

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 **March 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 served 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

(7 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 17, 2013

IN THE MATTER OF
MEDEX, 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 Medex, Inc. ("Medex") because of questions regarding the accuracy of assertions by Medex, and by others, in press releases and other public statements to investors, and in promotional emails, concerning, among other things: (i) the company's operations; and (ii) the company's outstanding shares.

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

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THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST, on January 17, 2013 through 11:59 p.m. EST, on January 31, 2013.

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

*Commissioner Paredes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69014 / March 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15223

In the Matter of

WENDELL A. JACOBSON,

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 Wendell A. Jacobson ("Jacobson" 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.

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III.

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

1. Jacobson was the whole owner, founder, and controlling person of Management Solutions, Inc., and had partnership interests in numerous other entities that own and manage over 8,000 units in apartment complexes located in eleven different states. Jacobson has never been registered with the Commission or held any securities licenses. Jacobson, 58 years old, is a resident of Fountain Green, Utah.

2. On December 18, 2012, a final judgment was entered by consent against Jacobson, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Management Solutions, Inc., et al., Civil Action Number 2:11-CV-1165, in the United States District Court for the District of Utah.

3. The Commission's complaint alleged that, in connection with the sale of membership interests in limited liability companies ("LLCs"), Jacobson misused and misappropriated investor funds; failed to disclose to investors that the investor funds would be immediately pooled with other investor funds and that, after commingling and pooling investor funds, Jacobson would redirect the funds to pay operating expenses of the numerous entities and pay promised returns to earlier investors. The complaint also alleged that Jacobson sold unregistered securities and acted as an unregistered 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 Jacobson's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Jacobson 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


By: Jill M. Peterson
Assistant Secretary

*Commissioner Karedes
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69015 / March 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15224

In the Matter of

ALLEN R. JACOBSON,

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 Allen R. Jacobson ("Allen Jacobson" or "Respondent").

II.

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

III.

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

1. Allen Jacobson, the son of Wendell A. Jacobson, was a partner and controlling person of Management Solutions, Inc., and had partnership interests in numerous other entities that own and manage over 8,000 units in apartment complexes located in eleven different states. Allen Jacobson has never been registered with the Commission or held any securities licenses. Allen Jacobson, 33, currently resides in Sterrett, Alabama.

2. On December 18, 2012, a final judgment was entered by consent against Allen Jacobson, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Management Solutions, Inc., et al., Civil Action Number 2:11-CV-1165, in the United States District Court for the District of Utah.

3. The Commission's complaint alleged that, in connection with the sale of membership interests in limited liability companies ("LLCs"), Jacobson misused and misappropriated investor funds; failed to disclose to investors that the investor funds would be immediately pooled with other investor funds and that, after commingling and pooling investor funds, Jacobson would redirect the funds to pay operating expenses of the numerous entities and pay promised returns to earlier investors. The complaint also alleged that Jacobson sold unregistered securities and acted as an unregistered 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 Allen Jacobson's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Allen Jacobson be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of

factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69046 / March 5, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15229

In the Matter of

IGIA, Inc.,
Impulse Communications, Inc.,
Infu-Tech, Inc.,
Innovative Technology Acquisition Corp.
(n/k/a Galea Life Sciences, Inc.), and
Intersolv, Inc. (n/k/a Merant
Solutions, Inc.),

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents IGIA, Inc., Impulse Communications, Inc., Infu-Tech, Inc., Innovative Technology Acquisition Corp. (n/k/a Galea Life Sciences, Inc.), and Intersolv, Inc. (n/k/a Merant Solutions, Inc.)

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. IGIA, Inc. (CIK No. 919603) 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). IGIA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended February 29, 2008, which failed to include audited financial statements as

required by Reg. S-X of the Securities Act. As of November 5, 2012, the company's stock (symbol "IGAI") was traded on the over-the-counter markets.

2. Impulse Communications, Inc. (CIK No. 1140101) is a Delaware corporation located in Wakefield, Rhode Island with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Impulse Communications 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 7, 2001.

3. Infu-Tech, Inc. (CIK No. 890152) is a void Delaware corporation located in Carlstadt, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infu-Tech 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 \$2.89 million for the prior nine months.

4. Innovative Technology Acquisition Corp. (n/k/a Galea Life Sciences, Inc.) (CIK No. 1140745) is a Delaware corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Innovative Technology is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 2002, which reported a net loss of over \$2 million for the period from its February 5, 1996 inception to July 31, 2002.

5. Intersolv, Inc. (n/k/a Merant Solutions, Inc.) (CIK No. 805330) is a Delaware corporation located in Rockville, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Intersolv is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended July 31, 1998.

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.

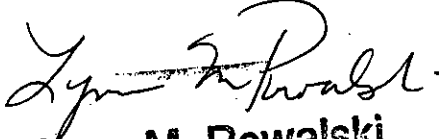
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69047 / March 5, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15230

In the Matter of

IdleAire Technologies Corp.,
Informedics, Inc.,
Infynia.com Corp.,
Injectomatic Systems International, Inc.
(n/k/a Galton Biometrics, Inc.),
Insilco Holding Co.,
Integrated Food Resources, Inc., and
Integrated Travel Group, Inc.
(f/k/a Nemco, 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 IdleAire Technologies Corp., Informedics, Inc., Infynia.com Corp., Injectomatic Systems International, Inc. (n/k/a Galton Biometrics, Inc.), Insilco Holding Co., Integrated Food Resources, Inc., and Integrated Travel Group, Inc. (f/k/a Nemco, Inc.)

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. IdleAire Technologies Corp. (CIK No. 1162298) is a delinquent Delaware corporation located in Knoxville, Tennessee with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IdleAire 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, 2007, which reported a net loss of over \$93 million for the prior twelve months.

2. Informedics, Inc. (CIK No. 727164) is an Oregon corporation located in Lake Oswego, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Informedics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended July 31, 1998.

3. Infynia.com Corp. (CIK No. 918411) is a delinquent Colorado corporation located in St. Laurent, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infynia.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001. As of November 5, 2012, the company's stock (symbol "INYC") was traded on the over-the-counter markets.

4. Injectomatic Systems International, Inc. (n/k/a Galton Biometrics, Inc.) (CIK No. 831671) is a forfeited Delaware corporation located in Barrie, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Injectomatic is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2003.

5. Insilco Holding Co. (CIK No. 1068049) is a dissolved Delaware corporation located in Mount Vernon, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Insilco Holding is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002, which reported a net loss of over \$53 million for the prior nine months.

6. Integrated Food Resources, Inc. (CIK No. 1072555) is a permanently revoked Nevada corporation located in Tigard, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Integrated Food is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 30, 2000, which reported a net loss of \$449,975 for the prior nine months.

7. Integrated Travel Group, Inc. (f/k/a Nemco, Inc.) (CIK No. 1082117) is a void Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Integrated Travel is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended June 30, 2002, which reported a net loss of \$94,047 for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2

or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69057 / March 7, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-13199

In the Matter of

CORNERSTONE CAPITAL
MANAGEMENT, INC., and
LAURA JEAN KENT,

Respondents.

ORDER DIRECTING DISBURSEMENT
OF DISTRIBUTION FUND

On December 18, 2009, the United States Securities and Exchange Commission ("Commission") issued a Notice of Proposed Plan of Distribution and Opportunity for Comment ("Distribution Plan") (Exchange Act Rel. No. 61208) pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103. The Notice advised parties that they could obtain a copy of the Distribution Plan at www.sec.gov. The Notice also advised that all persons desiring to comment on the Distribution Plan could submit their comments, in writing, within 30 days of the date of the Notice. No comments were received by the Commission in response to the Notice. On March 5, 2010, the Commission issued an Order Approving Plan and Appointing a Plan Administrator (Exchange Act Rel. No. 61653).

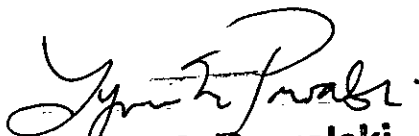
The Distribution Plan provides that the Plan Administrator will compile the necessary information regarding the Harmed Investors described in the Distribution Plan to be submitted to the U.S. Department of Treasury's Financial Management Service ("FMS") in the required file format, and Commission staff will then obtain authorization from the Commission to disburse pursuant to SEC Rule 1101(b)(6).¹

¹ The Distribution Plan provides for three disbursement payments to the Harmed Investors. This is the second Order Directing Disbursement. The first Order Directing Disbursement was approved on September 17, 2010 (Exchange Act Rel. No. 62936).

Accordingly, it is ORDERED that the Commission staff shall transmit the electronic file containing the necessary information regarding the Harmed Investors to FMS for the transfer and distribution of \$121,117.06 in funds to the Harmed Investors in accordance with 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. 69117 / March 12, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15243

In the Matter of

Indigo Aviation AB,
Industra Service Corp. (a/k/a
American Eco Corp.),
Infinity Products, Inc., and
Insight Medical Group, Inc. (n/k/a
Telycom Technologies, Inc.),

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Indigo Aviation AB, Industra Service Corp. (a/k/a American Eco Corp.), Infinity Products, Inc., and Insight Medical Group, Inc. (n/k/a Telycom Technologies, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Indigo Aviation AB (CIK No. 1057047) is a Swedish corporation located in Malmo, Sweden with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Indigo Aviation is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1998.

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2. Industra Service Corp. (CIK No. 889377) is a British Columbia corporation located in New Westminster, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Industra is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 1995, which reported a net loss of \$283,000 for the year ended December 31, 1995. Industra merged with American Eco Corp. (CIK No. 868076), an Ontario corporation located in Houston, Texas. American Eco is also 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 February 29, 2000, which reported a net loss of over \$4.2 million for the prior three months. On August 4, 2000, American Eco filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was closed on September 13, 2007.

3. Infinity Products, Inc. (CIK No. 1055576) is a permanently revoked Nevada corporation located in West Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Infinity Products 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 14, 2001, which reported a net loss of \$138,415 from its October 10, 1997 inception to December 31, 2000.

4. Insight Medical Group, Inc. (n/k/a Telycom Technologies, Inc.) (CIK No. 352903) is a void Delaware corporation located in Alicante, Spain with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Insight Medical is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended March 31, 2001, which reported a net loss of \$11,953 for the prior twelve months.

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69138 / March 14, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14909

In the Matter of

OPPENHEIMERFUNDS, INC.

and

OPPENHEIMERFUNDS
DISTRIBUTOR, INC.,

Respondents.

Order Appointing
Fund Administrator and
Approving Fund Administrator
Bond

On June 6, 2012, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b)(4) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against OppenheimerFunds, Inc. and OppenheimerFunds Distributor, Inc. ("Order"). Securities Act Release No. 9329 (June 6, 2012). The Commission ordered OppenheimerFunds, Inc. to pay disgorgement of \$9,879,706, prejudgment interest of \$1,487,190 and a civil money penalty of \$24,000,000 to the Commission. The Commission Order also created a Fair Fund for a distribution pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended.

Based on its review and consideration of several proposals, the Division of Enforcement's Office of Distributions ("OD") recommends that the Commission appoint Epiq Class Actions & Claims Solutions, Inc. ("Epiq") as the Fund Administrator. OD further requests that the Commission approve the Fund Administrator's bond requirement in the amount of \$35,500,000.

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 Epiq is appointed as the Fund Administrator, and Epiq shall obtain a bond in the manner prescribed in Rule 1105(c) in the approved amount of \$35,500,000.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Lynn M. Powalski
Deputy 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 **March 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 until 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:

ELISSE B. WALTER, CHAIRMAN

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(50 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3559 / March 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15221

In the Matter of

Ward Onsa,

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 Ward Onsa ("Respondent" or "Onsa").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Onsa, 60 years old, is a resident of Marco Island, Florida. From 1996 through 2010, Respondent managed investor funds and provided investment advice through Ward Onsa & Company, an unincorporated business entity. Onsa formed New Century Hedge Fund Partners I, L.P., (the "Fund") as a limited partnership that operated as a hedge fund. Onsa was the sole portfolio manager for the Fund and had exclusive control over its trading accounts. During the relevant time period, Onsa acted as an unregistered investment adviser to the Fund.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On December 15, 2011, Onsa pled guilty to one count of securities fraud in violation of Title 15 U.S.C. §§ 78j(b) and 78ff, before the United States District Court for the Eastern District of New York, in United States of America v. Onsa, Case Number 10-CR-730. On

July 26, 2012, a judgment in the criminal case was imposed against Onsa. He was sentenced to a prison term of 78 months and ordered to pay \$3.1 million in restitution.

3. The count of the indictment to which Onsa pleaded guilty alleged, among other things, that Onsa told investors in the Fund that he would purchase securities consistent with a "bearish" view of the stock markets and he guaranteed Fund investors a 25 percent annual return on capital. Contrary to representations he made to investors, Onsa's trading in the Fund was not successful and when the Fund became insolvent, Onsa continued to solicit investors and used new investor money to pay redemptions in Ponzi-like fashion. Onsa also fraudulently inflated account balances communicated to investors.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3560 / March 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15222

In the Matter of

NICHOLAS DELBROCCO,

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 Nicholas Delbrocco ("Delbrocco" 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, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and 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. From 2005 to 2006, Delbrocco was the chief executive officer, partial owner, and investment adviser representative of New England Asset Management, LLC ("NEAM"), an investment adviser registered with the Commission. In 2006, NEAM changed its name to Ocean State Asset Management, LLC ("OSAM"), which remained an investment adviser registered with the Commission. Delbrocco served as OSAM's chief executive officer, partial owner, and investment adviser representative from 2006 to 2009. In 2009, Delbrocco's title as chief executive officer changed to principal, and he continued to be a partial owner and investment adviser representative of OSAM. In 2010, Delbrocco assumed full ownership of OSAM, and in 2012, he added the position of chief compliance officer to his roles as principal, owner, and investment adviser representative of OSAM. Delbrocco, who is 49 years old, is a resident of North Kingstown, Rhode Island.

2. On October 18, 2012, Delbrocco pled guilty in the United States District Court for the Northern District of Ohio to one count of violating Title 18 United States Code Section 1954 (Offer, Acceptance, or Solicitation to Influence Operations of Employee Benefit Plan) and one count of violating Title 18 United States Code Section 1349 (Conspiracy to Commit Mail Fraud and Honest Services Mail Fraud), in a criminal action entitled United States of America v. Nicholas Delbrocco, Case No. 1:12-CR-00448-SL in the United States District Court for the Northern District of Ohio.

3. In connection with his guilty plea, Delbrocco admitted, inter alia, that, from February 2005 through August 2011, he offered and gave things of value to the Executive Secretary-Treasurer of the Ohio and Vicinity Regional Council of Carpenters ("Carpenters' Union") in order to obtain and maintain investment management business for NEAM and OSAM with the Ohio Carpenters' Pension Fund and the Ohio Carpenters' Annuity Fund. Delbrocco admitted to providing airline tickets, frequent flyer miles, rental vehicles, and hotel rooms to the Executive Secretary-Treasurer and his travel companions as well as meals, theater tickets, sporting event tickets, and firearms to an individual associated with the Executive Secretary-Treasurer. Delbrocco also admitted that he and others conspired to enrich themselves by devising a scheme to defraud and deprive the Carpenters' Union of its right to the honest and faithful services of the Executive Secretary-Treasurer through bribery and kickbacks and the concealment of material information related thereto.

IV.

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

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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69011)

Topaz Exchange, LLC; Order Granting Application for a Conditional Exemption Pursuant to Section 36(a) of the Exchange Act from Certain Requirements of Rules 6a-1 and 6a-2 under the Exchange Act

March 1, 2013

I. Introduction

On July 3, 2012, Topaz Exchange, LLC ("Applicant") submitted to the Securities and Exchange Commission ("Commission") an application on Form 1 under the Securities Exchange Act of 1934 ("Exchange Act"), to register as a national securities exchange.¹ In addition, the Applicant, pursuant to Rule 0-12² under the Exchange Act, has requested an exemption under Section 36(a)(1) of the Exchange Act³ from certain requirements of Rules 6a-1(a) and 6a-2 under

¹ On December 19, 2012, the Applicant submitted Amendment No. 1 to its Form 1 application. Amendment No. 1, among other things, includes changes to the Limited Liability Company Agreement and the Constitution of Topaz Exchange concerning board composition and size, the initial director election process, and the use of regulatory funds. Amendment No. 1 also includes revisions to proposed rules of Topaz Exchange to remove rules relating to complex orders; to respond to comments on the Form 1 application from Commission staff; and to reflect recent changes to comparable rules of International Securities Exchange, LLC ("ISE"). Amendment No. 1 further provides additional descriptions in the Form 1 application regarding proposed allocation procedures, auction mechanisms, execution of qualified contingent crosses, and the initial director election process, and removes references to complex orders. On December 31, 2012, the Applicant submitted Amendment No. 2 to its Form 1 application. Amendment No. 2, among other things, provides updated information regarding the board of directors of ISE and the Corporate Governance Committee of ISE and includes information regarding Longitude S.A., a newly incorporated affiliate of Topaz Exchange, which information includes the Articles of Incorporation of Longitude S.A. Amendment No. 2 also provides financial information for Longitude S.A. Finally, Amendment No. 2 provides an updated organizational chart that reflects the affiliates of Topaz Exchange.

² 17 CFR 240.0-12.

³ 15 U.S.C. 78mm(a)(1).

the Exchange Act (“Exemption Request”).⁴ This order grants the Applicant’s request for exemptive relief, subject to the satisfaction of certain conditions, which are outlined below.

II. Application for Conditional Exemption from Certain Requirements of Exchange Act Rules 6a-1 and 6a-2

A. Filing Requirements under Exchange Act Rule 6a-1(a)

Exchange Act Rule 6a-1(a) requires an applicant for registration as a national securities exchange to file an application with the Commission on Form 1. Exhibit C to Form 1 requires the applicant to provide certain information with respect to each of its subsidiaries and affiliates.⁵ For purposes of Form 1, an “affiliate” is “[a]ny person that, directly or indirectly, controls, is under common control with, or is controlled by, the national securities exchange . . . including any employees.”⁶ Form 1 defines “control” as “[t]he power, directly or indirectly, to direct the management or policies of a company, whether through ownership of securities, by contract, or otherwise”⁷ Form 1 provides, further, that any person that directly or indirectly has the

⁴ 17 CFR 240.6a-1(a) and 6a-2. See letter from Michael Simon, General Counsel, Secretary and Chief Regulatory Officer, Topaz Exchange, LLC, to Elizabeth Murphy, Secretary, Commission, dated December 14, 2012.

⁵ Specifically, Exhibit C requires the applicant to provide, for each subsidiary or affiliate, and for any entity that operates an electronic trading system used to effect transactions on the exchange: (1) the name and address of the organization; (2) the form of organization; (3) the name of the state and statute citation under which it is organized, and the date of its incorporation in its present form; (4) a brief description of the nature and extent of the affiliation; (5) a brief description of the organization’s business or function; (6) a copy of the organization’s constitution; (7) a copy of the organization’s articles of incorporation or association, including all amendments; (8) a copy of the organization’s by-laws or corresponding rules or instruments; (9) the name and title of the organization’s present officers, governors, members of all standing committees, or persons performing similar functions; and (10) an indication of whether the business or organization ceased to be associated with the applicant during the previous year, and a brief statement of the reasons for termination of the association.

⁶ Form 1 Instructions, Explanation of Terms, 17 CFR 249.1.

⁷ Id.

right to vote 25% or more of a class of voting securities, or has the power to sell or direct the sale of 25% or more of a class of voting securities, is presumed to control the entity.⁸

Exhibit D to Form 1 requires an applicant for exchange registration to provide unconsolidated financial statements for the latest fiscal year for each subsidiary or affiliate. Exhibit D requires the financial statements to include, at a minimum, a balance sheet and an income statement with such footnotes and other disclosures as are necessary to avoid rendering the financial statements misleading. Exhibit D provides, in addition, that if any affiliate or subsidiary of the applicant is required by another Commission rule to submit annual financial statements, a statement to that effect, with a citation to the other Commission rule, may be provided in lieu of the financial statements required in Exhibit D.

A Form 1 application is not considered filed until all necessary information, including financial statements and other required documents, have been furnished in the proper form.⁹

B. Filing Requirements under Exchange Act Rule 6a-2

Exchange Act Rule 6a-2(a)(2) requires a national securities exchange to update the information provided in Exhibit C within 10 days of any action that causes the information provided in Exhibit C to become inaccurate or incomplete. In addition, Exchange Act Rule 6a-2(b)(1) requires a national securities exchange to file Exhibit D on or before June 30 of each year, and Exchange Act Rule 6a-2(c) requires a national securities exchange to file Exhibit C every three years.

⁸ Id.

⁹ 17 CFR 202.3(b)(2). See also 17 CFR 240.0-3(a). Defective Form 1 applications "may be returned with a request for correction or held until corrected before being accepted as a filing." See 17 CFR 202.3(b)(2). See also Securities Exchange Act Release No. 40760 (Dec. 8, 1998), 63 FR 70844, 70881 (Dec. 22, 1998) ("Regulation ATS Adopting Release") at note 329 and accompanying text.

C. Exemption Request

On December 14, 2012, the Applicant requested that the Commission grant an exemption under Section 36 of the Exchange Act, subject to the conditions set forth below, from the requirement under Exchange Act Rule 6a-1 to file the information requested in Exhibits C and D to Form 1 for the "Foreign Indirect Affiliates," as defined below, of the Applicant.¹⁰ In addition, the Applicant requested an exemption, subject to certain conditions, with respect to the Foreign Indirect Affiliates from the requirements under: (1) Exchange Act Rule 6a-2(a)(2) to amend Exhibit C within 10 days if the information in Exhibit C becomes inaccurate or incomplete; and (2) Exchange Act Rules 6a-2(b)(1) and (c) to file periodic updates to Exhibits C and D.

The Applicant is a wholly-owned subsidiary of International Securities Exchange Holdings, Inc. ("ISE Holdings").¹¹ ISE Holdings is a wholly-owned subsidiary of U.S. Exchange Holdings, Inc., which is wholly-owned by a German stock corporation, Eurex Frankfurt AG ("Eurex Frankfurt"). Eurex Frankfurt is wholly-owned by a Swiss stock corporation, Eurex Zurich AG ("Eurex Zurich"), which, in turn, is fifty percent (50%) owned by Deutsche Börse AG ("Deutsche Börse") and fifty percent (50%) owned by Eurex Global Derivatives AG ("EGD"). Deutsche Börse has one hundred percent (100%) direct ownership interest in EGD. According to the Applicant, the parent ownership structure of U.S. Exchange Holdings, Inc. is comprised entirely of foreign entities, Eurex Frankfurt, Eurex Zurich, Deutsche Börse and EGD (collectively, the "Foreign Direct Affiliates"), which in turn hold ownership interests, either directly or indirectly, in excess of 25 percent (25%) in a large number of other foreign entities, some of which also own interests in other entities in excess of 25 percent (25%)

¹⁰ See Exemption Request, supra note 4.

¹¹ See Exemption Request, supra note 4, at 2.

as well (such Foreign Direct Affiliate-owned entities are referred to, collectively, as the “Foreign Indirect Affiliates”).¹²

Because of the limited and indirect nature of its connection to the Foreign Indirect Affiliates, the Applicant believes that the corporate and financial information of the Foreign Indirect Affiliates required by Exhibits C and D of Form 1 would have little relevance to the Commission’s review of the Applicant’s Form 1 application or to the Commission’s ongoing oversight of the Applicant as a national securities exchange if the Commission were to approve the Applicant’s Form 1 application, as amended.¹³ In this regard, the Exemption Request states that the Foreign Indirect Affiliates have no ability to influence the management, policies, or finances of the Applicant and no obligation to provide funding to, or ability to materially affect the funding of, the Applicant.¹⁴ The Exemption Request also states that: (1) the Foreign Indirect Affiliates have no ownership interest in the Applicant or in any of the controlling shareholders of the Applicant; and (2) there are no commercial dealings between the Applicant and the Foreign Indirect Affiliates.¹⁵ Further, the Exemption Request states that obtaining detailed corporate and financial information with respect to the Foreign Indirect Affiliates (1) is unnecessary for the protection of investors and the public interest and (2) would be unduly burdensome and inefficient because these affiliates are located in foreign jurisdictions and the disclosure of such information could implicate foreign information sharing restrictions in such jurisdictions.¹⁶

¹² See id.

¹³ See id.

