 of the Exchange Act ("Section 12 securities").<sup>32</sup>

The Commission has carefully considered these comments for narrowing the application of Rule 17Ad-17 to some subset of brokers and dealers or securities. The Commission

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<sup>28</sup> Letter from Annuity Committee, *supra* note 14. While commenters that opined on limiting the kinds of brokers and dealers covered by the amendments to Rule 17Ad-17 referred generally to "clearing firms", we believe the relevant question is whether to apply the amendments only to carrying firms. While firms that are not carrying firms may clear transactions – such as self-clearing firms with no customer business – it does not appear that commenters were addressing a limitation to clearing firms without regard to whether such firms actually carry accounts for customers that could be lost securityholders. Accordingly, the discussion in this release focuses on "carrying firms," not the broader universe of "clearing firms".

<sup>29</sup> Letter from SIFMA, *supra* note 14.

<sup>30</sup> Letter from ABA, *supra* note 14.

<sup>31</sup> 15 U.S.C. 78mm.

<sup>32</sup> 15 U.S.C. 78l.

acknowledges that there may be different means by which a broker or dealer may determine whether it has accounts of lost securityholders, as well as different means of exercising reasonable care to ascertain the correct addresses of those securityholders under Rule 17Ad-17.<sup>33</sup> However, the statutory directive of Section 17A(g) of the Exchange Act does not exclude any class of brokers or dealers from making such determinations or exercising such care. Rather, the terms “broker” and “dealer” used by Section 17A(g) are defined terms under Sections 3(a)(4) and (5) of the Exchange Act,<sup>34</sup> and neither the statutory language of Section 17A(g) nor any legislative history indicates that Congress intended the Commission to use an abbreviated or alternative version of these terms for purposes of this rule. Similarly, there is no indication that Congress intended that brokers’ and dealers’ obligations to search for lost securityholders should depend on the type of the securities, such as Section 12 securities, held in the securityholder’s account. Accordingly, the Commission believes that the approach set forth in the Proposing Release of applying Rule 17Ad-17 to all brokers and dealers remains an appropriate implementation of the recent amendments to the Exchange Act and that an exercise of exemptive authority at this stage would be premature.

The Commission is therefore interpreting the terms “broker” and “dealer” in paragraph (a) of the rule to mean a “broker” or “dealer” as defined, respectively, in Exchange Act Sections 3(a)(4)<sup>35</sup> and 3(a)(5).<sup>36</sup> Each broker or dealer that has customer security accounts will have to

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<sup>33</sup> For example, the specific functions of carrying and introducing firms may vary from firm to firm depending on particular carrying agreements. *See, e.g.*, FINRA Rule 4311.

<sup>34</sup> 15 U.S.C. 78c(a)(4) and (5).

<sup>35</sup> 15 U.S.C. 78c(a)(4).

<sup>36</sup> 15 U.S.C. 78c(a)(5).

determine whether one or more of its customers has become a lost securityholder for purposes of the rule, whether it is consequently subject to the requirements of Rule 17Ad-17 to search for those customers, and what means it should use for making such determinations and complying with such requirements.<sup>37</sup>

**b. Items of Correspondence**

As adopted, Rule 17Ad-17(a)(1) will now require brokers and dealers to search for “lost securityholders” as that term is defined in paragraph (b)(2) of the rule. Two commenters questioned the obligation to consider a securityholder “lost” after the return of a single item of correspondence, as provided in paragraph (b)(2) of the rule.<sup>38</sup> They suggested that this obligation, which previously applied only to recordkeeping transfer agents, will be burdensome on brokers and dealers because brokers and dealers, unlike transfer agents, routinely send out large amounts of mail to securityholders. These commenters argued that a single item of correspondence easily could be returned as undeliverable, perhaps even by mistake.<sup>39</sup> One of the commenters suggested that the Commission modify the rule to expand the number of returned correspondence to “no less than three before deeming a shareholder lost.”<sup>40</sup> The other commenter, while not addressing a minimum quantity of returned items, suggested limiting the

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<sup>37</sup> See, e.g., supra note 32.

<sup>38</sup> Letters from WFA and SIFMA, supra note 14.

<sup>39</sup> Another commenter questioned the use of the term “returned as undeliverable” in paragraph (b)(2) of the rule, asserting that no one can prove that correspondence returned by the U.S. Postal Service is undeliverable. Letter from Prescott Lovern, supra note 14. The Commission notes that the term “undeliverable”, a term of the U.S. Postal Service, has been in paragraph (b)(2) of Rule 17Ad-17 since the original rule’s adoption in 1997, and until receipt of this comment, the Commission had never received a request for guidance or a report of confusion concerning the term. Accordingly, at this time, the Commission does not believe there is sufficient basis for substituting another term in the rule.

<sup>40</sup> Letter from WFA, supra note 14.

categories of correspondence that trigger the lost securityholder designation to “annual tax forms (e.g., Forms 1099), returned checks, or account statements returned in two consecutive periods.”<sup>41</sup>

The Commission notes that the purpose of Rule 17Ad-17 has been to make certain that records of transfer agents – and now brokers and dealers – reflect the correct addresses for securityholders. Because of the importance of having accurate records and of maintaining contact with securityholders, the rule as adopted in 1997 – the version the Commission is directed by Congress to extend to brokers and dealers – provides that the obligation to search for a lost securityholder should attach when the first item of any type of correspondence is returned as undeliverable.<sup>42</sup> The 1997 rule recognized that a loss of contact with a securityholder does not turn on the number or nature of correspondence, simply that correspondence was returned as undeliverable. This objective and rationale for the rule conditioning “lost securityholder” status on a single item of any correspondence remain whether the records of a transfer agent or a broker or dealer are concerned. In addition, we note that to help make sure that the item was not returned because of simple addressing error of the sender or delivery error of the post office, Rule 17Ad-17 provides in paragraph (b)(2)(i) that if the sender resends the returned item within one month of its return, the sender does not have to consider the securityholder lost until the item is again returned as undeliverable. Consequently, brokers and dealers will have, as do transfer agents, a way to confirm that an item that is returned as undeliverable is actually undeliverable

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<sup>41</sup> Letter from SIFMA, supra note 14.

<sup>42</sup> Rule 17Ad-17 Adopting Release, supra note 18.

(i.e., was not returned because of error) before the requirement to search for the lost securityholder attaches.

Therefore, the Commission has determined not to adopt the suggestions to delay a broker's or dealer's obligation to search until several items or some specific type of correspondence have been returned as undeliverable.

**c. Other Issues Regarding Lost Securityholders**

One commenter suggested that if the proposed amendments to Rule 17Ad-17 were adopted, the rule should make clear that a broker's or dealer's obligation to search for lost securityholders applies to the same universe of securities to which a registered transfer agent's obligation applies,<sup>43</sup> which the commenter views as limited to Section 12 securities.<sup>44</sup> As stated previously, Section 17A(g) of the Exchange Act includes no indication that Congress intended to limit a broker-dealer's obligation under this rule to Section 12 securities. In addition, a transfer agent's obligations under Rule 17Ad-17 are not limited to Section 12 securities. While a transfer agent is required to register with the Commission only if it services one or more Section 12 securities,<sup>45</sup> once a transfer agent is registered, its obligations, including its search obligations under Rule 17Ad-17, are not limited to Section 12 securities.

The commenter also states that if a transfer agent has contractually agreed to search for the lost securityholders of a particular issuer, then no principal underwriter or selling broker of

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<sup>43</sup> Letter from Annuity Committee, *supra* note 14.

<sup>44</sup> Exchange Act, Section 12, 78 U.S.C. 78l.

<sup>45</sup> Exchange Act Section 17A(c)(1), 15 U.S.C. 78q-1(c)(1).

that issuer's securities should be obligated to search for the same lost securityholders.<sup>46</sup> Section 17A(g) of the Exchange Act does not limit its directive to extend Rule 17Ad-17 to a broker or dealer where some third party may have separate cause to search for lost securityholders that may be searched for by that broker or dealer, whether that separate cause is private contract or otherwise. Rather, the language of Section 17A(g) suggests that Congress intended transfer agents, brokers, and dealers all to have search requirements with respect to the securityholders on their records. Such interpretation of the statute is consistent with the fact that brokers' and dealers' records will have certain information about securityholders that is not available from the records of transfer agents and vice versa. We believe that Congress intended the Rule 17Ad-17 amendments to extend the benefits of the search requirements to the additional securityholders available on the records of brokers and dealers, not limit such requirements to the securityholders available on the records of transfer agents.

## **2. Requirements Applicable to Paying Agents**

New paragraph (c) of Rule 17Ad-17 implements the statutory directive of Section 17A(g) of the Exchange Act by requiring, among other things, that a paying agent must provide to each unresponsive payee a single written notification no later than seven months after the sending of any not yet negotiated check to inform the unresponsive payee that the unresponsive payee has been sent a check that has not yet been negotiated.

The Commission is adopting Rule 17Ad-17 largely as proposed. However, as described below, the Commission is adopting the term "unresponsive payee" throughout Rule 17Ad-17(c) in lieu of "missing securityholder" because of the potential for confusion and misinterpretation

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<sup>46</sup> Letter from Annuity Committee, supra note 14.

by paying agents and other parties. In addition, also as described below, the Commission is providing additional guidance about when certain of the requirements applicable to paying agents apply, clarifying when notifications must be sent by paying agents, and modifying paragraphs (c)(1) and (c)(3) from the text of the Proposing Release to allow the requisite calculations to rely on days as well as months.

**a. Definition of “Paying Agent”**

Consistent with the definition in Section 17A(g)(1)(D)(ii) of the Exchange Act,<sup>47</sup> new paragraph (c)(2) of Rule 17Ad-17 defines “paying agent” to “include any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from an issuer of securities and distributes the payments to the holders of the security.” One commenter stated that the rule’s proposed definition of “paying agent” is very broad and that not all of the term’s covered entities are registered with the Commission.<sup>48</sup> The commenter also noted that the proposed definition’s use of the term “any other person” covers entities that are outside the Commission’s jurisdiction. This commenter further suggested that the rule’s definition of “paying agent” might be revised and shortened, and because the rule will include the comprehensive term “any other person,” some of the other categories in the definition could be eliminated.

The Commission understands that the term “paying agent” applies broadly, but believes this expansive definition is consistent with congressional intent in light of the precise language requiring a range of specific entities to be included in the definition. While the Commission

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<sup>47</sup> Section 17A(g)(1)(D)(ii), 15 U.S.C. 78q-1(g)(1)(D)(ii).

<sup>48</sup> Letter from ABA, supra note 14.

recognizes that some of the entities covered by the definition of “paying agent” are not required to be registered with the Commission, the Commission believes that the broad definition of “paying agent” in Section 17A(g) of the Exchange Act provides the Commission with authority with respect to such entities for purposes of Rule 17Ad-17. Consequently, the Commission is adopting as proposed the statutory language defining “paying agent” specifically drafted by Congress for inclusion in Rule 17Ad-17.

Another commenter stated that the term “paying agent” should be defined to exclude any broker, dealer, transfer agent, investment adviser, indenture trustee, custodian, or any other person that is not contractually obligated to distribute money received from an issuer to an issuer’s securityholders.<sup>49</sup> Because Congress specifically provided a broad statutory definition of “paying agent” that expressly includes entities that accept payments from issuers of securities and distributes those payments to the holders of securities and does not limit this definition to circumstances in which there is a contractual obligation, the Commission is not adopting a more narrow definition of paying agent than provided by the statute.<sup>50</sup>

This commenter also suggests that the rule should exempt issuers that contract with other paying agents from the requirement to provide written notification to persons with checks that are not yet negotiated. The Commission does not interpret the definition of “paying agent” to apply to an issuer that has contracted with another entity to act as the issuer’s “paying agent” and that is not itself distributing payments to securityholders; accordingly, the Commission does not believe a specific exemption is required.

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<sup>49</sup> Letter from Annuity Committee, *supra* note 14.

<sup>50</sup> Rule 17Ad-1(c)(2).

**b. Definition of “Missing Securityholder” and “Unresponsive Payee”**

New paragraph (c)(3) of Rule 17Ad-17, consistent with Section 17A(g)(1)(D)(i) of the Exchange Act,<sup>51</sup> provides that a securityholder will be considered an “unresponsive payee” if a check that is sent to the securityholder is not negotiated before the earlier of the paying agent’s sending the next regularly scheduled check or the elapsing of six months after the sending of the not yet negotiated check.

As adopted, paragraph (c)(3) uses the term “unresponsive payee” instead of the term “missing securityholder,” which is used by Section 17A(g) of the Exchange Act and by the proposed rule. Five commenters objected to the proposed rule’s use of the term “missing securityholder,” asserting that the new term: (1) would be confused with the rule’s existing term “lost securityholder”; (2) is a misnomer because it does not actually involve securityholders that are missing but simply securityholders who have uncashed checks; and (3) should be replaced by a more descriptive term like “unresponsive payee” or “securityholder with an uncashed check.”<sup>52</sup>

In light of these comments, the Commission is adopting the term “unresponsive payee” in connection with the requirements of Rule 17Ad-17. While “missing securityholder” was expressly set forth for purposes of this rule by Congress in Section 17A(g)(1)(D)(ii) of the Exchange Act, the potential for confusion with the term “lost securityholder,” as defined since 1997 in paragraph (b)(2) of Rule 17Ad-17, by paying agents and others is apparent from the comments. In addition, as a defined term, an alternative term can be used without potentially

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<sup>51</sup> 15 U.S.C. 78q-1(g)(1)(D)(i).

<sup>52</sup> Letters from STA, ICI, BNY Mellon, SIFMA, and Computershare, *supra* note 14..

frustrating the intent of Congress in its carefully detailed requirements applicable to paying agents. The Commission therefore believes that the term “unresponsive payee” – suggested by several commenters – is a suitable alternative to “missing securityholder.”

One commenter suggested that the term “unresponsive payee” should apply only to natural persons in order to be consistent with the requirements applicable to “lost securityholders”.<sup>53</sup> The Commission agrees with the commenter that, with respect to lost securityholders, paragraph (a)(3)(iii) of Rule 17Ad-17 limits the required searches to natural persons.<sup>54</sup> However, unlike with respect to a lost securityholder, the paying agent will have no indication, such as returned mail, that it has an incorrect address for the unresponsive payee. The paying agents will only know that the check sent to the investor has not been returned as undeliverable and that the investor has not negotiated the check. Therefore, the notices required by Rule 17Ad-17 could be properly sent to the investor’s address on the records of the paying agent without the need for a database search to determine the investor’s correct address. In addition, Section 17A(g) of the Exchange Act provides no indication that Congress intended to limit a paying agent’s obligation to natural persons. Accordingly, the Commission has determined not to limit the meaning of “unresponsive payee” to natural persons.

Two commenters suggested that the Commission clarify that a securityholder may be deemed an unresponsive payee for purposes of paragraph (c) of Rule 17Ad-17 for having failed to cash a check, but that such status will not result in his being deemed a lost securityholder for

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<sup>53</sup> Letter from ICI, supra note 14. To avoid confusion, the adopted term “unresponsive payee” is used throughout this discussion, even though the comments referred to the proposed term “missing securityholder”.

<sup>54</sup> See Rule 17Ad-17 Adopting Release, supra note 18 above (limiting the search requirements of Rule 17Ad-17 to natural persons not known to be deceased as the databases used to search for lost securityholders when the rule was adopted in 1997 generally did not contain information on heirs or estates and were limited to natural persons).

purposes of paragraph (a) unless that person specifically meets the definition of “lost securityholder” in paragraph (b)(2) of Rule 17Ad-17.<sup>55</sup> The Commission agrees. The rule as amended would not require a person to be deemed a lost securityholder just because he has been classified as an unresponsive payee. For a securityholder to be deemed a lost securityholder, the securityholder must specifically meet the definition of “lost securityholder” in paragraph (b)(2) of Rule 17Ad-17.

A commenter asked how long a person who becomes an unresponsive payee will remain in that status.<sup>56</sup> Such status will cease when the securityholder negotiates the check or checks that caused the securityholder to be classified as an unresponsive payee. In response to this comment, the Commission has revised paragraph (c)(3) of Rule 17Ad-17 to clarify this point.

A commenter inquired about the situation where an unresponsive payee either becomes a lost securityholder or is known to have died.<sup>57</sup> Under Rule 17Ad-17(c)(1), if an unresponsive payee would be considered a lost securityholder by a transfer agent, broker, or dealer, the paying agent would not be required to send the notice of an unnegotiated check to the unresponsive payee until such time as the paying agent obtains a good address to send the notice. At such time, the investor would no longer be a lost securityholder. In response to this comment, the Commission has revised the rule text of paragraph (c)(1) of Rule 17Ad-17 to clarify this point. However, with respect to an unresponsive payee that is known to have died, the paying agent would still have the obligation to send the notice of an unnegotiated check. The fact that a

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<sup>55</sup> Letters from ICI and SIFMA, supra note 14.

<sup>56</sup> Letter from BNY Mellon, supra note 14.

<sup>57</sup> Letter from American Bankers, supra note 14. See also Letter from ICI, supra note 14, with respect to the status of a deceased person.

securityholder has died does not in and of itself mean that there is not a good address to send the notice, and such notice could be of benefit to the deceased securityholder's estate. The paying agent will not know if and how checks ultimately will be negotiated by the trustee or administrator of the estate.

This commenter also inquired about an unresponsive payee who has received one or more checks from a paying agent on a monthly basis but who has not negotiated any check.<sup>58</sup> Specifically, the commenter questioned whether there would be a notification requirement if the unresponsive payee were to negotiate the checks before the "six month period has lapsed" per paragraph (c)(3) of Rule 17Ad-17. We note that if an unresponsive payee were to negotiate a check before the elapsing of six months after the paying agent sent the check, Rule 17Ad-17 would not require the paying agent to send the notice required in paragraph (c)(1) of the rule for that check.

**c. Definition of "Regularly Scheduled Check"**

The term "regularly scheduled check" in Section 17A(g)(1)(D)(i) of the Exchange Act is not defined by the statute. One commenter suggested that the term should refer to checks that securityholders have made arrangements to have sent to them on a "pre-specified, regularly-scheduled basis" and that the term should not include ad hoc checks.<sup>59</sup> Another commenter noted that unnegotiated checks from paying agents are not necessarily related to scheduled interest and dividend payments and may not even be regularly scheduled.<sup>60</sup> A third commenter

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<sup>58</sup> Id.

<sup>59</sup> Letter from ICI, supra note 14.

<sup>60</sup> Letter from SIFMA, supra note 14.

suggested the notification requirement should apply only to those checks sent to the securityholder by the paying agent pursuant to its contractual obligation to pass along dividends and other distributions from an issuer to the securityholder and should not apply to unnegotiated checks sent by the paying agent to third parties on behalf of the securityholder or to unregistered checks that constitute the proceeds of a sale.<sup>61</sup>

Congress, in drafting Section 17A(g)(1)(B) of the Exchange Act, did not limit the meaning of “regularly scheduled check” to such instruments as “interest and dividend checks” or mention established “arrangements” in this connection.<sup>62</sup> In addition, Section 17A(g)(1) is captioned “Due Diligence for the Delivery of Dividends, Interest, and Other Valuable Property Rights”. On the other hand, Congress did refer to “regularly scheduled checks” in defining who would qualify as an unresponsive payee, rather than simply “checks.” Therefore, for purposes of Rule 17Ad-17, we are interpreting the term “regularly scheduled check” to include not only checks for interest and dividend payments but also any other regularly scheduled periodic payments from an issuer of securities to be distributed to securityholders as a class. Accordingly, the term “regularly scheduled check” would not include checks for payment solely to an individual securityholder and not to a class of securityholders pursuant to specific arrangements established at the request of the securityholder or to third parties on behalf of the securityholder.

**d. Notification**

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<sup>61</sup> Letter from American Bankers, supra note 14.

<sup>62</sup> The Commission notes that a number of periodic distributions by issuers, such as partnership distributions, may technically not be interest or dividend payments.

In the Proposing Release, the Commission proposed to incorporate the statutory definition of “missing securityholder” from Section 17A(g)(1)(D)(i) into subparagraph (c)(3) of Rule 17Ad-17.<sup>63</sup> Specifically, the proposed rule stated, “[T]he securityholder shall be considered a missing securityholder [i.e., an unresponsive payee] if a check is sent to the securityholder and the check is not negotiated before the earlier of the paying agent’s sending the next regularly scheduled check or the elapsing of six (6) months after the sending of the not yet negotiated check.”

Two commenters stated that some regularly scheduled distributions by paying agents are made on a monthly cycle.<sup>64</sup> In such a situation, they suggest that a securityholder who did not negotiate a check sent to him or her could become an unresponsive payee within one month (i.e., at the time of the next regularly scheduled check). One of the commenters stated that this monthly interval would frequently overlap the timeframe in which payees routinely negotiate their checks.<sup>65</sup> The other commenter likewise stated that, as a paying agent, it provides many clients with services that include payment of a monthly dividend.<sup>66</sup> As an example, the commenter noted that if a securityholder has mail held for himself or herself at one location while he or she spends part of the year at another location, as many retirees do, checks may not be delivered to – let alone negotiated by – the payee before the next monthly check is sent. This commenter suggested that it would be more practical to have a longer time for the required

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<sup>63</sup> Proposing Release, supra note 13.