¹⁴ See Exemption Request, supra note 4, at 2-3.

¹⁵ See Exemption Request, supra note 4, at 3.

¹⁶ See id. The Applicant also believes that providing the information required by Exhibits C and D with respect to the Foreign Indirect Affiliates could raise confidentiality concerns because many of the Foreign Indirect Affiliates are not public companies. Id.

As a condition to the granting of exemptive relief, the Applicant has agreed to provide: (i) a listing of the names of the Foreign Indirect Affiliates; (ii) an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant; and (iii) in Exhibit C of the Applicant's Form 1 application, a description of the nature of the Foreign Indirect Affiliates' affiliation with the Foreign Direct Affiliates and the Applicant. In addition, as a condition to the granting of exemptive relief from the requirements of Exchange Act Rule 6a-2(a)(2), 6a-2(b)(1), and 6a-2(c), as described above, the Applicant has agreed to provide amendments to the information required under conditions (i) through (iii) above on or before June 30th of each year. Further, the Applicant notes that it will provide the information required by Exhibits C and D for all of its affiliates other than the Foreign Indirect Affiliates, including the Foreign Direct Affiliates.¹⁷

III. Order Granting Conditional Section 36 Exemption

Section 6 of the Exchange Act¹⁸ sets forth a procedure for an exchange to register as a national securities exchange.¹⁹ Exchange Act Rule 6a-1(a)²⁰ requires an application for registration as a national securities exchange to be filed on Form 1 in accordance with the instructions in Form 1. A Form 1 application is not considered filed until all necessary information, including financial statements and other required documents, has been furnished in

¹⁷ See Exemption Request, supra note 4, at 3.

¹⁸ 15 U.S.C. 78f.

¹⁹ Specifically, Section 6(a) of the Exchange Act states that "[a]n exchange may be registered as a national securities exchange . . . by filing with the Commission an application for registration in such form as the Commission, by rule, may prescribe containing the rules of the exchange and such other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors." Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

²⁰ 17 CFR 240.6a-1(a).

the proper form.²¹ Exchange Act Rule 6a-2 establishes ongoing requirements to file certain amendments to Form 1.

Section 36(a)(1) of the Exchange Act provides that “the Commission, by rule, regulation, or order, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of [the Exchange Act] or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.”²²

For the reasons discussed below, the Commission believes that it is appropriate in the public interest and consistent with the protection of investors to exempt the Applicant from the requirement under Exchange Act Rule 6a-1 to provide the information required in Exhibits C and D to Form 1 with respect to the Foreign Indirect Affiliates, subject to the following conditions:

- (1) the Applicant must provide a list of the names of the Foreign Indirect Affiliates;
- (2) the Applicant must provide an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant; and
- (3) as part of Exhibit C to the Applicant’s Form 1 Application, the Applicant must provide a description of the nature of the affiliation between the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant.

The Commission believes, further, that it is appropriate in the public interest and consistent with the protection of investors to exempt the Applicant, with respect to the Foreign Indirect Affiliates, from the requirements under: (a) Exchange Act Rule 6a-2(a)(2) to amend

²¹ 17 CFR 202.3(b)(2). See also *supra* note 9.

²² 15 U.S.C. 78mm(a)(1).

Exhibit C within 10 days of any action that renders the information in Exhibit C inaccurate or incomplete; (b) Exchange Act Rules 6a-2(c) to provide periodic updates of Exhibit C; and (c) Exchange Act Rules 6a-2(b)(1) to provide periodic updates of Exhibit D, subject to the condition that the Applicant provide amendments to the information required under conditions (1) through (3) above on or before June 30th of each year.

As part of an application for exchange registration, the information included in Exhibits C and D is designed to help the Commission make the determinations required under Sections 6(b) and 19(a) of the Exchange Act²³ with respect to the application. The updated Exhibit C and D information required under Exchange Act Rule 6a-2 is designed to help the Commission exercise its oversight responsibilities with respect to national securities exchanges.

Specifically, Exhibit D is designed to provide the Commission with information concerning the financial status of an exchange and its affiliates and subsidiaries,²⁴ and Exhibit C provides the Commission with the names and organizational documents of these affiliates and subsidiaries.²⁵ Such information is designed to help the Commission determine whether an applicant for exchange registration would have the ability to carry out its obligations under the Exchange Act, and whether a national securities exchange continues to have the ability to carry out its obligations under the Exchange Act.

Since the most recent amendments to Form 1 in 1998,²⁶ many national securities exchanges that previously were member-owned organizations with few affiliated entities have

²³ 15 U.S.C. 78f(b) and 78s(a).

²⁴ See Securities Exchange Act Release No. 18843 (June 25, 1982), 47 FR 29259 (July 6, 1982) (proposing amendments to Form 1); see also Form 1, 17 CFR 249.1, and supra Section II.A.

²⁵ Form 1, 17 CFR 249.1. See also supra note 5.

²⁶ See Regulation ATS Adopting Release, supra note 9.

demutualized. Some of these demutualized exchanges have been consolidated under holding companies with numerous affiliates that, in some cases, have only a limited and indirect connection to the national securities exchange, with no ability to influence the management or policies of the registered exchange and no obligation to fund, or to materially affect the funding of, the registered exchange. The Commission believes that, for these affiliated entities, the information required under Exhibits C and D would have limited relevance to the Commission's review of an application for exchange registration or to its oversight of a registered exchange.

Based on the Applicant's representations, the indirect nature of the relationship between the Applicant and the Foreign Indirect Affiliates, and the information that the Applicant will provide with respect to the Foreign Direct Affiliates and the Foreign Indirect Affiliates, the Commission believes that it will have sufficient information to review the Applicant's Form 1 application and to make the determinations required under Sections 6(b) and 19(a) of the Exchange Act with respect to its application for registration as a national securities exchange.²⁷ The Commission believes, further, that it will have the information necessary to oversee the Applicant's activities as a national securities exchange if the Commission were to approve the Applicant's Form 1 application. In particular, the Commission notes that the Applicant has represented that it would have no direct connection to the Foreign Indirect Affiliates, that the Foreign Indirect Affiliates would have no ability to influence the management or policies of the Applicant, and that the Foreign Indirect Affiliates would have no obligation to fund, or ability to materially affect the funding of, the Applicant. In addition, the Commission notes that the

²⁷ 15 U.S.C. 78f(b) and 78s(a). Section 6(b) of the Exchange Act enumerates certain determinations that the Commission must make with respect to an exchange before granting the registration of the exchange as a national securities exchange. The Commission will not grant an exchange registration as a national securities exchange unless the Commission determines that the exchange meets these requirements. See Regulation ATS Adopting Release, supra note 9, at IV.B.

Applicant represented that: (1) the Foreign Indirect Affiliates have no ownership interest in the Applicant or in any of the controlling equity holders of the Applicant; and (2) there are no commercial dealings between the Applicant and the Foreign Indirect Affiliates.²⁸

Given the limited and indirect relationship between the Applicant and the Foreign Indirect Affiliates, as described above, the Commission believes that the detailed corporate and financial information required in Exhibits C and D with respect to the Foreign Indirect Affiliates is unnecessary for the Commission's review of the Applicant's Form 1 application and would be unnecessary for the Commission's oversight of the Applicant as a registered national securities exchange following any Commission approval of its Form 1 application.

For the reasons discussed above, the Commission finds that the conditional exemptive relief requested by the Applicant is appropriate in the public interest and is consistent with the protection of investors.

IT IS ORDERED, pursuant to Section 36 of the Exchange Act,²⁹ that the Applicant is exempt from the requirements to: (1) include in its Form 1 application the information required in Exhibits C and D to Form 1 with respect to the Foreign Indirect Affiliates; and (2) with respect to the Foreign Indirect Affiliates, update the information in Exhibits C and D to Form 1 as required by Exchange Act Rules 6a-2(a)(2), 6a-2(b)(1), and 6a-2(c) subject to the following conditions:

- (i) the Applicant must provide a list of the names of the Foreign Indirect Affiliates;
 - (ii) the Applicant must provide an organizational chart setting forth the affiliation of the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant;
- and

²⁸ See Exemption Request, *supra* note 4, at 3.

²⁹ 15 U.S.C. 78mm.

(iii) as part of Exhibit C to the Applicant's Form 1 Application, the Applicant must provide a description of the nature of the affiliation between the Foreign Indirect Affiliates and the Foreign Direct Affiliates and the Applicant.

In addition, the Applicant must provide amendments to the information required under conditions (i) through (iii) above on or before June 30th of each year.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69012; File No. 10-209)

March 1, 2013

Topaz Exchange, LLC; Notice of Filing of Application for Registration as a National Securities Exchange under Section 6 of the Securities Exchange Act of 1934

On July 3, 2012, Topaz Exchange, LLC ("Topaz Exchange" or "Applicant") submitted to the Securities and Exchange Commission ("Commission") a Form 1 application under the Securities Exchange Act of 1934 ("Exchange Act"), seeking registration as a national securities exchange under Section 6 of the Exchange Act.¹ On December 19, 2012, Topaz Exchange submitted Amendment No. 1 to its Form 1 application.² On December 31, 2012, Topaz Exchange submitted Amendment No. 2 to its Form 1 application.³

The Commission is publishing this notice to solicit comments on Topaz Exchange's Form 1 application, as amended. The Commission will take any comments it receives into

¹ On March 1, 2013, the Commission issued an order granting Topaz Exchange exemptive relief, subject to certain conditions, in connection with the filing of its Form 1 application. See Securities Exchange Act Release No. 69011. Because the Applicant's Form 1 application was incomplete without the exemptive relief, the date of filing of such application is March 1, 2013.

² Amendment No. 1, among other things, includes changes to the Limited Liability Company Agreement and the Constitution of Topaz Exchange concerning board composition and size, the initial director election process, and the use of regulatory funds. Amendment No. 1 also includes revisions to proposed rules of Topaz Exchange to remove rules relating to complex orders; to respond to comments on the Form 1 application from Commission staff; and to reflect recent changes to comparable rules of International Securities Exchange, LLC ("ISE"). Amendment No. 1 further provides additional descriptions in the Form 1 application regarding proposed allocation procedures, auction mechanisms, execution of qualified contingent crosses, and the initial director election process, and removes references to complex orders.

³ Amendment No. 2, among other things, provides updated information regarding the board of directors of ISE and the Corporate Governance Committee of ISE and includes information regarding Longitude S.A., a newly incorporated affiliate of Topaz Exchange, which information includes the Articles of Incorporation of Longitude S.A. Amendment No. 2 also provides financial information for Longitude S.A. Finally, Amendment No. 2 provides an updated organizational chart that reflects the affiliates of Topaz Exchange.

consideration in making its determination about whether to grant Topaz Exchange's request to be registered as a national securities exchange. The Commission will grant the registration if it finds that the requirements of the Exchange Act and the rules and regulations thereunder with respect to Topaz Exchange are satisfied.⁴

The Applicant's Form 1 application, as amended, provides detailed information on how Topaz Exchange proposes to satisfy the requirements of the Exchange Act. Topaz Exchange would be wholly-owned by its parent company, International Securities Exchange Holdings, Inc. ("ISE Holdings"), which also is the parent company of an existing national securities exchange, ISE. Topaz Exchange would operate a fully automated electronic trading platform for the trading of listed options and would not maintain a physical trading floor. Liquidity would be derived from orders to buy and orders to sell submitted to Topaz Exchange electronically by its registered broker-dealer members, as well as from quotes submitted electronically by market makers.

A more detailed description of the manner of operation of Topaz Exchange's proposed system can be found in Exhibit E to Topaz Exchange's Form 1 application. The proposed rulebook for the proposed exchange can be found in Exhibit B to Topaz Exchange's Form 1 application, and the governing documents for both Topaz Exchange and ISE Holdings can be found in Exhibit A and Exhibit C to Topaz Exchange's Form 1 application, respectively. A listing of the officers and directors of Topaz Exchange can be found in Exhibit J to Topaz Exchange's Form 1 application.

Topaz Exchange's Form 1 application, including all of the Exhibits referenced above, is available online at www.sec.gov/rules/other.shtml as well as in the Commission's Public

⁴ 15 U.S.C. 78s(a).

Reference Room. Interested persons are invited to submit written data, views, and arguments concerning Topaz Exchange's Form 1, including whether the application is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 10-209 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 10-209. 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/other.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to Topaz Exchange's Form 1 filed with the Commission, and all written communications relating to the application 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. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly

available. All submissions should refer to File Number 10-209 and should be submitted on or before [insert date 45 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

Release No. 34-69013; IA-3558; File No. 4-606

Duties of Brokers, Dealers, and Investment Advisers

AGENCY: Securities and Exchange Commission.

ACTION: Request for data and other information.

SUMMARY: The Securities and Exchange Commission is requesting data and other information, in particular quantitative data and economic analysis, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers. We intend to use the comments and data we receive to inform our consideration of alternative standards of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. We also will use this information to inform our consideration of potential harmonization of certain other aspects of the regulation of broker-dealers and investment advisers.

DATES: Comments should be received on or before [*insert 120 days after publication in the Federal Register*].

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

Electronic Submission:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-606 in the subject line.

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Paper Submission:

- Send paper submissions in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. All submissions should refer to File Number 4-606. 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 submissions of data on the Commission's Internet website (<http://www.sec.gov>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. Please refer to the Appendix at the end of this release for instructions on submitting data and other information.

FOR FURTHER INFORMATION CONTACT: Jennifer Marietta-Westberg, Assistant Director, Matthew Kozora, Financial Economist, Division of Risk, Strategy and Financial Innovation, at (202) 551-6655; David W. Blass, Chief Counsel, Lourdes Gonzalez, Assistant Chief Counsel – Sales Practices, Emily Westerberg Russell, Senior Special Counsel, Daniel Fisher, Branch Chief, Leila Bham, Special Counsel, Division of Trading and Markets, at (202) 551-5550; Office of Chief Counsel, at (202) 551-6825 and Office of Investment Adviser Regulation, at (202) 551-6787, Division of Investment Management; Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

DISCUSSION:

I. Introduction

A. Background

Today, broker-dealers and investment advisers routinely provide to retail customers¹ many of the same services, and engage in many similar activities related to providing personalized investment advice about securities to retail customers.² While both investment advisers and broker-dealers are subject to regulation and oversight designed to protect retail and other customers, the two regulatory schemes do so through different approaches notwithstanding the similarity of certain services and activities.

Investment advisers are fiduciaries to their clients, and their regulation under the Investment Advisers Act of 1940 (“Advisers Act”) is largely principles-based. In contrast, a broker-dealer is not uniformly considered a fiduciary to its customers.³ Broker-dealer conduct is

¹ For the purposes of this request for comment, and as noted in Part III below, the term “retail customer” has the same meaning as in Section 913 of the Dodd–Frank Wall Street Reform and Consumer Protection Act. Pub. L. 111-203, 124 Stat. 1376 (2010). Specifically, it means “a natural person, or the legal representative of such natural person, who (A) receives personalized investment advice about securities from a broker, dealer or investment adviser; and (B) uses such advice primarily for personal, family, or household purposes.” 15 U.S.C. 80b–11(g)(2).

² In 2006, the SEC retained the RAND Corporation’s Institute for Civil Justice (“RAND”) to conduct a survey, which concluded that the distinctions between investment advisers and broker-dealers have become blurred, and that market participants had difficulty determining whether a financial professional was an investment adviser or a broker-dealer and instead believed that investment advisers and broker-dealers offered the same services and were subject to the same duties. RAND noted, however, that generally investors they surveyed as part of the study were satisfied with their financial professional, be it a representative of a broker-dealer or an investment adviser. Angela A. Hung, *et al.*, *RAND Institute for Civil Justice, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008) (“RAND Study”).

³ A broker-dealer may have a fiduciary duty under certain circumstances. This duty may arise under state common law, which varies by state. Generally, courts have found that

subject to comprehensive regulation under the Securities Exchange Act of 1934 (“Exchange Act”) and the rules of each self-regulatory organization (“SRO”) to which the broker-dealer belongs. Both broker-dealers and investment advisers also are subject to applicable antifraud provisions and rules under the federal securities laws.

Studies suggest that many retail customers who use the services of broker-dealers and investment advisers are not aware of the differences in regulatory approaches for these entities and the differing duties that flow from them.⁴ Some of these regulatory differences primarily reflect the different functions and business activities of investment advisers and broker-dealers (for example, rules regarding underwriting or market making). Other differences reflect statutory differences,⁵ particularly when broker-dealers and investment advisers engage in the

broker-dealers that exercise discretion or control over customer assets, or have a relationship of trust and confidence with their customers, are found to owe customers a fiduciary duty similar to that of investment advisers. *See, e.g., United States v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006); *United States v. Szur*, 289 F.3d 200, 211 (2d Cir. 2002); *Associated Randall Bank v. Griffin, Kubik, Stephens & Thompson, Inc.*, 3 F.3d 208, 212 (7th Cir. 1993); *MidAmerica Fed. Savings & Loan Ass’n v. Shearson/American Express Inc.*, 886 F.2d 1249, 1257 (10th Cir. 1989); *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 953-954 (E.D. Mich. 1978), *aff’d*, 647 F.2d 165 (6th Cir. 1981). For the staff’s discussion of relevant case law see Study, *infra* note 10, at 54-55. *See also A Joint Report of the SEC and the CFTC on Harmonization of Regulation* (Oct. 2009), available at <http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf> at 8-9 and 67.

⁴ *See, e.g.,* RAND Study.

⁵ Advisers Act Section 202(a)(11) defines “investment adviser” to mean “any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities.” Advisers Act Section 202(a)(11)(C) excludes from the investment adviser definition any broker or dealer (i) whose performance of its investment advisory services is “solely incidental” to the conduct of its business as a broker or dealer; and (ii) who receives no “special compensation” for its advisory services. Broker-dealers providing investment

same or substantially similar activity (for example, providing personalized investment advice, including recommendations, about securities to retail customers).

Over the decades since the Advisers Act and Exchange Act were enacted, we have observed that the lines between full-service broker-dealers and investment advisers have blurred.⁶ Investment advisers and broker-dealers, for example, provide investment advice both on an episodic and on an ongoing basis.⁷ We have expressed concern when specific regulatory obligations depend on the statute under which a financial intermediary is registered instead of the services provided.⁸

advice in accordance with this exclusion are not subject to the fiduciary duty under the Advisers Act.

⁶ See *Certain Broker-Dealers Deemed Not to be Investment Advisers*, Exchange Act Release No. 51523 at 3 and 37 (Apr. 12, 2005) (“Release 51523”). Many financial services firms may offer both investment advisory and broker-dealer services. According to data from the Investment Adviser Registration Depository as of November 1, 2012, approximately 5% of Commission-registered investment advisers reported that they also were registered as a broker-dealer, and 22% of Commission-registered investment advisers reported that they had a related person that was a broker-dealer. As of October 31, 2012, 755 firms registered with FINRA as a broker-dealer, or approximately 17.4% of broker-dealers registered with FINRA, were also registered as an investment adviser with either the Commission or a state. See Letter from Angela Goelzer, FINRA, to Lourdes Gonzalez, Assistant Chief Counsel, Securities and Exchange Commission (Nov. 16, 2012). Further, as of mid-November 2012, approximately 41% of FINRA-registered broker-dealers had an affiliate engaged in investment advisory activities. *Id.* Many of these financial services firms’ personnel may also be dually registered as investment adviser representatives and registered representatives of broker-dealers. As of October 31, 2012, approximately 86% of investment adviser representatives were also registered representatives of a FINRA-registered broker-dealer. *Id.*

⁷ A broker-dealer that receives special compensation for the provision of investment advice would not be excluded from the definition of investment adviser. See *supra* note 5.

⁸ In Release 51523, we engaged in an analysis and discussion of the history of the Exchange Act and Advisers Act. We explained that the Advisers Act was intended to regulate what, at the time that Act was enacted, was a largely unregulated community of persons engaged in the business of providing investment advice for compensation. See Release 51523 at 22.

In a staff study (the "Study") required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"),⁹ our staff made recommendations to us that the staff believed would enhance retail customer protections and decrease retail customers' confusion about the standard of conduct owed to them when their financial professional provides them personalized investment advice.¹⁰ The staff made two primary recommendations in the Study. The first recommendation was that we engage in rulemaking to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The second recommendation was that we consider harmonizing certain regulatory requirements of broker-dealers and investment advisers where such harmonization appears likely

⁹ Pub. L. No. 111-203, 124 Stat. 1376. Section 913 of the Dodd-Frank Act, among other things, required a study of the effectiveness of the existing legal or regulatory standards of care that apply when broker-dealers and investment advisers (and persons associated with them) provide personalized investment advice and recommendations about securities to retail customers. It also required the identification of any legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

¹⁰ Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("Study"), available at www.sec.gov/news/studies/2011/913studyfinal.pdf. The views expressed in the Study were those of the staff and do not necessarily reflect the views of the Commission or the individual Commissioners. See also Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes (Jan. 21, 2011) ("Statement") (opposing the Study's findings and, among other things, stating that "stronger analytical and empirical foundation than provided by the Study is required before regulatory steps are taken that would revamp how broker-dealers and investment advisers are regulated").

to enhance meaningful investor protection, taking into account the best elements of each regime.¹¹

The staff explained that its recommendations were intended to address, among other things, retail customer confusion about the obligations broker-dealers and investment advisers owe to those customers, and to preserve retail customer choice without decreasing retail customers' access to existing products, services, service providers or compensation structures.¹² The staff stated in the Study that retail customers should not have to parse legal distinctions to determine whether the advice they receive from their financial professional is provided in their best interests, and stated that retail customers should receive the same or substantially similar protections when obtaining the same or substantially similar services from financial professionals.¹³ The staff further noted that the Commission could consider harmonization as part of the implementation of the uniform fiduciary standard or as separate initiatives.¹⁴

In preparing the Study's discussion of the benefits and costs of aspects of the staff's recommendations, the staff, among other things, considered comment letters that we received in response to an earlier request, and reiterated this request when meeting with interested parties, in

¹¹ As discussed in more detail below, we have a variety of options relating to the staff's recommendations; we could take no action with regard to either, or could take action to implement one or both recommendations, either partially or wholly. The choice of whether and how to take an action with respect to the recommendations would consider the facts and circumstances of the marketplace at the time of the potential action, as well as the regulatory landscape existing at such time (including, if applicable, any prior or contemporaneous actions which would impact the recommendations).

¹² Study at viii, x, 101, 109, and 166.

¹³ Study at viii and 101.

¹⁴ Study at 129.

order to better inform the Study.¹⁵ Few commenters, however, provided data regarding the benefits and costs of the current regulatory regime or the benefits and costs likely to be realized if we were to exercise the authority granted in Section 913. This may be because most comments were made in advance of the Study's publication and could not be informed by the staff's specific recommendations.¹⁶ Of the relatively few comments received after publication of the Study, one commenter expressed support for further economic analysis of the Study's recommendations and other approaches for Commission rulemaking, and offered to provide data and other information relating to implementing a uniform fiduciary standard of conduct.¹⁷

The Study recommended that we engage in rulemaking using the authority provided to us in Section 913 of the Dodd-Frank Act. The section grants us discretionary rulemaking authority under the Exchange Act and Advisers Act to adopt rules establishing a uniform fiduciary standard of conduct for all broker-dealers and investment advisers when providing personalized

¹⁵ *Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, Exchange Act Release No. 62577 (July 27, 2010) (requesting comment from the public to inform the preparation of the Study). The Commission received over 3,500 comment letters before and after publication of the Study. The comment letters are available at www.sec.gov/comments/4-606/4-606.shtml.

¹⁶ Before the Study was published, we received a comment describing results of a survey that had been conducted based on certain assumptions about a potential change in the standard of conduct, which differ from those set out in this request for information and data. The survey, for example, assumed that under a new standard of conduct, broker-dealer firms would no longer charge commissions and instead would only maintain fee-based accounts. See Oliver Wyman and Securities Industry and Financial Markets Association, *Standard of Care Harmonization Impact Assessment for SEC* (Oct. 27, 2010).

¹⁷ Comment Letter from Ira D. Hammerman, Senior Managing Director and General Counsel, Securities Industry and Financial Markets Association (July 14, 2011) ("SIFMA Letter") at 2. *But see*, Comment Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, *et al.*, (Mar. 28, 2012) ("Roper Letter") (asserting adoption of a uniform standard could be implemented in a way that does not lead to reduced investor choice or product access).

investment advice about securities to retail customers.¹⁸ That section further provides that such standard of conduct “shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice” and that the standard “shall be no less stringent than the standard applicable to investment advisers under Sections 206(1) and 206(2) of the Advisers Act when providing personalized investment advice about securities.”

The Commission recognizes that Section 913 of the Dodd-Frank Act does not mandate that we undertake any such rulemaking, and the Commission has not yet determined whether to commence a rulemaking. We expect that the data and other information provided to us in connection with this request will assist us in determining whether to engage in rulemaking, and if so, what the nature of that rulemaking ought to be. Among other considerations, we are sensitive to the fact that changes in existing legal or regulatory standards could result in economic costs and benefits and believe that such costs and benefits must be considered in the economic analysis that would be part of any rulemaking under the discretionary authority provided by Section 913 of the Dodd-Frank Act. In considering the options for a potential standard of conduct applicable to broker-dealers and investment advisers providing personalized investment advice to retail customers, we will take into account existing regulatory obligations that apply today to broker-dealers and investment advisers.

¹⁸ See Section 15(k) of the Exchange Act and Section 211(g) of the Advisers Act, each as added by Section 913 of the Dodd-Frank Act. Section 913 of the Dodd-Frank Act also added Section 15(l) of the Exchange Act and Section 211(h) of the Advisers Act to add discretionary authority to promulgate rules prohibiting or restricting certain broker-dealer and investment adviser sales practices, conflicts of interests, and compensation schemes that the Commission deems contrary to the public interest and the protection of investors. See Exchange Act each as added by Section 913 of the Dodd-Frank Act.

If we determine to engage in rulemaking, furthermore, the rulemaking process would provide us the opportunity to request further data and other information on the range of complex considerations associated with any proposal implementing such a standard, including any potential costs and benefits associated with the rulemaking. The rulemaking process would also allow commenters to address the extent to which any proposal would further the goals highlighted by Section 913, including (1) preserving retail customer choice with respect to, among other things, the availability of accounts, products, services, and relationships with investment advisers and broker-dealers, and (2) not inadvertently eliminating or otherwise impeding retail customer access to such accounts, products, services and relationships (for example, through higher costs). We may also consider reassessing and potentially harmonizing certain of the other regulatory obligations that apply to broker-dealers and investment advisers where such harmonization is consistent with the mission of the Commission.

B. Overview of the Request for Additional Data and Other Information

We are requesting below additional public input to assist us in evaluating whether and how to address certain of the standards of conduct for, and regulatory obligations of, broker-dealers and investment advisers. Since publishing the Study, the staff has continued to review current information and available data about the current marketplace for personalized investment advice and the potential economic impact of the staff's recommendations to inform its consideration of any potential rulemaking with respect to the Study's recommendations. While we and our staff have extensive experience in the regulation of broker-dealers and investment advisers, the public can provide further data and other information to assist us in determining whether or not to use the authority provided under Section 913 of the Dodd-Frank Act.

Data and other information from market intermediaries and others about the potential economic impact of the staff's recommendations, including information about the potential impact on competition, capital formation, and efficiency, may particularly help inform any action we may or may not take in this area. We also especially welcome the input of retail customers.

We are specifically requesting quantitative and qualitative data and other information and economic analysis (herein "data and other information") about the benefits and costs of the current standards of conduct of broker-dealers and investment advisers when providing advice to retail customers, as well as alternative approaches to the standards of conduct, including a uniform fiduciary standard of conduct applicable to all investment advisers and broker-dealers when providing personalized investment advice to retail customers. We recognize that retail customers are unlikely to have significant empirical and quantitative information. We welcome any information they can provide.

In this release, we discuss a potential uniform fiduciary standard of conduct and alternatives to that standard of conduct. A uniform fiduciary standard of conduct can be understood quite differently by various parties. In fact, public comments on such a standard have made widely varying assumptions about what a fiduciary duty would require. Comments have assumed, for example, that a uniform fiduciary duty would require all firms to, among other things: provide the lowest cost alternative; stop offering proprietary products; charge only asset-based fees, and not commissions; and continuously monitor all accounts.¹⁹ These outcomes

¹⁹ See also SIFMA Letter, *supra* note 17, at 7 and 10 (recommending, among other things, that the Commission articulate a new uniform standard of conduct, applicable to both broker-dealers and investment advisers, to "act in the best interest of the customer," while applying existing case law, guidance, and other legal precedent developed under Section 206 of the Advisers Act only to investment advisers, not broker-dealers) *compared with* the Roper Letter at 2 (recommending, among other things, that rather than replacing the current Advisers Act standard with something new and different, the Commission should

would not necessarily be the case. By contrast, many of the rules or other obligations discussed over the years for potential regulatory harmonization, such as recordkeeping, advertising, pay to play, and other obligations that currently apply to broker-dealers and investment advisers, are more specific. Accordingly, we believe that consideration of a uniform fiduciary standard of conduct would benefit from a set of assumptions and other parameters that commenters can use and critique in order to generate meaningful data and other information. The identification of particular assumptions or parameters, however, does not suggest our policy view or the ultimate direction of any action proposed by us.

We also request comment in this release on whether or to what extent we should consider making other adjustments to the regulatory obligations of broker-dealers and investment advisers, including regulatory harmonization. While this release addresses both a potential uniform fiduciary standard of conduct and regulatory harmonization more generally, and at times, discusses and requests comment relating to the potential interrelationship of the two, harmonization beyond a uniform fiduciary standard of conduct could be considered separately. As noted below, there are a variety of options relating to whether and how to act with respect to a potential uniform fiduciary standard of conduct or potential regulatory harmonization, including taking no action, taking action to implement one (either partially or wholly) and not the other, or taking action to implement both (again, either partially or wholly). In order to inform our consideration of all of these options, this release discusses both a potential uniform fiduciary standard of conduct and regulatory harmonization and encourages comment on the potential practical, regulatory, and economic effects that action or inaction with respect to one or both may

extend the existing Advisers Act standard (currently applicable to investment advisers) to broker-dealers, while clarifying its applicability in the context of broker-dealer conduct).

have. For example, we request comment on the extent to which regulatory harmonization might address customer confusion about the obligations owed to them by broker-dealers and not investment advisers (or by investment advisers and not broker-dealers) even if a uniform fiduciary standard of conduct is implemented. We also request comment on the extent to which regulatory harmonization might result in additional investor confusion or otherwise negatively impact investors.

We request data and other information relating to the provision of personalized investment advice about securities to retail customers to better understand the relationship between standards of conduct and the experiences of retail customers. In particular, we seek data and other information regarding: (a) investor returns generated under the existing regulatory regimes; (b) security selections of broker-dealers and investment advisers as a function of their respective regulatory regimes; (c) characteristics of investors who invest on the basis of advice from broker-dealers, invest on the basis of advice from an investment adviser, or invest utilizing both channels; (d) investor perceptions of the costs and benefits under each regime; and (e) investors' ability, and the associated cost to investors, to bring claims against their broker-dealer or investment adviser under their respective regulatory regimes.²⁰ We are also particularly interested in the activities, conflicts of interest²¹ and disclosure practices of investment advisers and broker-dealers, as well as the economics of the investment advice industry and characteristics of the current marketplace. We also are asking for data and other information about the benefits and costs of the current set of regulatory obligations that apply to broker-

²⁰ See Statement.

²¹ In this request for information and data, we use the term "conflict of interest" to mean a material conflict of interest.

dealers and investment advisers, and the benefits and costs of different approaches to harmonizing particular areas of broker-dealer and investment adviser regulation.

C. Suggested Guidelines and Considerations for Submissions of Data and Other Information

The data and other information requested in this document have the potential to be instructive in our determination of which, if any, new approach or approaches to consider implementing with respect to the regulatory obligations of investment advisers and broker-dealers. We welcome any relevant data and other information, as well as comment, in response to our inquiries below. Responsive data and other information would be more useful to us, however, if they are prepared and submitted in a consistent fashion. We set forth suggested guidelines (“Guidelines”) in the Appendix to this request for commenters to follow, where possible, in submitting data and other information. In particular, through the Guidelines, we request broker-dealers, investment advisers, and dually registered investment adviser/broker-dealers submitting comments to provide specific data and other information describing their businesses, retail customers, and retail customer accounts. We also request that other commenters (*e.g.*, retail customers, academics, trade associations, and consumer groups) provide the information requested in the Guidelines to the extent applicable or appropriate. We especially welcome the input of retail customers.²²

We are particularly interested in receiving data and other information that are empirical and quantitative in nature. We encourage all interested parties, however, to submit their comments, including qualitative and descriptive analysis of the benefits and costs of potential approaches and guidance. As stated above, we recognize that retail customers are unlikely to

²² This includes, where possible, information and data focusing on accounts that receive non-discretionary advice because they are most likely to be impacted by changes in the standard of conduct. *See* Guidelines in the Appendix.

have significant empirical and quantitative information. We welcome any information they can provide. In addition, if commenters prefer to respond to only some of the requests for comment, they are welcome to do so.

We describe throughout this request for data and other information a series of assumptions that commenters may use in order to facilitate our ability to compare, reproduce, and otherwise analyze responses to our questions in a robust fashion. The discussion of these assumptions does not suggest our policy view or the ultimate direction of any proposed action proposed by us. If commenters believe that we should make additional or different assumptions as a further analytical step we invite them to do so and explain clearly the additional or different assumptions made, address why such assumptions are appropriate, and compare and contrast results obtained under such assumptions with results obtained under the assumptions specified in this request. If commenters wish to submit multiple sets of comments resting on different sets of assumptions, they may do so. Although we seek to obtain responses that we can compare, reproduce, and otherwise analyze in a robust fashion, we also wish to emphasize that commenters have flexibility to provide whatever data and other information they believe is important to provide.

Examples of data and other information sought include empirical data, detailed datasets on a particular topic, economic analysis, legal analysis, statistical data such as survey and focus group results, and any other observational or descriptive data and other information. Such data and other information can be quantitative, qualitative, or descriptive. Again, commenters are invited to provide any other information that they believe would be useful to us as we consider our options in this area.

Commenters should only submit data and other information that they wish to make publicly available. Commenters concerned about making public proprietary or other highly sensitive data and other information may wish to pool their data with others (e.g., through a trade association, law firm, consulting firm or other group) and submit aggregated data in response to this request. While we request that commenters provide enough data and other information to allow us to compare, replicate, and otherwise analyze findings, commenters should remove any personally identifiable information (e.g., of their customers) before submitting data and other information in response to this request.²³

II. Request for Data and Other Information Relating to the Current Market for Personalized Investment Advice

We are requesting data and other information about the specific costs and benefits associated with the current regulatory regimes for broker-dealers and investment advisers²⁴ as applied to particular activities as a baseline for comparison, as described below. Accordingly, and in addition to the request for data and other information which follows in Parts III and IV below, we request data and other information relating to the economics and characteristics of the current regulatory regime, and other data and other information relating to investment adviser and broker-dealer conflicts of interest and the cost and effectiveness of disclosure. Many of the

²³ Cf. 17 CFR 248.3(u)(1) (defining for purposes of Regulation S-P, “personally identifiable financial information” as “any information: (i) A consumer provides to you to obtain a financial product or service from you; (ii) About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or (iii) You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer.”).

²⁴ Please see our staff’s discussion in the Study about the existing regulatory structures for investment advisers and broker-dealers, and the general differences and similarities between the regulatory regimes. See Study at 14-46 (discussing investment adviser obligations) and 46-83 (discussing broker-dealer obligations).

requests ask commenters to provide data and other information describing retail customer demographics and accounts; broker-dealer or investment adviser services offered to retail customers; security selections by or for retail customers; and the claims of retail customers in dispute resolution. We request commenters refer to the Appendix for the specific characteristics of each of these topics that are important to include when submitting data and other information. We also request commenters refer to other guidelines in the Appendix, particularly the request to provide background information and documentation to support any economic analysis.

To assist us in our analysis, we request that commenters provide the following:

1. Data and other information, including surveys of retail customers, describing the characteristics of retail customers who invest through a broker-dealer as compared to those who invest on the basis of advice from an investment adviser as well as retail customer perceptions of the cost/benefit tradeoffs of each regulatory regime.²⁵ Provide information describing retail customer accounts at broker-dealers and investment advisers, and the manner in which broker-dealers and investment advisers provide investment advice (*e.g.*, frequency, coverage (*i.e.*, account-by-account or relationship), and solicited or unsolicited). How do firms that offer both brokerage and advisory accounts advise retail customers about which type of account they should open? What are the main characteristics of each type of account? If possible, associate retail customer demographic information with account descriptions.
2. Data and other information describing the types and availability of services (including advice) broker-dealers or investment advisers offer to retail customers, as well as any observed recent changes in the types of services offered. Provide information as to why

²⁵ See Statement.

services offered may differ or have changed. Have differences in the standards of conduct under the two regulatory regimes contributed to differences in services offered or any observed changes in services offered? If possible, differentiate by retail customer demographic information.

3. Data and other information describing the extent to which different rules apply to similar activities of broker-dealers and investment advisers, and whether this difference is beneficial, harmful or neutral from the perspectives of retail customers and firms. Also, provide data and other information describing the facts and circumstances under which broker-dealers have fiduciary obligations to retail customers under applicable law, and how frequently such fiduciary obligations arise. If possible, differentiate by retail customer demographic information.
4. Data and other information describing the types of securities broker-dealers or investment advisers offer or recommend to retail customers. To the extent commenters believe that differences in the standards of conduct under the two regulatory regimes contribute to differences in the types of securities offered or recommended, provide data and other information as to why the types of securities offered or recommended may differ. If possible, differentiate by retail customer demographic information.
5. Data and other information describing the cost to broker-dealers and investment advisers of providing personalized investment advice about securities to retail customers, as well as the cost to retail customers themselves of receiving personalized investment advice about securities. Describe costs in terms of dollars paid and/or time spent. Do differences in the standards of conduct under the two regulatory regimes contribute to

differences in the cost of providing or receiving services? If possible, separate costs by service type, and differentiate by retail customer demographic and account information.

6. Data and other information describing and comparing the security selections of retail customers who are served by financial professionals subject to the two existing regulatory regimes.²⁶ If possible, associate retail customer demographic and account information with security selections, and identify whether initial retail customer ownership took place prior to opening the account and whether security selections were solicited or unsolicited.
7. Data and other information describing the extent to which broker-dealers and investment advisers engage in principal trading with retail customers, including data and other information regarding the types of securities bought and sold on a principal basis, the volume, and other relevant data points. For each type of security, compare volume and percentage of trades made on a principal basis against the volume and percentage of trades made on a riskless principal basis. Also, provide data and other information on the benefits and costs to broker-dealers and investment advisers of trading securities on a principal basis with retail customers, as well as the benefits and costs to retail customers to buying securities from or selling securities to a broker-dealer or an investment adviser acting in a principal capacity. To the extent possible, describe costs and benefits in terms of dollars paid and/or time spent (*e.g.*, any difference in price for a customer between a principal trade and a trade executed on an agency basis). Do differences in the two regulatory regimes contribute to any differences in the cost of trading securities on a principal basis? If possible, differentiate by retail customer demographic and account information.

²⁶

Id.

8. Data and other information describing and analyzing retail customer returns (net and gross of fees, commissions, or other charges paid to a broker-dealer or investment adviser) generated under the two existing regulatory regimes.²⁷ If possible, provide security returns, associate retail customer demographic and account information with security positions, and identify whether the retail customer held these security positions prior to account opening and identify whether security selections were solicited or unsolicited. If security returns are not available, describe the type of securities held in the account and total account returns, including changes in account value and account inflows/outflows.
9. Data and other information related to the ability of retail customers to bring claims against their financial professional under each regulatory regime, with a particular focus on dollar costs to both firms and retail customers and the results when claims are brought.²⁸ We especially welcome the input of persons who have arbitrated, litigated, or mediated claims (as a retail customer, broker-dealer or investment adviser), their counsel, and any persons who presided over such actions. In particular, describe the differences between claims brought against broker-dealers and investment advisers with respect to each of the following:
- a. the differences experienced by retail customers, in general, between bringing a claim against a broker-dealer as compared to bringing a claim against an investment adviser;

²⁷ *Id.*

²⁸ *Id.*

- b. any legal or practical barriers to retail customers bringing claims against broker-dealers or investment advisers;
- c. the disposition of claims;
- d. the amount of awards, if any;
- e. costs related to the claim forum, as it affects retail customers, firms, and associated persons of such firms;
- f. time to resolution of claims;
- g. the types of claims brought against broker-dealers (we welcome examples of mediation, arbitration and litigation claims);
- h. the types of claims brought against investment advisers (we welcome examples of mediation, arbitration and litigation claims);
- i. the nature of claims brought against broker-dealers as compared to the nature of claims brought against investment advisers (*e.g.*, breach of fiduciary duty, suitability, breach of contract, tort); and
- j. the types of defenses raised by broker-dealers and investment advisers under each regime.

If possible, differentiate by retail customer demographic and account information.

10. Data and other information describing the nature and magnitude of broker-dealer or investment adviser conflicts of interest and the benefits and costs of these conflicts to retail customers. Also provide data and other information describing broker-dealer or investment adviser actions to eliminate, mitigate, or disclose conflicts of interest.

Describe the nature and magnitude of broker-dealer or investment adviser conflicts of interest with the type and frequency of activities where conflicts are present, and describe

the effect actions to mitigate conflicts of interest have on firm business and on the provision of personalized investment advice to retail customers.

11. Data and other information describing broker-dealer or investment adviser costs from providing mandatory disclosure to retail customers about products and securities. Describe costs in terms of dollars and, where cost estimates are not available, estimate time spent. If possible, differentiate by the form of disclosure (oral or written) and the amount of information the disclosure presents. Also, if possible, separate disclosure costs by associated activity.
12. Data and other information describing the effectiveness of disclosure to inform and protect retail customers from broker-dealer or investment adviser conflicts of interest. Describe the effectiveness of disclosure in terms of retail customer comprehension, retail customer use of disclosure information when making investment decisions, and retail customer perception of the integrity of the information. Please provide specific examples. If possible, differentiate by the form of disclosure (oral or written), the amount of information the disclosure presents, and retail customer demographic and account information. Also, if possible, measure disclosure effectiveness by associated activity.
13. Identification of differences in state law contributing to differences in the provision of personalized investment advice to retail customers. Provide data and other information describing differences across states with respect to retail customer brokerage or advisory account characteristics, broker-dealer or investment adviser services offered and the types of securities they offer or recommend, and the cost of providing services to retail customers. Do differences in state law contribute to differences in the recovery of

claimants? Do differences in state law contribute to differences in the mitigation or elimination of conflicts of interest? Provide information describing why. If possible, associate retail customer demographic information with account descriptions.

14. Data and other information describing the extent to which retail customers are confused about the regulatory status of the person from whom they receive financial services (*i.e.*, whether the party is a broker-dealer or an investment adviser). Provide data and other information describing whether retail customers are confused about the standard of conduct the person providing them those services owes to them. Describe the types of services and/or situations that increase or decrease retail customers' confusion and provide information describing why. Describe the types of obligations about which retail customers are confused and provide information describing why.

Provide explanations describing why responses to particular questions are not possible. Are there operational or cost constraints that make the data and other information unavailable? If so, please explain what they are. Also provide data and other information on other factors important in describing the current market for personalized investment advice that may aid or guide us in future analysis.

III. Request for Data and Other Information Relating to a Uniform Fiduciary Standard of Conduct and Alternative Approaches

We discuss below potential alternative approaches to establishing a uniform fiduciary standard of conduct for broker-dealers and investment advisers and request data and other information with respect to those approaches and their potential implications for the marketplace.²⁹ To be clear, the discussion of these potential approaches – including the

²⁹ In Part IV, we discuss certain possible approaches for harmonizing certain other aspects of the regulation of broker-dealers and investment advisers.

identification of particular assumptions or alternatives – does not suggest our policy view or the ultimate direction of any proposed action by us. Furthermore, the approaches presented here are non-exclusive. As discussed above, this description of potential approaches is instead intended to (1) assist commenters in providing more concrete empirical data and other information and more precise comment in response to this request and (2) assist us in more readily comparing, reproducing, and otherwise analyzing data and other information provided by commenters.

We recognize that commenters may be able to provide additional data and other information that may be helpful to us under assumptions and alternatives that are different from, or in addition to, those presented under the various approaches described below. We invite commenters to explain clearly the different or additional assumptions and alternatives they provide, address why such assumptions and alternatives are appropriate, and compare and contrast results obtained under such assumptions and alternatives with results obtained under the assumptions or alternatives specified in this request.

We intend to use the data and other information provided to inform us about the current market for personalized investment advice about securities and how different approaches to establishing a uniform fiduciary standard of conduct on broker-dealers and investment advisers may impact retail customers, investment advisers and broker-dealers.

A. Initial Clarification and Assumptions

As an initial matter, to provide clarity to commenters and establish a common baseline of assumptions, we indicate that commenters should make the assumptions set forth below in considering our subsequent description of a possible uniform fiduciary standard of conduct when a broker-dealer or investment adviser provides personalized investment advice to a retail customer. However, as described above in the introduction to this Part III, the identification of

particular assumptions does not suggest our policy view or the ultimate direction of any proposed action by us. We invite comment based on other assumptions chosen by commenters, and we invite comparisons between analyses made under assumptions chosen by commenters and analyses made under the assumptions – particularly alternatives to Assumption 1 and Assumption 8 below – we have set forth below.

1. Assume that the term “personalized investment advice about securities” would include a “recommendation,” as interpreted under existing broker-dealer regulation,³⁰ and would include any other actions or communications that would be considered investment advice about securities under the Advisers Act (such as comparisons of securities or asset allocation strategies). It would not include “impersonal investment advice” as that term is used for purposes of the Advisers Act.³¹ The term “personalized investment advice” would also not include general investor educational tools, provided those tools do not constitute a recommendation under current law.³²
2. Assume that the term “retail customer” would have the same meaning as in Section 913 of the Dodd-Frank Act, which is “a natural person, or the legal representative of such natural person, who (1) receives personalized investment advice about securities from a

³⁰ See Study at 124-125 (staff’s discussion of what constitutes a “recommendation” under the broker-dealer regulatory regime).

³¹ We have defined “impersonal investment advice” for certain purposes under the Advisers Act to mean “investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts.” 17 CFR 275.203A–3(a)(3)(ii). See also 17 CFR 275.206(3)–1; Study at 123 (staff’s discussion of what constitutes “impersonal investment advice”).

³² See Study at 125 (staff’s discussion of communications that generally would not constitute a “recommendation” under existing broker-dealer regulation).

broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family, or household purposes.”³³

3. Assume that any action would apply to all SEC-registered broker-dealers and SEC-registered investment advisers. To the extent commenters are of the view that the duty should be limited to a particular subset of SEC-registered broker-dealers or SEC-registered investment advisers or expanded to include all broker-dealers or investment advisers, commenters should explain how and why it should be limited or expanded, and include any relevant data and other information to support such an application.
4. Assume that the uniform fiduciary standard of conduct would be designed to accommodate different business models and fee structures of firms, and would permit broker-dealers to continue to receive commissions; firms would not be required to charge an asset-based fee. As provided in Section 913, “[t]he receipt of compensation based on commissions, fees or other standard compensation for the sale of securities, for example, would not, in and of itself, be considered a violation” of the uniform fiduciary standard of conduct.³⁴ Broker-dealers also would continue to be permitted to engaged in, and receive

³³ Sec. 913, Pub. L. 111-203, 124 Stat. 1376; 15 U.S.C. 80b-11(g)(2). *See also supra* note 1.

³⁴ *See* 15 U.S.C. 78o(k)(1); 15 U.S.C. 80b-11(g)(1).