<sup>64</sup> Letters from Computershare and BNY Mellon, supra note 14.

<sup>65</sup> Letter from Computershare, supra note 14.

<sup>66</sup> Letter from BNY Mellon, supra note 14.

notification of a check that was not negotiated and for the triggering of “unresponsive payee” status in those circumstances. One of these commenters recommended a minimum time of not less than 60 days from the payable date of a dividend or from the sending of a check before notification to an unresponsive payee would have to be made.<sup>67</sup>

The Commission notes that the paying agent would have to send only one notification for a given check and that such notification could be sent along with another check or other subsequent mailing. In addition, the Commission notes that while a particular payee receiving monthly checks may become an “unresponsive payee” after a single month, the requirement to provide an actual notification to the payee allows a full seven months following the sending of the unnegotiated check (i.e., about six months in the case of an unnegotiated monthly check) before the paying agent must send such notification. As clarified in Rule 17Ad-17(c)(1), if the unresponsive payee negotiates the check in that seven-month interval, he or she will no longer be an unresponsive payee and no notification will need to be sent. Accordingly, the Commission does not at this time believe there is a need to create an initial 60-day period or other time frame before which notifications would not be required. In any case, the timeline for qualifying as an unresponsive payee and the related notification duty are statutory requirements that are set forth, respectively, in Sections 17A(g)(1)(D)(i) and 17A(g)(1)(A) of the Exchange Act.<sup>68</sup>

Two commenters asked if a paying agent may issue one generic notification to alert an unresponsive payee of multiple checks, perhaps from different issuers, that remain unnegotiated

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<sup>67</sup> Letter from Computershare, supra note 14.

<sup>68</sup> 15 U.S.C. 78q-1(g)(1)(D)(i) and 78q-1(g)(1)(A).

for the seven-month measuring period.<sup>69</sup> Section 17A(g)(1)(A) of the Exchange Act requires that the paying agent “provide a single written notification to each [unresponsive payee] that the [unresponsive payee] has been sent a check that has not yet been negotiated.” It is not clearly stated in the statute whether the paying agent must provide: (1) a single written notification to *each unresponsive payee* who has been sent a check that has not yet been negotiated; or (2) a single written notification to the unresponsive payee for *each check* that has been sent but has not yet been negotiated. The Commission believes that the apparent congressional purpose of Section 17A(g)(1)(A) is to help ensure that securityholders receive and have the benefits of their distribution checks, which can be accomplished through a notice covering one or multiple checks. While a paying agent’s per-check notice may focus a securityholder’s attention on each check, a notice covering multiple checks may serve as a signal to a securityholder that there is an issue with systems or methods used by that securityholder for negotiating checks from that paying agent. Accordingly, we interpret the statutory language as permitting either approach to be used by a paying agent, provided that the applicable time requirements of Rule 17Ad-17 – in particular, the seven-month measuring interval – are met with respect to each individual check. For a notice covering multiple checks, this interpretation means that the notification must sufficiently identify each not yet negotiated check and that the notice must be sent to the unresponsive payee no later than seven months after the sending of the *oldest* not yet negotiated check that is covered by the notice.

Commenters further suggested that a check that has not yet been negotiated should be excluded from notification requirements if the check is “redeposited” into the securityholder’s

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<sup>69</sup> Letters from ICI and BNY Mellon, *supra* note 14.

account. One commenter suggested that such check redepositing should occur within six months of its issuance.<sup>70</sup> The Commission understands these comments to mean that the checks or equivalent funds would be deposited into the securityholders' brokerage or other accounts with no record of the holders' potential status as unresponsive payees. While we recognize that the deposit of a previously issued check into the account of a securityholder would have the effect of assuring that the funds represented by the check are no longer held in abeyance and are available to benefit the securityholder, there is no evidence to suggest that it was Congress' intent to establish or encourage such a depository arrangement for a securityholder where one did not exist prior to the transmittal of the check or checks subject to redeposit. To the extent a securityholder has established standing or other prior instructions for any check or checks to be deposited into its account in a particular manner, a check deposited in compliance with such instructions may properly be considered to have been negotiated by the securityholder for the purpose of Rule 17Ad-17. However, there is no evidence to suggest Congress intended to allow paying agents to avoid the notification requirements of Rule 17Ad-17 simply by depositing the monetary equivalent of the uncashed check into an account for the unresponsive payee.

Another commenter observed that broker-dealers provide periodic statements to customers that include all disbursements, including checks, and that such statements could serve as the notifications contemplated by the rule amendments.<sup>71</sup> While the Commission recognizes that generally all transactions, including checks, are detailed in brokers' periodic statements, we do not believe that such all-inclusive statements in their present form would present the kind of

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<sup>70</sup> Letters from ICI and SIFMA, supra note 14.

<sup>71</sup> Letter from ICI, supra note 14.

focused notification of uncashed checks that Congress intended in enacting Section 17A(g)(1)(A).

Three commenters requested clarification on whether the written notification would include electronic communications.<sup>72</sup> Consistent with our prior guidance on electronic delivery of customer disclosures and confirmations, a paying agent may provide the written notification electronically if the customer has affirmatively consented to receiving disclosures generally in such manner.<sup>73</sup>

One of these commenters suggested that instead of using the statutory terms 6 months and 7 months as measuring times, the rule could use 180 calendar days and 210 calendar days, respectively, which the commenter suggests are easier to accommodate in accounting periods and in programming systems. Accordingly, to accommodate variances in entities' accounting procedures and systems, the Commission is adopting language to provide the option of using months or days. Rule 17Ad-17(c), as adopted, allows "6 months (or 180 days)" and "7 months (or 210 days)."

**e. Exemption for Checks Less than \$25**

New paragraph (c)(4) of Rule 17Ad-17, consistent with Exchange Act Section 17A(g)(1)(B), excludes a paying agent from the notification requirements where the value of the not yet negotiated check is less than \$25.<sup>74</sup> One commenter suggested that significant cost

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<sup>72</sup> Letters from ICI, SIFMA, and American Bankers, *supra* note 14.

<sup>73</sup> "Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940," 61 FR 24644 (May 15, 1996).

<sup>74</sup> Section 17A(g)(1)(B), 15 U.S.C. 78q-1(g)(1)(B).

savings might accrue by increasing the rule's notification threshold on uncashed checks to \$100, instead of \$25.<sup>75</sup> The Commission has determined not to modify the \$25 amount established by Section 17A(g) of the Exchange Act for purposes of paragraph (c)(4) of Rule 17Ad-17 at this time, which would require deviating from a specific de minimis level recently selected by Congress.

**f. Minimization of Disruptions**

In the Proposing Release, the Commission requested comment on Congress' directive in Section 17A(g)(2) that "[t]he Commission shall seek to minimize disruptions to current systems used by or on behalf of paying agents to process payments to account holders and avoid requiring multiple paying agents to send written notifications to a missing security holder [i.e., unresponsive payees] regarding the same not yet negotiated check." Two commenters responded that, while there would be certain increases in programming and administrative costs, they do not believe the amendments would cause any significant disruptions.<sup>76</sup> With regard to paying agents, these commenters stated that the obligation to notify would fall only on the paying agent that holds the relevant records and that, accordingly, it would be unlikely that multiple paying agents would be sending redundant notices about the same checks to securityholders. We agree with these commenters that it would be unlikely for multiple paying agents to be sending redundant notices about the same checks. The Commission also agrees with the commenters' views that the rule amendments should not cause significant disruptions.

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<sup>75</sup> Letter from SIFMA, supra note 14.

<sup>76</sup> Letters from STA and ICI, supra note 14.

**g. State Escheatment Laws**

New paragraph (c)(5) of Rule 17Ad-17, as required by Exchange Act Section 17A(g)(1)(C),<sup>77</sup> provides that the requirements of paragraph (c)(1) of Rule 17Ad-17 “shall have no effect on state escheatment laws.” Two commenters observed that future timelines for state escheatment practices are at some point likely to conflict with the timeline for notifying missing securityholders.<sup>78</sup> These commenters suggested that the Commission clarify in the adopting release how firms should apply the rule if a conflict should arise with state escheatment laws. Rather than address hypothetical situations of what may happen if a conflict arises at some future time between federal and state law, the Commission will consider how to address any such actual conflict at the time it is made aware that such a conflict exists.

One commenter stated that language in footnote 15 of the Proposing Release constituted an effort by the Commission to “eliminate federal preemption subtly.”<sup>79</sup> Footnote 15 of the Proposing Release stated, “Generally, after expiration of a certain period of time, which varies from state to state but is usually three to seven years, an issuer or its transfer agent must remit abandoned property (e.g., securities and funds of lost securityholders) to a state’s unclaimed property administrator pursuant to the state’s escheatment laws.”<sup>80</sup> Footnote 15 of the Proposing Release was not a statement concerning federal preemption but instead was intended to be

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<sup>77</sup> Section 17A(g)(1)(C), 15 U.S.C. 78q-1(g)(1)(C).

<sup>78</sup> Letters from WFA and SIFMA, supra note 14. Another commenter, Mary Patman, observed that one way to resolve escheatment problems is “to require the shareholder to be informed about unclaimed property laws and educate them on how to prevent their investments from getting turned over to the state in the first place,” but she also indicated that this was probably impossible. Letter from Ms. Putman, supra note 14.

<sup>79</sup> Letter from Prescott Lovern, Esq., supra note 14.

<sup>80</sup> Proposing Release, supra note 13. This footnote is replicated herein at note 21.

merely a general statement of the operation of state escheatment law. Similarly, the Commission is not in this release or in Rule 17Ad-17 making any statement regarding federal preemption or regarding preemption's relationship to state escheatment laws.

### 3. Compliance Date

Three commenters requested clarification concerning the effective and compliance dates of the amendments to Rule 17Ad-17.<sup>81</sup> One of these commenters suggested that compliance with the amended rule be required 12 months after its approval date,<sup>82</sup> as proposed, and the other two commenters suggested that compliance with the amended rule be required 18 months after the approval date to allow added time for the development of new systems.<sup>83</sup>

In response to the comments, the Commission is making clear that the rules will be effective 60 days after publication in the Federal Register and that the compliance date will be twelve months after publication in the Federal Register. The compliance date is the date on which all entities subject to the requirements of the rule must be in compliance with the rule. Although the Commission is aware that changes to systems require time to plan and implement, we do not find that the two commenters who requested additional time sufficiently justified their need in light of the statutory directive and the policy goals it apparently seeks to advance. Therefore, we are adopting the compliance date substantially as proposed.

One commenter asked whether the rule would apply retroactively, meaning that

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<sup>81</sup> Letters from STA, ICI, and Annuity Committee, supra note 14.

<sup>82</sup> Letter from STA, supra note 14.

<sup>83</sup> Letters from ICI and Annuity Committee, supra note 14.

notifications might be required for checks already outstanding.<sup>84</sup> The Commission notes that the changes to the rule will apply only prospectively.

#### 4. Rule 15b1-6: Notice to Brokers and Dealers of Rule Amendments

Another commenter observed that the rule covers brokers, dealers, transfer agents, and others who may not be aware that the rule will apply to them.<sup>85</sup> It suggests a separate rule, referencing Rule 17Ad-17, be added to the Commission's rules under Section 15(b) of the Exchange Act, which applies to brokers and dealers, to keep brokers and dealers apprised of the requirements. The Commission agrees with this commenter's suggestion and is adopting a new technical rule, Rule 15b1-6, which will provide ongoing notice to brokers and dealers of their obligations under Rule 17Ad-17.<sup>86</sup>

The Commission is adopting Rule 15b1-6 simply to provide ongoing notice to brokers and dealers of amendments to Rule 17Ad-17 that affect brokers and dealers, and it imposes no independent obligation on any party.<sup>87</sup> Rule 15b1-6 is solely a mechanism to provide additional notice – on an ongoing basis – to certain registrants regarding amendments to Rule 17Ad-17 that will now impose substantive obligations on them as described in the Proposing Release and this release.<sup>88</sup>

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<sup>84</sup> Letter from STA, *supra* note 14.

<sup>85</sup> Letter from ABA, *supra* note 14.

<sup>86</sup> *Id.*

<sup>87</sup> *See* 6 U.S.C. 553(b).

<sup>88</sup> The adoption of Rule 15b1-6 does not require analysis under the Regulatory Flexibility Act or under the Small Business Regulatory Enforcement Fairness Act. 5 U.S.C. 601 and 5 U.S.C. 804.

## 5. Recordkeeping

Currently, Rule 17Ad-17(c)<sup>89</sup> requires that every recordkeeping transfer agent shall maintain records to demonstrate compliance with the requirements of the rule (including written procedures that describe the transfer agent's methodology for complying) and requires that such records be maintained for a period of not less than three years with the first year in an easily accessible place.<sup>90</sup> These recordkeeping requirements have been part of Rule 17Ad-17 since its adoption in 1997.<sup>91</sup> In the Proposing Release, the Commission proposed redesignating paragraph (c) as paragraph (d) and amending that paragraph to require brokers, dealers, and paying agents (in addition to transfer agents) to maintain such records. The Commission also proposed a conforming amendment to Rule 17Ad-7(i)<sup>92</sup> so that it would cross-reference redesignated paragraph (d), rather than paragraph (c), of Rule 17Ad-17. The Commission received no comments on these proposed recordkeeping amendments and is adopting them as proposed, with a technical change to avoid unnecessarily duplicative language between Rule 17Ad-7(i) and Rule 17Ad-17(d).<sup>93</sup>

## 6. Title

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<sup>89</sup> 17 CFR 240.17Ad-17(c).

<sup>90</sup> Pursuant to Rule 17Ad-7(i), 17 CFR 240.17Ad-7(i), transfer agents have had to maintain records to show their compliance with Rule 17Ad-17. This same requirement for transfer agents, brokers, dealers, and paying agents is now stated explicitly in amended Rule 17Ad-17. In order to maintain consistency with amended Rule 17Ad-17, we have adopted a technical change to Rule 17Ad-7(i) so that it will cross-reference new Rule 17Ad-17(d) rather than superseded Rule 17Ad-17(c).

<sup>91</sup> Rule 17Ad-17 Adopting Release, *supra* note 18, Section II.B at pages 52232-52233.

<sup>92</sup> 17 CFR 240.17Ad-7(i).

<sup>93</sup> Specifically, Rule 17Ad-17(d) now requires transfer agents, brokers, and dealers to "retain such records in accordance with Rule 17Ad-7(i)", rather than "for a period of not less than three (3) years with the first year in an easily accessible place".

One commenter suggested that the Commission's proposed name for Rule 17Ad-17 ("Transfer agents', brokers', and dealers' obligation to search for lost securityholders; paying agents' obligation to search for missing securityholders") is too long.<sup>94</sup> The commenter suggests: "Lost and missing securityholders" as the title for Rule 17Ad-17. The Commission agrees that a shorter title is appropriate and is adopting the title "Lost securityholders and unresponsive payees" for amended Rule 17Ad-17.

### III. Paperwork Reduction Act

As explained in the Proposing Release, certain provisions of proposed amendments to Rule 17Ad-17 required a new and mandatory "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>95</sup> 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.<sup>96</sup> In accordance with 44 U.S.C. 3507 of the PRA, the Commission submitted the requirements of the proposed amendments to Rule 17Ad-17 entailing a "collection of information" to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, and the Commission published notice requesting public comment on such requirements in the Proposing Release.<sup>97</sup>

The control number for this release is OMB Control Number 3225-0469 and the title is "Transfer Agents' Obligation to Search for Lost Securityholders (17 CFR 240.17Ad-17)." The

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<sup>94</sup> Letter from ABA, supra note 14.

<sup>95</sup> 44 U.S.C. 3501 et seq.

<sup>96</sup> 44 U.S.C. 3506(c)(1).

<sup>97</sup> For Proposing Release, see supra note 13. We note that neither Rule 15b1-6 nor the amendments to Rule 17Ad-7 require any "collection of information" within the meaning of the PRA.

Commission anticipates changing the title of the collection to “Obligation to Search for Lost Securityholders and Notify Unresponsive Payees” to reflect the amendments to Rule 17Ad-17 and the change in the title of the rule.<sup>98</sup>

**A. Summary of Collection of Information**

As adopted, the amendments to Rule 17Ad-17 require a new and mandatory “collection of information” within the meaning of the PRA. This collection of information consists of: (1) brokers and dealers collecting information in order to comply with new requirements to search for lost securityholders under paragraph (a) of Rule 17Ad-17; (2) paying agents collecting information in order to comply with new requirements to provide notifications to unresponsive payees under paragraph (c) of Rule 17Ad-17; and (3) brokers, dealers, and paying agents making and maintaining records under paragraph (d) of Rule 17Ad-17 to demonstrate compliance with the requirements of Rule 17Ad-17, including written procedures which describe their methodology for complying.<sup>99</sup> The records required by paragraph (d) must be maintained for a period of not less than three years, with the first year in an easily accessible place, consistent with Rule 17Ad-7(i) under the Exchange Act.

**B. Use of Information**

Brokers and dealers will use the information collected pursuant to paragraph (a) of Rule 17Ad-17 – namely, information regarding the accounts of lost securityholders and the addresses of lost securityholders – to engage in searches for lost securityholders. Paying agents will use the information collected pursuant to paragraph (c) of Rule 17Ad-17 – namely, information

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<sup>98</sup> See *supra* Section II.B.6.

<sup>99</sup> For the definition of “paying agent,” see discussion at Section II.B.2.a, *supra*. For the definition of “unresponsive payee,” see discussion at Section II.B.2.b, *supra*.

regarding the accounts of unresponsive payees and the status of their negotiations of checks sent by the paying agent – to provide notifications to unresponsive payees that they have been sent checks but have not negotiated them.

The Commission will use the information collected under paragraph (d) of Rule 17Ad-17 to monitor the records made and maintained by every recordkeeping transfer agent, broker or dealer, and paying agent to demonstrate compliance with the requirements set forth in Rule 17Ad-17. Such records will include written procedures that describe the entity's methodology for complying with the rule.

### C. Respondents

The Commission estimates that approximately 4,705 brokers and dealers would be subject to paragraph (a) of Rule 17Ad-17, which would require them to do certain database searches for their lost securityholders. While applicable to all brokers and dealers, we are estimating that, as a practical matter, paragraph (a) will apply primarily to those brokers and dealers that carry securities accounts for customers (i.e., carrying firms), of which there are about 301 brokers and dealers.<sup>100</sup>

The Commission estimates that approximately 28,577 entities – issuers, transfer agents, brokers, dealers, indenture trustees, and custodians – potentially will be subject to the requirements of paragraph (c) of Rule 17Ad-17, which would require them to send certain

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<sup>100</sup> There are approximately 4,705 brokers and dealers registered with the Commission, according to December 31, 2011 FOCUS Report data. Of these registrants, 4,404 brokers and dealers claimed exemptions from Rule 15c3-3 on their FOCUS Reports. Accordingly, the Commission estimates that there are approximately 301 carrying brokers and dealers (4,705 minus 4,404 equals 301).

notifications to unresponsive payees.<sup>101</sup> However, we estimate that only approximately 3,035 entities accept payments from an issuer of a security and distribute those payments to the holders of the security, thereby qualifying as “paying agents” for purposes of paragraph (c).<sup>102</sup> In general, the Commission believes that in this specialized area most paying agents will consist of the large brokers and dealers and large transfer agents (including bank transfer agents), firms that typically serve as financial intermediaries between issuers and securityholders.

All brokers, dealers, and paying agents – an estimated total of 7,439 entities<sup>103</sup> – also will be subject to the recordkeeping provisions of paragraph (d) of Rule 17Ad-17, which requires maintaining records to demonstrate compliance with Rule 17Ad-17, including written procedures that describe the entity’s methodology for compliance. Such records must be retained for not less than three years, the first year in an easily accessible place.

#### **D. Revisions to Reporting and Burden Estimates**

In the Proposing Release, the Commission initially estimated for the purposes of Rule 17Ad-17 that, on an annual basis: (1) approximately 250,000 searches by brokers and dealers

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<sup>101</sup> As discussed in Sections IV and V.C.2 of the Proposing Release and in Section III.D.2 below, the 28,577 entities comprise approximately 10,379 issuers that file reports with the Commission, 4,705 brokers and dealers registered with the Commission (see *supra* note 100), 536 transfer agents registered with the Commission, 11,797 investment advisors registered with the Commission, 264 indenture trustees, and 896 custodians.