We also note that nothing in Section 206(1) and 206(2) of the Advisers Act prohibits the receipt of transaction-based compensation, such as commissions. A person engaged in the business of effecting transactions in securities for the account of others, would however, absent an available exemption, be required to register as a broker-dealer. *See* Exchange Act Sections 3(a)(4) and 15(a); 15 U.S.C. 78c(a)(4) and 78o(a). *See also SEC v. Hansen*, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,426 (S.D.N.Y. 1984) (stating that receiving transaction-based compensation is among the activities that indicate a person may be acting as a broker); *Mutual Fund Distribution Fees; Confirmations*, Exchange Act Release No. 62544 (July 21, 2010) (proposing rules governing ongoing mutual fund asset-based sales charges), n. 168 (“As a form of

compensation from, principal trades. To satisfy the uniform fiduciary standard of conduct, however, assume that at a minimum a broker-dealer or investment adviser would need to disclose material conflicts of interest, if any, presented by its compensation structure.³⁵

5. Assume that the uniform fiduciary standard of conduct would not generally require a broker-dealer or investment adviser to either (i) have a continuing duty of care or loyalty to a retail customer after providing him or her personalized investment advice about securities,³⁶ or (ii) provide services to a retail customer beyond those agreed to between the retail customer and the broker-dealer or investment adviser. Assume that the question of whether a broker-dealer or investment adviser might have a continuing duty, as well as the nature and scope of such duty, would depend on the contractual or other arrangement or understanding between the retail customer and the broker-dealer or investment adviser, including the totality of the circumstances of the relationship and course of dealing between the customer and the firm, including but not limited to contractual provisions, disclosure and marketing documents, and reasonable customer expectations arising from

deferred sales load, all payments of ongoing sales charges to intermediaries would constitute transaction-based compensation. Intermediaries receiving those payments thus would need to register as broker-dealers under Section 15 of the Exchange Act unless they can avail themselves of an exception or exemption from registration. Marketing and service fees paid to an intermediary may similarly require the intermediary to register under the Exchange Act.”).

³⁵ See discussion *infra* Part III.B.1.

³⁶ See 15 U.S.C. 78o(k)(1) (“Nothing in this section [authorizing a uniform standard of conduct for the provision of personalized investment advice] shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.”).

the firm's course of conduct.³⁷ Similarly, the uniform fiduciary standard of conduct would apply within the context of the scope of services agreed to between the customer and the broker-dealer or investment adviser, and would not generally require the broker-dealer or investment adviser to provide services beyond those agreed to through a contractual or other arrangement or understanding with the retail customer.

6. As discussed below, assume that the offering or recommending of only proprietary or a limited range of products would not, in and of itself, be considered a violation of the uniform fiduciary standard of conduct.³⁸
7. Assume that Section 206(3) and Section 206(4) of the Advisers Act and the rules thereunder would continue to apply to investment advisers, and would not apply to broker-dealers.³⁹ Assume that to satisfy its obligations under the uniform fiduciary

³⁷ We understand that market participants generally have taken the view that the extent to which a continuing duty of loyalty or care exists under the Advisers Act depends on the scope of the relationship with the customer. They believe, for example, that investment advisers who act as financial planners generally would not have a continuing duty to a customer after providing the financial plan.

³⁸ See 15 U.S.C. 78o(k)(2) ("The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of the [uniform standard of conduct for the provision of personalized investment advice.]").

³⁹ Section 206(4) of the Advisers Act makes it unlawful for an investment adviser to "engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative" and authorizes the Commission "by rules and regulations [to] define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative." See also *infra* the discussion of principal trading and the inapplicability of Section 206(3) of the Advisers Act in Part III.B.1.

We have authority to adopt rules for broker-dealers that are substantially similar to those adopted under Sections 206(3) and 206(4) of the Advisers Act. For purposes of our request for information and data about a uniform fiduciary standard of conduct, we request that commenters assume that such rules will not be incorporated into such a standard of conduct. However, commenters may wish to express their views on whether

standard of conduct, however, a broker-dealer would need to disclose any material conflicts of interest associated with its principal trading practices.

8. Assume that existing applicable law and guidance governing broker-dealers, including SRO rules and guidance, would continue to apply to broker-dealers.

B. Discussion of a Possible Uniform Fiduciary Standard

Pursuant to Section 913 of the Dodd-Frank Act, “[t]he Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers . . . shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.”⁴⁰ We have not yet determined whether to exercise this authority. Section 913 also provides that any standard of conduct we adopt shall be no less stringent than the standard applicable to investment advisers under Sections 206(1) and 206(2) of the Advisers Act.⁴¹ The Supreme Court has construed Advisers Act Sections 206(1) and 206(2) as requiring an investment adviser to fully disclose to its clients all material information that is intended “to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.”⁴²

the Commission should engage in rulemaking to impose such rules on broker-dealers as part of harmonization of the regulatory obligations of broker-dealers and investment advisers. See discussion *infra* Part IV.

⁴⁰ 15 U.S.C. 80b-11(g)(1); 15 U.S.C. 78o(k)(1).

⁴¹ *Id.*

⁴² *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963).

The Study recommended that we should engage in rulemaking to implement the uniform fiduciary standard described in Section 913 of the Dodd-Frank Act. The staff recommended that, in implementing the uniform fiduciary standard, we should address both components of the uniform fiduciary standard: a duty of loyalty and a duty of care. The staff also supported extending the existing guidance and precedent under the Advisers Act regarding fiduciary duty, which has developed primarily through Commission and staff interpretive pronouncements under the antifraud provisions of the Advisers Act, as well as through case law and numerous enforcement actions, to broker-dealers, where similar facts and circumstances would make the guidance and precedent relevant and justify a similar outcome.⁴³

We request data and other information on the benefits and costs of implementing the uniform fiduciary standard (as described below), entailing two key elements: a duty of loyalty and a duty of care. Our description below of a potential uniform fiduciary standard is only one example of how we could implement a uniform fiduciary standard designed to require broker-dealers and investment advisers to provide advice that is in the best interest of the customer. The discussion of the uniform fiduciary standard described below and the potential alternative approaches does not suggest our policy view or the ultimate direction of any proposed action by us. To obtain the most comparable and useful data and other information on a uniform fiduciary standard, however, we ask commenters to consider the uniform fiduciary standard as described below. We also

⁴³ As discussed in more detail below, the Commission acknowledges that existing guidance and precedent under the Advisers Act regarding fiduciary duty turn on the specific facts and circumstances, including the types of services provided and disclosures made. Accordingly, the existing guidance and precedent may not directly apply to broker-dealers depending on the facts and circumstances.

discuss certain potential alternative approaches in the discussion below and request comment on those alternatives.

We recognize, among other things, that the list of potential options discussed below – including the uniform fiduciary standard of conduct, potential alternative approaches to the uniform fiduciary standard of conduct, and taking no action at this time – is not exhaustive, and that commenters may formulate additional alternative approaches. To the extent commenters are of the view that we should consider additional alternative approaches, we request they explain those approaches, address their reasons for recommending such approaches, and compare such approaches to the ones specified in detail below.

1. Uniform fiduciary standard of conduct – the duty of loyalty

The duty of loyalty is a critical component of a fiduciary duty. As noted above, Dodd-Frank Section 913(g) addresses the duty of loyalty by providing: “[i]n accordance with such rules [that the Commission may promulgate with respect to the uniform fiduciary standard] . . . any material conflicts of interest shall be disclosed and may be consented to by the customer.”⁴⁴ The uniform fiduciary standard would be designed to promote advice that is in the best interest of a retail customer by, at a minimum, requiring an investment adviser or a broker-dealer providing personalized investment advice to the customer to fulfill its duty of loyalty. This would be accomplished by eliminating its material conflicts of interest, or providing full and fair disclosure to retail customers about those conflict of

⁴⁴ 15 U.S.C. 80b–11(g)(1); 15 U.S.C. 78o(k)(1).

interest.⁴⁵ Commenters should assume that we would provide specific detail or guidance, summarized below, about complying with the duty of loyalty component of the uniform fiduciary duty. As described above in the introduction to this Part III, the identification of particular assumptions does not suggest our policy view or the ultimate direction of any proposed action by us. We invite comment on other assumptions and comparisons between analyses made under such other assumptions and analyses made under the assumptions set forth below.

1. *Assume that any rule under consideration would expressly impose certain disclosure requirements.* Assume that each broker-dealer and investment adviser that provides personalized investment advice about securities to a retail customer would be required to provide the following to that retail customer:
 - a. Disclosure of all material conflicts of interest the broker-dealer or investment adviser has with that retail customer. This requirement would reflect an overarching, general obligation to disclose all such conflicts of interest. Depending on the nature of the

⁴⁵ The staff made a number of recommendations in the Study for the Commission to consider in implementing a duty of loyalty. First, the Study recommended that we should facilitate the provision of uniform, simple and clear disclosures to retail customers about the terms of their relationships with broker-dealers and investment advisers, including any material conflicts of interests. The Study identified a number of potential disclosures that the Commission should consider (*e.g.*, a general relationship guide akin to the new Part 2A of Form ADV, the form investment advisers use to register with the Commission and states, which is provided to advisory clients). *See* Study at 114-117. Second, the Study recommended that we should consider whether rulemaking would be appropriate to prohibit certain conflicts, to require firms to mitigate conflicts through specific action, or to impose specific disclosure and consent requirements. *Id.* Third, the Study recommended that we should address through guidance and/or rulemaking how broker-dealers should fulfill the uniform fiduciary standard when engaging in principal trading. *Id.* at 118-120.

conflict and unless otherwise provided, this disclosure largely could be made through the general relationship guide described below.

- b. Disclosure in the form of a general relationship guide similar to Form ADV Part 2A, to be delivered at the time of entry into a retail customer relationship.⁴⁶ The relationship guide would contain a description of, among other things, the firm's services, fees, and the scope of its services with the retail customer, including: (i) whether advice and related duties are limited in time or are ongoing, or are otherwise limited in scope (e.g., limited to certain accounts or transactions); (ii) whether the broker-dealer or investment adviser only offers or recommends proprietary or other limited ranges of products; (iii) whether, and if so the circumstances in which, the broker-dealer or investment adviser will seek to engage in principal trades with a retail customer. It also could include disclosure of other material conflicts of interest, such as conflicts of interest presented by compensation structures.⁴⁷
- c. Oral or written disclosure at the time personalized investment advice is provided of any new material conflicts of interest or any material change of an existing conflict.

2. *Assume that any rule under consideration would treat conflicts of interest arising from principal trades the same as other conflicts of interest. Assume that such a rule would*

⁴⁶ We note that FINRA has requested comment on a concept proposal to require the provision of a disclosure statement for retail customers at or before commencing a business relationship that would include many items of information analogous to what is required in Form ADV Part 2. FINRA Regulatory Notice 10-54, "Disclosure of Services, Conflicts and Duties" (Oct. 2010). Nothing in this request for information and data suggests that FINRA or any other regulatory body could or could not, or should or should not adopt rules or requirements that it determines are appropriate and that meet applicable legal standards.

⁴⁷ A general relationship guide could also include other disclosures, such as a firm's disciplinary history.

make clear that it would not incorporate the transaction-by-transaction disclosure and consent requirements of Section 206(3) of the Advisers Act for principal trading.⁴⁸ At a minimum, as with other conflicts of interest, the broker-dealer would be required to disclose material conflicts of interest arising from principal trades with retail customers.⁴⁹

3. *Assume that the rule would prohibit certain sales contests.* The rule would prohibit the receipt or payment of non-cash compensation (*e.g.*, trips and prizes) in connection with the provision of personalized investment advice about the purchase of securities.

2. Uniform fiduciary standard of conduct – the duty of care

The duty of care is another critical component of the uniform fiduciary standard.

We would specify, through the duty of care, certain minimum professional obligations of

⁴⁸ Assume that the rule would not relieve an investment adviser from its obligations under Advisers Act Section 206(3). We note that we have the authority to apply similar requirements to broker-dealers. Also assume that the rule would not relieve an investment adviser who is also registered as a broker-dealer from its obligations to comply with Advisers Act Section 206(3) or the rules thereunder. *See* 17 CFR 275.206(3)-3T.

As stated above, we request that, for purposes of our request for information and data about a uniform fiduciary standard of conduct, commenters assume that we will not incorporate these obligations into the uniform fiduciary standard of conduct. However, commenters may wish to express their views, on whether the Commission should engage in rulemaking to impose such rules on broker-dealers as part of harmonization of the regulatory obligations of broker-dealers and investment advisers. *See* discussion *infra* Part IV.

⁴⁹ SRO rules currently impose requirements on broker-dealers when broker-dealers engage in principal trading. *See, e.g.*, NASD Rule 2440 (Fair Prices and Commissions); IM-2440-1 (Mark-Up Policy); IM-2440-2 (Mark-Up Policy for Debt Securities); NASD Rule 2310 (Suitability) (effective until July 9, 2012, when replaced by FINRA Rule 2111); NASD Rule 3010 (Supervision); NASD Rule 3012 (Supervisory Control System). As noted above, these requirements would continue to apply to a broker-dealer under a uniform fiduciary standard of conduct.

broker-dealers and investment advisers,⁵⁰ which would be designed to promote advice that is in the best interests of the retail customer. Commenters should assume, for purposes of this request for data and other information, that we would implement the duty of care by imposing on a broker-dealer or investment adviser, when providing personalized advice to a retail customer about securities, the uniform obligations described below. As described above in the introduction to this Part III, the identification of particular assumptions does not suggest our policy view or the ultimate direction of any proposed action by us. We invite comment based on other assumptions chosen by commenters, and we invite comparisons between analyses made under assumptions chosen by commenters and analyses made under the assumptions we have set forth below.

1. *Suitability obligations*: A duty to have a reasonable basis to believe that its securities and investment strategy recommendations are suitable for at least some customer(s) as well as for the specific retail customer to whom it makes the recommendation in light of the retail customer's financial needs, objectives and circumstances;⁵¹
2. *Product-specific requirements*: Specific disclosure, due diligence, or suitability requirements for certain securities products recommended (such as penny stocks, options,

⁵⁰ The staff stated in the Study that the Commission could articulate and harmonize such professional standards by referring to, and expanding upon, as appropriate, the explicit minimum standards of conduct relating to the duty of care currently applicable to broker-dealers (e.g., suitability (including product-specific suitability), best execution, and fair pricing and compensation requirements) under applicable rules. See Study at 50-53.

⁵¹ See Study at 27-28 and 61-64 (discussing investment adviser and broker-dealer suitability obligations, respectively).

debt securities and bond funds, municipal securities, mutual fund share classes, interests in hedge funds and structured products);⁵²

3. *Duty of best execution*: A duty on a broker-dealer and an investment adviser (where the investment adviser has the responsibility to select broker-dealers to execute client trades) to seek to execute customer trades on the most favorable terms reasonably available under the circumstances,⁵³ and
4. *Fair and reasonable compensation*: A requirement that broker-dealers and investment advisers receive compensation for services that is fair and reasonable, taking into consideration all relevant circumstances.⁵⁴

3. Uniform fiduciary standard of conduct – application of prior guidance and precedent regarding investment adviser fiduciary duty

In the interests of increasing investor protection and reducing investor confusion, the staff recommended in the Study that the uniform fiduciary standard be no less stringent than the existing fiduciary standard for investment advisers under Advisers Act Sections 206(1) and 206(2).⁵⁵ Accordingly, the staff recommended that existing guidance and precedent under the

⁵² See *id.* at 65-66 (discussing relevant rules imposing specific disclosure, diligence and suitability requirements for certain securities products).

⁵³ See *id.* at 28-29 and 69-70 (describing investment adviser and broker-dealer duties of best execution).

⁵⁴ See *id.* at 66-69 (describing broker-dealer obligations to charge fair prices, commissions, and other charges and fees).

⁵⁵ As explained above, guidance and precedent under Sections 206(3) and 206(4) of the Advisers Act, and the rules adopted under those sections, would not be part of the uniform fiduciary standard of conduct.

Advisers Act regarding fiduciary duty should continue to apply to investment advisers and be extended to broker-dealers, as applicable, under a uniform fiduciary standard of conduct.

Application of this guidance and precedent turns on the specific facts and circumstances, including the types of services provided and disclosures made. We understand, accordingly, that existing guidance and precedent may not directly apply to broker-dealers depending on the facts and circumstances. Therefore, to aid commenters, we have identified below certain fiduciary principles that commenters should assume would continue to apply to investment advisers and be extended to broker-dealers. We also request commenters to identify specific citations to any case law and enforcement actions and other guidance under the Advisers Act regarding the fiduciary duty that they believe should or should not apply to broker-dealers when providing personalized investment advice about securities to retail customers.

For purposes of this request for data and other information, commenters should make the assumptions below regarding the application of prior guidance and precedent under a uniform fiduciary standard of conduct. As described above in the introduction to this Part III, the identification of particular assumptions does not suggest our policy view or the ultimate direction of any proposed action by us. We invite comment based on other assumptions chosen by commenters, and we invite comparisons between analyses made under assumptions chosen by commenters and analyses made under the assumptions we have set forth below.

1. *Allocation of investment opportunities:* A fiduciary's duty of loyalty generally would require a firm to disclose to a retail customer how it would allocate investment

opportunities among its customers,⁵⁶ and between customers and the firm's own account;⁵⁷ for example, this disclosure could include, among other things, the firm's method of allocating shares of initial public offerings, as well as its method (*e.g.*, *pro rata*, "first in, first out") of allocating out of its principal account to its customers when agency orders are placed on a riskless principal basis.

2. *Aggregation of orders*: A firm may aggregate or "bunch" orders on behalf of two or more of its retail customers, so long as the firm does not favor one customer over another.⁵⁸ A firm would need to disclose whether and under what conditions it aggregates orders;⁵⁹ if

⁵⁶ The Commission has brought numerous enforcement actions alleging that investment advisers unfairly allocated client trades to preferred clients without making adequate disclosure. *See, e.g., Alpine Woods Capital Investors, LLC* and *Samuel A. Lieber*, Admin. Proc. File No. 3-14233 (Feb. 7, 2011) (finding the investment adviser violated Advisers Act Section 206(2) when it disproportionately allocated shares from an initial public offering to the advantage of the firm's two smallest mutual funds); *Nevis Capital Mgmt., LLC*, Investment Advisers Act Release No. 2214 (Feb. 9, 2004) (settled order); *The Dreyfus Corp., et al.*, Investment Advisers Act Release No. 1870 (May 10, 2000) (settled order); *Account Mgmt. Corp.*, Investment Advisers Act Release No. 1529 (Sept. 29, 1995) (settled order).

⁵⁷ The Commission has brought numerous enforcement actions alleging that investment advisers unfairly allocated trades to their own accounts and allocated less favorable or unprofitable trades to their clients' accounts. *See, e.g., Nicholas-Applegate Capital Mgmt.*, Investment Advisers Act Release No. 1741 (Aug. 12, 1998) (settled order); *Timothy J. Lyons*, Investment Advisers Act Release No. 1882 (June 20, 2000) (settled order); *SEC v. Lyons*, 57 S.E.C. 99 (2003); *SEC v. Alan Brian Bond, et al.*, Litigation Release No. 18923 (Civil Action No. 99-12092 (S.D.N.Y.) (Oct. 7, 2004).

⁵⁸ The staff takes the position that an investment adviser, when directing orders for the purchase or sale of securities, may aggregate or "bunch" those orders on behalf of two or more of its accounts, so long as the bunching is done for the purpose of achieving best execution, and no customer is disadvantaged or advantaged by the bundling. *See SMC Capital, Inc.*, SEC No-Action Letter (Sept. 5, 1995).

⁵⁹ The staff understands that, consistent with applicable law, broker-dealers currently only aggregate orders in limited circumstances, such as when orders are received outside of normal trading hours and aggregated in anticipation of execution when the market reopens, or when the broker-dealer has discretion over the trade. Similarly, the staff

the firm does not aggregate orders when it has the opportunity to do so, the firm would need to explain its practice and describe the costs to customers of not aggregating.⁶⁰

C. Alternative Approaches to the Uniform Fiduciary Standard of Conduct

We identify below alternative approaches to the uniform fiduciary standard discussed above. In considering the alternatives, it would be helpful to obtain information about whether and, if so, how each alternative meets the goals of enhancing retail customer protections and decreasing retail customers' confusion about the standard of conduct owed to them when their financial professional provides them personalized investment advice. It would also be helpful to obtain information about the relative costs and benefits of these alternatives, including the extent to which one alternative may provide (1) greater benefits for the same or lower cost than other alternatives or (2) lower benefits for the same or higher cost than other alternatives. The identification of particular alternatives does not suggest our policy view or the ultimate direction of any proposed action by us.

Keeping in mind these goals, we request comment on the following alternative approaches, including the costs and benefits of each approach, as well as other approaches. We could:

1. Apply a uniform requirement for broker-dealers and investment advisers to provide disclosure about (a) key facets of the services they offer and the types of products or services they offer or have available to recommend; and (b) material conflicts they may have with retail customers, without imposing a uniform fiduciary standard of conduct.

recognizes that aggregation of orders may not occur frequently with regard to non-discretionary advisory accounts.

⁶⁰

See Item 12 of Form ADV Part 2A.

2. Apply the uniform fiduciary standard of conduct discussed above on broker-dealers and investment advisers, but without extending to broker-dealers the existing guidance and precedent under the Advisers Act regarding fiduciary duty.⁶¹ The existing guidance and precedent under the Advisers Act regarding fiduciary duty would continue to apply to investment advisers.
3. Without modifying the regulation of investment advisers, apply the uniform fiduciary standard discussed above, or parts thereof, to broker-dealers. This “broker-dealer-only” standard could involve establishing a “best interest” standard of conduct for broker-dealers, which would be no less stringent than that currently applied to investment advisers under Advisers Act Sections 206(1) and 206(2), when they provide personalized investment advice about securities to retail customers.
4. Without modifying the regulation of broker-dealers, specify certain minimum professional obligations under an investment adviser’s duty of care (which are currently not specified by rule). As discussed above, any rules or guidance would take into account Advisers Act fiduciary principles, such as the duty to provide suitable investment advice (*e.g.*, with respect to specific recommendations and the client’s portfolio as a whole) and to seek best execution where the adviser has the responsibility to select broker-dealers to execute client trades. These requirements could be similar to those rules currently applicable to broker-dealers, as described further in the Study.⁶²

⁶¹ The Securities Industry and Financial Markets Association suggested this approach. See SIFMA Letter, *supra* note 17.

⁶² For a more detailed description of such requirements, see the Study at 61-70.

5. Consider following models set by regulators in other countries. For instance, the United Kingdom's Financial Services Authority (FSA) requires persons providing personalized investment advice to a retail client to act in the client's best interests, and has set limits on how investment advisers charge for their services, including prohibiting (a) the receipt of ongoing charges unless there are ongoing services, and (b) the receipt of commissions from those providing the investment advice.⁶³ Similarly, the Treasury of Australia imposed a best interest obligation on persons providing personal advice that would (a) require the provider of the advice to place a retail client's interests before its own,⁶⁴ and (b) prohibit the receipt of "conflicted" remuneration, such as commission payments relating to the provision of advice.⁶⁵ Further, the European Securities and Markets

⁶³ See Financial Services Authority Handbook, Conduct of Business Sourcebook ("COBS"), 2.1.1, available at <http://fsahandbook.info/FSA/html/handbook/COBS/2/1> (FSA's "client best interest rule"). See also COBS, 9.2.1(1), (2); COBS, 9.2.2 (requiring that a firm's recommendations be suitable and reasonable based on the client's risk profile). Effective in 2012, the FSA will require firms to disclose to retail clients the type (either "independent" or "restricted") and breadth of advice being offered (e.g., limited to certain products or a comprehensive, fair and unbiased analysis of the relevant market). See COBS, 6.2A.5R, 6.2A.6R, available at <http://fsahandbook.info/FSA/html/handbook/COBS>. The Adviser Charging rules, also going into effect in 2012, will prohibit receipt of any remuneration for advice that is not disclosed and agreed upon in advance of the recommendation. See COBS, 6.1A.

⁶⁴ See The Corporations Amendment (Further Future of Financial Advice Measures) Act 2012, ("Financial Advice Measures"), available at http://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r4739_aspassed/toc_pdf/11270b01.pdf;fileType=application%2Fpdf. See also Australian Securities & Investments Commission, *Regulatory Guide 175: Licensing: Financial Product Advisers – Conduct and Disclosure 15* (2011), available at [http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg175-010411.pdf/\\$file/rg175-010411.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg175-010411.pdf/$file/rg175-010411.pdf) (discussing the implied warranty, under the Australian Securities and Investments Commission Act 2001, to render advice through "due care and skill").

⁶⁵ See Financial Advice Measures.

Authority (ESMA) published guidelines to clarify the application of certain aspects of its current Markets in Financial Instruments Directive (MiFID) suitability requirements (arising from both MiFID and the MiFID Implementing Directive).⁶⁶

As described above in Part III.B, we invite comment on other potential alternative approaches not specified in this request for data and other information and comparisons between those alternative approaches and the potential uniform fiduciary standard of conduct and alternatives we describe above.

D. Preserving Current Standard of Conduct Obligations

Consistent with our discretionary authority under Section 913, we could also determine to take no further action at this time with respect to the standards of conduct applicable to broker-dealers and investment advisers; existing regulatory requirements would continue to apply. We request data and other information relating to the current market for personalized investment advice in Part II above. It generally would be helpful to obtain information about how taking no action would compare to a uniform fiduciary standard of conduct and the alternative approaches described above. In particular, it would be helpful to obtain information about the costs and benefits of the current regulatory regime as compared to the uniform fiduciary standard of conduct and the alternative approaches described above. Such comparisons would be particularly helpful as commenters consider providing data and other information in connection with the requests specified in Part III.E below.

⁶⁶ See Guidelines on certain aspects of the MiFID suitability requirements, ESMA, 2012, 387 (July 6, 2012), available at <http://www.esma.europa.eu/system/files/2012-387.pdf>.

E. Request for Data and Other Information Relating to Changes in the Marketplace for Personalized Investment Advice Resulting from the Uniform Fiduciary Standard of Conduct and Alternative Approaches

The Commission requests the following data and other information relating to changes in the marketplace for personalized investment advice for retail customers that might occur as a result of implementing the uniform fiduciary standard of conduct and the alternative approaches described above. As noted above, in providing this data and other information, the Commission believes it would be useful to also obtain information about the benefits and costs of continuing the current regulatory regime, as requested in Part II above, as a baseline for comparing the uniform fiduciary standard of conduct and the alternative approaches. Accordingly, to the extent applicable, the Commission requests commenters to provide such comparisons. As in Part II, many of the requests ask commenters to provide data and other information describing retail customer demographics and accounts; broker-dealer or investment adviser services offered; financial securities; and the claims of retail customers in dispute resolution. We request commenters to refer to the Appendix for the specific characteristics of each of these topics that are important to include when submitting data and other information. We also request commenters refer to other guidelines in the Appendix, particularly the request to provide background information and documentation to support any economic analysis.

1. Commenters have highlighted several activities of broker-dealers and investment advisers that are most likely to be impacted by a uniform fiduciary standard for the provision of personalized investment advice about securities to retail customers.⁶⁷

- Recommending proprietary products and products of affiliates;

⁶⁷ The inclusion of activities in this list does not necessarily reflect the Commission's belief that these activities will be impacted by a uniform fiduciary standard, see the discussion of clarifications and assumptions in the introductions to Part III and Part III.A.

- Engaging in principal trades with respect to a recommended security (*e.g.*, fixed income products);
 - Recommending a limited range of products and/or services;
 - Recommending a security underwritten by the firm or a broker-dealer affiliate, including initial public offerings;
 - Allocating investment opportunities among retail customers (*e.g.*, IPO allocation);
 - Advising on a trading strategy involving concentrated positions;
 - Receiving third-party compensation in connection with securities transactions or distributions (*e.g.*, sales loads, ongoing asset-based fees, or revenue sharing); and
 - Providing ongoing, episodic or one-time advice.
- a. Provide comment on this list of activities. Does this list capture the activities of broker-dealers and investment advisers that would be most impacted by a uniform fiduciary standard of conduct when providing personalized investment advice about securities to retail customers?
- b. Provide data and other information describing the likely benefits and costs for firms and retail customers from firms engaging in these activities under the uniform fiduciary standard of conduct and each of the alternative approaches discussed above. In particular, describe the cost to broker-dealers and investment advisers in terms of dollars and time spent from providing these activities to retail customers under the uniform fiduciary standard and each of the alternative approaches. Also provide data and other information describing the benefits and costs to firms and retail customers likely to result from voluntary actions firms may take that are not necessarily

- mandated by the relevant standard. If possible, separate costs by service type, and differentiate by retail customer demographic and account information.
- c. Provide data and other information related to the nature and magnitude of conflicts of interest when firms engage in these activities under the uniform fiduciary standard and each of the alternative approaches discussed above. How would the uniform fiduciary standard or each of the alternative approaches increase or decrease broker-dealer or investment adviser conflicts of interest?
2. Provide data and other information describing the types and availability of services (including advice) and securities that broker-dealers or investment advisers would offer or recommend to retail customers under the uniform fiduciary standard and each of the alternative approaches discussed above. Would the application of a particular approach discussed above require a firm, or give a firm an incentive, to modify or eliminate current business practices? What would be the impact or potential impact of each approach discussed above on retail customer cost and access to personalized investment advice and to security offerings? How could such impact or costs be mitigated? Provide data and other information describing why the business practices would be so modified or eliminated, and whether retail customer access would change. Indicate whether business practices are transaction-specific, account-specific, customer-specific, or firm-wide. If possible, separate costs by service type and differentiate by retail customer demographic and account information.
 3. Provide data and other information describing the security selections of retail customers under the uniform fiduciary standard and each of the alternative approaches discussed

above. If possible, associate retail customer demographic and account information with security selections.

4. Provide data and other information related to the ability of retail customers to bring claims against their financial professional under the uniform fiduciary standard and each of the alternative approaches discussed above, with a particular focus on alternative forums and dollar costs to both firms and retail customers and the results when claims are brought. Describe disposition of claims, costs related to claim forum, time to resolution, and awards if any. If possible, differentiate by retail customer demographic and account information.⁶⁸
5. Provide information, data and comment on the extent to which the uniform fiduciary standard and each of the alternative approaches discussed above affect investor protection and confusion investors have about the standard of conduct applicable to their financial professionals when providing personalized investment advice about securities.⁶⁹
6. Provide information, data and comment on the costs and benefits to investment advisers and broker-dealers associated with implementing the uniform fiduciary standard and each of the alternative approaches discussed above. Discuss any changes investment advisers and broker-dealers would need to make to, among others, their customer documentation, internal controls, and training programs, as well as other changes they would need to make, and why.
7. Provide data and other information describing to what extent firms would rely on disclosure to comply with the uniform fiduciary standard and each of the alternative

⁶⁸ See *supra* Item 9(a)-(j) in Part II of this request for information and data.

⁶⁹ See *supra* note 2.

approaches detailed above. How would retail customers be expected to react to changes in practice and changes in disclosure? How do retail customers choose between a firm with disclosed conflicts and a firm whose business model does not involve the same conflict(s)?

8. Provide data and other information on how other aspects of the market for personalized investment advice would change if we adopt any of the alternative approaches discussed above. In particular, provide data about how the alternatives described above would impact the costs to retail customers and any associated effect on access to products and services. As stated above, specific information about the potential economic impact of the staff's recommendations, including information about the potential impact on competition, capital formation and efficiency, may particularly help inform any action we may take in this area.
9. Provide data and other information describing the benefits and costs related to alternative approaches to the standards of conduct other than those specified in this request for data and other information. Additional approaches and standards of conduct for persons providing personalized investment advice include but are not limited to those standards established under the laws of other countries.
10. Provide explanations describing why responses to particular questions are not possible.

F. Request for Data and Other Information Relating to Account Conversions

In 2007, as a result of the court decision in *Financial Planning Association v. SEC*⁷⁰ (“FPA”), broker-dealers offering fee-based brokerage accounts (*i.e.*, brokerage accounts in which

⁷⁰ *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007). The court vacated Rule 202(a)(11)-1 under the Advisers Act which excepted broker-dealers from being classified as investment advisers based solely on their receipt of asset-based fees

the broker-dealer charged a single asset-based fee, instead of commissions; for its services) became subject to the Advisers Act with respect to those accounts; as such, those client relationships, which had previously been primarily subject to Exchange Act and SRO rules, became subject to the Advisers Act and the fiduciary duty thereunder. Business practices since *FPA* present an example from which to draw comparative costs and benefits differences between retail brokerage and advisory accounts, as well as the cost and benefit and potential consequences of imposing a fiduciary standard on broker-dealers. In 2007, our staff had estimated that there were over one million fee-based brokerage accounts, representing approximately \$300 billion, many of which were converted to advisory accounts⁷¹ or otherwise were transitioned back to traditional commission-based brokerage accounts. Broker-dealers that converted fee-based brokerage accounts to advisory accounts (especially those that converted to non-discretionary advisory accounts) and retail customers whose accounts were converted as a result of *FPA* are in a position to provide comparative cost and benefit data for retail brokerage and advisory accounts (for the firm and/or the retail customer), and therefore to provide cost and benefit data on the imposition of a fiduciary standard generally.

In addition, we are aware that some firms have made the decision to convert their retail brokerage accounts to advisory accounts outside of the specific context of *FPA*. We understand such account conversions may have occurred for a variety of reasons, including a firm's decision to change its business model. We similarly believe that firms that have engaged in such account conversions and retail customers whose accounts were converted are in a position to provide

and in effect, exempted broker-dealers that offered these fee-based accounts from regulation as investment advisers.

⁷¹ *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 at 4 (Sept. 24, 2007).

comparative cost and benefit data for retail brokerage and advisory accounts (for the firm and/or the retail customer), and therefore to provide cost and benefit data on the imposition of a fiduciary standard generally.

We recognize that any such data and other information relating to the conversion of brokerage accounts to advisory accounts, and the imposition of a fiduciary standard will only be an approximation of the costs and benefits of the uniform fiduciary standard described above. Specifically, the uniform fiduciary standard described above does not incorporate the entirety of the Advisers Act, whereas any brokerage accounts converted to advisory accounts would be subject to the Advisers Act as a whole. Accordingly, to the extent possible, we request that any such data and other information exclude costs and benefits associated with complying with aspects of the Advisers Act not included within the uniform fiduciary standard (such as sections 206(3) and 206(4) and the rules thereunder) or, if commenters are unable to exclude such costs, we request that they indicate that the data and other information include costs of complying with such sections and rules. Similarly, with respect to broker-dealers that converted fee-based brokerage accounts to advisory accounts as a result of *FPA*, we request that the data provided exclude to the extent possible, or at a minimum identify that, such data include costs (*e.g.*, legal and consulting fees, other costs) related to the uncertainty regarding the treatment of such accounts immediately following *FPA*.

We generally request data and other information on costs and benefits from or relating to: (1) broker-dealers that converted fee-based brokerage accounts to advisory accounts as a result of *FPA*; (2) firms that independently determined to convert retail brokerage accounts to advisory accounts outside of the context of *FPA*; and (3) retail customers whose accounts were converted

under either of these scenarios.⁷² We also request certain data and other information on costs and benefits from firms and retail customers who did not convert brokerage to advisory accounts as a result of the *FPA* decision. In addition to the specific requests below, when providing this data and other information, we request commenters' responses be made, where possible, in compliance with the guidelines set forth in the Appendix, and also request commenters provide background information and documentation to support any economic analysis. We request commenters separate, if possible, all data and other information (including associated retail customer demographic information on the accounts) based on whether the account conversions resulted from *FPA* or whether the account conversions were voluntary.

1. Provide data and other information describing whether account conversions were in response to *FPA*, or to an independent determination by firms or retail customers. If the latter, provide data and other information describing factors contributing to the conversion of brokerage accounts to advisory accounts. Also provide data and other information about administrative costs and customer notifications arising from the transition from brokerage accounts to advisory accounts.
2. Provide data and other information describing retail customer accounts transitioning from brokerage accounts to advisory accounts including the amount of assets and securities held. Also, provide data and other information describing factors contributing to retail customers' decisions to convert to advisory accounts, including perceived costs and benefits of brokerage accounts and advisory accounts. If possible, associate retail customer demographic information with account descriptions.

⁷² We reiterate that the uniform fiduciary standard of conduct would not prohibit the receipt of commissions, or require conversion of accounts from brokerage to advisory.

3. Provide data and other information describing the factors contributing to broker-dealers' decision not to offer fee-based accounts, which would be advisory accounts, in response to *FPA*. In addition, provide data and other information describing retail customer accounts that were not transitioned from a brokerage account to an advisory account in response to *FPA* when the firm provided the customer the opportunity to transition, including the amount of assets and securities held. Also, provide data and other information describing factors contributing to retail customers' decisions not to convert to advisory accounts, including perceived costs and benefits of brokerage accounts and advisory accounts. If possible, associate retail customer demographic information with account descriptions.
4. Provide data and other information describing the impact of the account conversion on the types of services and securities dual registrants offer to retail customers transitioning from brokerage accounts to advisory accounts. Did the application of the Advisers Act require a firm, or give a firm an incentive, to modify or eliminate then-current business practices? Provide data and other information describing why the business practices were so modified or eliminated. Indicate whether business practices are transaction-specific, account-specific, customer specific, or firm-wide, and differentiate by retail customer demographic and account information.
5. Provide data and other information describing changes, if any, in the benefits and costs of providing services to retail customers transitioning from brokerage accounts to advisory accounts. Did retail customers transitioning accounts experience a change in costs? If possible, separate costs by service type, and differentiate by retail customer demographic and account information.

6. Provide data and other information describing changes, if any, to the security selections of dual registrants and the types of securities held by retail customers transitioning from brokerage accounts to advisory accounts. Also provide quantitative data and other information describing changes, if any, to the security returns (net and gross of fees) of retail customers transitioning accounts. If security returns are not available, describe total account returns, including changes in account value and the amount of account inflows/outflows. If possible, identify whether initial security ownership took place before the account transition and whether account selections were solicited or unsolicited, and differentiate by retail customer demographic and account information.
7. Provide data and other information describing changes, if any, to the ability of retail customers that transitioned from brokerage to advisory accounts to bring claims against their financial professional with a particular focus on dollar costs to the retail customer and the results when claims are brought. We especially welcome the input of persons who have arbitrated, litigated, or mediated claims (as a retail customer, broker-dealer or investment adviser), their counsel, and any persons who presided over such actions. In particular, describe changes for claims brought against broker-dealers and investment advisers with respect to each of the following:
 - a. the experience of retail customers, in general, between bringing a claim against a broker-dealer as compared to bringing a claim against an investment adviser;
 - b. any legal or practical barriers to retail customers bringing claims against broker-dealers or investment advisers;
 - c. the disposition of claims;
 - d. the amount of awards;

- e. costs related to the claim forum, as it affects retail customers, firms, and associated persons of such firms;
- f. time to resolution of claims;
- g. the types of claims brought against broker-dealers (we welcome examples of mediation, arbitration and litigation claims);
- h. the types of claims brought against investment advisers (we welcome examples of mediation, arbitration and litigation claims);
- i. the nature of claims brought against broker-dealers as compared to the nature of claims brought against investment advisers (*e.g.*, breach of fiduciary duty, suitability, breach of contract, tort); and
- j. the types of defenses raised by broker-dealers and investment advisers under each regime.

If possible, differentiate by retail customer demographic and account information.

8. Provide data and other information describing changes, if any, to the experiences of retail customers that were transitioned from brokerage to advisory accounts. Among other things, did retail customer satisfaction with their account change? If possible, control for retail customer demographic and account information.
9. Provide other data and other information describing the benefits and costs, if any, of transitioning retail customer brokerage accounts to advisory accounts. If possible, differentiate by retail customer demographic and account information. Also, provide data and other information describing the benefits and costs to firms or retail customers from the regulations prior to account conversion. Lastly, provide explanations describing why responses to particular questions are not possible.

IV. Request for Data and Other Information Relating to Potential Areas for Further Regulatory Harmonization

We seek data and other information on the nature and extent to which we should consider harmonizing the regulatory obligations of broker-dealers and investment advisers other than their standard of conduct. As stated above, in the Study the staff recommended that the Commission consider harmonizing certain regulatory requirements of broker-dealers and investment advisers where such harmonization appears likely to add meaningful investor protection, taking into account the best elements of each regime. We request that commenters, in particular, provide such data and other information regarding harmonizing some or all such obligations in situations where a broker-dealer and an investment adviser perform the same or substantially similar function, such as the provision of personalized investment advice about securities to retail customers where harmonization is consistent with the mission of the Commission.⁷³ We also are mindful that we should consider changes to the standard of conduct of broker-dealers and investment advisers within the context of the overall set of regulatory obligations that apply to those firms and the potential costs and benefits that may be associated with such changes. The extent to which the standard of conduct changes, for example, could result in certain other regulatory requirements no longer being workable in practice, or becoming unnecessarily duplicative of current requirements in whole or in part. Similarly, if we were to adopt a uniform fiduciary standard of conduct for broker-dealers and investment advisers, we should consider whether regulatory obligations that apply today to only one registrant class or the other would meaningfully enhance investor protections if applied uniformly to both.

⁷³ See Study at 129-139.

In the Study, the areas the staff suggested the Commission consider for harmonization included advertising and other communications, supervision, licensing and registration of firms, licensing and continuing education requirements for persons associated with firms, books and records, and the use of finders and solicitors. The staff stated that this listing was not intended to be a comprehensive or exclusive listing of potential areas of harmonization.

We seek data and other information on these areas of potential harmonization, including with respect to the advantages and disadvantages of engaging in such harmonization. As we explained in Part I.B above, many of the areas the staff identified for potential harmonization are more specific than a uniform fiduciary standard of conduct. Accordingly, we do not provide an extensive discussion of the various options available for considering regulatory harmonization, which could generally include:

- Applying certain broker-dealer obligations to investment advisers, or vice versa;
- Eliminating certain obligations that apply to broker-dealers but not investment advisers, or vice versa;
- Creating new obligations that would apply to both broker-dealers and investment advisers; or
- Taking no further action at this time with respect to regulatory harmonization.

As discussed above, we believe that a broad consideration of harmonization of regulatory obligations is important in helping us assess whether and to what extent we should consider making adjustments to the other regulatory obligations of broker-dealers and investment advisers. We invite commenters to provide us with their views on the benefits and costs for different approaches for potential harmonization. For example, we request comment on the extent to which regulatory harmonization might address customer confusion about the obligations owed to

them by broker-dealers and not investment advisers (or by investment advisers and not broker-dealers) even if a uniform fiduciary standard of conduct is implemented. We also request comment on the extent to which regulatory harmonization might result in additional investor confusion or otherwise negatively impact investors.

A. Potential Areas for Harmonization

In the Study, the staff recommended that the Commission consider whether to pursue various options for harmonizing investment adviser and broker-dealer regulation. As a preliminary matter, and in order to continue to evaluate the potential impact of harmonization, we are requesting data and other information on the potential harmonization of the non-exhaustive areas set forth below. These specific areas of potential harmonization largely reflect the areas of harmonization recommended by the staff in the Study. The staff's recommendations generally focused on adopting the existing elements of each regulatory regime that the staff believed are most effective in protecting retail customers, and the discussion below largely reflects these recommendations. We request comment on which of these areas, if any, the Commission should consider for harmonization, what harmonization in such areas should entail in practice, and the benefits and costs associated with such harmonization, including the extent to which such harmonization would increase or reduce retail customer confusion about the regulatory obligations of broker-dealer and investment advisers. We may consider harmonization of other areas not addressed below. Accordingly, we request comment on which areas, if any, the Commission should consider for harmonization, and what such harmonization should entail.

The identification of these areas below and the description of how harmonization may be accomplished are not intended to suggest a policy view of the Commission or the ultimate

direction of any proposed action by the Commission. Indeed, the description of each area of potential harmonization below is but one example of many ways in which the Commission may harmonize regulation, should the Commission determine such harmonization is appropriate. We are cognizant that the Commission may decide not to pursue harmonization, may pursue harmonization in different areas, or pursue a different approach to harmonization in the areas identified by the Study, and we seek comment on such areas and approaches, including the associated benefits and costs.

We also seek comment as to whether harmonization in each area identified below or by a commenter as appropriate for such action should involve changing the existing standards of one regime to accomplish harmonization, or whether an entirely different requirement should be adopted for both investment advisers and broker-dealers.

We request data and other information, including whether meaningful investor protection would be enhanced, on the following potential areas of harmonization where existing investment adviser and broker-dealer obligations differ:⁷⁴

1. ***Advertising and Other Communications***: Advertising and other firm communications can have a significant impact on retail customers, as they can persuade customers to enter into relationships or engage in transactions. As noted in the Study, both investment advisers and broker-dealers are subject to general prohibitions on misleading communications, but specific content restrictions differ. The Study concludes that a significant difference between investment adviser and broker-dealer regulation regarding advertisements and other communications is that, under certain circumstances, a registered principal of the

⁷⁴ For more information about the potential harmonization areas, see Study at 129-139.

broker-dealer must approve a communication before distributing it to the public, and certain communications must be filed for review with the applicable regulatory body.⁷⁵

While the Advisers Act does not specifically prescribe that a communication must be approved before distribution to the public, the Commission has stated that an adviser's compliance policies and procedures, at a minimum, should address, among others, the accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements.⁷⁶ We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Advertisements and other customer communications, generally.
- b. Developing similar substantive advertising and customer communications rules and/or guidance for broker-dealers and investment advisers regarding the content of advertisements and other customer communications for similar services? Please identify any particular rules that could be applied to both broker-dealers and investment advisers, and any rules that would not be appropriate to apply to both.

If a particular rule would not be appropriate for both, why not?

⁷⁵ For the staff's discussion regarding potential harmonization of requirements related to advertising and other communications, see Study at 130-132.

⁷⁶ *See Compliance Programs of Investment Advisers and Investment Companies*, Investment Advisers Act Release No. 2204 (Dec. 17, 2003) (adopting Advisers Act Rule 206(4)-7) ("Compliance Rule") (stating that "[w]e expect that an adviser's policies and procedures, at a minimum, should address the following issues to the extent that they are relevant to that adviser: [...] [t]he accuracy of disclosures made to investors, clients, and regulators, including account statements and advertisements; [...] and] [m]arketing advisory services, including the use of solicitors..."). For this purpose, the Advisers Act requires an adviser to designate a chief compliance officer ("CCO"). The Commission has stated in the Compliance Rule that the CCO should be knowledgeable about the Advisers Act and have the authority to develop and enforce appropriate compliance policies and procedures for the adviser.

- c. Establishing consistent internal pre-use review requirements for investment adviser and broker-dealer advertisements, such as by requiring investment advisers to designate employees to review and approve communications and advertisements?
 - d. Imposing consistent pre- and post-use filing requirements for similar investment adviser and broker-dealer advertisements?
2. *Use of Finders and Solicitors*: The term “finder” is generally understood (for purposes of broker-dealer regulation) to mean an intermediary who receives a fee for “finding” potential investors for issuers seeking to sell securities. Similarly, a “solicitor” is an intermediary used by advisers to “solicit” clients and prospective clients for advisory services. Intermediaries who “find” investors can have a significant impact on retail customers, as they can persuade investors to enter into relationships or engage in transactions. The regulation of these intermediaries differs. One who receives transaction-based compensation in connection with the sale of securities, including a finder, must register as a broker-dealer unless an exemption from registration is available. By contrast, while solicitors may fall within the definition of “investment adviser” under the Advisers Act, the Commission has taken the position that a solicitor who engages in solicitation activities in accordance with Rule 206(4)-3(a)(2)(iii) is an associated person of an investment adviser and is not required to register with the Commission as an investment adviser solely as a result of those activities.⁷⁷ An investment adviser that uses a solicitor’s services must treat the solicitor as an associated person to the extent the solicitor acts as such for the adviser, and the adviser has a responsibility to supervise the solicitation

⁷⁷ *Requirements Governing Payments of Cash Referral Fees by Investment Advisers*, Investment Advisers Act Release No. 688 (July 12, 1979).

activities.⁷⁸ In addition, the Advisers Act regulation focuses on disclosure to clients of the solicitor's material conflicts of interest.⁷⁹ We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing the existing regulatory requirements applicable to finders and solicitors, generally.
 - b. Establishing similar disclosure requirements regarding any conflict associated with the solicitor's and finder's receipt of compensation for referring a retail customer to an investment adviser or broker-dealer?
3. **Supervision:** Effective supervisory systems and control procedures are important investor protection tools, as they can help firms identify and prevent abusive practices. As the Study notes, while both broker-dealers and investment advisers are required to supervise persons that act on their behalf, broker-dealers are subject to more specific supervisory requirements, including rules that expressly require broker-dealers to, among other things, establish a supervisory system, conduct periodic inspections of branch offices and supervise outside business activities and private securities transactions of associated persons.⁸⁰ As discussed above, investment advisers are also required to adopt compliance

⁷⁸ *Id.* An investment adviser's supervision obligations are discussed below.

⁷⁹ For the staff's discussion regarding potential harmonization of requirements related to the use of finders and solicitors, see Study at 132-133.