<sup>102</sup> As discussed below at Section III.D.2, the estimate of 3,035 paying agents comprises 1,038 issuers, 301 brokers and dealers, 536 transfer agents, 264 indenture trustees, and 896 custodians. While approximately 10,379 issuers file reports with the Commission, we interpret the statutory definition of “paying agent” to include only such issuers that “accept[] payments from an issuer of a security and distributes payments to the holders of the security,” a clause that the Commission’s experience with the mechanics of such payments indicates will exclude the vast majority of issuers. Accordingly, we estimate that the definition will exclude approximately 90% of issuers, leaving 10% – or approximately 1,038 issuers – as paying agents. Similarly, based on the Commission’s experience with payments to holders of securities, we expect that not all broker-dealers will act as paying agents; rather, such functions will largely be performed by carrying firms. Accordingly, we assume that all estimated 301 carrying firms will be paying agents. See *supra* note 100.

<sup>103</sup> The estimate of 7,439 entities comprises 1,038 issuers, 4,705 brokers and dealers (both carrying firms and non-carrying firms), 536 transfer agents, 264 indenture trustees, and 896 custodians.

would be required by paragraph (a) of Rule 17Ad-17 as proposed, with each search taking approximately five minutes; and (2) approximately 50,000 notifications by an estimated 1,000 paying agents would be required by paragraph (c) of Rule 17Ad-17 as proposed, with each notification taking approximately three minutes. We further estimated that these searches and notifications would require, respectively, 500 and 100 hours of recordkeeping time.

Accordingly, we estimated that the total estimated burden of the proposed amendments to Rule 17Ad-17 would be 23,933 hours.<sup>104</sup>

In response to the Proposing Release, we received comments that costs stated in the Proposing Release “likely are greater than estimated,”<sup>105</sup> that the “hours of work” and “estimated costs are low,”<sup>106</sup> and that “costs may be higher” than estimated.<sup>107</sup> In light of these comments and similar ones, the Commission has reexamined the estimates in the Proposing Release and revised them as described below.

**1. Paragraph (a) of Rule 17Ad-17 (Application of Rule 17Ad-17 to Brokers and Dealers)**

Under paragraph (a) of the amendments to Rule 17Ad-17, brokers and dealers will now be required to conduct certain database searches for lost securityholders. Such database searches must be conducted without charge to the lost securityholders. In the Proposing Release, the Commission stated that much of the information required to be collected in order to effectuate

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<sup>104</sup> 250,000 searches of five minutes apiece would require 20,833 hours and 50,000 notifications of three minutes apiece would require 2,600 hours. Accordingly, the total burden would be 23,933 hours (20,833 hours + 2,600 hours + 600 hours of recordkeeping time). Proposing Release, supra note 13, at 16,710.

<sup>105</sup> Letter from Wells Fargo, supra note 14.

<sup>106</sup> Letter from SIFMA, supra note 14.

<sup>107</sup> Letter from ABA, supra note 14.

such searches (such as the TINs of lost securityholders) is already maintained by brokers and dealers; accordingly, in many cases there should not be an additional cost to the broker or dealer to obtain the required information. We initially assumed that, with automated equipment and much of the information required to be collected already in the possession of brokers and dealers, lost securityholder searches could be performed in about two minutes. We increased the estimated search time in the Proposing Release to five minutes to allow for additional contingencies that may occur in connection with database searches.

In the Proposing Release, the Commission initially estimated that there were 5,063 broker-dealers registered with the Commission, who would perform approximately 250,000 searches per year – that is, approximately 49 searches for lost securityholders per broker or dealer per year (250,000 divided by 5,063 equals 49 searches per broker-dealer), or less than one search per broker-dealer per week. However, as noted in section III.C above, we anticipate – and the Proposing Release assumed – that Rule 17Ad-17 will as a practical matter apply mainly to brokers and dealers that carry securities accounts for customers (i.e., carrying firms), which tend to be the larger firms.

In reviewing these estimates, some commenters noted that burdens generally may be higher than anticipated in the Proposing Release. Wells Fargo noted that some project costs, such as printing and operating databases, tend to include associated expenses that are not included in the broader categories such as “labor.”<sup>108</sup> The ABA commented that the “costs may be higher than estimated,” noting further that searches for lost securityholders will apply to all brokers and dealers, of which there are more than 5,000, and, while they are assumed to be

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<sup>108</sup> Letter from Wells Fargo, supra note 14.

already performing such work on their own, the ABA questioned whether some of them may lack the necessary systems and may need to make additional financial outlays in this connection.<sup>109</sup>

The Commission continues to believe that carrying firms, which we estimate to number approximately 301,<sup>110</sup> represent the population of brokers and dealers most likely to be affected by the burdens associated with paragraph (a) of Rule 17Ad-17. In addition, such brokers and dealers tend to be larger than the overall population of firms and are the ones most likely to have the systems and processes in place for dealing with searches for securityholders, including lost securityholders. In fact, members of the broker-dealer community have stated that these new requirements are unnecessary because broker and dealers already know how to keep track of their customers. We also note that brokers and dealers may enter into commercial arrangements among themselves – such as those between an introducing and a carrying firm – to help ensure compliance with the requirements of Rule 17Ad-17 without unnecessarily burdensome system builds, just as they do in other aspects of their business.<sup>111</sup>

With respect to specific burden estimates, commenters did not address the five minute estimate for the search time under paragraph (a) of Rule 17Ad-17, but instead suggested that we should increase our estimates of the number of searches that would be required. In particular, SIFMA stated, “SIFMA member firms estimate that the number of searches and notifications could be significantly more than the Commission’s stated estimates – perhaps as much as four

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<sup>109</sup> Letter from ABA, *supra* note 14.

<sup>110</sup> See *supra* note 100.

<sup>111</sup> See *supra* note 33 and accompanying text.

times more.”<sup>112</sup> After evaluating these comments, the Commission is retaining the estimated search time but has determined to increase the estimated number of searches per year by brokers and dealers in paragraph (a) of Rule 17Ad-17 from 250,000 to 650,000,<sup>113</sup> which increases the estimated total annual hourly burden from 20,833 hours (250,000 searches times five minutes, divided by 60 minutes) to 54,160 hours (650,000 searches times five minutes, divided by 60 minutes).<sup>114</sup> The revised hourly burden estimate is the equivalent – on average – of approximately 42 searches per carrying firm per week (650,000 searches divided by 301 carrying firms divided by 52 weeks equals 41.5 searches per carrying firm per week) or approximately 9 searches per carrying firm per business day (650,000 searches divided by 301 carrying firms divided by 250 business days equals 8.6 searches per carrying firm per day).<sup>115</sup>

**2. Paragraph (c) of Rule 17Ad-17 (Requirements Applicable to Paying Agents)**

Under amended paragraph (c) of Rule 17Ad-17, a paying agent must provide not less than one written notification to each unresponsive payee no later than seven months after such securityholder has been sent a check that has not yet been negotiated. The notification may be sent with a check or other mailing subsequently sent to the unresponsive payee but must be

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<sup>112</sup> Letter from SIFMA, supra note 14.

<sup>113</sup> The estimate of 250,000 searches was based on initial discussions with participants in the securities industry. See Proposing Release, supra note 13, Section IV.A. The increase to 650,000 searches is based on the subsequent feedback from commenters, who suggested that the estimates might be “as much as four times more.” See, e.g., letter from SIFMA, supra note 14.

<sup>114</sup> See Proposing Release, supra note 13, Section IV.A.

<sup>115</sup> While calculating averages for purposes of this analysis, the Commission recognizes that searches may in fact be clustered around certain dates, such as dates established by a firm’s internal policies and procedures for conducting searches or dates established by Rule 17Ad-17 itself.

provided no later than seven months after the sending of the not yet negotiated check. In the Proposing Release, the Commission stated that the burden for issuing a notification to an unresponsive payee would be modest, approximately three minutes, given the existence of automated systems that can be used for these purposes in the entities expected to be affected by the amendments to Rule 17Ad-17.<sup>116</sup>

In the Proposing Release, the Commission initially estimated that there would be 1,000 entities acting as paying agents that would be affected by paragraph (c) of Rule 17Ad-17, and that those entities would issue approximately 50,000 notifications per year is equivalent – that is, 50 notifications per paying agent per year (50,000 notifications per year divided by 1,000 paying agents equals 50 notifications per paying agent per year), or fewer than one notification per paying agent per week (50 notifications per paying agent per year divided by 52 weeks per year equals 0.96 notifications per week).

Based on the comments described above about burdens being higher than estimated in the Proposing Release,<sup>117</sup> the Commission has determined to increase both its estimate of the number of paying agents and its estimate of the number of notifications that would be issued by such paying agents. The Commission's initial estimate that only 1,000 entities would be affected by paragraph (c) of Rule 17Ad-17 is equivalent to approximately 3.5% of the total estimate of 28,577 paying agent candidates estimated in the Proposing Release (1,000 divided by 28,577

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<sup>116</sup> Proposing Release, Section IV.C, supra note 13. The estimate was based on discussions with industry participants.

<sup>117</sup> Letters from ABA, SIFMA, and Wells Fargo, supra note 14.

equals 3.5%).<sup>118</sup> To better account for the perspective of commenters and drawing on Commission experience with the mechanics of payments to securityholders, we have increased the estimate of paying agents to 3,035 by assuming that: (1) all estimated 536 transfer agents, estimated 264 indenture trustees, and estimated 896 custodians included in the 28,577 entities will be paying agents; (2) only the estimated 301 brokers and dealers that are carrying firms (who are typically the largest firms with the capacity to manage payments to securityholders) will be paying agents; and (3) only an estimated 1,038 of issuers that file reports with the Commission will be paying agents (10,379 multiplied by 0.10 equals 1,038).<sup>119</sup>

In addition, based on the comments received regarding the potential burden of paragraph (c) of Rule 17Ad-17 and the increased estimate in the number of paying agents, we are also increasing the estimated number of annual notifications by paying agent. Commenters did not address our estimated time of three minutes for each unresponsive payee notification, and the Commission has determined to retain this notification time. Accordingly, the Commission is increasing the number of notifications that it estimates will be issued by paying agents each year

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<sup>118</sup> The 28,577 entities comprise approximately 10,379 issuers that file reports with the Commission, 4,075 brokers and dealers registered with the Commission, 536 transfer agents registered with the Commission, 11,797 investment advisors registered with the Commission, 264 indenture trustees, and 896 custodians. With the exception of the estimate of brokers and dealers, which is based on December 31, 2011, FOCUS Report data (see *supra* note 100), these estimates are drawn from various Commission sources as of January 2011. The Proposing Release estimated a total paying agent population of 28,935 entities because it used an older estimate of 5,063 brokers and dealers.

We emphasize that all of these populations they can be subject to substantial variations over time. The Commission also notes that the statutory definition of “paying agent” includes “any other person” after specifying all of the categories of financial entities already included in the Commission’s estimate of the potential universe of paying agents. Accordingly, we anticipate that only a *de minimis* number of entities not already covered by one of the named categories would be deemed “paying agents” and have therefore assumed no such persons for purposes of this analysis.

<sup>119</sup> While approximately 10,379 issuers file reports with the Commission, we interpret the statutory definition of “paying agent” to include only such issuers that “accept[] payments from an issuer of a security and distributes payments to the holders of the security,” a clause that the Commission’s experience with the mechanics of such payments indicates will exclude the vast majority of issuers.

from 50,000 to 758,750, which is the equivalent of approximately one notification being made per paying agent per business day (1 notification multiplied by 3,035 paying agents multiplied by 250 business days).<sup>120</sup> The revised number of notifications results in an increase in the estimated total annual hourly burden on paying agents from 2,500 hours (50,000 notifications times three minutes, divided by 60 minutes) to 37,938 hours (758,750 notifications times three minutes, divided by 60 minutes).

**3. Paragraph (d) of Rule 17Ad-17 (Recordkeeping)**

Amended paragraph (d) of Rule 17Ad-17 will now requires brokers, dealers, and paying agents that are subject to paragraph (a) and/or paragraph (c) of the rule to maintain records to demonstrate their compliance with the rule, including written procedures which describe their methodology for copying. The records required by the amended rule must be maintained for a period of not less than three years, with the first year in an easily accessible place, consistent with Rule 17Ad-7(i) under the Exchange Act.

Based on discussions with market participants, we initially estimated in the Proposing Release that the annual burden for making and keeping these records, which should be processed electronically, would be approximately one hour for every 500 lost securityholder accounts and one hour for every 500 unresponsive payee accounts. Based on this incremental burden, we estimated that the total recordkeeping burden would be approximately 600 hours (250,000 lost securityholders searches divided by 500 accounts plus 50,000 notifications to unresponsive payees divided by 500 accounts, times 1 hour).

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<sup>120</sup> See supra note 114 regarding the clustering of these notifications in practice.

We received no specific comment on this incremental burden estimate of one hour, and we continue to believe it appropriate. As described above, however, the Commission is increasing its estimate of the number of searches that will be undertaken for lost securityholders to 650,000 searches and is increasing its estimate of the number of notifications that will be sent to unresponsive payees to 758,750. Accordingly, we are increasing our estimate of the total recordkeeping burden as a result of the amendments to Rule 17Ad-17 from approximately 600 hours to approximately 2,818 hours: 1,300 hours with respect to searches for lost securityholders (650,000 searches divided by 500 accounts, times 1 hour) and 1,518 hours with respect to notifications to unresponsive payees (758,750 notifications divided by 500 accounts, times 1 hour).

#### **4. Total Revised Estimated Burden**

In summary, the total revised estimated burden resulting from the amendments to Rule 17Ad-17 and based on the assumptions and estimates described above would be 94,916 hours: 54,160 hours associated with the 650,000 searches expected to be undertaken by brokers and dealers pursuant to the amendments to paragraph (a) of Rule 17Ad-17; 37,938 hours associated with the 758,750 notifications to unresponsive payees expected to be made by paying agents pursuant to the amendments to paragraph (c) of Rule 17Ad-17; and 2,818 hours associated with the making and keeping of records anticipated to be necessary for brokers, dealers, and paying agents to comply with the amendments to Rule 17Ad-17 under paragraph (d) of the rule (54,160 hours plus 37,938 hours plus 2,818 hours).

#### **E. Collection of Information is Mandatory**

All collections of information pursuant to Rule 17Ad-17 will be mandatory.

#### **F. Confidentiality**

The information collected under the amendments to Rule 17Ad-17 would be generated mainly from the internal records of brokers, dealers, and paying agents. The Commission expects that some of this information, if included in a filing with the Commission, would be deemed confidential to the extent permitted by law with respect to such filing. Additionally, with respect to other information collected under the amendments and included in a filing with the Commission, a broker, dealer, or paying agent can request to the Commission that the information be kept confidential.<sup>121</sup> If such a request is made, the Commission will ordinarily keep the information confidential to the extent permitted by law.<sup>122</sup>

#### **G. Record Retention Period**

Brokers, dealers, and paying agents will be required to retain records and information under Rule 17Ad-17 for a period of three years, with the first year in an easily accessible place.<sup>123</sup>

### **IV. Economic Analysis**

#### **A. Introduction**

Exchange Act Section 23(a)(2) requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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<sup>121</sup> See 17 CFR 200.83. Additional information about how to request confidential treatment of information submitted to the Commission is available on the Commission's website at: <http://www.sec.gov/foia/howfo2.htm#privacy>.

<sup>122</sup> See, e.g., Exchange Act Section 24, 15 U.S.C. 78x (governing the public availability of information obtained by the Commission) and 5 U.S.C. 552 *et seq.*

<sup>123</sup> The recordkeeping requirements are found in paragraph (d) of Rule 17Ad-17, 17 CFR 240.17Ad-17(d).

Furthermore, Exchange Act Section 3(f) requires the Commission, when engaging in rulemaking under the Exchange Act where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

As described above, the Commission is adopting amendments to Rule 17Ad-17 under congressional directive. As originally adopted, Rule 17Ad-17 requires transfer agents to conduct database searches for lost securityholders. Such loss of contact can be harmful to securityholders because they no longer receive corporate communications or interest and dividend payments; in certain cases, securities, cash, and other property may be placed at risk of being deemed abandoned.

As discussed above in detail, Section 929W of the Dodd-Frank Act amended Section 17A of the Exchange Act to extend to brokers and dealers the requirement of Rule 17Ad-17 to search for "lost securityholders." Separately, the statute requires "paying agents" to provide written notification to each unresponsive payee that the securityholder has been sent a check that has not been negotiated, and defines "paying agent" to include, "any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security." The Commission is adopting amendments to Rule 17Ad-17 to address these statutory requirements and to require brokers, dealers, and paying agents subject to the amended rule to make and keep records to demonstrate compliance with the amended rule, including written procedures that describe their methodology for complying.

While the Commission is adopting amendments to Rule 17Ad-17 specifically to implement the statutory mandate, the Commission recognizes that there may be costs and

benefits resulting from the statute and amendments to Rule 17Ad-17. Extending the requirements of Rule 17Ad-17 to brokers and dealers represents a new regulatory obligation for brokers and dealers, and these entities will face associated costs of complying with the new obligations. Furthermore, paying agents – including transfer agents, brokers, and dealers – will incur costs associated with the new requirements of Rule 17Ad-17 to provide certain notifications to unresponsive payees. The definition of “paying agent” is sufficiently broad that these costs will also be incurred by entities that do not register with – and have not historically been regulated by – the Commission. At the same time, lost securityholders and unresponsive payees may benefit by receiving securities, cash, or other property as a result of the searches and notifications required by the statute and the resulting amendments to Rule 17Ad-17.

These costs and benefits are discussed below. Additionally, the Commission has considered alternative ways of implementing the statute suggested by commenters, including narrowing the scope of “brokers and dealers” and shortening the definition of “paying agent.” We discuss aspects of these alternative proposals below as well.

#### **B. Economic Baseline**

Originally adopted in 1997, Rule 17Ad-17 requires recordkeeping transfer agents to conduct database searches for lost securityholders. At the time, the Commission staff estimated that 1.34% of total accounts held by such transfer agents were lost, representing around \$450 million in lost assets.<sup>124</sup> An informal survey by the Commission staff in 2000 of seven large transfer agents (representing about 75% of shareholder accounts), found that 2.23% of total

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<sup>124</sup> Testimony of Larry E. Bergmann, Senior Associate Director, Division of Market Regulation, U.S. Securities & Exchange Commission, before the House Subcommittee on Finance and Hazardous Materials, Committee on Commerce, available at <http://www.sec.gov/news/testimony/ts162000.htm> (“Bergmann Testimony”).

accounts were lost securityholder accounts.<sup>125</sup> Under state escheatment laws, an account that becomes “lost” may result in the assets in the account being deemed abandoned. In the same 2000 survey, the Commission estimated that 0.87% of shareholder accounts, representing an average of \$243 per account and over \$93 million in total, were remitted to the states as unclaimed property.

As required by the Dodd-Frank Act, the Commission is extending the obligation under Rule 17Ad-17 to search for lost securityholders to brokers and dealers. While brokers and dealers house and manage certain securityholder accounts, there are good economic reasons to believe the likelihood of accounts becoming lost is lower for brokers and dealers than for transfer agents. Brokers and dealers rely on their customers and account holders as a source of revenue, so have an economic incentive to maintain up-to-date records. Additionally, because the customers’ and account holders’ assets are held by brokers and dealers, and because most of their contact in the ordinary course of business is with the broker or dealer (not a transfer agent), customers have a stronger incentive to keep their account information updated with the brokers and dealers than with transfer agents, so as to not lose contact with their assets. Indeed, though recent data are scarce because the Commission has not to date formally tracked the number of lost securityholder accounts at brokers and dealers, there are studies that support this hypothesis to some extent.

In a 2001 survey of transfer agents and broker-dealers by the Government Accountability Office (“GAO”) (then called the General Accounting Office), the GAO found that, similar to Commission surveys, approximately 2% of accounts at transfer agents and

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<sup>125</sup> Id.

brokers-dealers were classified as lost. While the GAO concluded that few differences may exist between transfer agents and broker-dealers in the ratio of lost securityholder accounts to total accounts, they did find that 95% of brokers-dealers reported less than 1% of accounts as lost, while for transfer agents, 75% reported less than 1% of accounts as lost. Similarly, a less formal 2000 survey of 17 brokers-dealers by SIFMA (then called the Securities Industry Association) found that lost securityholders accounted for 0.79% of total accounts held at brokers-dealers.<sup>126</sup>

Nevertheless, while the overall incidence of lost securityholder accounts relative to total securityholder accounts held may be lower at brokers and dealers than transfer agents, the absolute magnitude, in terms of both number of lost accounts and dollar amount of assets at risk of being abandoned, may still be economically meaningful. Transfer agents serve as an intermediary between issuers and owners of securities, passing along dividends, interest payments, and other corporate communications and distributions to a company's investors. However, a Commission Briefing Paper from 2007 on proxy voting mechanics noted that, at the time, approximately 85% of exchange-traded securities were held in street name, as opposed to investor name.<sup>127</sup> Because transfer agents typically only see the street name on their records, the broker or dealer holding the securities on behalf of investors effectively becomes the intermediary. That is, a transfer agent's searches for lost securityholders likely will not identify lost securityholders who hold securities at a broker or dealer in street name since only the broker's or dealer's internal records will show such securityholders. Rule 17Ad-17 was

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<sup>126</sup> "Lost Security Holders: SEC Should Use Data to Evaluate Its 1997 Rule," GAO Report GAO-01-978, September 2001, available at <http://www.gao.gov/assets/240/232703.pdf> ("GAO Report").

<sup>127</sup> "Roundtable on Proxy Voting Mechanics," Commission Briefing Paper, 2007, available at <http://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm>.

originally adopted to minimize instances where lost property is claimed by the states, by establishing minimum search requirements for lost securityholders. Because brokers and dealers now serve as the effective intermediary for a large majority of securities holdings, they may be in a position to identify a greater number of lost accounts than transfer agents and find lost securityholders with a greater amount of securities and other assets than transfer agents.

In addition to extending the requirement to search for lost securityholders to brokers and dealers, the amendments to Rule 17Ad-17 also require paying agents to notify unresponsive payees in writing when they have unnegotiated checks outstanding. The Commission currently lacks accurate data – including any informal survey or other incomplete dataset that may be indicative – on the number of unresponsive payees, as well as whether a securityholder has not negotiated a check due to, for example, lost or stolen property or investor inattention. However, based on initial estimates in the Proposing Release we provided for public comment and adjusted based on such comment as described in section III above,<sup>128</sup> the Commission estimates that approximately 800,000 notifications would be sent per year.

**C. Benefits and Impact on Efficiency, Competition, and Capital Formation**

As mentioned in the discussion of the economic baseline, the general purpose of Rule 17Ad-17 is to reduce the number of securityholder accounts that become lost, and therefore to minimize the risk that lost property is claimed by the states under escheatment laws. This risk can be economically significant – in 2000, the Commission staff estimated that over \$93 million in assets, or an average of \$243 per account, were remitted to the states as unclaimed property.<sup>129</sup>

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<sup>128</sup> See, e.g., Letters from SIFMA and Wells Fargo, supra note 14.

<sup>129</sup> See Bergmann Testimony, supra note 127.

Extending the rule to brokers and dealers provides another mechanism for minimizing such remittances. A large majority of securities are held in street name rather than investor name -- up to 85% of securities, by one Commission estimate -- and because transfer agents record only the street name in such cases, brokers and dealers effectively serve as the intermediary between issuers and investors for these holdings and are in a better position than transfer agents in those cases to identify and find lost securityholders. Therefore, the rule should reduce the number of lost securityholders, which would benefit the securityholders "found" by restoring to them their lost securities and other assets that might otherwise be lost to them or escheated.

The Commission recognizes that brokers and dealers already have an economic incentive to search for lost securityholders, since they rely on securityholders for revenue. Therefore, it is possible that the benefits of the rule, in terms of a reduction in the number of lost securityholders, will be relatively modest. However, the Commission believes that establishing minimum search requirements will facilitate the realization of such incentives for identifying and finding lost securityholders, as was apparently intended by Congress.

In the case of unresponsive payees, the Commission believes that, due to instances of lost or stolen property, there may exist a subset of investors who are unaware that an unnegotiated check has gone missing. The rule should benefit these investors by invoking the services of paying agents to reduce the number of unnegotiated checks. While these benefits are difficult to quantify, the Commission estimates that paying agents would send approximately 800,000 notifications per year; accordingly, if even a relatively small percentage of notifications result in checks that would not otherwise have been negotiated being negotiated, there may be a significant aggregate monetary benefit to investors.

The Commission also expects the amendments to Rule 17Ad-17 to modestly improve the efficient allocation and use of resources to the extent that the new rules reduce the number of lost securityholders and unresponsive payees. Fewer lost securityholders and unresponsive payees should reduce the amount of property that is effectively idle and not being used deliberately for an economic purpose because the securityholder is unaware of the existence of the property, as well as reduce the costs securityholders face when attempting to track down and claim lost assets. Furthermore, by identifying lost securityholders and finding lost and idle property, there may be beneficial trades that occur as found accountholders rebalance their portfolios, to the extent that it is optimal to do so. This result should in turn lead to enhanced liquidity and improved price efficiency as assets become available for trade.

The Commission also expects that identification of lost accountholders may lead to better corporate governance, either through improved proxy voting rates or through trades that place the securities in the hands of more active investors. Both channels could result in enhanced managerial monitoring and corporate governance, which in turn would promote capital formation as firms make investment choices that are expected to be more closely aligned with the interests of investors.

Finally, the Commission expects that the amendments will have a marginal, if any, impact on competition. Fundamentally, the regulatory problem that Congress addressed in directing the amendment of Rule 17Ad-17 is about efficiency losses associated with lost property that is ultimately claimed by the state, and not about uncompetitive capital markets. We generally expect the benefits of the rule to be realized in terms of the efficient allocation of resources of securityholders and corresponding effects on capital formation through improved monitoring and governance, and not improved competition.

#### D. Costs and Impact on Efficiency, Competition, and Capital Formation

The amendments to Rule 17Ad-17 create new regulatory obligations for brokers, dealers, and paying agents (which include transfer agents, brokers, dealers, and other entities). Brokers and dealers must conduct searches for lost securityholders, while paying agents must provide notifications to an unresponsive payee that he or she is the holder of an unnegotiated check. Furthermore, because the definition of "paying agent" captures certain entities that distribute cash flows from issuers to investors, the amendments create obligations under the Exchange Act for entities that have not historically been regulated by the Commission and for issuers that have had to file only disclosures. To the extent that brokers and dealers and paying agents do not already have systems in place to perform these functions and make and keep the records required to demonstrate compliance (including the written procedures to describe their methodology for complying), these entities will incur costs for any necessary modifications to information gathering, management, recordkeeping, and reporting systems or procedures.

As already discussed, brokers and dealers have an economic incentive to search for lost accounts. While the new rule imposes costs on brokers and dealers, they may already be shouldering some of these costs voluntarily, minimizing the incremental costs of the rule. Nevertheless, in their 2001 study cited above, the GAO found that approximately 40% of transfer agents and brokers and dealers spent less than \$10 per lost account to search for lost securityholders, though larger firms were likely to spend more, and about 10% of firms spent greater than \$40.<sup>130</sup> The Commission believes this finding provides a reasonable range of cost estimates to brokers and dealers for their obligation to search for lost securityholders since there

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<sup>130</sup> See GAO Report, *supra* note 129. Even though Rule 17Ad-17 covered only transfer agents at the time of the 2001 GAO report, the report surveyed transfer agents, brokers, and dealers in order to ascertain their activities in dealing with lost securityholders.

appears to be no technology, market, or other development over the last decade that would have materially increased the per-securityholder cost.

The costs incurred by paying agents in fulfilling their obligations to notify unresponsive payees are less certain, and the Commission currently lacks accurate data – including any informal survey or other incomplete dataset that may be indicative – on the number of unresponsive payees. Since unresponsive payees are not lost but merely unresponsive, paying agents do not incur search costs; variable costs should be limited to identifying and recording when a check has gone unnegotiated, and providing the required written notification. However, certain paying agents may not have the same existing economic incentives to identify and notify unresponsive payees as brokers and dealers already have to search for lost securityholders.

Therefore, unlike brokers and dealers that conduct such searches voluntarily being required to do so under the amendments to Rule 17Ad-17, certain paying agents may temporarily face higher fixed costs to set up the systems and procedures to perform their new regulatory obligations. Furthermore, if fixed costs meaningfully outweigh variable costs, there could be competitive burdens placed on smaller entities.

In addition to these search and notification costs, brokers, dealers, and paying agents will incur costs in making and retaining the records required under the amendments to Rule 17Ad-17, including the requirement to maintain written procedures describing their methodology for complying with such amendments. These costs may be moderated for regulated entities like brokers and dealers, who must already maintain extensive sets of records regarding securityholders, including their contacts with such persons. However, the Commission recognizes that these recordkeeping costs may be higher for paying agents who have not been previously regulated by the Commission in this regard, including issuers and certain custodians.

## E. Alternatives Considered

The Commission requested comment on the costs and benefits of the amendments to Rule 17Ad-17 in the Proposing Release, and has considered the comments as well as alternative ways to implement the statute where possible. Several commenters offered alternative interpretations of the phrase “brokers and dealers,” suggesting that the statute be read in such a way that the rule does not apply to all brokers and dealers, as a means to mitigate some of the burden of the amendments.<sup>131</sup> Furthermore, one commenter suggested the Commission could use exemptive authority under Section 36 of the Exchange Act to narrow the scope of the phrase “brokers and dealers.”<sup>132</sup> While the Commission appreciates these comments, as explained above, we believe that the Dodd-Frank Act constrains their implementation, particularly in light of the relatively recent adoption of the statute by Congress, and that applying the rule to all brokers and dealers is the appropriate approach at this time, even though the costs of compliance may fall primarily on those brokers and dealers that carry customers’ accounts (*i.e.*, carrying firms). As described above, however, the Commission is not imposing any requirements as to the means by which brokers and dealers comply with their obligations under Rule 17Ad-17, and brokers and dealers may of course negotiate among themselves the most efficient allocation of the costs associated with the rule.

Similarly, several commenters suggested that the Commission revise or shorten the definition of “paying agent,” since the definition captures entities that do not register with the

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<sup>131</sup> Letters from Mr. Barnard, Annuity Committee, and SIFMA, *supra* note 14.

<sup>132</sup> Letter from ABA, *supra* note 14.

Commission and have not historically fallen under the Commission's regulatory purview.<sup>133</sup> As with the interpretations of "brokers and dealers," the Commission at this time believes that following the statutory language is the appropriate approach. Moreover, to apply rules to only a subset of entities that were specified by Congress as "paying agents" may create unnecessary competitive differences among paying agents, while not fully realizing the benefits of notifying certain classes of unresponsive payees of unnegotiated checks.

Finally, as discussed above, it is not clearly stated in the statute whether the paying agent must provide: (1) a single written notification to *each unresponsive payee* who has been sent a check that has not yet been negotiated; or (2) a single written notification to the unresponsive payee for *each check* that has been sent but has not yet been negotiated. While the Commission considered requiring a written notification for each check that is not yet negotiated, the Commission has determined that the Dodd-Frank Act permits it to allow paying agents to decide how best to comply with the statutory mandate. Under the final rules, a paying agent has the option to send a single notification for multiple unnegotiated checks, provided that the single notification sufficiently identifies each unnegotiated check and is sent no later than seven months after the initial sending of the oldest unnegotiated check in the notification. The Commission believes that the regulatory benefits associated with the statutory mandate can be achieved with a single notification for multiple checks; requiring a separate written notification for each check would impose additional regulatory costs on paying agents without realizing corresponding regulatory benefits.

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<sup>133</sup> Letters from ABA, Annuity Committee, and American Bankers, *supra* note 14.

## **V. Final Regulatory Flexibility Act Analysis (“FRFA”)**

A FRFA has been prepared in accordance with Section 4(a) of the Regulatory Flexibility Act.<sup>134</sup> The Commission prepared the Initial Regulatory Flexibility Act Analysis in conjunction with the Proposing Release on March 18, 2011.<sup>135</sup>

### **A. Need for and Objectives of the Rule**

This rulemaking action was expressly directed Section 929W of the Dodd-Frank Act, which added paragraph (g) to Section 17A of the Exchange Act. The objectives of this rulemaking, as discussed above in Sections I and II, are to help reduce the number of lost securityholders and unresponsive payees, and to further the Commission’s mission of protecting investors. The legal basis for the rulemaking is set forth in Section 17A(g) of the Exchange Act.<sup>136</sup>

### **B. Significant Issues Raised by Public Comment**

Comments from the public suggested that certain cost estimates included in the Proposing Release were too low.<sup>137</sup> Accordingly, as discussed in more detail above, especially in Section IV, we have revised the rule’s cost estimates.

### **C. Small Entities Subject to the Rule**

#### **1. Brokers and Dealers**

The amendments to Rule 17Ad-17 will apply to all brokers and dealers. However, as

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<sup>134</sup> 5 U.S.C. 603(a). We note that neither the amendments to Rule 17Ad-17 nor the adoption of technical Rule 15b1-6 requires analysis under the Regulatory Flexibility Act.

<sup>135</sup> *Supra* note 13, at Section VI.

<sup>136</sup> 15 U.S.C. 78q-1(g).

<sup>137</sup> Letters from ABA, SIFMA, and Wells Fargo, *supra* note 14.

described above, we anticipate that the amendments will as a practical matter apply mainly to brokers and dealers that carry securities for customer accounts (i.e., carrying firms), which tend to be larger broker and dealer firms. There are 301 brokers and dealers registered with the Commission that we believe act as carrying firms, none of which qualifies as a small entity.<sup>138</sup> According to Exchange Act Rule 0-10(c),<sup>139</sup> a broker or dealer is a small entity if it: (1) had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Section 240.17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this section.<sup>140</sup> Of the 4,705 brokers and dealers registered with the Commission, the Commission estimates that approximately 812 are classified as “small” entities for purposes of the Regulatory Flexibility Act. There are 301 brokers and dealers registered with the Commission that we believe act as carrying firms, none of which qualifies as a small entity. Accordingly, we do not expect that the amendments to Rule 17Ad-17 will have any significant effect on small brokers or dealers.<sup>141</sup>

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<sup>138</sup> See supra note 100.

<sup>139</sup> 17 CFR 240.0-10(c).

<sup>140</sup> Paragraph (i) of Rule 0-10, 17 CFR 240.0-10, discusses the meaning of “affiliated person” as referenced in Paragraph (c) of Rule 0-10.

<sup>141</sup> 17 CFR 240.17Ad-17.

## 2. Paying Agents

Certain amendments to Rule 17Ad-17 will apply to all paying agents. Section 17A(g)(D)(ii) defines the term “paying agent” to include “any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payment from the issuer of a security and distributes the payments to the holder of the security.” With respect to data for the entities who could potentially qualify as “paying agents” under this definition: (1) of the 10,379 issuers that file reports with the Commission, 1,207 qualify as small businesses;<sup>142</sup> (2) of the 536 transfer agents registered with the Commission or with the Federal banking agencies, 135 qualify as small businesses;<sup>143</sup> (3) of the 4,075 brokers and dealers registered with the Commission, 812 qualify as small businesses, as discussed above;<sup>144</sup> (4) of the 11,797 investment advisers registered with the Commission, 718 qualify as small businesses;<sup>145</sup> (5) of the 264 indenture trustees, four qualify as small businesses;<sup>146</sup> and (6) of the 896 custodians, 11 qualify as small businesses.<sup>147</sup> The Commission has no supportable basis to estimate the number of small entities with respect to other persons that potentially may be included in the definition under the “any other person” provision. As noted in Section IV, while approximately 28,577 entities have been identified as potential paying agents, the Commission

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<sup>142</sup> Exchange Act Rule 0-10(a), 17 CFR 240.0-10(a).

<sup>143</sup> Exchange Act Rule 0-10(h), 17 CFR 240.0-10(h).

<sup>144</sup> Exchange Act Rule 0-10(c), 17 CFR 240.0-10(c).

<sup>145</sup> Investment Advisers Act Rule 0-7(a), 17 CFR 275.0-7(a).

<sup>146</sup> Trust Indenture Act Rule 0-7, 17 CFR 260.0-7.

<sup>147</sup> Small Business Administration Act Rule 201, 13 CFR 121.201.

estimates that only approximately 3,035 such entities will actually qualify as paying agents under Rule 17Ad-17.

We believe that a high proportion of paying agent services will be provided by: (1) brokers and dealers that carry customer securities (which, as discussed above in Section V.C.1, would not be small entities) and (2) transfer agents (including bank transfer agents) that provide such services. These firms that typically serve as intermediaries between issuers and securityholders are not typically small businesses as defined in Exchange Act Rule 0-10(c).<sup>148</sup>

#### **D. Reporting, Recordkeeping, and Other Compliance Requirements**

New paragraph (d) of Rule 17Ad-17 requires brokers, dealers, and paying agents maintain records to demonstrate compliance with the amendments to Rule 17Ad-17, including written procedures that describe their methodology for complying with the amendments. Such records are required to be maintained for not less than three years, the first year in an easily accessible place in accordance with Rule 17Ad-17(i).<sup>149</sup> Records are subject to examination by the appropriate regulatory agency as defined by Section 3(a)(34)(B) of the Exchange Act.<sup>150</sup>

#### **E. Agency Action to Minimize Effect on Small Entities**

As required by Section 604 of the Regulatory Flexibility Act,<sup>151</sup> with respect to small entities, the Commission considered whether viable alternatives to the rulemaking exist that could accomplish the stated objectives of Section 17A(g) of the Exchange Act and whether they

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<sup>148</sup> 17 CFR 240.0-10(c).

<sup>149</sup> 17 CFR 240.240.17Ad-17(i).

<sup>150</sup> 15 U.S.C. 78c(a)(34)(B).

<sup>151</sup> 5 U.S.C. 604.

would minimize any significant economic impact of the rules on small entities. Specifically, the Commission considered the following alternatives: (1) the establishment of differing compliance requirements that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the new rules insofar as they affect 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.

Section 929W of the Dodd-Frank Act, which added Section 17A(g) to the Exchange Act, expressly requires the amendments to Rule 17Ad-17. We believe that small entities should be included under the amendments because, as discussed above, the statutory language does not suggest that Congress intended to exclude or exempt any class of brokers, dealers, or paying agents from compliance. Rather, furthering the apparent goal of Congress – reuniting securityholders and payees with their property – requires the searches and notifications contemplated by Section 929W to be made by entities regardless of their size. In addition, as noted in Section V.C above, we believe that a significant majority of the entities affected by the amendments will be brokers, dealers, and transfer agents that are not small entities. We expect that, in practice, most brokers and dealers conducting searches for lost securityholders will be carrying firms, which are not small entities, and likewise we expect that most paying agents providing notifications to unresponsive payees will be carrying firms and the larger transfer agents (including bank transfer agents).<sup>152</sup>

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<sup>152</sup> See *supra* Section V.C.1 and Section V.C.2 .

A copy of the FRFA may be obtained by contacting Thomas C. Etter, Jr., Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-7010, telephone no. (202) 551-5713.

## VII. Statutory Basis and Text of Amendments

### Statutory Basis

Pursuant to Section 17A(g) of the Exchange Act, 15 U.S.C. 78q-1(g), the Commission has amended § 240.17Ad-7 and § 240.17Ad-17 and added § 240.15b1-6 under the Exchange Act in the manner set forth below.

### List of Subjects in 17 CFR Part 240

Reporting and recordkeeping requirements; Securities.

### Text of the Amendments

In accordance with the foregoing, the Commission has amended Part 240 of Chapter II of Title 17 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 and the following citation is added in numerical order to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78mm, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; 18 U.S.C. 1350; and 12 U.S.C. 5221(e)(3) unless otherwise noted.

Section 240.17Ad-17 is also issued under Pub. L. 111-203, § 929W, 124 Stat. 1869 (2010).

\* \* \* \* \*

.....  
1. Add Section 240.15b1-6 to read:

\* \* \* \* \*

§ 240.15b1-6 Notice to brokers and dealers of requirements regarding lost securityholders and unresponsive payees.

Brokers and dealers are hereby notified of Rule 17Ad-17, which addresses certain requirements with respect to lost securityholders and unresponsive payees that may be applicable to them.

2. Section 240.17Ad-7(i) is amended by removing “240.17Ad-17(c)” and adding in its place “240.17Ad-17(d)”.

3. Section 240.17Ad-17 is amended by:

a. Revising the heading.

b. Revising paragraph (a)(1).

c. In paragraph (a)(2) adding the phrase “, broker, or dealer” following the word “agent”.

d. Revising paragraph (a)(3).

e. In paragraph (b)(2)(i) adding the phrase “or customer security account records of the broker or dealer” following the word “file” and adding the phrase “,broker, or dealer” following the phrase “securityholder, the transfer agent”.

f. In paragraph (b)(2)(ii) adding the phrase “, broker, or dealer” following the word “agent”.

g. Redesignating paragraph (c) as paragraph (d), and adding new paragraph (c).h.

Revising newly redesignated paragraph (d).

The revisions to Section 240.17Ad-17 read as follows:

§ 240.17Ad-17 Lost securityholders and unresponsive payees.

(a)(1) Every recordkeeping transfer agent whose master securityholder file includes accounts of lost securityholders and every broker or dealer that has customer security accounts that include accounts of lost securityholders shall exercise reasonable care to ascertain the correct addresses of such securityholders. In exercising reasonable care to ascertain such lost securityholders' correct addresses, each such recordkeeping transfer agent and each such broker or dealer shall conduct two database searches using at least one information database service.