⁸⁰ Existing broker-dealer supervisory obligations generally require firms to, among other things, establish and maintain a supervisory system for their business activities and to supervise the activities of their registered representatives, principals and other associated persons for purposes of achieving compliance with applicable securities regulations, including the rules relating to principal trades. See NASD Rule 3010. Moreover, broker-dealers are required to "establish procedures for the review and endorsement by a

policies and procedures, which generally would include policies and procedures for the supervision of persons associated with an adviser.⁸¹ Further, the Advisers Act code of ethics rules (Advisers Act Rule 204A-1) specifically requires, among other things, that an investment adviser pre-approve acquisitions of securities in any initial public offerings or in limited offerings by certain of its investment advisory personnel. Investment advisers are also required to disclose to clients certain material outside business activities of their supervised persons.⁸² We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing supervisory requirements of investment advisers and broker-dealers, generally.
- b. Establishing a single set of universally applicable requirements versus scaling requirements based on the size (*e.g.*, number of employees or a different metric) and nature of a broker-dealer or an investment adviser? Please identify any particular requirements that should apply to both broker-dealers and investment advisers, and any requirements that should not apply to both, and why or why not. If requirements were scaled, what would be appropriate metrics and thresholds?⁸³

registered principal in writing . . . of all transactions . . . of its registered representatives with the public relating to the investment banking or securities business of such member.” NASD Rule 3010(d)(1).

⁸¹ *See supra* note 77.

⁸² *See* Part 2A of Form ADV.

⁸³ For the staff’s discussion regarding potential harmonization of requirements related to supervision, see Study at 135-136.

4. *Licensing and Registration of Firms:* Broker-dealers and investment advisers register with the Commission and/or states using forms that are similar but separate. In addition, broker-dealers must, prior to commencing business, satisfy FINRA's membership application process, which aims to fully evaluate relevant aspects of applicants and to identify potential weaknesses in their internal systems, thereby helping to ensure that successful applicants would be capable of conducting their business in compliance with applicable regulation. Investment advisers are not subject to this type of review by the Commission. As stated in the Study, substantive review of investment adviser applications could improve investor protection as it could help prevent firms that are unprepared to engage in the advisory business or to meet the obligations they will be assuming under the federal securities laws from entering the advisory business. We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing the licensing and registration requirements applicable to firms, generally.
- b. Harmonizing the disclosure requirements in Form ADV and Form BD to the extent they address similar issues.
- c. Imposing a substantive review of investment advisers prior to registration similar to, or distinct from, the review applicable to broker-dealers.⁸⁴

5. *Continuing Education Requirements for Persons Associated with Broker-Dealers and Investment Advisers:* Associated persons of broker-dealers are required to fulfill

⁸⁴ For the staff's discussion regarding potential harmonization of requirements related to licensing and registration of firms, see Study at 136-137.

continuing education requirements. No such requirement exists for investment adviser personnel at the federal level, who instead must disclose to clients their education and business background. As noted in the Study, continuing education can help to further a regulatory goal that investors are served by professionals that are knowledgeable in current industry trends, practices and regulations.⁸⁵ We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing the continuing education requirements applicable to the associated persons of investment advisers and broker-dealers, generally.
- b. Requiring associated persons of investment advisers to be subject to federal qualification examinations and continuing education requirements?

6. ***Books and Records***: Books and records are important for firms to facilitate effective supervision and compliance, and for regulators to access information and verify the entity's compliance with applicable requirements. Broker-dealers are required to retain all communications received and sent, as well as all written agreements (or copies thereof), relating to a firm's "business as such,"⁸⁶ whereas advisers are required to retain a more limited set of records falling into specific enumerated categories. As noted in the Study, "[t]hese differences limit the effectiveness of internal supervision and compliance structures and the ability of regulators to access information and verify the entity's

⁸⁵ For the staff's discussion regarding potential harmonization of requirements related to continuing education requirements, see Study at 138.

⁸⁶ See Exchange Act Rules 17a-4(b)(4) and (b)(7); 17 CFR 240.17a-4(b)(4) and (b)(7).

compliance with applicable requirements.”⁸⁷ We request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing the recordkeeping requirements applicable to investment advisers and broker-dealers, generally.
- b. Applying the “business as such” record retention standard to investment advisers?

7. ***Other Potential Areas for Harmonization:*** We request information and comment on whether there are other potential areas of harmonization where the nature of existing investment adviser and broker-dealer obligations differ and investor protection would be meaningfully enhanced. In particular, we request data and other information on the enhancement to meaningful investor protection as well as the benefits and costs of harmonizing requirements relating to:

- a. Harmonizing a set of business conduct rules for both broker-dealers and investment advisers, where relevant to investment advisers’ businesses.
- b. Harmonizing other requirements for broker-dealers and investment advisers.
- c. Establishing a single set of universally applicable requirements versus scaling requirements based on the size (*e.g.*, number of employees or a different metric) and nature of a broker-dealer or an investment adviser.

For each other potential area of harmonization addressed, please identify any particular requirements that should apply to both broker-dealers and investment advisers, and any requirements that should not apply to both, and why or why not.

⁸⁷

See Study at 139.

B. Request for Data and Other Information Relating to Changes in the Marketplace for Personalized Investment Advice Resulting from Harmonization


The Commission requests the following data and other information relating to changes in the marketplace for personalized investment advice about securities for retail customers as a result of implementing each area of harmonization described above. In providing such data and other information, we request commenters follow the Guidelines found in the Appendix to this request for data and other information including the request therein for background information.

1. Provide data and other information on the benefits and costs to firms and retail customers, including synergies (*i.e.*, enhanced cost efficiencies for firms), specific examples of effects on investor protection, and potential barriers to entry (*i.e.*, cost prohibitions), which would result from harmonization of each of the areas identified above.
2. Provide data and other information about alternative approaches to harmonization that the Commission should consider, including options for reducing costs on broker-dealers and investment advisers while increasing the effective protection of retail customers.
3. Provide data and other information describing the impact or potential impact the implementation of the uniform fiduciary standard of conduct, or any of the alternative approaches discussed in Part III of this request for data and other information, would have on the benefits and costs to firms and to retail customers of each area of harmonization. Indicate, for example, whether harmonization of a particular area of regulation would impact the costs or benefits associated with complying with the uniform fiduciary standard and each of the alternative approaches discussed above. Also provide comment and data on whether the harmonization of one or more of the areas described

above has any impact (*i.e.*, whether it enhances, detracts, or has no impact) on the implementation of the uniform fiduciary standard of conduct or any of the other approaches described in Part III of this request for data and other information.

4. For dual registrants, provide data and other information on any cost savings and potential retail customer benefit of having a consistent set of standards.
5. Provide data and other information describing the extent to which harmonization would increase or reduce retail customers' confusion about the regulatory status of the person from whom they receive financial services (*i.e.*, whether the party is a broker-dealer or an investment adviser) and provide information describing why. Provide data and other information describing the extent to which harmonization would increase or reduce retail customers' confusion about the types of obligations owed to them and provide information describing why.

By the Commission.



Elizabeth M. Murphy
Secretary

Dated: March 1, 2013

APPENDIX: Suggested Submission Guidelines for Comments

This Appendix outlines the background and particular data and other information we request commenters to provide and the general guidelines we request commenters to follow when submitting data and other information. While we are particularly interested in receiving data and other information that is empirical and quantitative in nature, we welcome and encourage all interested parties to submit their comments, including qualitative and descriptive analysis of the benefits and costs of potential approaches and guidance. We ask that commenters provide only data and other information that they wish to make publicly available, and that commenters who may be concerned about making proprietary or other highly sensitive data and other information public may wish to pool their data with that of others (*e.g.*, through a trade association, law firm, consulting firm or other group) and submit aggregated data in response to this request for data and other information. While we request commenters to provide enough data and other information to allow the Commission to replicate findings, commenters should remove any personally identifiable information (*e.g.*, of their customers) before submitting data and other information in response to this request.⁸⁸ Commenters can submit data and other information using a sample of retail customers. We ask commenters to sample in a manner which is independent of retail customer characteristics, and to describe the sampling methodology including sample identification, data collection, and any other important factor in sample construction. Also, if possible, provide a description of the population of retail customers not included in the sample. We also ask commenters to provide a variable to allow the Commission to distinguish among accounts. The variable should not incorporate personally identifiable information, and can be as simple as a random number.

⁸⁸ See *supra* note 23.

We ask commenters to provide a cover letter when submitting data files to the Commission. As part of the cover letter, we ask commenters to include documentation describing each field in the data files including the units of measurement (*e.g.*, percent, thousands, thousands of dollars, millions, millions of dollars), variable name, general and specific formats (*e.g.*, number, character, date, length of character field, format of date), and value if missing (*e.g.*, "." or ""). Other important documentation includes an overall description of the dataset, the source of the information, and the time period of observations. We ask commenters to send the data on a physical storage medium such as a CD ROM or DVD, either in plain text or comma-separated values (csv) files. We also ask commenters to clearly label the physical storage medium, providing commenter name, date, and a short description of the data files. Commenters can submit more than one dataset if, for instance, the data is available on different systems or in different locations. In this case, we ask commenters to provide a variable in each dataset that links account information and that allows the Commission to distinguish among accounts. We also ask commenters to submit only one copy of the data files.

A. Commenter Identification and Background

We request commenters to provide background information to add context to submissions and improve our understanding of the current marketplace:

1. Indicate your status (or the status of your organization if you are writing on behalf of an organization), as applicable, as a Commission-registered broker-dealer, Commission-registered investment adviser, associated person of a Commission-registered broker dealer or Commission-registered investment adviser, dually registered entity or individual, retail customer, or other (if other, please describe).

2. If you are (or are writing on behalf of) a broker-dealer, investment adviser, or dually registered investment adviser/broker-dealer, or associated person thereof, describe the firm's business, including number and type of business segments, sources and total amount of firm revenue, and the proportion of firm revenue attributable to retail customers.
3. If you are (or are writing on behalf of) a broker-dealer, investment adviser, or dually registered investment adviser/broker-dealer, describe the retail customer segment of the firm's business, including the number and type of accounts (brokerage or advisory), total asset value within each account type, and the proportion of retail customers to whom the firm provides personalized investment advice. If the firm is dually registered, also indicate the proportion of accounts (based on the number of accounts and total assets under management) that are advisory accounts and the proportion that are brokerage accounts, and of the advisory accounts, the proportion that are non-discretionary accounts. Also, if the firm is dually registered, indicate the proportion of retail customer advisory accounts and the proportion of brokerage accounts receiving personalized investment advice.

B. Requests for Specific Characteristic Information

We ask commenters to provide the following specific characteristics when providing data and other information describing retail customer demographics and accounts; broker-dealer or investment adviser services offered; securities; and the claims of retail customers in dispute resolution:

1. Retail customer demographic information – age, wealth, income, education, and risk profile.
2. Retail customer account information – general type (brokerage or advisory), specific type (e.g., clearing, execution-only, full-service), amount of assets held, compensation arrangement (e.g., fees, commissions) and amount, investment strategy, the date of account opening, and the state in which the account is held.
3. Broker-dealer or investment adviser services offered – type (e.g., include trade execution; product, transaction, and asset allocation recommendations; and provision of customer-specific research and analysis).
4. Securities – type (e.g., stocks, bonds, funds, options, structured products), CUSIP number or other standard identifier, investment rating (if any), and date of initial retail customer ownership.
5. Security Positions – long or short position, number of shares/units held, position value, and the currency of valuation.
6. Retail customer claims evidence – nature of claim, forum for claim, time to resolution, and outcome.

If providing aggregate data and other information, we ask that commenters fully describe the sample population, including the number of retail customers and total assets under management, retail customer demographics, account characteristics, and security characteristics.

C. Submission Guidelines for Economic Analysis

The market for personalized investment advice is difficult to analyze because of the number of factors that empirical tests must address in order to achieve definitive conclusions. While some reports and studies address the market for personalized investment advice, the

difficulty to control for certain factors and/or insufficient documentation of the empirical sample and methodology results in interpretive difficulties. When submitting qualitative and quantitative economic analysis, we request commenters adhere to the following guidelines:

1. The analysis should focus on non-discretionary retail customer brokerage and advisory accounts. To the extent the analysis focuses on institutional investor accounts or discretionary accounts, if possible please specify this.
2. Identify and discuss all underlying assumptions, including actions that may be taken in response to a change in regulation. If providing quantitative analysis also clearly articulate empirical methodologies leading to analytical conclusions and provide tests statistics to validate claims. Isolate the additional benefits and costs from any additional assumptions made. If providing qualitative economic analysis also identify and discuss all supporting evidence.
3. Identify and distinguish initial benefits and costs (including those associated with transitioning from existing standards to potential new standards of conduct), and on-going benefits and costs. Also identify whether certain benefits and costs may decrease or increase over time. Indicate whether benefits and costs are transaction-specific, account-specific, business segment specific, or firm-wide. If possible, separate the benefits from the costs and isolate by activity and by account type. When describing transition costs, describe and explain any relevant actions that may be taken in response to a change in regulation, including possible ways to mitigate costs or increase benefits.
4. Describe the sample population, including the number of retail customers and total assets under management, retail customer demographics, and account

characteristics. And, if possible, provide a description of the population of retail customers not included in the sample.

5. Submit data that would allow the Commission to replicate findings.
6. Identify which requested quantitative data, if any, is not possible, or would be prohibitively costly, to provide, and explain why.

SECURITIES AND EXCHANGE COMMISSION
REQUEST FOR DATA AND OTHER INFORMATION

The Securities and Exchange Commission is requesting data and other information, in particular quantitative data and economic analysis, relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers. We intend to use the comments and data we receive to inform our consideration of alternative standards of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. We also will use this information to inform our consideration of potential harmonization of certain other aspects of the regulation of broker-dealers and investment advisers.

Publication is expected in the Federal Register during the week of

(Rel. No. 34-69013; IA-3558)

Emily Russell
202-551-5576

Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 69020 / March 1, 2013

Admin. Proc. File No. 3-15086

In the Matter of the Application of

Julio C. Ceballos
1045 Wheeler Ave PH
Bronx, NY 10472

for Review of Disciplinary Action Taken by FINRA

ORDER GRANTING
MOTION TO DISMISS
APPLICATION FOR REVIEW

I.

On October 31, 2012, Julio C. Ceballos, formerly a registered representative associated with Chase Investment Services Corp., a FINRA member firm, filed an application for review of a disciplinary action taken against him by FINRA.¹ FINRA barred him from associating with any FINRA member in any capacity, effective March 19, 2012, because he failed to respond to two requests for information it issued pursuant to FINRA Rule 8210.² On November 21, 2012,

¹ The Financial Industry Regulatory Authority, Inc. is a private, not-for-profit, self-regulatory organization registered with, and overseen by, the Securities and Exchange Commission. It was created in July 2007 following the consolidation of the National Association of Securities Dealers, Inc. and the member regulation, enforcement, and arbitration functions of the NYSE Regulation, Inc. *Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to NYSE Rule 2*, Securities Exchange Act Release No. 56751, 2007 SEC LEXIS 2902, at *3-4 (Nov. 6, 2007); *Order Approving Proposed Rule Change to Amend the By-Laws of NASD to Implement Governance and Related Changes to Accommodate the Consol. of the Member Firm Regulatory Functions of NASD and NYSE Reg., Inc.*, Exchange Act Release No. 56145, 2007 SEC LEXIS 1640, at *133 (July 26, 2007). The consolidation of the two SROs eliminated their overlapping jurisdiction and set in motion the writing of a uniform set of rules to be administered by the surviving entity—a process that continues to this day.

² Rule 8210(a)(1) states, in relevant part, that the staff has the right to "require a member, person associated with a member, or person subject to the Association's jurisdiction to provide information orally, in writing, or electronically . . . with respect to any matter involved in the investigation . . ." FINRA Rule 8210(a)(1). The rule "provides a means, in the absence of subpoena power, for the [the association] to obtain from its members information necessary to conduct investigations." *Howard Brett Berger*, Exchange Act Release No. 58950, 2008 SEC LEXIS 3141, at *13 (Nov. 14, 2008), *petition for review denied*, 347 F. App'x 692 (2d Cir. 2009) (unpublished).

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FINRA filed a motion to dismiss his application, arguing that Ceballos failed to file a timely appeal and exhaust his administrative remedies. Ceballos did not respond. For the reasons set forth below, we grant FINRA's motion.

II.

A. Ceballos Failed to Respond to Two Requests for Information Issued by FINRA Pursuant to Rule 8210

Ceballos was associated with Chase from June 2010 until February 2011. On April 6, 2011, Chase filed a Uniform Termination Notice for Securities Industry Registration on Form U5.³ In it, Chase disclosed that it terminated Ceballos's association with the firm, effective February 1, 2011, because he allegedly had written checks from a JP Morgan Chase bank account with insufficient funds.

On April 6, 2011, FINRA sent Ceballos a letter pursuant to FINRA Rule 8210 requesting information. FINRA asked Ceballos to provide a signed statement that addressed the allegations in the Form U5, copies of all correspondence and memoranda regarding the circumstances surrounding his termination, and information about other complaints, if any, while he was associated with Chase. The deadline for Ceballos's response was April 20, 2011. FINRA sent its request by both first-class and certified mail to Ceballos's last known residential address listed in the Central Registration Depository.⁴

There is no evidence in the record that the letter FINRA sent by first-class mail was returned. The letter sent by certified mail was returned by the United States Postal Service marked "Return to Sender/Unclaimed/Unable to Forward." Ceballos does not dispute that he lived at the CRD address during the entire period at issue. Ceballos, however, never responded to FINRA's Rule 8210 request for information.

On May 24, 2011, FINRA sent Ceballos a second Rule 8210 request asking for the same information as in its earlier letter, a copy of which it attached. The second request set a deadline of June 7, 2011 for Ceballos to respond and warned him that he could be subject to disciplinary action if he failed to comply. FINRA sent the second request by first-class and certified mail to the CRD address.

³ Broker-dealers, investment advisers, and issuers of securities must file a Form U5 with FINRA to terminate the registration of an individual associated with such broker-dealer, investment adviser, or issuer.

⁴ As part of the registration process, associated persons such as Ceballos are required to sign and file with FINRA a Form U4, which obligates them to keep a current address on file with FINRA at all times. *Perpetual Sec., Inc.* Exchange Act Release No. 56613, 2007 SEC LEXIS 2353, at *35 (Oct. 4, 2007); *Nazmi C. Hassanieh*, Exchange Act Release No. 35029, 52 SEC 87, 1994 SEC LEXIS 3862, at *8 (Nov. 30, 1994). A notice issued pursuant to Rule 8210 is deemed received by such person when mailed to the individual's last known residential address as reflected in the CRD. FINRA Rule 8210(d). *See also* NASD Notice to Members 97-31, 1997 NASD LEXIS 35, at *1-2 (May 1997) (reminding registered persons to keep a current mailing address with NASD "[f]or at least two years after an individual has been terminated by the filing of . . . [a] Form U5") (emphasis in original).

Again, there is no evidence in the record that the letter FINRA sent by first-class mail was returned. A return receipt for the one sent by certified mail, signed by "Julio Ceballos," showed that it was delivered on May 26, 2011. Ceballos, again, did not respond.

B. FINRA Sanctioned Ceballos

On December 15, 2011, FINRA notified Ceballos in writing, pursuant to FINRA Rule 9552(a), that it intended to suspend him from associating with any member firm in any capacity on January 9, 2012 unless he took corrective action before that date by complying with its Rule 8210 requests. That notice also advised Ceballos that he could request a hearing under Rule 9552(e), which, if made timely, would stay the effective date of the suspension.⁵ The notice further warned Ceballos that, if the suspension was imposed, FINRA would automatically bar him from associating with any member firm in any capacity on March 19, 2012 unless he requested termination of the suspension based on full compliance.⁶

FINRA served its written notice on Ceballos at the CRD address by overnight courier service, first-class mail, and certified mail.⁷ The overnight courier service delivered the notice on December 16, 2011. There is no evidence that the copy sent by first-class mail was returned. And the United States Postal Service returned the certified mailing receipt to FINRA marked "Return to Sender/Unclaimed/Unable to Forward." Ceballos did not take any action to comply with the outstanding requests or request a hearing.

On January 9, 2012, FINRA sent Ceballos a letter informing him that, as of that date, he was suspended from associating with any FINRA member in any capacity pursuant to Rule 9552(d). That letter reminded Ceballos that an automatic bar would be imposed on March 19, 2012 if he did not fully comply with the notice of suspension, which required him to fully respond to the SRO's two earlier Rule 8210 information requests and file a request to terminate his suspension.⁸ FINRA served the letter on Ceballos at the CRD address by overnight courier service and by first-class mail. The courier delivered the notice on January 10, 2012. There is no evidence that the letter sent by first-class mail was returned.

⁵ Rule 9559(c) provides that, "[u]nless the Chief Hearing Officer or the Hearing Officer assigned to the matter orders otherwise for good cause shown, a timely request for a hearing shall stay the effectiveness of a notice issued under Rules 9551 through 9556."

⁶ Rule 9552(f) permits a suspended individual to file a written request for termination of the suspension on the ground of full compliance with the notice of suspension. Rule 9552(h) provides that a suspended person who fails to request termination of the suspension within three months of issuance of the original notice of suspension will be barred automatically.

⁷ Rule 9552(b) provides for service of a notice of suspension in accordance with FINRA Rule 9134, which permits service by both mail and courier service at an individual's residential CRD address. FINRA Rule 9134(a) – (b)(1). Service by mail is complete upon mailing while service by courier service is complete upon delivery. FINRA Rule 9134(b)(3).

⁸ Rule 9552 does not explicitly require FINRA to send a letter confirming the effectiveness of a suspension after it sends a notice of suspension. The letter dated January 9, 2012 nonetheless is consistent with notice of suspension sent on December 15, 2011 and complies with the service requirements applicable to a notice of suspension. *See supra* note 7.

On March 9, 2012, FINRA e-mailed a copy of the December 15, 2011 notice of suspension to Ceballos and instructed him to list his current address and telephone number in all correspondence. In its motion to dismiss this proceeding, FINRA states that it sent the e-mail as a courtesy in response to a telephone call Ceballos made to FINRA staff that same day. FINRA did not elaborate on what Ceballos said during the call.

Ceballos took no action to end his suspension by supplying the information requested by FINRA, and the automatic bar from associating with any member firm in any capacity took effect on March 19, 2012. On March 20, 2012, FINRA sent Ceballos a letter notifying him that he was barred and could appeal its decision by filing an application for review with the Commission within thirty days of his receipt of the letter. FINRA sent that letter to Ceballos by overnight courier service and by first-class mail to his CRD address. The courier delivered the letter on March 21, 2012. Once again, there is no evidence that the letter sent by first-class mail was returned.

On June 18, 2012, in response to a telephone call from Ceballos, FINRA e-mailed a copy of its letter, dated March 20, 2012, to him and noted that it contained specific information about his option to file an appeal.⁹ It was not until October 31, 2012—more than four months later—that the Commission received an undated and unsigned letter from Ceballos seeking its review of FINRA's action barring him from associating with any member firm in any capacity. Ceballos listed his CRD address as part of his contact information in the application for review.

III.

A. Ceballos Did Not File a Timely Appeal

Pursuant to § 19(d)(2) of the Securities Exchange Act of 1934 and Commission Rule of Practice 420(b), an applicant who chooses to appeal a final FINRA disciplinary sanction must file an application for review with the Commission within thirty days after receiving notice of the final disciplinary sanction.¹⁰ Exchange Act § 19(d)(2) authorizes the Commission to extend the thirty-day period, but we have long emphasized in Rule of Practice 420(b) that we will not do so "absent a showing of extraordinary circumstances."¹¹

⁹ The record contains no further details about the telephone conversation.

¹⁰ 15 U.S.C. § 78s(d)(2); 17 C.F.R. § 201.420(b). Exchange Act § 19(d)(2) and Rule 420(b) also require notice of the FINRA final disciplinary sanction to be filed with the Commission so that the Commission can determine whether to review the sanction on its own motion. *Id.*

¹¹ 15 U.S.C. § 78s(d)(2) (providing that a person aggrieved by a final disciplinary sanction may file an appeal within thirty days of receiving notice of the sanction or "within such longer period" as the Commission may determine); 17 C.F.R. § 201.420(b) ("The Commission will not extend this 30-day period, absent a showing of extraordinary circumstances."); see also *Lance E. Van Alstyne*, Exchange Act Release No. 40738, 1998 SEC LEXIS 2610, at *13 & n.15 (Dec. 2, 1998) ("In the interests of finality, only under extraordinary circumstances will we authorize the filing of a late appeal from an SRO action that is subject to the Section 19(d)(1) filing requirement.") (citations omitted).

Courts have recognized that strict compliance with filing deadlines facilitates finality and encourages parties to act timely in seeking relief. As we have repeatedly stated, "parties to administrative proceedings have an interest in knowing when decisions are final and on which decisions their reliance can be placed." For this reason, the "extraordinary circumstances" exception is to be narrowly construed and applied only in limited circumstances. To do otherwise would thwart the very clear policies of finality and certainty underlying the thirty-day filing deadline set forth in Exchange Act Section 19(d) and Rule of Practice 420(b).¹²

Rule 420 is the "exclusive remedy for seeking an extension of the 30-day period."¹³

Ceballos did not file his application for review within the requisite period. We see no extraordinary circumstances here that would warrant our acceptance of this late-filed appeal. For several months, FINRA repeatedly sought specific information, warned Ceballos of the consequences of his failure to respond, and informed him of the options he had to challenge the sanctions. FINRA properly served Ceballos at the CRD address listed in FINRA's records—the same address that Ceballos uses in his application for review.¹⁴ FINRA imposed a bar on Ceballos on March 19, 2012 and notified him of this action through its letter, dated March 20, which the overnight courier service delivered on March 21, 2012. Ceballos should have filed an application for Commission review no later than April 20. Instead of complying with the requirements clearly enumerated in the letter, Ceballos did nothing for almost two months until, on June 18, 2012, he called FINRA.

In response to his call, FINRA e-mailed Ceballos another copy of the letter dated March 20, 2012 and highlighted the specific information it discussed about the requirements for filing a timely appeal with the Commission.¹⁵ Yet, Ceballos failed to do anything further during the next four months. The Commission received Ceballos's application for review on October 31, 2012, more than six months after the deadline for seeking Commission review expired.¹⁶

¹² *Pennmont Sec.*, Exchange Act Release No. 61967, 2010 SEC LEXIS 1353, at *16 (Apr. 23, 2010) (citations omitted), *petition denied*, 414 F. App'x 465 (3d Cir. 2011) (unpublished).

¹³ 17 C.F.R. § 201.420(b).

¹⁴ See *Edward J. Jakubik*, Exchange Act Release No. 61541, 2010 SEC LEXIS 1014, at *16 (Feb. 18, 2010) (finding that applicant was deemed to have received the association's default decision that was properly served at his CRD address); Rule 8210(d) *supra* note 4; Rule 9134 *supra* note 7.

¹⁵ Ceballos does not dispute that he received FINRA's letters and had a continuing duty to read mail sent to him at his CRD address. E.g., *William T. Banning*, Exchange Act Release No. 28588, 1990 SEC LEXIS 3453, at *4 & n.7 (Dec. 22, 2004) (finding that an applicant who was no longer an associated person during the period at issue nonetheless had a continuing duty to receive and read mail sent to his CRD address) (citation omitted).

¹⁶ Ceballos, who is *pro se*, failed to comply with a number of Rules of Practice in connection with the filing of his application for review. Ceballos did not serve FINRA with a copy of his application for review as required by Rule of Practice 420(c). 17 C.F.R. § 201.420(c). Nor did he file a certificate of service under Rule 151(d), or date and sign the application for review under Rule 152(b). 17 C.F.R. §§ 201.151(d), 201.152(b). Although these

(continued...)

Ceballos did not seek permission to extend the thirty-day deadline under Rule 420(b) and offers no explanation for the delinquent appeal.¹⁷ Instead, he attached to his application for review what he claims are copies of the documents FINRA requested. Those documents include a letter to Ceballos from JP Morgan Chase Bank, dated March 2, 2012, that acknowledges that the bank did not notify Ceballos about his low balances or insufficient funds "as quickly as expected between October 25, 2010 and January 31, 2011," and certain checking account statements, processed checks, and account transaction histories.¹⁸ But he fails to offer any reason why he could not have provided FINRA with these documents prior to March 19, 2012, when the bar from association with any FINRA member took effect.¹⁹ In any event, we cannot reasonably construe Ceballos's belated attempt to comply with FINRA's Rule 8210 requests as the kind of circumstances required to justify an extension of the deadline for filing an appeal.²⁰ To do so would undermine the important investor protections Rule 8210 is meant to safeguard.²¹

(...continued)

deficiencies provide an independent basis for rejecting his appeal, we have determined in our discretion to waive them in this instance.

¹⁷ See *Jakubik*, 2010 SEC LEXIS 1014, at *16 (finding no extraordinary circumstances where applicant failed to explain why he waited nearly five years to file his application despite having received timely notice of NASD action).

¹⁸ Ceballos's Application for Review at 2-21. Ceballos has not moved the Commission for leave to adduce this additional evidence as required by Commission Rule of Practice 452, 17 C.F.R. § 201.452, which states that motions for leave to adduce additional evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." FINRA states in its motion to dismiss that Ceballos did not provide FINRA with this information before filing his application for review, but does not state whether it objects to its admission. Ceballos has not explained why he did not introduce these documents earlier or why they are material to our determination of whether there are extraordinary circumstances that warrant accepting his untimely appeal. We decline to admit this new evidence.

¹⁹ Whatever difficulty Ceballos may have faced in responding to FINRA's deadlines—and, here, there is no evidence that he had any difficulty—he should have should have "raised, discussed, and resolved [it] with the [FINRA] staff in the cooperative spirit and prompt manner contemplated by the Rules." *Joseph Ricupero*, Exchange Act Release No. 62891, 2010 SEC LEXIS 2988, at *23 (Sept. 10, 2010) (citation omitted), *petition for review denied*, 436 F. App'x 31 (2d Cir. 2011) (unpublished).

²⁰ See *Robert M. Ryerson*, Exchange Act Release No. 57839, 2008 SEC LEXIS 1153, at *14 (May 20, 2008) (finding no extraordinary circumstances where, among other things, NASD "did not cause the fourteen-month delay between the issuance of the [underlying] decision and the filing of the petition before [the Commission]," but rather the delay "resulted from [applicant's] deliberate choice not to appeal"); cf. *Pennmont Sec.*, 2010 SEC LEXIS 1353, at *21 (finding no extraordinary circumstances where applicants elected to pursue objections in federal courts first).

²¹ See *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 SEC LEXIS 820, at *12-13 (Apr. 11, 2008) (finding that delay and neglect by an associated person in responding to a Rule 8210 request "undermine the ability of [FINRA] to conduct investigations and thereby protect the public interest"), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

B. Ceballos Did Not Exhaust His Administrative Remedies

Ceballos was also required to exhaust FINRA administrative remedies before seeking relief from the Commission. We have emphasized that "[i]t is clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review."²² On this basis, we repeatedly have held that "we will not consider an application for review if the applicant failed to exhaust FINRA's procedures for contesting the sanction at issue."²³

As the Second Circuit has reasoned:

Were SRO members, or former SRO members, free to bring their SRO-related grievances before the SEC without first exhausting SRO remedies, the self-regulatory function of SROs could be compromised. Moreover, like other administrative exhaustion requirements, the SEC's promotes the development of a record in a forum particularly suited to create it, upon which the Commission and, subsequently, the courts can more effectively conduct their review. It also provides SROs with the opportunity to correct their own errors prior to review by the Commission. The SEC's exhaustion requirement thus promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress's delegation of authority to SROs to settle, in the first instance, disputes relating to their operations.²⁴

The December 15, 2011 notice of suspension stated that FINRA intended to suspend Ceballos on January 9, 2012 unless he took corrective action by complying with the Rule 8210 requests. The notice also stated that, alternatively, he could request a hearing under Rule 9552(e), which would have stayed the effectiveness of the suspension under Rule 9559(c). But Ceballos did not request a hearing and does not explain in the application for review why he failed to exhaust the procedure FINRA afforded him.

²² *MFS Sec. Corp.*, Exchange Act Release No. 47626, 2003 SEC LEXIS 789, at *22 & n.29 (Apr. 3, 2003) (citing *Royal Sec. Corp.*, Exchange Act Release No. 5171, 36 SEC 275, 1955 SEC LEXIS 94, at *5 (May 20, 1955)), *aff'd*, 380 F.3d 611 (2d Cir. 2004).

²³ *E.g.*, *Norman S. Chen*, Exchange Act Release No. 65345, 2011 SEC LEXIS 3224, at *6, 11 (Sept. 16, 2011) (dismissing applicant's appeal for failure to exhaust administrative remedies where FINRA barred applicant under Rule 9552 for failing to respond to Rule 8210 information requests); *see also Gregory S. Profeta*, Exchange Act Release No. 62055, 2010 SEC LEXIS 1563, at *5-8 (May 6, 2010) (same); *Jeffrey A. King*, Exchange Act Release No. 52571, 2005 SEC LEXIS 2516, at *8-10 (Oct. 7, 2005) (same); *David I. Cassuto*, Exchange Act Release No. 48087, 2003 SEC LEXIS 1496, at *10-14 (June 25, 2003) (same); *Gary A. Fox*, Exchange Act Release No. 46511, 2002 SEC LEXIS 2381, at *3-6 (Sep. 18, 2002) (same); *MFS Sec. Corp.*, 2003 SEC LEXIS 789, at *21-26 (refusing to consider applicant's denial of access to services claim because applicant failed to exhaust New York Stock Exchange's procedures).

²⁴ *MFS Sec. Corp. v. SEC*, 380 F.3d 611, 621-22 (2d Cir. 2004).

The December 15, 2011 notice further informed Ceballos that, after the suspension took effect, he could request its termination based on full compliance. To the extent that Ceballos intends for us to consider the documents he attached to his application for Commission review as responsive to FINRA's Rule 8210 requests, we decline to do so. Rule 9552(f) permits a suspended individual to file *with FINRA* a written request for termination of the suspension on the ground of full compliance with the notice of suspension. Rule 9552(h) provides that a suspended person who fails to request *from FINRA* termination of the suspension within three months of issuance of the original notice of suspension will be barred automatically. Thus, FINRA rules required Ceballos to provide the documents to FINRA in the first instance. This would have allowed FINRA to evaluate the sufficiency of Ceballos's response and provided a record for us to review. We see no reason here to depart from our precedent requiring an applicant for Commission review to exhaust his administrative remedies.

Accordingly, IT IS ORDERED that FINRA's motion to dismiss the application for review filed by Julio C. Ceballos is GRANTED.

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. 69021 / March 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15225

In the Matter of

Clean Power Technologies, Inc.,

Respondent.

**ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

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

III.

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

1. CPWE (CIK No. 1282387) is a Nevada corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission under Exchange Act Section 12. As of September 20, 2012, the common stock of

CPWE (symbol CPWE) was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Inc., had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. CPWE has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended May 31, 2010.

IV.

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69022 / March 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15226

In the Matter of

Maverick Oil and Gas, Inc.,

Respondent.

**ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

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

III.

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

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1. MAVO (CIK No. 1193159) is a revoked Nevada corporation located in Fort Lauderdale, Florida with a class of securities registered with the Commission under Exchange Act Section 12. As of October 9, 2012, the common stock of MAVO (symbol MAVO) was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Inc., had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. MAVO has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended February 28, 2009.

IV.

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69023 / March 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15227

In the Matter of

ATI Liquidating, Inc.
(n/k/a Aviza Technology, Inc.),

Respondent.

**ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against ATI Liquidating, Inc. (n/k/a Aviza Technology, Inc.) ("AVZAQ" or "Respondent").

II.

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

III.

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

1. AVZAQ (CIK No. 1311396) is a Delaware corporation located in Scotts Valley, California with a class of securities registered with the Commission under Exchange Act Section 12. As of September 6, 2012, the common stock of

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AVZAQ was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Inc., had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3). The Respondent filed a Chapter 11 bankruptcy proceeding on June 9, 2009, which was still pending as of September 6, 2012.

2. AVZAQ has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended December 26, 2008.

IV.

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69024 / March 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15228

In the Matter of

Atlantic Southern Financial Group, Inc.,

Respondent.

**ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

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

III.

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

1. ASFN (CIK No. 1313730) is a Georgia corporation located in Macon, Georgia with a class of securities registered with the Commission under Exchange Act Section 12. As of September 5, 2012, the common stock of ASFN

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was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Inc. and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. ASFN has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports with the Commission since the period ended September 30, 2010.

IV.

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 69034 / March 4, 2013

Admin. Proc. File No. 3-14942

In the Matter of

SEI HOLDINGS, INC. (n/k/a STONELEIGH
REALTY INVESTORS, LLLP), *et al.*

ORDER DISMISSING PROCEEDING WITH RESPECT TO SEI HOLDINGS, INC.

On July 9, 2012, the Commission instituted an administrative proceeding against SEI Holdings, Inc. (n/k/a Stoneleigh Realty Investors, LLLP) and six other registrants under § 12(j) of the Securities Exchange Act of 1934.¹ The Order Instituting Proceedings alleged that Stoneleigh violated periodic reporting requirements and sought to suspend or revoke the registration of its securities.

On September 10, 2012, the Division of Enforcement filed a motion to dismiss Stoneleigh from this proceeding because, "contrary to the allegations in the Order Instituting Proceedings, Stoneleigh has no registered class of securities under Exchange Act Section 12." The Division further states that, although Stoneleigh filed a registration statement under § 12(g) on July 8, 2005, it effectively withdrew that registration statement by letter on August 15, 2005.²

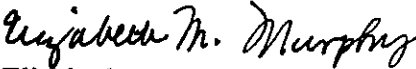
¹ 15 U.S.C. § 78l(j). All of the other respondents' registrations have been revoked as part of this proceeding. See *SEI Holdings Inc.*, Exchange Act Release No. 67642, 2012 WL 3277133, at *3 (Aug. 13, 2012).

² Stoneleigh submitted an untimely response to the Division's motion, which, in any event, does not address the issues raised in the Division's motion and provides no basis to deny it.

It is appropriate to grant the Division's motion because Stoneleigh currently does not have registered securities and because revocation or suspension of registration is the only remedy available in a proceeding instituted under Exchange Act § 12(j).³

Accordingly, it is ORDERED that this proceeding be, and it hereby is, dismissed with respect to SEI Holdings, Inc. (n/k/a Stoneleigh Realty Investors, LLLP).

By the Commission.


Elizabeth M. Murphy
Secretary

³ See, e.g., *Amstem Corp.*, Exchange Act Release No. 67104, 2012 WL 1980671 (June 4, 2012) (dismissing proceeding where respondent filed a Form 15 after proceeding was instituted and therefore no longer had a class of securities registered under § 12); *BCI Telecom Holding, Inc.*, Exchange Act Release No. 62649, 2010 WL 3043630 (Aug. 4, 2010) (dismissing proceeding where unregistered issuer had been mistakenly confused with its registered corporate affiliate).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69051 / March 6, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15231

In the Matter of
CYDE Liquidating Co.,
Respondent.

ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against CYDE Liquidating Co., successor by name change to CyberDefender Corporation ("CyberDefender" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

12 of 50

1. CyberDefender (CIK No. 1377720) is a Delaware corporation located in Los Angeles, California. At all times relevant to this proceeding, the securities of CyberDefender have been registered under Exchange Act Section 12(g). On February 23, 2012, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, and the case was still pending as of August 24, 2012. As of September 5, 2012, the company's stock (symbol "CYDEQ") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc., had thirteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. CyberDefender has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2011.

IV.

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

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

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

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

By the Commission.


By: **Lynn M. Powalski**
Deputy Secretary

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69056 / March 7, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14645

In the Matter of

FELTL & COMPANY, INC.,

Respondent.

ORDER DIRECTING TRANSFER OF
REMAINING FUNDS TO THE UNITED
STATES TREASURY

On November 28, 2011, the Securities and Exchange Commission ("Commission") instituted settled administrative proceedings against Feltl & Company, Inc. ("Feltl") for violating Sections 204A, 206(2), 206(3), and 206(4) of the Investment Advisers Act of 1940, and Rules 204A-1 and 206(4)-7 thereunder ("Order"). Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b)(4) of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, Exchange Act Rel. No. 65838 (November 28, 2011). The Commission ordered, among other things, that Feltl deposit \$142,527 in disgorgement into an escrow account for distribution ("Disgorgement Fund") to affected advisory clients as defined in the Order, and that Feltl be responsible for administering the Disgorgement Fund, including bearing all costs and complying with all tax responsibilities associated with the distribution. If the total amount otherwise payable to a client was less than the *de minimus* amount of \$20.00, Feltl was to instead pay such amount to the Commission for transfer to the United States Treasury. The Order also required that Feltl submit to the Commission's staff for its approval a final accounting and certification of the disposition of the Disgorgement Fund. The Commission's staff was to submit the final accounting to the Commission for approval and request Commission approval to send any remaining amount to the United States Treasury.

Feltl has completed its distributions to affected advisory clients. After the Order was entered, Feltl calculated the total amounts due to each individual affected advisory client and determined that its total proposed payments were more than its total required disgorgement amount. The staff did not object to Feltl voluntarily distributing its total proposed payments. Feltl calculated the total amount due, excluding amounts deemed to be *de minimus* by the Order, and determined that \$143,397.75 should be distributed to 62 advisory clients. On January 17, 2012,


Feltl made these distributions by crediting client accounts and issuing checks to other clients. By May 25, 2012, all of the checks issued had been cashed. Feltl determined that a total *de minimus* amount of \$22.00 was due to two clients. On August 8, 2012, Feltl sent the \$22.00 to the Commission for transfer to the United States Treasury, and the Commission is in possession of that amount.

Pursuant to the terms of the Order, Feltl submitted a certification and final accounting to the Commission's staff. The final accounting, which was 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 Order, is approved.

Accordingly, IT IS ORDERED that the remaining balance of \$22.00 shall be transferred to the United States Treasury.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69060)

Order Granting a Temporary Exemption Pursuant to Section 36(a)(1) of the Securities Exchange Act of 1934 from the Filing Deadline Specified in Rule 613(a)(1) of the Exchange Act

March 7, 2013

Rule 613(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ requires the Financial Industry Regulatory Authority, Inc. (“FINRA”) and the seventeen registered national securities exchanges (collectively, the “SROs”) to “jointly file on or before 270 days from the date of publication of the Adopting Release [for Rule 613 of the Exchange Act²] in the Federal Register a national market system plan to govern the creation, implementation, and maintenance of a consolidated audit trail and central repository as required by [the rule].” The Adopting Release for Rule 613 was published in the Federal Register on August 1, 2012,³ thus requiring the national market system plan (the “NMS plan”) to be filed on or before April 28, 2013.⁴ On February 8, 2013, the Commission received a request from the SROs, pursuant to Rule 0-12 under the Exchange Act,⁵ that the Securities and Exchange Commission (“Commission”) grant a temporary exemption under Section 36 of the Exchange Act,⁶ from the deadline specified in Rule 613(a)(1) of the Exchange Act⁷ for submitting the NMS plan to the Commission.⁸

¹ 17 CFR 242.613(a)(1).

² 17 CFR 242.613.

³ Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012) (“Adopting Release”).

⁴ April 28, 2013, is a Sunday. Therefore, in accordance with Rule 160(a) of the Commission Rules of Practice, the deadline for filing the NMS plan is Monday, April 29, 2013. The SROs, however, had established an earlier deadline for the filing of the NMS plan of Friday, April 26, 2013.

⁵ 17 CFR 240.0-12.

⁶ 15 U.S.C. 78mm(a)(1).

⁷ 17 CFR 242.613(a)(1).

In the Request Letter, the SROs noted that Rule 613 requires that they include in the NMS plan “cost estimates for the proposed solution, and a discussion of the costs and benefits of alternative solutions considered but not proposed.”⁹ They also noted that Rule 613 requires that the NMS plan include a discussion of “[t]he process by which the [SROs] solicited views of their members and other appropriate parties regarding the creation, implementation, and maintenance of the consolidated audit trail, a summary of the views of such members and other parties, and how the [SROs] took such views into account in preparing the [NMS plan].”¹⁰

In order to satisfy these requirements, the SROs believe that conducting a request for proposal (“RFP”) process is necessary prior to filing an NMS plan. The SROs believe that such a process will ensure that potential alternative solutions for creating the consolidated audit trail can be presented to the SROs for their consideration, and will provide the SROs with information necessary to prepare a detailed cost/benefit analysis as required by Rule 613. To ensure that the RFP process is effective, the SROs believe the concepts that will be contained in the RFP should be subject to public comment before the document is finalized and formally published. The SROs believe that public comment will ensure that the RFP addresses areas of concerns to the industry and the SROs, and will also provide potential bidders with information on the RFP prior to its formal publication. To this end, the SROs published an RFP concept document on December 5, 2012, and requested public feedback by January 18, 2013.¹¹

The SROs stated in their Request Letter that they do not believe that the 270-day time period provided for in Rule 613(a)(1) provides sufficient time for the development of the RFP,

⁸ See Letter from Robert L.D. Colby, Chief Legal Officer, FINRA, to Elizabeth M. Murphy, Secretary, Commission, dated February 7, 2013 (the “Request Letter”).

⁹ See Request Letter (quoting Adopting Release, *supra* 3, at 45725).

¹⁰ See Request Letter (quoting 17 CFR 242.613(a)(1)(xi)).

¹¹ See Request Letter.

formulation and submission of bids, and review and evaluation of such bids. The SROs also stated that they believe additional time beyond the 270 days provided for in Rule 613(a)(1) is necessary in order to provide sufficient time for effective consultation with and input from the industry and the public on the proposed solution chosen by the SROs for the creation of the consolidated audit trail at the conclusion of the RFP process and the NMS plan itself. The SROs believe that such a comment process is necessary in order to gather information needed to perform an effective cost/benefit analysis, including the estimated costs to broker-dealers and other market participants of building the consolidated audit trail in accord with the proposed solution, as well as to meaningfully assess and respond to the comments and draft the final NMS plan for submission to the Commission.

In the Request Letter, the SROs provided the following estimated timeline, which is based on their current expectation for conducting the RFP process and drafting the NMS plan:

- December 5, 2012: The SROs published an RFP concept document for comment
- January 18, 2013: Deadline to submit comments on the RFP concept document made publicly available (i.e., a 45-day comment period)
- February 2013: The SROs will publish the final RFP for bids
- March 2013: The SROs will solicit public comment on certain portions of the draft NMS plan that are not dependent on the RFP process and can benefit from public comment
- April 2013: Deadline for submitting bids in response to the RFP
- July 2013: The SROs will select a proposed solution after reviewing and evaluating the RFP bids

- August 2013: The SROs will solicit public comment on other specific portions of the proposed NMS plan that the SROs believe can benefit from public comment and that incorporate the RFP process and the proposed solution, including soliciting estimates on industry costs
- October 2013: Comments must be submitted on the proposed solution (i.e., a 60-day comment period)
- December 6, 2013: The SROs file the proposed NMS plan with the Commission

For the reasons set forth above, the SROs stated that a temporary exemption from the filing deadline until December 6, 2013 is “necessary to allow the SROs to conduct the thoughtful and comprehensive analysis this important regulatory initiative deserves.”¹² The SROs also stated their belief that “the timeline outlined above will lead to a significantly better and more informed process and, as a result, the proposed solution will be the result of a more meaningful and careful analysis.”¹³

Section 36 of the Exchange Act¹⁴ authorizes the Commission, by rule, regulation, or order, to exempt, either conditionally or unconditionally, any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

After considering the SROs’ proposed process for developing the NMS plan, the Commission finds that it is appropriate in the public interest, and is consistent with the protection of investors, to grant the SROs a temporary exemption from the deadline for filing the NMS plan

¹² See Request Letter.

¹³ Id.