The transfer agent, broker, or dealer shall search by taxpayer identification number or by name if a search based on taxpayer identification number is not reasonably likely to locate the securityholder. Such database searches must be conducted without charge to a lost securityholder and with the following frequency:

(i) Between three and twelve months of such securityholder becoming a lost securityholder; and

(ii) Between six and twelve months after the first search for such lost securityholder by the transfer agent, broker, or dealer.

(2) A transfer agent, broker, or dealer may not use a search method or service to establish contact with lost securityholders that results in a charge to a lost securityholder prior to completing the searches set forth in paragraph (a)(1) of this section.

(3) A transfer agent, broker, or dealer need not conduct the searches set forth in paragraph (a)(1) of this section for a lost securityholder if:

(i) It has received documentation that such securityholder is deceased; or

(ii) The aggregate value of assets listed in the lost securityholder's account, including all dividend, interest, and other payments due to the lost securityholder and all securities owned by the lost securityholder as recorded in the master securityholder files of the transfer agent or in the customer security account records of the broker or dealer, is less than \$25; or

(iii) The securityholder is not a natural person.

(b) For purposes of this section:

\* \* \* \* \*

(2) *Lost securityholder* means a securityholder:

(i) To whom an item of correspondence that was sent to the securityholder at the address contained in the transfer agent's master securityholder file or in the customer security account records of the broker or dealer has been returned as undeliverable; provided, however, that if such item is re-sent within one month to the lost securityholder, the transfer agent, broker, or dealer may deem the securityholder to be a lost securityholder as of the day the re-sent item is returned as undeliverable; and

(ii) For whom the transfer agent, broker, or dealer has not received information regarding the securityholder's new address.

(c)(1) The paying agent, as defined in paragraph (c)(2) of this section, shall provide not less than one written notification to each unresponsive payee, as defined in paragraph (c)(3) of this section, stating that such unresponsive payee has been sent a check that has not yet been negotiated. Such notification may be sent with a check or other mailing subsequently sent to the unresponsive payee but must be provided no later than seven (7) months (or 210 days) after the

sending of the not yet negotiated check. The paying agent shall not be required to send a written notice to an unresponsive payee if such unresponsive payee would be considered a lost securityholder by a transfer agent, broker, or dealer.

(2) The term paying agent shall include any issuer, transfer agent, broker, dealer, investment adviser, indenture trustee, custodian, or any other person that accepts payments from the issuer of a security and distributes the payments to the holders of the security.

(3) A securityholder shall be considered an unresponsive payee if a check is sent to the securityholder by the paying agent and the check is not negotiated before the earlier of the paying agent's sending the next regularly scheduled check or the elapsing of six (6) months (or 180 days) after the sending of the not yet negotiated check. A securityholder shall no longer be considered an unresponsive payee when the securityholder negotiates the check or checks that caused the securityholder to be considered an unresponsive payee.

(4) A paying agent shall be excluded from the requirements of paragraph (c)(1) of this section where the value of the not yet negotiated check is less than \$25.

(5) The requirements of paragraph (c)(1) of this section shall have no effect on state escheatment laws.

(d) Every recordkeeping transfer agent, every broker or dealer that has customer security accounts, and every paying agent shall maintain records to demonstrate compliance with the requirements set forth in this section, which records shall include written procedures that describe the transfer agent's, broker's, dealer's, or paying agent's methodology for complying with this section, and shall retain such records in accordance with Rule 17Ad-7(i).

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

January 16, 2013

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68683 / January 17, 2013

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Omnibus Order Directing the Appointment of Tax Administrator in  
Administrative Proceedings that Establish Distribution Funds

The Commission's orders in administrative proceedings may lead to the payment of disgorgement and/or penalties for distribution. Such distribution funds may create qualified settlement funds ("QSFs") under Treasury Regulation 1.468B-1(c), 26 CFR § 1.468B-1(c), and have a variety of tax-related obligations. The Division of Enforcement ("Division") has evaluated the proposals received from potential tax administrators for the QSFs and, of those proposals, has determined that Damasco & Associates LLP ("Damasco"), a certified public accounting firm located in Half Moon Bay, California, is best suited to act as tax administrator for the QSFs for calendar years 2013 through 2015 in such administrative proceedings.

Accordingly,

IT IS ORDERED that:

- A. Pursuant to the Commission's Rules on Fair Fund and Disgorgement Plans (17 CFR §§ 201.1101, *et seq.*), Damasco is appointed as the tax administrator (the "Tax Administrator") when requested by staff in calendar years 2013 through 2015 in those administrative proceedings where distribution funds have been established. For the life of the distribution funds to which Damasco is appointed in 2013, 2014 and 2015, Damasco will have the limited authority and power to: (1) act as the administrator for tax purposes for each QSF; (2) prepare, sign, and file the necessary tax returns and tax-related documents for the QSFs; (3) make the tax payments on behalf of the QSFs; (4) obtain the necessary tax-related documents and identifiers, such as an employer identification number, on behalf of the QSFs; (5) perform other tax-related and reporting duties on behalf of the QSFs as required by Department of the Treasury regulations relating to QSF administrators; (6) prepare a final accounting when a QSF distribution has been completed, on a form provided by the Commission; (7) prepare distribution checks and mail to injured investors for small QSFs, when requested to do so by a fund administrator pursuant to a Commission approved distribution plan; and (8) communicate on behalf of the QSFs on matters set forth in this paragraph.

- B. The Tax Administrator will, from time to time, have custody or control of monies transferred to the Tax Administrator to make tax payments. Therefore, the Tax Administrator, before taking possession of those monies, will obtain a bond, pursuant to the 2013-2015 Letter Agreement executed between the Commission and the Tax Administrator.
- C. The Tax Administrator will submit, at least 30 days prior to any date on which a tax payment is required on behalf of any QSF or as soon as is practicable, documentation showing the amount necessary to satisfy the tax liability of each QSF as well as all other documents supporting such amount, to the following:

1. Where the Respondent has agreed to pay the taxes of the QSF, the Tax Administrator will submit the documentation to the Respondent, with a copy to the Commission staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

The Respondent will pay the amount of the documented taxes to the Tax Administrator by check or wire transfer. The Tax Administrator, in turn, will be responsible for paying the taxes to the Internal Revenue Service ("IRS") and the relevant state and local taxing authority, if any, on behalf of the QSF. The Tax Administrator will provide written confirmation of the payment of the taxes to the Commission staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

2. Where the money in the QSF is held by an escrow agent, the Tax Administrator will submit the documentation to the escrow agent, with a copy to the Commission staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

Upon approval to disburse by the staff to whom authority is delegated by paragraph F., below, the escrow agent will disburse to the Tax Administrator, by check or wire transfer from the QSF, the amount of taxes as calculated by the Tax Administrator. Such tax payments will come first from any earnings or interest in the QSF, and second, if necessary, from the principal of the QSF. The Tax Administrator, in turn, will be responsible for paying the taxes to the IRS and the relevant state and local taxing authority, if any, on behalf of the QSF. The Tax Administrator will provide written confirmation of the payment of the taxes to the Commission

staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

3. In all other proceedings, the Tax Administrator will submit documentation to the Commission staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

Upon approval to disburse by staff to whom authority is delegated by paragraph F., below, the Commission staff will disburse to the Tax Administrator, by check or wire transfer from the QSF, the amount of the taxes as calculated and documented by the Tax Administrator. Such tax payments will come first from any earnings or interest in the QSF and second, if necessary, from the principal of the QSF. The Tax Administrator, in turn, will be responsible for paying the taxes to the IRS and the relevant state and local taxing authority, if any, on behalf of the QSF. The Tax Administrator will provide written confirmation of the payment of the taxes to the Commission staff member assigned to the proceeding and to the Distributions Program Analysis mailbox.

- D. The Tax Administrator will comply with all reporting requirements applicable to a QSF as defined in Treasury Regulation 1.468B-1(a), as amended, and will file on a timely basis all required federal, state, and local tax returns and will contemporaneously provide copies of such filings to the assigned Commission staff member and to the Distributions Program Analysis mailbox.
- E. The Tax Administrator will keep records and bill each QSF for the services provided to it pursuant to the 2013-2015 Letter Agreement executed between the Commission and the Tax Administrator.

1. In the proceedings in which the Respondent has agreed to pay for the expenses of the QSF, the Tax Administrator will submit the bill to the Respondent for payment by check or wire transfer.

2. Where the money in the QSF is held by an escrow agent, the Tax Administrator will submit the bill to the assigned Commission staff member and to the Distributions Program Analysis mailbox for approval. Where services have been billed according to the terms of the Tax Administrator's 2013-2015 Letter Agreement with the Commission, and are for an amount less than or equal to \$10,000 per case per tax filing per quarter, payment may

be approved by staff to whom authority is delegated by paragraph F., below. For bills totaling an amount greater than \$10,000 per case per tax filing per quarter, the Commission staff assigned to the proceeding must seek Commission approval for payment. After payment of the Tax Administrator's bill has been approved, the escrow agent is authorized to pay the bill of the Tax Administrator by check or wire transfer from the QSF. Payment will come first from any earnings or interest in the QSF and second, if necessary, from the principal of the QSF.

3. In all other proceedings, the Tax Administrator will submit the bill to the assigned Commission staff member and to the Distributions Program Analysis mailbox for approval. After payment of the Tax Administrator's bill has been approved, which approval will be as described in paragraph E.2., above, the Commission staff will pay the bill of the Tax Administrator by check or wire transfer from the QSF. Payment will come first from any earnings or interest in the QSF and second, if necessary, from the principal of the QSF.

In all proceedings, the fees billed will be as agreed upon in the Tax Administrator's 2013-2015 Letter Agreement with the Commission, as executed by the Secretary of the Commission on behalf of the Commission.

- F. Pursuant to Section 4A of the Securities Exchange Act of 1934 (15 U.S.C. § 78d-1), the authority as set forth in paragraphs C.2., C.3., E.2. and E.3., above, to approve the payment of the Tax Administrator's fees and expenses and to approve the disbursement of QSF tax payments based on the calculations of the Tax Administrator is delegated to the Division's Deputy Managing Executive ("DME") in his/her capacity as the Assistant Director of the Office of Distributions ("OD") and to the Supervisory Assistant Chief Litigation Counsel ("SACLC") in the OD or the equivalent level manager as designated by the DME.
- G. The Secretary of the Commission will, upon request by the Division staff during calendar years 2013, 2014, and 2015, issue orders that appoint Damasco as the Tax Administrator in administrative proceedings.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 68688 / January 18, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15180**

**In the Matter of**

**AlphaTrade.com,**

**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 AlphaTrade.com.

**II.**

After an investigation, the Division of Enforcement alleges that:

A. Respondent AlphaTrade.com (CIK No. 1076462) is a Nevada corporation whose address identified in its filing with the Commission is in Las Vegas, Nevada. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of January 2, 2013, AlphaTrade.com's common stock (symbol "APDTQ") was quoted on the OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3). In 2011, the company filed for Chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the District of Nevada.

B. Respondent is delinquent in its periodic filings with the Commission, having not filed any periodic reports for any reporting period subsequent to September 30, 2010. Respondent has repeatedly failed to meet its obligations to file timely periodic reports, and failed to heed a delinquency letter sent to it by the Division of Corporation Finance requesting compliance with Respondent's periodic filing obligations.

C. 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.

D. 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 Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act, 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 twenty (20) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

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

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
January 18, 2013

In the Matter of

AlphaTrade.com

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 AlphaTrade.com because it has not filed any periodic reports for any reporting period subsequent to September 30, 2010.

The Commission is of the opinion that the public interest and the protection of the 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 above-listed company is suspended for the period from 9:30 a.m. EST on January 18, 2013, through 11:59 p.m. EST on February 1, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-68690; File No. SR-DTC-2012-810)

January 18, 2013

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing Advance Notice to Reduce Liquidity Risk Relating to Its Processing of Maturity and Income Presentments and Issuances of Money Market Instruments

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> thereunder, notice is hereby given that on December 28, 2012, The Depository Trust Company (“DTC”) filed with the Securities and Exchange Commission (“Commission”) the advance notice described in Items I, II and III below, which Items have been prepared primarily by DTC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

DTC is proposing to change the current Largest Provisional Net Credit (“LPNC”) risk management control in order to increase withholding from one to two largest provisional credits (on an acronym<sup>3</sup> basis). DTC is also proposing to modify its Rules as they relate to the Issuing/Paying Agent’s (“IPA’s”) refusal to pay process. DTC is proposing not to process a reversal of a transaction initiated by an IPA when issuances of Money Market Instruments (“MMIs”) in an acronym exceed, in dollar value, the maturity or income presentments (“Maturity Obligations”) of MMIs in the same acronym on the same day. As a result, at the

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(i).

<sup>3</sup> DTC employs a four-character acronym to designate an issuer’s Money Market Instrument program. An issuer can have multiple acronyms. The Issuing/Paying Agent’s bank uses the acronym(s) when submitting an instruction for a given issuer’s Money Market Instrument securities.

point in time when issuances of MMIs in an acronym exceed, in dollar value, the Maturity Obligations of the MMIs in the same acronym on that day, DTC will remove the LPNC control with respect to the affected acronym.

II. Clearing Agency's Statement of Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. DTC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of such statements.<sup>4</sup>

(A) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

MMI presentment processing is initiated automatically by DTC each morning for MMIs maturing that day. The automatic process electronically sweeps all maturing positions of MMI CUSIPs from DTC Participant accounts and creates the Maturity Obligations. The matured MMIs are, subject to DTC Rules, delivered to the applicable IPA, a DTC Participant, and DTC debits the IPA's account for the amount of the Maturity Obligations. In accordance with DTC Rules, payment will be due from the IPA for net settlement to the extent, if any, that the IPA has a net debit balance in its settlement account at end-of-day.

Without regard to DTC net settlement, MMI issuers and IPAs commonly view the primary source of funding of payments for Maturity Obligations of MMIs as flowing from new issuances of MMIs in the same acronym by that issuer on that day. In a situation where those

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<sup>4</sup> The Commission has modified the text of the summaries prepared by DTC.

new issuances exceed the Maturity Obligations, the issuer would have no net funds payment due to the IPA on that day. However, because Maturity Obligations of MMIs are processed automatically at DTC, IPAs currently operationally have the ability to pay for all of an issuer's maturities. An IPA that refuses payment on an MMI must communicate its intention to DTC using the DTC Participant Terminal/Browser Service ("PTS/PBS") MMRP function. This communication is referred to as an Issuer Failure/Refusal to Pay ("RTP") and it allows the Paying Agent to enter a refusal to pay instruction for a particular issuer acronym up to 3:00 p.m. Eastern Time ("ET") on the date of the affected maturity or income presentment. Such an instruction will cause DTC, pursuant to its Rules, to reverse all transactions related to that issuer's acronym, including Maturity Obligations and any new issuances, posing a potential for systemic risk since the reversals may override DTC's risk management controls (e.g., collateral monitor<sup>5</sup> and net debit cap<sup>6</sup>).

To mitigate the risks associated with an RTP, DTC employs the LPNC risk management control. On each processing day, DTC withholds intraday credit from each MMI Participant for the largest credit with respect to an issuer's acronym, for purposes of calculating the

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<sup>5</sup> DTC tracks collateral in a Participant's account through the Collateral Monitor ("CM"). At all times, the CM reflects the amount by which the collateral value in the account exceeds the net debit balance in the account. When processing a transaction, DTC verifies that the CM of each of the deliverer and receiver will not become negative when the transaction is processed. If the transaction would cause either party to have a negative CM, the transaction will recycle until the deficient account has sufficient collateral to proceed or until the applicable cutoff occurs.

<sup>6</sup> The net debit cap control is designed so that DTC may complete settlement, even if a Participant fails to settle. Before completing a transaction in which a Participant is the receiver, DTC calculates the effect the transaction would have on such Participant's account, and determines whether any resulting net debit balance would exceed the Participant's net debit cap. Any transaction that would cause the net debit balance to exceed the net debit cap is placed on a pending (recycling) queue until the net debit cap will not be exceeded by processing the transaction.

Participant's net settlement balance and collateral monitor. As such, this single largest credit is provisional and is not included in the calculation of the Participant's collateral monitor or in the settlement balance measured against its net debit cap. DTC believes that the LPNC control will help protect DTC against either (i) the single largest issuer failure on a business day, or (ii) multiple failures on a business day that, taken together, do not exceed the largest provisional net credit.

Maturity payment procedures were designed to limit credit, liquidity, and operational risk for DTC and Participants in the MMI program. In an effort to further mitigate these risks, DTC is proposing the following changes to current processing associated with (1) the LPNC control and (2) limiting intraday MMI reversals under specified conditions:

(1) Increase Withholding from One to Two LPNCs

DTC is proposing to change the current LPNC risk management control in order to increase withholding from one to two largest provisional credits (on an acronym basis). DTC believes this will provide increased risk protection in the event of transaction reversals due to multiple issuer defaults or a single issuer default with two or more MMI programs.

DTC has conducted a simulation analysis to measure the impact to IPAs and custodians/dealers of an increase in LPNC controls from one to two on settlement blockage<sup>7</sup> intraday during peak processing periods. DTC analyzed the blockage level for both the IPAs and custodians/dealers as separate segments since each react to the additional blockage in different ways. DTC believes the results of the simulation analysis indicated that there will be no material change in settlement blockage.

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<sup>7</sup> Settlement blockage refers to transactions that cannot be completed due to a receiver's net debit cap or collateral monitor controls.

(2) Eliminate Intraday Reversals When MMI Issuances Exceed Maturity Obligations

DTC is also proposing to modify its Rules as they relate to the refusal to pay process. As planned, DTC will not process a reversal of a transaction initiated by an IPA when issuances of MMIs in an acronym exceed, in dollar value, the Maturity Obligations of MMIs in the same acronym on the same day. In such instances, DTC will not process a reversal of the transaction because the IPA would have no reason to exercise the refusal to pay for that acronym on that settlement day. As a result, because the LPNC control is designed to protect against transaction reversals, at the point in time when issuances of MMIs in an acronym exceed, in dollar value, the Maturity Obligations of the MMIs in the same acronym on that day, DTC proposes not to apply the LPNC control with respect to the affected acronym.

Anticipated Effect on and Management of Risk

DTC believes that the proposed changes will mitigate the systemic risk associated with MMI transaction reversals due to an IPA refusal to pay instruction by increasing withholding from one to two largest provisional credits (on an acronym basis). DTC believes that this will provide increased risk protection in the event of transaction reversals due to multiple issuer defaults or a single issuer default with two or more MMI programs. By mitigating DTC's and the financial systems exposure to this systemic risk, DTC believes that the proposed change will contribute to the goal of financial stability in the event of a default, and is consistent with the CPSS-IOSCO Recommendations for Securities Settlement Systems<sup>8</sup> applicable to DTC.

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<sup>8</sup> Principles for Financial Market Infrastructures of the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("CPSS-IOSCO") (April 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

DTC has discussed this proposal with various industry groups, including the Participants that transact in MMIs, none of whom objected, according to DTC. According to DTC, the Participants understand that the elimination of intraday reversals when issuances exceed Maturity Obligations will result in no material change in settlement blockage and will mitigate systemic risk as a whole. DTC believes the proposed changes should promote settlement finality by precluding reversals for those issuances.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

The subject proposal regarding MMIs was developed in consultation with various industry organizations. Written comments relating to the proposed changes contained in the advance notice have not yet been solicited or received. DTC will notify the Commission of any written comments received by DTC.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The clearing agency may implement the proposed change pursuant to Section 806(e)(1)(G) of the Clearing Supervision Act<sup>9</sup> if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission received the advance notice or (ii) the date the Commission receives any further information it requested for consideration of the notice. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be

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<sup>9</sup> 12 U.S.C. 5465(e)(1)(G).

implemented in less than 60 days from the date of receipt of the advance notice, or the date the Commission receives any further information it requested, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission. The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.<sup>10</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-DTC-2012-810 on the subject line.

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<sup>10</sup> DTC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Act and Rule 19b-4 thereunder. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. Pursuant to Section 19(b)(2) of the Act, within 45 days of the date of publication of the proposed rule change in the Federal Register or within such longer period up to 90 days if the Commission designates or the self-regulatory organization consents the Commission will either: (i) by order approve or disapprove the proposed rule change or (ii) institute proceedings to determine whether the proposed rule change should be disapproved. 15 U.S.C. 78s(b)(2)(A). See Release No. 34-68548 (December 28, 2012), 78 FR 795 (January 4, 2013).

Paper Comments:

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

All submissions should refer to File Number SR-DTC-2012-810. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, D.C. 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of DTC and on DTC's website at [http://dtcc.com/downloads/legal/rule\\_filings/2012/dtc/Advance\\_Notice\\_SR\\_2012\\_810.pdf](http://dtcc.com/downloads/legal/rule_filings/2012/dtc/Advance_Notice_SR_2012_810.pdf). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-DTC-2012-810 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

*Kevin M. O'Neill*

Kevin M. O'Neill  
Deputy Secretary

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68703 / January 22, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-14856

In the Matter of

EGAN-JONES RATINGS  
COMPANY and SEAN EGAN,

Respondents.

ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS AND  
CEASE-AND-DESIST ORDERS PURSUANT  
TO SECTIONS 15E(d) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary for the protection of investors and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Egan-Jones Ratings Company ("EJR") and Sean Egan ("Egan") (collectively, "Respondents").

II.

Following the institution of these proceedings on April 24, 2012, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

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## SUMMARY

1. EJR violated Exchange Act Section 15E(a)(1) and Rule 17g-1(b) thereunder when it made willful and material misrepresentations and omissions in its July 2008 application to the Commission to register as a Nationally Recognized Statistical Rating Organization ("NRSRO") for issuers of asset-backed securities ("ABS") and government securities. In EJR's July 2008 application to register in these two additional classes, EJR falsely stated that, as of the date of its application, it had 150 outstanding ABS issuer ratings and 50 outstanding government issuer ratings. EJR further falsely stated in its application that it had been issuing credit ratings in these categories as a credit rating agency on a continuous basis since 1995. In fact, at the time of its July 2008 application, EJR had not issued – that is, made available on the Internet or through another readily accessible means – any ABS or government issuer ratings. EJR's willful misstatements and omissions concealed the fact that it did not meet the requirements for registration of an NRSRO with respect to these categories. Egan signed the application on EJR's behalf, certifying that it was "accurate in all significant respects," even though he knew or should have known that it contained these material misrepresentations and omissions.

2. EJR violated Exchange Act Section 15E(b)(2) and Rule 17g-1(f) when it made willful and material misrepresentations or omissions regarding the number of EJR's outstanding ABS and government issuer ratings, and the length of time that it had been issuing credit ratings in these categories on a continuous basis, in subsequent annual certifications submitted to the Commission. EJR willfully made these misstatements and omissions in order to maintain its registration as an NRSRO in these classes.

3. In addition, EJR falsely stated in submissions to the Commission that it was unaware whether its subscribers held long or short positions in particular securities. In fact, EJR's salespeople were aware of certain clients' holdings, and in some instances knew whether clients had long or short positions. In at least three instances, information about whether a client had a long or short position was conveyed to Egan, EJR's primary analyst.

4. EJR also violated numerous statutory provisions and Commission rules governing NRSROs. EJR failed to enforce its policies to address conflicts of interest arising from employee ownership of securities, and allowed two analysts to participate in determining the credit ratings for issuers whose securities they owned. EJR also (1) failed to make or retain a record of the procedures and methodologies it used to determine credit ratings; (2) failed to make or retain certain internal records regarding its outstanding ratings; and (3) failed to retain emails regarding its determination of credit ratings for approximately eighteen months after it became registered as an NRSRO.

5. Egan made, and caused EJR to make, misstatements in its submissions to the Commission. He provided inaccurate information for inclusion in EJR's applications and annual certifications and signed the applications, certifying that the information provided in them was "accurate in all significant respects," when he knew or should have known that it was not.

6. Egan caused EJR's violations of the conflicts-of-interest and books and records violations by failing to ensure EJR's compliance with NRSRO rules. Egan was aware of these requirements and, as EJR's president, was ultimately responsible for EJR's compliance with these provisions, yet failed to take appropriate action to ensure that EJR complied. As EJR's primary

analyst, he failed to maintain the required records of credit ratings and as EJR's president, he failed to establish procedures for record retention among the members of his staff.

### RESPONDENTS

7. EJR is a subscriber-paid credit rating agency located in Haverford, Pennsylvania. On December 21, 2007, the Commission approved EJR's application to become registered as an NRSRO for financial institutions, insurance companies, and corporate issuers. On December 4, 2008, the Commission approved EJR's application for registration as an NRSRO for issuers of ABS and issuers of government securities, municipal securities, or securities issued by a foreign government ("government securities").

8. Sean Egan is the founder, president and owner of EJR. Since EJR became registered as an NRSRO, Egan has been EJR's primary, and at times sole, analyst responsible for issuing credit ratings. Egan signed the applications for NRSRO registration and annual certifications that EJR submitted to the Commission, and provided the majority of the information contained in those submissions.

### FACTUAL BACKGROUND

#### **A. The Credit Rating Agency Reform Act and Rules Governing NRSROs**

9. The Credit Rating Agency Reform Act of 2006 ("Rating Agency Act"), enacted on September 29, 2006, defined the term "nationally recognized statistical rating organization" to mean a credit rating agency that: (1) issues credit ratings certified by qualified institutional buyers for certain classes of issuers; and (2) is registered with the Commission. The Exchange Act defines a credit rating agency as an entity that, among other things, is "engaged in the business of issuing credit ratings on the Internet or through another readily accessible means." Accordingly, an entity seeking registration with the Commission as an NRSRO must be a credit rating agency that issues credit ratings on the Internet or through another readily accessible means.

10. The Rating Agency Act also provided authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules for registered credit rating agencies. Under this authority, the Commission has adopted Rules 17g-1 through 17g-7 and Form NRSRO. Exchange Act Rule 17g-1(a) requires a credit rating agency applying for registration as an NRSRO to use Form NRSRO to furnish the Commission with an initial application. Section 15E(b)(1) of the Exchange Act and Rule 17g-1(e) require a firm, after becoming registered as an NRSRO, to promptly update its registration application if any of the information becomes materially inaccurate, and Section 15E(b)(2) of the Exchange Act and Rule 17g-1(f) require NRSROs to provide the Commission with an annual certification on Form NRSRO. The annual certification must contain updates of certain information, a certification that the information furnished with Form NRSRO continues to be accurate, and a list of material changes to the application for registration that occurred during the previous calendar year.

11. An applicant or NRSRO must also furnish the Commission with information on Form NRSRO regarding the procedures and methodologies that the applicant or NRSRO uses to determine credit ratings, policies and procedures to prevent the misuse of material, nonpublic

information, any conflict of interest relating to the issuance of credit ratings, whether it has a code of ethics in effect, and financial information.

12. In addition to registration and annual certification requirements, NRSROs must comply with recordkeeping requirements and rules governing conflicts of interest. For example, Rule 17g-2 provides that NRSROs must create and maintain certain records, including records regarding each rating issued by the NRSRO. Rule 17g-5 prohibits an NRSRO from having certain conflicts of interest relating to the issuance or maintenance of a credit rating and requires an NRSRO to disclose and to establish and maintain written policies and procedures to address and manage other potential conflicts of interest.

#### **B. EJR's Applications for NRSRO Registration**

13. EJR submitted its initial application on Form NRSRO on August 16, 2007. In the application, EJR sought NRSRO registration for three classes of credit ratings: (i) issuers of financial institutions, brokers, and dealers; (ii) issuers of insurance companies; and, (iii) corporate issuers. EJR submitted supplements to its pending application on September 20, 2007 and November 13, 2007. Egan signed the application and supplements on EJR's behalf (collectively, "August 2007 Application"), in his capacity as president of EJR, and provided the majority of the information contained in the August 2007 Application. On December 21, 2007, the Commission granted EJR's application.

14. On July 14, 2008, EJR submitted an application for NRSRO registration in the remaining two classes of credit ratings: (i) issuers of ABS and (ii) issuers of government securities.<sup>1</sup> EJR submitted a supplement to this application on September 2, 2008. As president of EJR, Egan signed the application and supplemental submission for EJR (collectively, "July 2008 Application"), and provided the majority of the information contained in the July 2008 Application. On December 4, 2008, the Commission granted EJR's application.

15. EJR submitted an annual certification to the Commission for calendar year 2007 on March 28, 2008 ("2007 Annual Certification"), an annual certification for 2008 on March 27, 2009 ("2008 Annual Certification"), an annual certification for 2009 on March 30, 2010 ("2009 Annual Certification"), an annual certification for 2010 on March 28, 2011 ("2010 Annual Certification"), and an annual certification for 2011 on March 30, 2012 ("2011 Annual Certification"). Egan signed each of these certifications, certifying that they were "accurate in all significant respects," and provided the majority of the information contained in them when, in fact, certain of the misstatements and omissions alleged herein were neither corrected nor acknowledged as incorrect as the rules required.

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<sup>1</sup> The term "asset-backed security" is defined as "a security that is primarily serviced by the cash flows of a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distributions of proceeds to the security holders; provided that in the case of financial assets that are leases, those assets may convert to cash partially by the cash proceeds from the disposition of the physical property underlying such leases." 17 C.F.R. § 229.1101(c). Securities Act Rule 191 and Exchange Act Rule 3b-19 provide that the "issuer" of an asset-backed security is the "depositor" for that asset-backed security. 17 C.F.R. § 230.191(a); 17 C.F.R. § 240.3b-19(a). Pursuant to Regulation AB, each ABS prospectus explicitly identifies the depositor on the front cover of the prospectus. 17 C.F.R. § 229.1002(a).

**C. EJR's Misstatements Concerning its Experience Rating Issuers of ABS and Government Securities**

16. Form NRSRO requires an applicant seeking NRSRO registration to indicate for each class of ratings: (1) the approximate number of credit ratings that it had outstanding in that class at the time of the registration application; and (2) "the approximate date the Applicant/NRSRO began issuing credit ratings as a 'credit rating agency' in that class on a continuous basis through the present."

17. Consistent with the definition of "NRSRO" in effect at the times of EJR's applications, the instructions concerning this section of Form NRSRO stated that "an Applicant/NRSRO must have been in business as a 'credit rating agency' for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO." The instructions further stated that to meet the definition of "credit rating agency" under the Exchange Act, "the Applicant must, among other things, issue 'credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee'" for each class of credit ratings for which the Applicant was seeking NRSRO status.<sup>2</sup>

18. The applicant must furnish at least two qualified institutional buyer ("QIB") certifications that address each class of credit ratings for which it is applying for registration, and those certifications must state that the QIB has "seriously considered" the credit ratings of the applicant "in the course of making some of its investment decisions" for at least three years.

19. Accordingly, an applicant seeking to become registered as an NRSRO for a class of ratings was required to have issued credit ratings in that category on the Internet or through another readily accessible means for at least three years prior to its application.

20. In its July 2008 Application, which Egan signed and certified as being "accurate in all significant respects," EJR falsely stated that it had 150 outstanding credit ratings on issuers of ABS and 50 outstanding credit ratings on issuers of government securities. Months later, in its 2008 Annual Certification, EJR revised its number of outstanding ABS issuer ratings from 150 to fourteen and the number of outstanding government issuer ratings from 50 to nine. Egan provided these numbers to his staff for purposes of filling out the application and certification.

21. Moreover, in its July 2008 Application, EJR falsely stated that it had been issuing ratings on ABS and government issuers on a continuous basis since 1995. EJR reiterated this 1995 date in its 2008 Annual Certification. However, in its 2009 Annual Certification, EJR stated that it had been issuing ratings on issuers of ABS on a continuous basis only since December 2005 and on issuers of government securities since April 2005. EJR reiterated these 2005 dates in its 2010 and 2011 Annual Certifications.

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<sup>2</sup> Section 3(a)(61) of the Exchange Act defines a "credit rating agency" as "any person (A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company; (B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and (C) receiving fees from either issuers, investors, or other market participants, or a combination thereof."

22. In fact, at the time of its July 2008 Application and 2008 Annual Certification, EJR had never issued credit ratings on issuers of ABS or government securities on the internet or through another readily accessible means.

23. Although EJR claimed to have 150 outstanding ABS issuer ratings and 50 government issuer ratings at the time of its July 2008 Application, and claimed that it had issued fourteen ABS issuer ratings and nine government ratings at the time of its 2008 Annual Certification, EJR has no contemporaneous records showing that it had issued credit ratings on ABS or government issuers prior to July 2008 or at the time of its 2008 Annual Certification.

24. As the primary research analyst and president of EJR throughout the entire period from 1995 through 2011, Egan knew or should have known that EJR had not been issuing ratings on issuers of ABS and government securities on a "continuous basis" since 1995 or making such ratings accessible to EJR's subscribers.

25. EJR's sales representatives did not market or distribute ABS or government issuer ratings to the firm's subscribers at any time prior to the 2008 Annual Certification. By contrast, during the same period EJR's salespeople actively marketed the firm's ratings on corporate issuers, and EJR published these ratings on its website and distributed them to its subscribers through blast e-mails. Furthermore, apart from Egan, the other main analyst employed by EJR between October 2008 and September 2009, did not rate any ABS or government issuers and was not aware that EJR had ever issued such ratings.

26. In addition, although EJR claimed to have significant experience rating issuers of ABS in its NRSRO application, from early 2008 through 2009, Egan and EJR engaged in discussions with at least five different third parties regarding arrangements under which these third parties would analyze or work with EJR to rate ABS issuers on behalf of EJR. Agreements and term sheets with two of these entities that were retained by EJR on a trial basis specifically provided for the third parties to provide proposed ABS ratings to EJR or help EJR "develop" models or methodologies for ABS ratings.

27. EJR did not issue ratings on issuers of ABS or government securities on the internet or otherwise make such ratings readily accessible until January 2010, when Egan asked a member of his staff to post ABS and government issuer ratings on its website.

28. EJR's misstatements concerning its experience rating issuers of ABS and government securities were material and concealed the fact that EJR did not meet the Commission's requirements for registration as an NRSRO for issuers of ABS and government securities.

**D. EJR Submitted Inaccurate QIB Certifications with its July 2008 Application**

29. Form NRSRO requires applicants to submit two certifications from QIBs that address each class of credit ratings for which the applicant is seeking registration. At the time of EJR's 2007 and 2008 NRSRO applications, a QIB was required to certify that it: (1) meets the definition of QIB; and (2) has "seriously considered" the credit ratings of the applicant in the course of making some of its investment decisions in the classes of credit ratings listed by the QIB for at least the three years immediately preceding the date of the certification.

30. The QIB certifications EJR submitted with its application for registration in the categories of issuers of ABS and government securities were inaccurate because neither QIB

actually had received ratings from EJR on issuers of ABS or government securities. Moreover, one of the entities had not been an EJR client for three years as of the date of the certification.

31. Egan knew or should have known that the QIBs who submitted the certifications had not, in fact, "seriously considered" any credit ratings of EJR for ABS or government issuers because neither QIB had received such ratings. EJR and Egan did not make any effort to verify the accuracy of the forms.

#### **E. Additional Misstatements by EJR**

32. EJR inaccurately stated in its August 2007 NRSRO Application, 2007 Annual Certification, and July 2008 Application that it "does not know if a subscriber is long or short a particular security." In fact, EJR salespeople were aware of certain clients' holdings, and EJR even marketed a portfolio monitoring service whereby clients would be alerted to "specific names we recognize as emerging risks among your holdings." On multiple occasions, EJR's salespeople were informed whether clients had long or short positions in particular securities. In at least three instances, Egan received information about whether a client had a long or a short position.

33. Exhibit 5 to Form NRSRO requires an applicant or NRSRO to provide a copy of its written code of ethics in effect or a statement of the reasons it does not have a written code of ethics. EJR's code of ethics in its November 2007 supplemental response to its initial application and its 2007 Annual Certification stated that employees were not permitted to trade in securities of issuers rated by EJR, except in certain limited circumstances. However, this provision was missing in versions of EJR's code of ethics signed by two EJR analysts.

#### **F. EJR's Conflict of Interest Violations**

34. Exchange Act Section 15E(h)(1) requires an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed to address and manage conflicts of interest. Rule 17g-5(c)(2) prohibits an NRSRO from issuing a credit rating when an analyst who participated in determining the rating owned the securities of the entity subject to that rating.

35. EJR violated these provisions because two EJR analysts participated in determining credit ratings for issuers whose securities they owned. In 2009, an EJR analyst participated in determining ratings on at least seventeen different issuers while owning the securities of those issuers. Subsequently, a second EJR analyst determined a credit rating of an issuer whose securities he owned. Before the report was published, Egan emailed the analyst and informed him that he should talk to EJR's compliance officer before publishing the report on the issuer, and stated that Egan, rather than the analyst, "might have to release it." EJR's compliance officer subsequently advised the analyst that he was permitted to publish the report, as long as he did not trade the security.

36. Exchange Act Rule 17g-5(a)(2) provides that an NRSRO is prohibited from having certain conflicts of interest relating to the issuance or maintenance of a credit rating, unless the NRSRO establishes, maintains, and enforces written policies and procedures to address the conflict of interest. One of those conflicts, listed in Rule 17g-5(b)(6), is allowing persons within the NRSRO to directly own the securities of an issuer or obligor subject to a credit rating of the NRSRO.

37. EJR repeatedly failed to adequately enforce its written policies and procedures to address conflicts of interest. Although EJR's code of ethics generally prohibited employees from

owning securities of issuers rated by EJR, EJR did not undertake any effort to verify that employees had produced statements for all of their securities accounts, and at least one employee failed to provide statements for all of his accounts. EJR thus failed to discover until months later that this employee had traded in securities of issuers rated by EJR, in violation of EJR's conflict of interest policy.

#### **G. EJR's Books and Records Violations**

38. Rule 17g-2(a)(6) requires an NRSRO to make and retain records documenting the established procedures and methodologies used by the NRSRO for determining credit ratings, and Rule 17g-1(i) requires NRSROs to make its current Form NRSRO and certain exhibits to the Form public, including, in Exhibit 2, a general description of the procedures and methodologies. These requirements are intended to allow the Commission to determine whether the NRSRO is adhering to its policies and whether the publicly available description in the NRSRO's Form NRSRO is sufficient for users to understand the methods. EJR did not make or retain the documentation required under Rule 17g-2(a)(6). Other than the brief descriptions provided in its Form NRSRO Exhibit 2, EJR had no written procedures and methodologies for determining credit ratings.

39. Rule 17g-2(a)(2) requires, among other things, that an NRSRO make and retain records of the identity of the credit analyst(s) that participated in determining a credit rating, the identity of the credit analyst(s) that approved the credit rating before it was issued. EJR failed to maintain these records.

40. Rule 17g-2(b)(2) requires an NRSRO to retain all internal records used to form the basis of a credit rating issued by the NRSRO. EJR did not retain these records. EJR had no procedures for maintaining work papers used in determining credit ratings, and did not implement procedures until mid-2009. Even after 2009, EJR failed to retain individual copies of the model that was used in determining each rating, and did not retain records of manual adjustments to the model output made by analysts.

41. Rule 17g-2(b)(7) requires an NRSRO to retain all communications, including electronic communications, received or sent by the NRSRO and its employees that relate to "initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating." EJR had no system in place to retain employee emails until June 2009 when, a few days before the Commission staff was scheduled to conduct its periodic examination of EJR, EJR hired a third-party consultant to implement an email retention system that would retain all EJR staff emails. Prior to June 2009, no system was in place to prevent employees from deleting emails, and those deleted emails were not retained.

#### **H. Egan's Liability**

42. Egan made and caused EJR to make the material misstatements and omissions in its applications and annual certifications. Egan provided the information to his staff so that they could make the submissions and knew or should have known that the information was inaccurate, yet certified that the information in the submissions was "accurate in all significant respects."

43. Egan caused EJR to violate the conflict-of-interest and books and records requirements. Egan failed to retain the required records for EJR's ratings, failed to ensure that others retained the required records, and failed to institute a system for staff to do so. He failed to

ensure compliance with the conflict of interest provisions by not preventing impermissible employee trading.

### VIOLATIONS

44. Section 15E(d) of the Exchange Act provides that the Commission shall, by order, censure, place limitations on, suspend, or revoke the registration of any NRSRO, or with respect to any associated person, censure, place limitations on, suspend or bar such person from being associated with an NRSRO, if the Commission finds that such action is necessary for the protection of investors and in the public interest and that the NRSRO or any person associated with the NRSRO has, among other things, committed any act specified in Sections 15(b)(4)(A) or (D) of the Exchange Act. These acts include that the NRSRO, or person associated with the NRSRO, “willfully made or caused to be made” statements that were false or misleading in any application for registration (15(b)(4)(A)) or “willfully violated any provision of . . . this title” (15(b)(4)(D)).<sup>3</sup>

45. Pursuant to Section 15E(a)(1) of the Exchange Act, a credit rating agency that elects to be treated as an NRSRO:

shall furnish to the Commission an application for registration . . . containing . . . the procedures and methodologies that the applicant uses in determining credit ratings . . . and . . . any other information and documents concerning the applicant . . . as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

46. By willfully making material misstatements and omissions in its August 2007 Application, EJR willfully violated Section 15E(a)(1) and Rule 17g-1(a), which require a credit rating agency applying for registration as an NRSRO to furnish the Commission with an initial application on Form NRSRO that follows the Form’s instructions.

47. By willfully making material misstatements and omissions in its July 2008 Application for the two additional classes, EJR willfully violated Section 15E(a)(1) and Rule 17g-1(b), which require an NRSRO applying for registration in an additional class of credit ratings to furnish the Commission with an application on Form NRSRO that follows the Form’s instructions.

48. By willfully making material misstatements and omissions in its annual certifications, EJR willfully violated Section 15E(b)(2) and Rule 17g-1(f), which require NRSROs to, not later than 90 days after the end of each calendar year, file with the Commission an amendment to its registration certifying that the information and documents in the application for registration continue to be accurate.

49. By willfully submitting false QIBs, EJR willfully violated Sections 15E(a)(1)(B)(ix) and 15E(a)(1)(C), which require applicants to provide written certifications from clients who had used the applicant’s ratings in the specified classes.

<sup>3</sup> 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 v. Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

50. By willfully failing to have employees sign the Code of Ethics on a timely basis and allowing two employees to sign a version of the Code that omitted the provision governing ownership of securities, and by failing to adequately collect and review employees' brokerage statements, EJR willfully violated Section 15E(h)(1), which requires an NRSRO to establish, maintain, and enforce written policies and procedures to address and manage conflicts of interest, and Rule 17g-5(c)(2).

51. By willfully failing to make and retain records with respect to each current credit rating, EJR willfully violated Section 17(a) of the Exchange Act and Rule 17g-2(a)(2), which require an NRSRO to make and retain such records, including the identity of the analysts that participated in determining the credit rating, the identity of the person who approved the rating, and whether the rating was solicited or unsolicited.

52. By willfully failing to make and retain a record documenting the established procedures and methodologies it uses to determine credit ratings, EJR willfully violated Section 17(a) of the Exchange Act and Rule 17g-2(a)(6).

53. By willfully failing to retain internal records, including nonpublic information and work papers, used to form the basis of a credit rating, EJR willfully violated Section 17(a) of the Exchange Act and Rule 17g-2(b)(2).

54. By willfully failing to retain internal and external communications, including electronic communications received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating, EJR willfully violated Section 17(a) of the Exchange Act and Rule 17g-2(b)(7).

55. EJR willfully violated Section 15E(h)(1) of the Exchange Act and Rule 17g-5(c)(2) by issuing or maintaining a credit rating where an analyst involved in determining the credit rating, or a person responsible for approving the credit rating, owns securities in the rated entity.

56. As a result of the conduct described above, Egan willfully made, or caused EJR to make, material misstatements in its Form NRSRO; and caused EJR's violations of Sections 15E and 17(a) of the Exchange Act and Rules 17g-1, 17g-2, and 17g-5.

### UNDERTAKINGS

Respondents have undertaken to do the following within 180 days of the entry of this Order: ✓

57. EJR shall complete a comprehensive review of its policies, procedures, practices, and internal controls that relate to the findings in this Order and the findings of the 2012 Section 15E Examination of EJR conducted by the Commission's Office of Credit Ratings ("2012 EJR Exam").

58. EJR shall adopt, implement, and maintain policies, procedures, practices and internal controls that correct the issues identified in this Order, the September 12, 2012 summary letter concerning the 2012 EJR Exam from the SEC's Office of Credit Ratings, and any deficiencies identified in EJR's comprehensive review.

59. EJR shall submit a report, approved and signed under penalty of perjury by Sean Egan and EJR's Compliance Officer, to Thomas Butler, Director, Office of Credit Ratings,

Securities and Exchange Commission New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281-1022, and M. Alexander Koch, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5041, which details the results of the review, the new policies, procedures, practices, and internal controls adopted, and the actions taken to implement and maintain the new policies, procedures, practices, and internal controls.

60. Respondents shall certify, in writing, compliance with the undertakings set forth in paragraphs 57 – 59, above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make requests for further evidence of compliance, and Respondent shall provide such evidence. The certification and supporting material shall be submitted to M. Alexander Koch, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street N.E., Washington, DC 20549-5041, with a copy to the Office of Chief Counsel of the Enforcement Division, Securities and Exchange Commission, no later than thirty (30) days from the date of the completion of the undertakings.

#### IV.

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

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

A. Respondents EJR and Egan cease and desist from committing or causing any violations and any future violations of Sections 15E(a)(1), 15E(b), 15E(h)(1), and 17(a) of the Exchange Act and Rules 17g-1, 17g-2, and 17g-5 thereunder.

B. Respondent EJR's NRSRO registrations for the classes of (a) issuers of asset-backed securities and (b) issuers of government, municipal and foreign government securities be, and hereby are, revoked. EJR shall have the right to apply to the Commission for registration in those classes after eighteen (18) months from the date of this Order.

C. Respondent Egan be, and hereby is, barred from association with any NRSRO registered in the classes of (a) issuers of asset-backed securities or (b) issuers of government, municipal and foreign government securities, with the right to apply to the Commission for reentry after eighteen (18) months from the date of this Order.

D. Respondents shall comply with the undertakings enumerated in Section III above.

E. Any reapplication for NRSRO registration or association by the Respondents will be subject to the applicable laws and regulations governing the registration and reentry process, and registration and reentry may be conditioned upon a number of factors, including, but not limited to, EJR's and Egan's compliance with this Order and the undertakings herein.

F. In the event that EJR or Egan issue or maintain any credit ratings for (a) issuers of asset-backed securities or (b) issuers of government, municipal and foreign government securities, EJR and Egan shall prominently disclose, in a form not unacceptable to the Commission staff, that such ratings are not issued or maintained by a registered NRSRO. EJR's

non-NRSRO credit ratings shall be listed in a separate section of EJR's website with clear and prominent language identifying them as non-NRSRO ratings. EJR shall also include a prominent statement that it is not an NRSRO registered for (a) issuers of asset-backed securities or (b) issuers of government, municipal, and foreign government securities, on all sections of its website that mention EJR's NRSRO registration or contain links to EJR's Form NRSRO filings. EJR shall send written notification to all current subscribers of EJR's ratings of issuers of asset-backed securities or issuers of government, municipal and foreign government securities stating that EJR is not an NRSRO registered for these classes of securities.

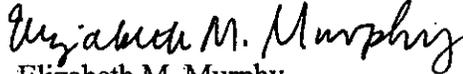
G. Pursuant to Section 21B of the Exchange Act, Respondents shall pay a civil money penalty in the amount of \$30,000 to the United States Treasury. Payment shall be made in the following installments: (1) Respondents shall pay \$15,000 within fourteen (14) days of the entry of this Order; and (2) Respondents shall pay \$15,000 within sixty (60) days of the entry of the Order, as well as post-judgment interest on the second installment. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

- (1) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying EJR and Egan as Respondents in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

By the Commission.

  
Elizabeth M. Murphy  
Secretary

*Commissioner Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3536 / January 22, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15182

In the Matter of

Raymond Y.H. Park,

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 Raymond Y.H. Park ("Park" 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. Park was the head trader for Tiger Asia Fund, L.P., and Tiger Asia Overseas Fund, Ltd., two private funds (the "Funds"), managed by Tiger Asia Management, LLC ("TAM"),

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an investment adviser registered with the Commission. Park, 40 years old, is a resident of Riverdale, New York.

2. On December 14, 2012, a final judgment was entered by consent, without admitting or denying the allegations of the complaint, against Park, permanently enjoining him from future violations of Sections 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, 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. Tiger Asia Mgmt., LLC, et al., 12-cv-07601 (DMC), in the United States District Court for the District of New Jersey.

3. The Commission's complaint alleged that Park engaged in insider trading when TAM entered into wall crossing agreements during December 2008 and January 2009 for three private placements of Chinese bank stocks, subsequently violated the wall crossing agreements by short selling the stocks, and then covered the short positions with private placement shares purchased at a discount. The complaint further alleged that by trading after receiving the material nonpublic information concerning the private placements, Park breached a duty owed to the provider of the private placement information, the placement agents representing the sellers of the securities. The complaint also alleged that Park aided and abetted TAM, Tiger Asia Partners, LLC and Sung Kook Hwang, the portfolio manager of the Funds, in their violations of the Advisers Act. Park, at Hwang's direction, placed trades in Chinese bank stocks at month's end in November and December 2008 and January and February 2009 in an attempt to manipulate the price of those stocks to increase assets under management, which in turn would increase management fees during those four months.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Park 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 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 Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3535 / January 22, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15181

In the Matter of

Sung Kook Hwang,

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 Sung Kook (Bill) Hwang ("Hwang" 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. Hwang was the sole principal and portfolio manager for Tiger Asia Fund, L.P., and Tiger Asia Overseas Fund, Ltd. (the "Funds"), both private funds, and the managing

member of Tiger Asia Management, LLC ("TAM"), an investment adviser registered with the Commission. Hwang, 48 years old, is a resident of Tenafly, New Jersey.

2. On December 14, 2012, a final judgment was entered by consent, without admitting or denying the allegations in the complaint, against Hwang, permanently enjoining him from future violations of Sections 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, 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. Tiger Asia Mgmt., LLC, et al., 12-cv-07601 (DMC), in the United States District Court for the District of New Jersey.

3. The Commission's complaint alleged that Hwang engaged in insider trading when TAM entered into wall crossing agreements during December 2008 and January 2009 for three private placements of Chinese bank stocks, subsequently violated the wall crossing agreements by short selling the stocks, and then covered the short positions with private placement shares purchased at a discount. The complaint further alleged that by trading after receiving the material nonpublic information concerning the private placements, Hwang breached a duty owed to the provider of the private placement information, the placement agents representing the sellers of the securities. The complaint also alleged that Hwang violated the Advisers Act by directing trades to be placed in certain Chinese bank stocks at month's end in November and December 2008 and January and February 2009 in an attempt to manipulate the price of those stocks to increase assets under management, which in turn would increase management fees during those four months.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Hwang 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

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68722 / January 24, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15184

In the Matter of

**ERIC D. ROGERS,**

Respondent.

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

**I.**

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

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1. Rogers, age 31, resides in Oceanside, New York. During the relevant time period, Rogers was a registered representative and proprietary trader at Spectrum Trading, LLC ("Spectrum"), a former Delaware limited liability company and registered broker-dealer based in New York, New York. Rogers held Series 7, 55 and 63 securities licenses.

2. On January 18, 2013, a final judgment was entered by consent against Rogers, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Eric D. Rogers, Civil Action Number 13-CV-0374, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged, *inter alia*, that, while working as a trader at Spectrum in 2007, Rogers was tipped material, nonpublic information concerning the possible acquisition of 3Com Corp. ("3Com"), which had been misappropriated in breach of a duty owed to the source of the information. The complaint further alleged that Rogers purchased 3Com securities based on that material, nonpublic information, and knew, or should have known, that the information he received was obtained in breach of a fiduciary or other duty of trust and confidence owed to the source of the information. Following the announcement of the acquisition, Rogers sold the securities, generating total profits of approximately \$207,000.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Rogers be, and hereby is, barred from association with any broker or dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 68732 / January 25, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13553**

**In the Matter of**  
  
**Mary Beth Stevens**  
  
**Respondent.**

**ORDER DIRECTING DISBURSEMENT**  
**OF FAIR FUND**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-13554**

**In the Matter of**  
  
**Paul W. Oliver, Jr.**  
  
**Respondent.**

On December 22, 2011, the Commission issued a Corrected Notice of Proposed Plan of Distribution and Opportunity for Comment ("Notice"). Exchange Act Rel. No. 66039 (Dec. 22, 2011). The Notice advised interested parties that they could obtain a copy of the Proposed Plan of Distribution from the Commission's public website or by submitting a written request. The Notice required that all persons seeking to comment on the Proposed Plan of Distribution had to submit their comments no later than thirty days from the date of the Notice. No comments were received in response to the Notice.

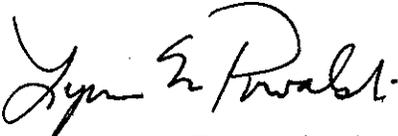
On February 24, 2012, the Commission issued a Corrected Order Approving Plan of Distribution and Appointing a Fund Administrator. Exchange Act Rel. No. 66468 (Feb. 24, 2012). Pursuant to the Final Plan of Distribution, the fund administrator has validated the electronic payment file for disbursements to six clients whose funds were misappropriated ("Eligible Clients"). *Final Plan of Distribution*, Admin. Proc. File Nos. 3-13553 and 3-13554 at 3.

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Accordingly, it is hereby ORDERED that the Commission staff shall disburse \$273,344.83 from the Fair Fund to the Eligible Clients identified in the validated payment file pursuant to the Final Plan of Distribution.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

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

**SECURITIES EXCHANGE ACT OF 1934**

Release No. 68729 / January 25, 2013

**ADMINISTRATIVE PROCEEDING**

File No. 3-15186

**In the Matter of**

**Law Enforcement Associates Corp.,  
Matrixx Resource Holdings, Inc.,  
Mortgage Assistance Center Corp.,  
MVP Network, Inc.,  
Sino Shipping Holdings, Inc.,  
Sonnen Corp.,  
Superior Oil & Gas Co.,  
Tekoil & Gas Corp.,  
Trend Mining Co., and  
Unico, 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 Law Enforcement Associates Corp., Matrixx Resource Holdings, Inc., Mortgage Assistance Center Corp., MVP Network, Inc., Sino Shipping Holdings, Inc., Sonnen Corp., Superior Oil & Gas Co., Tekoil & Gas Corp., Trend Mining Co., and Unico, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Law Enforcement Associates Corp. (CIK No. 1165921) is a defaulted Nevada corporation located in Raleigh, North Carolina with a class of securities registered with

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the Commission pursuant to Exchange Act Section 12(g). Law Enforcement Associates 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, 2011, which reported a net loss of over \$329,000 for the prior three months. On July 27, 2011, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of North Carolina, which was converted to a Chapter 7 proceeding on March 8, 2012, and was still pending as of January 15, 2013. As of January 15, 2013, the company's stock (symbol "LAWEQ") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Matrixx Resource Holdings, Inc. (CIK No. 30966) is a void Delaware corporation located in Sugar Land, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Matrixx Resource Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2007, which reported a net loss of over \$2.6 million for the prior nine months. As of January 15, 2013, the company's stock (symbol "MXXH") 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. Mortgage Assistance Center Corp. (CIK No. 1025856) is a dissolved Florida corporation located in Dallas, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mortgage Assistance Center 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 \$1.1 million for the prior three months. As of January 15, 2013, the company's stock (symbol "MTGC") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. MVP Network, Inc. (CIK No. 103501) is a revoked Nevada corporation located in St. Louis, Missouri with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MVP Network is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of over \$156,000 for the prior nine months. As of January 15, 2013, the company's stock (symbol "MVPN") was traded on the over-the-counter markets.

5. Sino Shipping Holdings, Inc. (CIK No. 312258) is a void Delaware corporation located in Shanghai, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sino Shipping Holdings 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, 2010, which reported a net loss of over \$304,000 for the prior three months. As of January 15, 2013, the company's stock (symbol "SSHZ") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Sonnen Corp. (CIK No. 1403739) is a Nevada corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sonnen 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, 2011, which reported a net loss of over \$702,000 for the prior nine months. As of January 15, 2013, the company's stock (symbol "SONP") was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Superior Oil & Gas Co. (CIK No. 1216774) is a defaulted Nevada corporation located in Calumet, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Superior Oil & Gas 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, 2010, which reported a net loss of over \$9.7 million for the prior nine months. As of January 15, 2013, the company's stock (symbol "SIOR") was quoted on OTC Link, had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

8. Tekoil & Gas Corp. (CIK No. 1368154) is a void Delaware corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tekoil & Gas 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 over \$18.8 million for the prior nine months. On June 10, 2008, Tekoil & Gas filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of Texas, and the case was closed on September 22, 2011. As of January 15, 2013, the company's stock (symbol "TKGN") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

9. Trend Mining Co. (CIK No. 1115954) is a Delaware corporation located in Hilton Head, South Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Trend Mining 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 \$1 million for the prior nine months. As of January 15, 2013, the company's stock (symbol "TRDM") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

10. Unico, Inc. (CIK No. 1110737) is an Arizona corporation located in New Orleans, Louisiana with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Unico 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 31, 2010, which reported a net loss of over \$1 million for the prior three months. As of January 15, 2013, the company's stock (symbol "UNCO") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

## B. DELINQUENT PERIODIC FILINGS

11. 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.

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

13. 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 them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

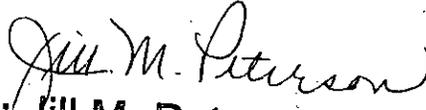
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

January 25, 2013

**In the Matter of**

**Law Enforcement Associates Corp.,  
Matrixx Resource Holdings, Inc.,  
Mortgage Assistance Center Corp.,  
Sino Shipping Holdings, Inc.,  
Sonnen Corp.,  
Superior Oil & Gas Co.,  
Tekoil & Gas Corp.,  
Trend Mining Co., and  
Unico, 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 Law Enforcement Associates Corp. because it has not filed any periodic reports since the period ended March 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Matrixx Resource Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Mortgage Assistance Center Corp. because it has not filed any periodic reports since the period ended March 31, 2008.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sino Shipping Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sonnen Corp. because it has not filed any periodic reports since the period ended March 31, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Superior Oil & Gas Co. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tekoil & Gas Corp. 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 Trend Mining Co. because it has not filed any periodic reports since the period ended June 30, 2007.

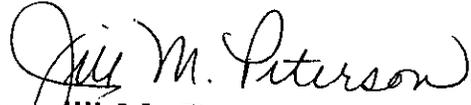
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Unico, Inc. because it has not filed any periodic reports since the period ended May 31, 2010.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 25, 2013, through 11:59 p.m. EST on February 7, 2013.

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. 68731 / January 25, 2013**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-15187**

**In the Matter of**

**Largo Vista Group, Ltd.,  
Montavo, Inc.,  
OBN Holdings, Inc.,  
PrepaYd, Inc.,  
Ready Welder Corp., and  
Snowdon Resources Corp.,**

**Respondents.**

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

**I.**

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Largo Vista Group, Ltd., Montavo, Inc., OBN Holdings, Inc., PrepaYd, Inc., Ready Welder Corp., and Snowdon Resources Corp.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Largo Vista Group, Ltd. (CIK No. 915471) is a revoked Nevada corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Largo Vista Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of over \$357,000 for the prior nine months. As of January 15, 2013, the company's stock (symbol "LGOV") was quoted on OTC Link (previously, "Pink Sheets") operated by

OTC Markets Group Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Montavo, Inc. (CIK No. 1092800) is a void Delaware corporation located in Bellevue, Washington with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Montavo is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended June 30, 2011, which reported a net loss of over \$778,000 for the prior six months. As of January 15, 2013, the company's stock (symbol "MTVO") 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. OBN Holdings, Inc. (CIK No. 1261204) is a defaulted Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OBN Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended March 31, 2010, which reported a net loss of over \$5.1 million for the prior nine months. As of January 15, 2013, the company's stock (symbol "OBNI") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. PrepaYd, Inc. (CIK No. 1436872) is a Nevada corporation located in Henderson, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PrepaYd is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2010, which reported a net loss of over \$489,000 for the prior year. As of January 15, 2013, the company's stock (symbol "PPDC") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Ready Welder Corp. (CIK No. 1453114) is a void Delaware corporation located in San Pedro, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ready Welder 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, 2010, which reported a net loss of over \$49,000 for the prior three months. As of January 15, 2013, the company's stock (symbol "RDYW") was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Snowdon Resources Corp. (CIK No. 1365554) is a defaulted Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Snowdon Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended January 31, 2011, which reported a net loss of over \$334,000 for the prior nine months. As of January 15, 2013, the company's stock (symbol "SWDO") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

## B. DELINQUENT PERIODIC FILINGS

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 them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

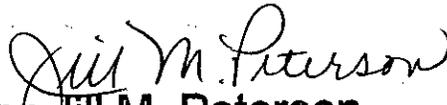
This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

**January 25, 2013**

**In the Matter of**

**Largo Vista Group, Ltd.,  
Montavo, Inc.,  
OBN Holdings, Inc.,  
PrepaYd, Inc.,  
Ready Welder Corp., and  
Snowdon Resources Corp.,**

**File No. 500-1**

**ORDER OF SUSPENSION OF  
TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Largo Vista Group, Ltd. 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 Montavo, Inc. because it has not filed any periodic reports since the period ended June 30, 2011.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of OBN Holdings, Inc. because it has not filed any periodic reports since the period ended March 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of PrepaYd, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Ready Welder Corp. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Snowden Resources Corp. because it has not filed any periodic reports since the period ended January 31, 2011.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 25, 2013, through 11:59 p.m. EST on February 7, 2013.

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. 68727 / January 25, 2013**

**ADMINISTRATIVE PROCEEDING**

**File No. 3-15185**

**In the Matter of**

**Medis Technologies Ltd.,  
Modern Medical Modalities Corp.,  
National Datacomputer, Inc.,  
New Media Lottery Services, Inc.,  
Sino-Bon Entertainment, Inc.,  
Tamir Biotechnology, Inc., and  
TechMedia Advertising, 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 Medis Technologies Ltd., Modern Medical Modalities Corp., National Datacomputer, Inc., New Media Lottery Services, Inc., Sino-Bon Entertainment, Inc., Tamir Biotechnology, Inc., and TechMedia Advertising, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Medis Technologies Ltd. (CIK No. 1090507) 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). Medis Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of over \$43 million for the prior six months. As of January 15, 2013, the company's stock

(symbol "MDTL") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Modern Medical Modalities Corp. (CIK No. 902635) is a New Jersey corporation located in Union, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Modern Medical Modalities 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, 2010, which reported a net loss of over \$227,000 for the prior three months. As of January 15, 2013, the company's stock (symbol "MODM") 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. National Datacomputer, Inc. (CIK No. 812880) is a Delaware corporation located in Bedford, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). National Datacomputer is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2010, which reported a net loss of over \$288,000 for the prior year. As of January 15, 2013, the company's stock (symbol "NDCP") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. New Media Lottery Services, Inc. (CIK No. 1172635) is a void Delaware corporation located in Harrisonburg, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New Media Lottery Services is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended April 30, 2010, which reported a net loss of over \$5.5 million for the prior year. As of January 15, 2013, the company's stock (symbol "NWMD") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Sino-Bon Entertainment, Inc. (CIK No. 1119809) is a revoked Nevada corporation located in Shenzhen City, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sino-Bon 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, 2010. As of January 15, 2013, the company's stock (symbol "SIBO") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Tamir Biotechnology, Inc. (CIK No. 708717) is a Delaware corporation located in Monmouth Junction, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Tamir Biotechnology is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2011. As of January 15, 2013, the company's stock (symbol "ACEL") was quoted on OTC Link, had ten

market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. TechMedia Advertising, Inc. (CIK No. 1415605) is a defaulted Nevada corporation located in Singapore with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Techmedia Advertising is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the period ended April 30, 2010, which reported a net loss of over \$2.7 million for the prior nine months. As of January 15, 2013, the company's stock (symbol "TECM") was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

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 them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, 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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

January 25, 2013

In the Matter of

Medis Technologies Ltd.,  
Modern Medical Modalities Corp.,  
National Datacomputer, Inc.,  
New Media Lottery Services, Inc.,  
Sino-Bon Entertainment, Inc.,  
Tamir Biotechnology, Inc., and  
Techmedia Advertising, 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 Medis Technologies Ltd. because it has not filed any periodic reports since the period ended June 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Modern Medical Modalities Corp. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of National Datacomputer, Inc. because it has not filed any periodic reports since the period ended December 31, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of New Media Lottery

Services, Inc. because it has not filed any periodic reports since the period ended April 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sino-Bon Entertainment, Inc. because it has not filed any periodic reports since the period ended September 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Tamir Biotechnology, Inc. because it has not filed any periodic reports since the period ended January 31, 2011.

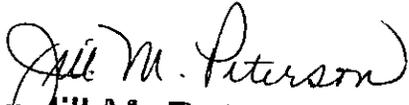
It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Techmedia Advertising, Inc. because it has not filed any periodic reports since the period ended April 30, 2010.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on January 25, 2013, through 11:59 p.m. EST on February 7, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary



3. As a result of her conviction, Loisel was sentenced to 12 months and one day in federal prison, followed by 36 months of supervised release. A final forfeiture money judgment, in the amount of \$800,000, was also entered against Loisel.

III.

In view of the foregoing, the Commission finds that Loisel 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 Loisel is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 68736 / January 25, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-11676**

**In the Matter of**

**JOHN W. ADAMS and AIP, LLC,**

**Respondents.**

**ORDER MODIFYING DISTRIBUTION PLAN  
AND DIRECTING DISBURSEMENT OF  
DISGORGEMENT FUND**

On February 23, 2009, the Commission issued a Notice of Proposed Plan of Disgorgement Distribution and Opportunity for Comment ("Notice") in connection with this proceeding pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103 (Exchange Act Rel. No. 59433). The Notice advised parties they could obtain a copy of the Proposed Plan of Distribution ("Distribution Plan") at [www.sec.gov](http://www.sec.gov). The Notice also advised that all parties desiring to comment on the Distribution Plan could submit their comments, in writing, no later than March 25, 2009. No comments were received by the Commission in response to the Notice. On May 6, 2009, the Commission issued an Order Approving Distribution Plan of a Disgorgement Fund ("Order") (Exchange Act Rel. No. 59870).

The Distribution Plan states that upon approval of the Plan, the Fund Administrator shall establish an Escrow Account and a Controlled Distribution Account (collectively the "Accounts") at Wells Fargo Bank, N.A. ("Wells Fargo"). After the Plan was approved, however, the Fund Administrator was unable to establish the Accounts at Wells Fargo due to a change in the bank's policy. Instead, the Fund Administrator established the Accounts at Huntington National Bank. The Division requests that the Commission approve this modification to the Distribution Plan.

The Distribution Plan also provides that in order to distribute the funds, the Fund Administrator will submit a Payment List to the assigned Commission staff, who will obtain authorization from the Commission to disburse pursuant to Rule 1101(b)(6). The Payment List, which is in the amount of \$2,628,775.28, has been received by Commission staff and the staff requests that the Commission authorize disbursement of the funds.

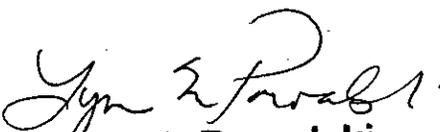
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Accordingly, it is ORDERED that:

- 1) The Distribution Plan is hereby modified. All references to Wells Fargo Bank, N.A. shall be replaced with Huntington National Bank; and
- 2) The Commission staff shall transfer \$2,628,775.28 of the Disgorgement Fund to Huntington National Bank, and the Fund Administrator shall distribute the monies to investors, as provided for in the Distribution Plan.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68737 / January 25, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-14958

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In the Matter of	:	ORDER ESTABLISHING FAIR FUND,
	:	APPOINTING A FUND
	:	ADMINISTRATOR, APPROVING
HURON CONSULTING	:	DISTRIBUTION PLAN AND
	:	AUTHORIZING TRANSFER
GARY L. BURGE, CPA	:	OF DISTRIBUTION FUND
and WAYNE E. LIPSKI, CPA,	:	
	:	
Respondents.	:	

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On July 19, 2012, the Securities and Exchange Commission ("Commission") instituted and simultaneously settled cease-and-desist proceedings against Huron Consulting Group Inc. ("Huron"), a provider of financial and operational consulting services, Gary L. Burge, CPA, Huron's former Chief Financial Officer and Treasurer, and Wayne E. Lipski, CPA, Huron's former Controller and Chief Accounting Officer (collectively, the "Respondents"), for violating various provisions of the federal securities laws (the "Order"). The Order directed, among other things, that the Respondents pay a total of \$1,294,436.52 in disgorgement, prejudgment interest and penalties.<sup>1</sup> The Respondents have made the payments required under the Order. Prior to the Commission's Order, on January 18, 2011, private plaintiffs settled a class action, *Hughes v. Huron Consulting Group, Inc., et al.*, Civil Action No. 1:09-cv-04734 (N.D. Ill. 2010) (the "Class Action"). The Class Action settlement calls for a distribution to injured investors of \$27 million plus 474,547 shares of Huron common stock.

The Division of Enforcement (the "Division") has concluded that the Class Action alleges securities law violations arising from substantially similar facts over the identical period of time and that distributing funds paid in the Commission's administrative proceeding through the Class Action's distribution process would be fair and reasonable and an efficient way for the Commission to benefit investors injured as a result of the Respondents' misconduct. On December 13, 2012, the Commission issued a Notice of Proposed Plan of Distribution and Opportunity for Comment (Exchange Act Rel. No. 68420) pursuant to Rule 1103 of the

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<sup>1</sup> See Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Remedial Sanctions, Exchange Act Rel. No. 67472 (July 19, 2012).

Commission's Rules on Fair Fund and Disgorgement Plans (the "Rules"), 17 C.F.R. § 201.1103. The Proposed Plan of Distribution (the "Distribution Plan") proposed that the disgorgement, prejudgment interest, and, if the Commission orders the establishment of a Fair Fund pursuant to Section 308 of the Sarbanes-Oxley Act of 2002 (as amended), the penalty, paid by Respondents be transferred pursuant to Rule 1102(a) of the Rules, 17 C.F.R. § 201.1102(a), to the court registry account established for the Class Action, for distribution to injured investors in accordance with the Plan of Allocation approved by the court in the Class Action. The Commission received no comments on the Distribution Plan. The Division requests that the Commission approve the Distribution Plan.

The Division recommends that a Fair Fund be established to add penalties paid to the disgorgement funds in this matter (the "Huron Distribution Fund") because, according to the claims administrator for the Class Action, the Garden City Group, Inc. ("GCG"), the Class Action claimants' losses exceed the combined value of the Class Action fund and the Huron Distribution Fund. In addition, the Division recommends that GCG be appointed as the Fund Administrator for the Huron Distribution Fund.

The Commission now finds that in accordance with Rule 1102(a), 17 C.F.R. § 201.1102(a), the complaint filed in the Class Action alleges violations arising from the same or substantially similar facts as those alleged in the Commission's Order.

Accordingly, IT IS ORDERED that:

- A. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is established for the \$1,294,436.52 paid by the Respondents.
- B. Pursuant to Rule 1105(a) of the Rules, 17 C.F.R. § 201.1105(a), GCG is appointed as Fund Administrator.
- C. Pursuant to Rule 1104 of the Rules, 17 C.F.R. § 201.1104, the Distribution Plan is approved.
- D. Pursuant to Rule 1102(a) of the Rules, 17 C.F.R. § 201.1102(a), Commission staff shall transfer the Huron Distribution Fund in the amount of \$1,294,436.52 to the court registry in *Hughes v. Huron Consulting Group, Inc. et al.*, Civil Action No. 1:09-cv-04734 (N.D. Ill. 2010), for distribution with the Class Action distribution fund and in accordance with the Distribution Plan.
- E. The district court of the Class Action is hereby given notice of Section 21(d)(4) of the Securities Exchange Act of 1934, and consistent with the foregoing law, that disgorgement funds collected in this proceeding shall not be distributed as payment for attorneys' fees or expenses.
- F. GCG will be responsible for all tax compliance and reporting obligations of the Huron Distribution Fund, and the payment of taxes, if any, will be made from the Class Action settlement fund.

- G. The Huron Distribution Fund shall not pay for any administrative expenses incurred, including taxes, mailing, postage or any other expenses of implementing the joint distribution; however, if the Huron Distribution Fund cannot be distributed simultaneously with the payments from the Class Action Fund, then payment of GCG fees from the Huron Distribution Fund will be permitted only for necessary expenses incurred that are not related to the administration of the class action distribution, and only if such fees are reviewed with no objection from Commission staff and are then approved by the district court in the Class Action;
- H. In the event that any portion of the Huron Distribution Fund is not distributed to injured investors, less fees and/or expenses that may appropriately be deducted in accordance with Paragraph G from the Huron Distribution Fund, any residual amount remaining after completion of the distribution will be paid to the Commission for transmittal to the United States Treasury.
- I. Commission staff shall file a final accounting with the Commission for approval that is based on the accountings filed by GCG on behalf of the Class Action and approved by the District Court.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

*Commissioner Gallagher  
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 68764 / January 30, 2013**

**ADMINISTRATIVE PROCEEDING  
File No. 3-13304**

**In the Matter of**

**CentreInvest, Inc.,  
OOO CentreInvest Securities,  
Vladimir Chekholko,  
William Herlyn,  
Dan Rapoport, and  
Svyatoslav Yenin,**

**Respondents.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-  
DESIST ORDER PURSUANT TO  
SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934 AS TO DAN RAPOPORT**

**I.**

On December 8, 2008, 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 CentreInvest, Inc. ("CI-New York"), OOO CentreInvest Securities ("CI-Moscow"), Vladimir Chekholko, William Herlyn, Dan Rapoport ("Rapoport") and Svyatoslav Yenin.

**II.**

In connection with these proceedings, Respondent Rapoport 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, Rapoport consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Dan Rapoport ("Order"), as set forth below.

### III.

On the basis of this Order and Rapoport's Offer, the Commission finds<sup>1</sup> that:

#### SUMMARY

1. These proceedings arise out of violations of the broker-dealer registration, reporting, and record-keeping requirements of the Exchange Act by CI-Moscow, a Moscow-based unregistered broker-dealer, and its New York-based affiliate, CI-New York, a registered broker-dealer. From 2004 through November 2007, CI-Moscow – directly and through CI-New York – solicited institutional investors in the United States to purchase and sell thinly-traded stocks of Russian companies, without registering as a broker-dealer as required by Section 15(a) of the Exchange Act or meeting the requirements for the exemption from registration for foreign broker-dealers under Exchange Act Rule 15a-6(a).

#### SETTLING RESPONDENT

2. **Dan Rapoport**, age 43, was, during the relevant period, a resident of Russia. He joined CI-Moscow in 1995. Rapoport relocated to New York and became a registered representative at CI-New York in January 1999. He served as CI-New York's managing director from January 2001 until November 2001. Rapoport returned to CI-Moscow, as a managing director, in 2003, and was later promoted to executive director. While at CI-Moscow, Rapoport was responsible for the brokerage operations at both CI-Moscow and CI-New York. CI-Moscow terminated his employment in February 2008. During portions of the relevant period, Rapoport held series 7, 24 and 63 licenses.

#### ENTITY RESPONDENTS

3. **OOO CentreInvest Securities** ("CI-Moscow") is a Moscow-based broker-dealer and limited liability company, specializing in the sale of second-tier Russian equities. During the relevant period, it was an affiliate of CI-New York. It was founded in 1992 under the laws of Russia and is regulated by the Russian Federal Financial Markets Service. CI-Moscow has never been registered with the Commission as a broker or dealer. On August 31, 2009, an administrative law judge issued an initial decision in these proceedings, finding that CI-Moscow violated Section 15(a) of the Exchange Act. That decision barred CI-Moscow from associating with any broker or dealers, imposed a cease-and-desist order, ordered disgorgement of \$2,400,000 (plus prejudgment interest) and assessed a civil penalty of \$1,275,000. The initial decision became the final decision of the Commission with respect to CI-Moscow on January 29, 2010.

4. **CentreInvest, Inc.** ("CI-New York") is a registered broker-dealer organized under the laws of New York State with its principal place of business in New York, New York. During

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

the relevant period, it was a subsidiary of Cyprus-based Intelsa Investments Limited. CI-New York first registered with the Commission on June 23, 1998, and during the relevant period, employed four to five full-time employees. On October 2, 2008, the Financial Industry Regulatory Authority, Inc. expelled CI-New York for failure to file a Financial and Operational Combined Uniform Single report. On July 31, 2009, an administrative law judge issued an Order Making Findings and Imposing Sanctions as to CI-New York. That order revoked the broker-dealer registration of CI-New York; ordered CI-New York to cease and desist from committing or causing any violations, or future violations of Sections 15(a) and 17(a) and Rules 15b3-1, 17a-4(b)(4), and 17a-4(j) of the Exchange Act; ordered the payment of disgorgement of \$441,972 (plus prejudgment interest); and imposed a civil monetary penalty of \$1,575,000.

### **CI-MOSCOW AND RAPOPORT ACTED AS A BROKER-DEALER BUT FAILED TO REGISTER OR COMPLY WITH AN EXEMPTION FROM REGISTRATION**

5. From about 2003 until at least November 2007, CI-Moscow directly and indirectly solicited investors in the United States to purchase and sell thinly-traded stocks of Russian companies – so-called “second-tier” Russian companies – without registering as a broker-dealer, as required by Section 15(a) of the Exchange Act, or meeting the requirements for an exemption.

6. Under Rapoport’s direction, employees of CI-New York, regularly solicited U.S. institutional investors for the purchase and sale of Russian securities. Investors who expressed interest in a transaction were referred to CI-Moscow to complete the transaction.

7. In some cases, Rapoport and other employees of CI-Moscow, who were not licensed to sell securities under U.S. law or registered as brokers or dealers under U.S. law and were not exempt from such licensing and registration requirements, solicited U.S. investors directly.

8. Rapoport knew that any representative of CI-Moscow who solicited a U.S. investor would have to be licensed and registered with the Commission or an appropriate U.S. self-regulatory organization.

9. CI-New York failed to maintain proper records concerning CI-Moscow’s transactions with the U.S. investors.

10. Respondents, including Rapoport, benefited financially from CI-Moscow’s transactions in securities with or on behalf of U.S. investors. For example, in 2006 alone, CI-Moscow received at least \$928,000 in revenue as a result of its unlawful solicitation of U.S. institutional investors.

### **VIOLATIONS**

11. Rule 15a-6 of the Exchange Act provides conditional exemptions from broker-dealer registration for foreign broker-dealers that engage in certain specified activities involving U.S. investors. Specifically, Rule 15a-6(a)(3) permits unregistered foreign broker-dealers to solicit

and effect transactions for some U.S. institutional investors through a registered broker-dealer intermediary subject to a number of conditions, including compliance by both the registered broker-dealer and foreign broker-dealer with certain reporting, record keeping and other requirements designed to ensure the protection of U.S. investors. Rule 15a-6(b)(3) defines a "foreign broker or dealer" as "any non-U.S. resident person (including any U.S. person engaged in business as a broker or dealer entirely outside the United States, except as otherwise permitted by this rule) that is not an office or branch of, or a natural person associated with, a registered broker-dealer, whose securities activities, if conducted in the U.S., would be described by the definition of "broker" or "dealer" in Sections 3(a)(4) or 3(a)(5) of the [Exchange] Act." Section 3(a)(4) of the Exchange Act generally defines a "broker" to include any person "engaged in the business of effecting transactions in securities for the account of others," with a limited exception for banks to the extent that they engage in certain types of bank activities. A person "effects transactions in securities" if he or she participates in such transactions "at key points in the chain of distribution." Massachusetts Fin. Servs., Inc. v. Security Investor Protection Corp., 411 F. Sup. 411, 415 (D. Mass.), aff'd, 545 F. 2d 754 (1st Cir. 1976).

12. CI-Moscow and Rapoport failed to qualify for any exemption from registration.

13. As a result of the conduct described above, Rapoport willfully<sup>2</sup> violated Section 15(a) of the Exchange Act, which makes it illegal for a broker to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any security unless the broker is registered with the Commission or, in the case of a natural person, is associated with a registered broker or dealer.

#### IV.

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

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

A. Rapoport cease and desist from committing or causing violations and any future violations of Section 15(a) of the Exchange Act.

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

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<sup>2</sup> 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)).

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.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (i) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (ii) any arbitration award related to the conduct that served as the basis for the Commission order; (iii) 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 (iv) 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. Rapoport shall pay disgorgement of \$22,084.75, prejudgment interest of \$7,317.65, and civil penalties of \$39,000, for a total of \$68,402.40, to the United States Treasury. Payment shall be made in the following installments: (i) \$22,800.80 shall be paid within five (5) business days following the date on which this Order is entered; (ii) \$22,800.80 shall be paid within 90 days following the date on which this Order is entered; and (iii) \$22,800.80 shall be paid within 180 days following the date on which this Order is entered. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center  
Accounts Receivable Branch  
HQ Bldg., Room 181, AMZ-341  
6500 South MacArthur Boulevard  
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Rapoport as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover

letter and check or money order must be sent to Andrew M. Calamari, Regional Director,  
Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, NY,  
10281.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 68772 / January 30, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15195

In the Matter of

WILLIAM B. MITCHELL,

Respondent.

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

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

*33a of 33*

### III.

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

1. Mitchell, 45 years old, is a resident of Middle River, Maryland. Mitchell worked for Garfield Taylor, Inc. ("GTI") as its Vice President for Finance from May 2004 to November 2005 and rejoined GTI as an independent contractor in 2009. From July 2008 through February 2009, Mitchell worked for Gibraltar Asset Management Group, LLC ("GAM"), as Executive Vice President of Strategic Planning. In February 2009, he became the President of GAM and held that position through at least August 2009. Mitchell is also the President and sole owner of Relief Defendant Marketing and Financial Consultants, Inc.

2. Mitchell was not registered as a broker-dealer or associated with a registered broker-dealer at the time he worked for GTI and GAM.

3. On January 16, 2013, a final judgment was entered by consent against Mitchell, permanently enjoining him from future violations of Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Garfield Taylor, Inc., et al., Civil Action No. 1:11-CV-02054-RLW, in the United States District Court for the District of Columbia.

4. The Commission's complaint alleged that Defendant Garfield M. Taylor, operating through GTI and GAM, defrauded over 130 investors, primarily middle-class residents and charitable organizations in the Washington, DC metropolitan area, of more than \$27 million from at least 2005 until 2010. The complaint further alleged that Garfield Taylor orchestrated the frauds with the assistance of Mitchell and four other co-defendants; that Garfield Taylor induced Mitchell (who was not a licensed securities broker) to solicit and refer new investors to Taylor in exchange for commission payments based on the amounts invested; and that Mitchell solicited new investors and referred multiple potential investors to GTI in return for thousands of dollars in commission payments from GTI based on the amounts of money ultimately invested.

### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Mitchell be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities

with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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