¹⁴ 15 U.S.C. 78mm.

contained in Rule 613(a)(1)¹⁵ until December 6, 2013. The Commission understands that the creation of a consolidated audit trail is a significant undertaking and that a proposed NMS plan must include detailed information and discussion about many things, including the methods for reporting the required data; a detailed estimate of the costs to plan sponsors and to members of the plan sponsors of creating, implementing, and maintaining the consolidated audit trail (including issues relating to funding of the consolidated audit trail); an analysis of the impact on competition, efficiency and capital formation of creating, implementing and maintaining the NMS plan; and a discussion of any reasonable alternative approaches that the plan sponsors considered including a description of any such alternative approach, the relative advantages and disadvantages of each such alternative, including an assessment of the alternative's costs and benefits, and the basis upon which the plan sponsors selected the approach in the NMS Plan submitted.¹⁶

Additionally, given that the planned RFP process as described in the Request Letter is expected to include multiple solicitations for public comment, the Commission believes that it is appropriate in the public interest and consistent with the protection of investors to provide the SROs with additional time. This additional time to complete the RFP process should allow the SROs to engage in a more thoughtful and comprehensive process for the development of an NMS plan. In this regard, the Commission notes that the additional time to solicit comment from the industry and the public at certain key points in the development of the NMS plan could identify issues that can be resolved earlier in the development of the consolidated audit trail and

¹⁵ As noted above, the current deadline for submitting the NMS plan is April 29, 2013. This deadline is calculated pursuant to Rule 613(a)(1) which requires the NMS plan to be filed 270 days from the date of publication of the Adopting Release in the Federal Register. See note 4, supra.

¹⁶ See Rule 613(a)(1).

prior to filing the NMS plan with the Commission. In granting the SROs' request, the Commission expects the SROs to work diligently to adhere to the milestones specified by the SROs in the Request Letter. The Commission also expects the SROs to utilize the additional time to prepare a detailed and complete NMS plan for the Commission and the public to consider.

Accordingly, IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act,¹⁷ that the SROs are temporarily exempted from the deadline for submitting the NMS plan to govern the creation, implementation, and maintenance of a consolidated audit trail and central repository contained in Rule 613(a)(1) until December 6, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

¹⁷ 15 U.S.C. 78mm.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69062; File No. 4-631)

March 7, 2013

Joint Industry Plan; Notice of Filing of the Third Amendment to the National Market System Plan to Address Extraordinary Market Volatility by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, National Stock Exchange, Inc., New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc.

Pursuant to Section 11A of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 608 thereunder², notice is hereby given that, on February 21, 2013, NYSE Euronext, on behalf of New York Stock Exchange LLC (“NYSE”), NYSE MKT LLC (“NYSE MKT”), and NYSE Arca, Inc. (“NYSE Arca”), and the following parties to the National Market System Plan: BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Board Options Exchange, Incorporated, Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, and National Stock Exchange, Inc. (collectively with NYSE, NYSE MKT, and NYSE Arca, the “Participants”), filed with the Securities and Exchange Commission (the “Commission”) a proposal to amend the Plan to Address Extraordinary Market Volatility (“Plan”).³ The proposal represents the third amendment to the Plan (“Third Amendment”), and reflects changes unanimously approved by the Participants. The Third Amendment to the Plan proposes to amend the Plan to provide that odd-lot sized transactions will not be exempt from the Plan and proposes to make a clarifying technical change. A copy of the Plan, as proposed to be

¹ 15 U.S.C. 78k-1.

² 17 CFR 242.608.

³ See Letter from Janet M. McGinness, Executive Vice President & Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated February 19, 2013 (“Transmittal Letter”).

amended, is attached as Exhibit A hereto. The Commission is publishing this notice to solicit comments from interested persons on the Third Amendment to the Plan.

I. Rule 608(a) of Regulation NMS

A. Purpose of the Plan

The Participants filed the Plan in order to create a market-wide limit up-limit down mechanism that is intended to address extraordinary market volatility in “NMS Stocks,” as defined in Rule 600(b)(47) of Regulation NMS under the Act.⁴ The Plan sets forth procedures that provide for market-wide limit up-limit down requirements that would be designed to prevent trades in individual NMS Stocks from occurring outside of the specified Price Bands.⁵ These limit up-limit down requirements would be coupled with Trading Pauses, as defined in Section I(Y) of the Plan, to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity).

As set forth in Section V of the Plan, the price bands would consist of a Lower Price Band and an Upper Price Band for each NMS Stock.⁶ The price bands would be calculated by the Securities Information Processors (“SIPs” or “Processors”) responsible for consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Act.⁷ Those price bands would be based on a Reference Price⁸ for each NMS Stock that equals the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the immediately preceding five-minute period. The price bands for an NMS Stock would be

⁴ 17 CFR 242.600(b)(47). See also Section I(H) of the Plan.

⁵ See Section V of the Plan.

⁶ Capitalized terms used herein but not otherwise defined shall have the meaning ascribed to such terms in the Plan. See Exhibit A, infra.

⁷ 17 CFR 242.603(b). The Plan refers to this entity as the Processor.

⁸ See Section I(T) of the Plan.

calculated by applying the Percentage Parameter for such NMS Stock to the Reference Price, with the Lower Price Band being a Percentage Parameter⁹ below the Reference Price, and the Upper Price Band being a Percentage Parameter above the Reference Price. Between 9:30 a.m. and 9:45 a.m. ET and 3:35 p.m. and 4:00 p.m. ET, the price bands would be calculated by applying double the Percentage Parameters.

The Processors would also calculate a Pro-Forma Reference Price for each NMS Stock on a continuous basis during Regular Trading Hours. If a Pro-Forma Reference Price did not move by one percent or more from the Reference Price in effect, no new price bands would be disseminated, and the current Reference Price would remain the effective Reference Price. If the Pro-Forma Reference Price moved by one percent or more from the Reference Price in effect, the Pro-Forma Reference Price would become the Reference Price, and the Processors would disseminate new price bands based on the new Reference Price. Each new Reference Price would remain in effect for at least 30 seconds.

⁹ As initially proposed by the Participants, the Percentage Parameters for Tier 1 NMS Stocks (*i.e.*, stocks in the S&P 500 Index or Russell 1000 Index and certain ETPs) with a Reference Price of \$1.00 or more would be five percent and less than \$1.00 would be the lesser of (a) \$0.15 or (b) 75 percent. The Percentage Parameters for Tier 2 NMS Stocks (*i.e.*, all NMS Stocks other than those in Tier 1) with a Reference Price of \$1.00 or more would be 10 percent and less than \$1.00 would be the lesser of (a) \$0.15 or (b) 75 percent. The Percentage Parameters for a Tier 2 NMS Stock that is a leveraged ETP would be the applicable Percentage Parameter set forth above multiplied by the leverage ratio of such product. On May 24, 2012, the Participants amended the Plan to create a 20% price band for Tier 1 and Tier 2 stocks with a Reference Price of \$0.75 or more and up to and including \$3.00. The Percentage Parameter for stocks with a Reference Price below \$0.75 would be the lesser of (a) \$0.15 or (b) 75 percent. See Letter from Janet M. McGinness, Senior Vice President, Legal and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, Commission, dated May 24, 2012 ("First Amendment").

When one side of the market for an individual security is outside the applicable price band, the Processors would be required to disseminate such National Best Bid¹⁰ or National Best Offer¹¹ with an appropriate flag identifying it as non-executable. When the other side of the market reaches the applicable price band, the market for an individual security would enter a Limit State,¹² and the Processors would be required to disseminate such National Best Offer or National Best Bid with an appropriate flag identifying it as a Limit State Quotation.¹³ All trading would immediately enter a Limit State if the National Best Offer equals the Lower Limit Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Limit Band and does not cross the National Best Offer. Trading for an NMS Stock would exit a Limit State if, within 15 seconds of entering the Limit State, all Limit State Quotations were executed or canceled in their entirety. If the market did not exit a Limit State within 15 seconds, then the Primary Listing Exchange would declare a five-minute trading pause, which would be applicable to all markets trading the security.

These limit up-limit down requirements would be coupled with trading pauses¹⁴ to accommodate more fundamental price moves (as opposed to erroneous trades or momentary gaps in liquidity). As set forth in more detail in the Plan, all trading centers¹⁵ in NMS Stocks,

¹⁰ 17 CFR 242.600(b)(42). See also Section I(G) of the Plan.

¹¹ Id.

¹² A stock enters the Limit State if the National Best Offer equals the Lower Price Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Price Band and does not cross the National Best Offer. See Section VI(B) of the Plan.

¹³ See Section I(D) of the Plan.

¹⁴ The primary listing market would declare a trading pause in an NMS Stock; upon notification by the primary listing market, the Processor would disseminate this information to the public. No trades in that NMS Stock could occur during the trading pause, but all bids and offers may be displayed. See Section VII(A) of the Plan.

¹⁵ As defined in Section I(X) of the Plan, a trading center shall have the meaning provided

including both those operated by Participants and those operated by members of Participants, would be required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the limit up-limit down and trading pause requirements specified in the Plan.

Under the Plan, all trading centers would be required to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processors would disseminate an offer below the Lower Price Band or bid above the Upper Price Band that nevertheless inadvertently may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; such bid or offer would not be included in National Best Bid or National Best Offer calculations. In addition, all trading centers would be required to develop, maintain, and enforce policies and procedures reasonably designed to prevent trades at prices outside the price bands, with the exception of single-priced opening, reopening, and closing transactions on the Primary Listing Exchange.

As stated by the Participants in the Plan, the limit up-limit down mechanism is intended to reduce the negative impacts of sudden, unanticipated price movements in NMS Stocks,¹⁶ thereby protecting investors and promoting a fair and orderly market.¹⁷ In particular, the Plan is designed to address the type of sudden price movements that the market experienced on the afternoon of May 6, 2010.¹⁸

in Rule 600(b)(78) of Regulation NMS under the Act.

¹⁶ 17 CFR 242.600(b)(47).

¹⁷ See Transmittal Letter, *supra* note 3.

¹⁸ The limit up-limit down mechanism set forth in the Plan would replace the existing single-stock circuit breaker pilot. See e.g., Securities Exchange Act Release Nos. 62251 (June 10, 2010), 75 FR 34183 (June 16, 2010) (SR-FINRA-2010-025); 62883 (September

The following summarizes the Third Amendment to the Plan and the rationale behind those changes:

- Amending Section VI.A.1 of the Plan to clarify that odd-lot sized transactions are not exempt from the Plan. The Participants believe that odd-lot sized transactions should benefit from the protections of the Plan.
- Amending Section VIII.A.3 of the Plan to clarify that no Price Bands shall be calculated and disseminated and therefore trading shall not enter a Limit State less than 30 minutes before the end of Regular Trading Hours. The proposed change is designed to reduce confusion by correcting language in the Plan.

B. Governing or Constituent Documents

The governing documents of the Processor, as defined in Section I(P) of the Plan, will not be affected by the Plan, but once the Plan is implemented, the Processor's obligations will change, as set forth in detail in the Plan. In particular, as set forth in Section V of the Plan, the Processor will be responsible for calculating and disseminating Price Bands during Regular Trading Hours, as defined in Section I(R) of the Plan. Each Participant would take such actions as are necessary and appropriate as a party to the Market Data Plans, as defined in Section I(F) of the Plan, to cause and enable the Processor for each NMS Stock to fulfill the functions set forth in the Plan.

C. Implementation of Plan

The initial date of the Plan operations will be April 8, 2013.

D. Development and Implementation Phases

10, 2010), 75 FR 56608 (September 16, 2010) (SR-FINRA-2010-033).

The Plan will be implemented as a one-year pilot program in two Phases, consistent with Section VIII of the Plan: Phase I of Plan implementation will begin on the initial date of Plan operations, in select symbols, with full Phase I of the Plan implementation completed three months after the initial date of Plan operations, or such earlier date as may be announced by the Processor with at least 30 days notice; Phase II of Plan will commence six months after the initial date of the Plan or such earlier date as may be announced by the Processor with at least 30 days notice. The Participants proposed that Phase II of the Plan will begin on the first Monday after the six months after the initial date of the Plan, or if an earlier date is determined, Phase II will begin on a Monday.

At the beginning of Phase I, the Plan shall apply to select symbols from the Tier 1 NMS Stocks identified in Appendix A of the Plan. During full Phase I implementation, the Plan shall apply to all Tier 1 NMS Stocks, as defined in Appendix A of the Plan, and the first price bands shall be calculated and disseminated as specified in Section V(A) of the Plan. In Phase II, the Plan shall fully apply to all NMS Stocks.

Phase I and Phase II of the Plan may each be rolled out to applicable NMS Stocks over a period not to exceed two weeks. Any such roll-out period will be made available in advance of the implementation dates for Phases I and II of the Plan via the Participants' websites and trader updates, as applicable.

E. Analysis of Impact on Competition

The Participants do not believe that the Plan imposes any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Participants also do

not believe that the Plan introduces terms that are unreasonably discriminatory for the purposes of Section 11A(c)(1)(D) of the Act.¹⁹

F. Written Understanding or Agreements relating to Interpretation of, or Participation in, Plan

The Participants state that they have no written understandings or agreements relating to interpretation of the Plan. Section II(C) of the Plan sets forth how any entity registered as a national securities exchange or national securities association may become a Participant.

G. Approval of Amendment of the Plan

Each of the Plan's Participants has executed a written amended Plan.

H. Terms and Conditions of Access

Section II(C) of the Plan provides that any entity registered as a national securities exchange or national securities association under the Act may become a Participant by: (1) becoming a participant in the applicable Market Data Plans, as defined in Section I(F) of the Plan; (2) executing a copy of the Plan, as then in effect; (3) providing each then-current Participant with a copy of such executed Plan; and (4) effecting an amendment to the Plan as specified in Section III(B) of the Plan.

I. Method of Determination and Imposition, and Amount of, Fees and Charges

Not applicable.

J. Method and Frequency of Processor Evaluation

Not applicable.

K. Dispute Resolution

The Plan does not include specific provisions regarding resolution of disputes between or among Participants. Section III(C) of the Plan provides for each Participant to designate an

¹⁹ 15 U.S.C. 78k-1(c)(1)(D).

individual to represent the Participant as a member of an Operating Committee.²⁰ No later than the initial date of the Plan, the Operating Committee would be required to designate one member of the Operating Committee to act as the Chair of the Operating Committee. The Operating Committee shall monitor the procedures established pursuant to the Plan and advise the Participants with respect to any deficiencies, problems, or recommendations as the Operating Committee may deem appropriate. Any recommendation for an amendment to the Plan from the Operating Committee that receives an affirmative vote of at least two-thirds of the Participants, but is less than unanimous, shall be submitted to the Commission as a request for an amendment to the Plan initiated by the Commission under Rule 608 of Regulation NMS under the Act.²¹

II. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the Third Amendment to the Plan is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-631 on the subject line.

Paper comments:

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

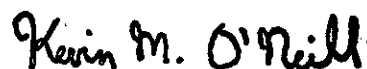
All submissions should refer to File Number 4-631. This file number should be included on the

²⁰ See Section I(J) of the Plan.

²¹ 17 CFR 242.608.

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 Third Amendment to the Plan that are filed with the Commission, and all written communications relating to the Third Amendment to the Plan 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 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the Participants' principal offices. 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 4-631 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

EXHIBIT A

Proposed new language is *italicized*; proposed deletions are in [brackets].

PLAN TO ADDRESS EXTRAORDINARY MARKET VOLATILITY

SUBMITTED TO

THE SECURITIES AND EXCHANGE COMMISSION

PURSUANT TO RULE 608 OF REGULATION NMS

UNDER THE

SECURITIES EXCHANGE ACT OF 1934

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Preamble

The Participants submit to the SEC this Plan establishing procedures to address extraordinary volatility in NMS Stocks. The procedures provide for market-wide limit up-limit down requirements that prevent trades in individual NMS Stocks from occurring outside of the specified Price Bands. These limit up-limit down requirements are coupled with Trading Pauses to accommodate more fundamental price moves. The Plan procedures are designed, among other things, to protect investors and promote fair and orderly markets. The Participants developed this Plan pursuant to Rule 608(a)(3) of Regulation NMS under the Exchange Act, which authorizes the Participants to act jointly in preparing, filing, and implementing national market system plans.

I. Definitions

(A) "Eligible Reported Transactions" shall have the meaning prescribed by the Operating Committee and shall generally mean transactions that are eligible to update the last sale price of an NMS Stock.

(B) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(C) "Limit State" shall have the meaning provided in Section VI of the Plan.

(D) "Limit State Quotation" shall have the meaning provided in Section VI of the Plan.

(E) "Lower Price Band" shall have the meaning provided in Section V of the Plan.

(F) "Market Data Plans" shall mean the effective national market system plans through which the Participants act jointly to disseminate consolidated information in compliance with Rule 603(b) of Regulation NMS under the Exchange Act.

(G) "National Best Bid" and "National Best Offer" shall have the meaning provided in Rule 600(b)(42) of Regulation NMS under the Exchange Act.

(H) "NMS Stock" shall have the meaning provided in Rule 600(b)(47) of Regulation NMS under the Exchange Act.

(I) "Opening Price" shall mean the price of a transaction that opens trading on the Primary Listing Exchange, or, if the Primary Listing Exchange opens with quotations, the midpoint of those quotations.

(J) "Operating Committee" shall have the meaning provided in Section III(C) of the Plan.

(K) "Participant" means a party to the Plan.

(L) "Plan" means the plan set forth in this instrument, as amended from time to time in accordance with its provisions.

(M) "Percentage Parameter" shall mean the percentages for each tier of NMS Stocks set forth in Appendix A of the Plan.

(N) "Price Bands" shall have the meaning provided in Section V of the Plan.

(O) "Primary Listing Exchange" shall mean the Participant on which an NMS Stock is listed. If an NMS Stock is listed on more than one Participant, the Participant on which the NMS Stock has been listed the longest shall be the Primary Listing Exchange.

(P) "Processor" shall mean the single plan processor responsible for the consolidation of information for an NMS Stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act.

(Q) "Pro-Forma Reference Price" shall have the meaning provided in Section V(A)(2) of the Plan.

(R) "Regular Trading Hours" shall have the meaning provided in Rule 600(b)(64) of Regulation NMS under the Exchange Act. For purposes of the Plan, Regular Trading Hours can end earlier than 4:00 p.m. ET in the case of an early scheduled close.

(S) "Regulatory Halt" shall have the meaning specified in the Market Data Plans.

(T) "Reference Price" shall have the meaning provided in Section V of the Plan.

(U) "Reopening Price" shall mean the price of a transaction that reopens trading on the Primary Listing Exchange following a Trading Pause or a Regulatory Halt, or, if the Primary Listing Exchange reopens with quotations, the midpoint of those quotations.

(V) "SEC" shall mean the United States Securities and Exchange Commission.

(W) "Straddle State" shall have the meaning provided in Section VII(A)(2) of the Plan.

(X) "Trading center" shall have the meaning provided in Rule 600(b)(78) of Regulation NMS under the Exchange Act.

(Y) "Trading Pause" shall have the meaning provided in Section VII of the Plan.

(Z) "Upper Price Band" shall have the meaning provided in Section V of the Plan.

II. Parties

(A) List of Parties

The parties to the Plan are as follows:

- (1) BATS Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214
- (2) BATS Y-Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214
- (3) Chicago Board Options Exchange, Incorporated
400 South LaSalle Street
Chicago, Illinois 60605
- (4) Chicago Stock Exchange, Inc.
440 South LaSalle Street
Chicago, Illinois 60605
- (5) EDGA Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310
- (6) EDGX Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310
- (7) Financial Industry Regulatory Authority, Inc.
1735 K Street, NW

Washington, DC 20006

- (8) NASDAQ OMX BX, Inc.
One Liberty Plaza
New York, New York 10006
- (9) NASDAQ OMX PHLX LLC
1900 Market Street
Philadelphia, Pennsylvania 19103
- (10) The Nasdaq Stock Market LLC
1 Liberty Plaza
165 Broadway
New York, NY 10006
- (11) National Stock Exchange, Inc.
101 Hudson, Suite 1200
Jersey City, NJ 07302
- (12) New York Stock Exchange LLC
11 Wall Street
New York, New York 10005
- (13) NYSE MKT LLC
20 Broad Street
New York, New York 10005
- (14) NYSE Arca, Inc.
100 South Wacker Drive
Suite 1800
Chicago, IL 60606
- (B) Compliance Undertaking

By subscribing to and submitting the Plan for approval by the SEC, each Participant agrees to comply with and to enforce compliance, as required by Rule 608(c) of Regulation NMS under the Exchange Act, by its members with the provisions of the Plan. To this end, each Participant shall adopt a rule requiring compliance by its members with the provisions of the Plan, and each Participant shall take such actions as are necessary and appropriate as a

participant of the Market Data Plans to cause and enable the Processor for each NMS Stock to fulfill the functions set forth in this Plan.

(C) New Participants

The Participants agree that any entity registered as a national securities exchange or national securities association under the Exchange Act may become a Participant by: (1) becoming a participant in the applicable Market Data Plans; (2) executing a copy of the Plan, as then in effect; (3) providing each then-current Participant with a copy of such executed Plan; and (4) effecting an amendment to the Plan as specified in Section III(B) of the Plan.

(D) Advisory Committee

(1) Formation. Notwithstanding other provisions of this Plan, an Advisory Committee to the Plan shall be formed and shall function in accordance with the provisions set forth in this section.

(2) Composition. Members of the Advisory Committee shall be selected for two-year terms as follows:

(A) Advisory Committee Selections. By affirmative vote of a majority of the Participants, the Participants shall select at least one representatives from each of the following categories to be members of the Advisory Committee: (1) a broker-dealer with a substantial retail investor customer base; (2) a broker-dealer with a substantial institutional investor customer base; (3) an alternative trading system; (4) a broker-dealer that primarily engages in trading for its own account; and (5) an investor.

(3) Function. Members of the Advisory Committee shall have the right to submit their views to the Operating Committee on Plan matters, prior to a decision by the Operating

Committee on such matters. Such matters shall include, but not be limited to, proposed material amendments to the Plan.

(4) Meetings and Information. Members of the Advisory Committee shall have the right to attend meetings of the Operating Committee and to receive any information concerning Plan matters; provided, however, that the Operating Committee may meet in executive session if, by affirmative vote of a majority of the Participants, the Operating Committee determines that an item of Plan business requires confidential treatment.

III. Amendments to Plan

(A) General Amendments

Except with respect to the addition of new Participants to the Plan, any proposed change in, addition to, or deletion from the Plan shall be effected by means of a written amendment to the Plan that: (1) sets forth the change, addition, or deletion; (2) is executed on behalf of each Participant; and, (3) is approved by the SEC pursuant to Rule 608 of Regulation NMS under the Exchange Act, or otherwise becomes effective under Rule 608 of Regulation NMS under the Exchange Act.

(B) New Participants

With respect to new Participants, an amendment to the Plan may be effected by the new national securities exchange or national securities association executing a copy of the Plan, as then in effect (with the only changes being the addition of the new Participant's name in Section II(A) of the Plan) and submitting such executed Plan to the SEC for approval. The amendment shall be effective when it is approved by the SEC in accordance with Rule 608 of Regulation NMS under the Exchange Act or otherwise becomes effective pursuant to Rule 608 of Regulation NMS under the Exchange Act.

(C) Operating Committee

(1) Each Participant shall select from its staff one individual to represent the Participant as a member of an Operating Committee, together with a substitute for such individual. The substitute may participate in deliberations of the Operating Committee and shall be considered a voting member thereof only in the absence of the primary representative. Each Participant shall have one vote on all matters considered by the Operating Committee. No later than the initial date of Plan operations, the Operating Committee shall designate one member of the Operating Committee to act as the Chair of the Operating Committee.

(2) The Operating Committee shall monitor the procedures established pursuant to this Plan and advise the Participants with respect to any deficiencies, problems, or recommendations as the Operating Committee may deem appropriate. The Operating Committee shall establish specifications and procedures for the implementation and operation of the Plan that are consistent with the provisions of this Plan and the Appendixes thereto. With respect to matters in this paragraph, Operating Committee decisions shall be approved by a simple majority vote.

(3) Any recommendation for an amendment to the Plan from the Operating Committee that receives an affirmative vote of at least two-thirds of the Participants, but is less than unanimous, shall be submitted to the SEC as a request for an amendment to the Plan initiated by the Commission under Rule 608 of Regulation NMS.

IV. Trading Center Policies and Procedures

All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the limit up - limit down

requirements specified in Sections VI of the Plan, and to comply with the Trading Pauses specified in Section VII of the Plan.

V. Price Bands

(A) Calculation and Dissemination of Price Bands

(1) The Processor for each NMS stock shall calculate and disseminate to the public a Lower Price Band and an Upper Price Band during Regular Trading Hours for such NMS Stock. The Price Bands shall be based on a Reference Price for each NMS Stock that equals the arithmetic mean price of Eligible Reported Transactions for the NMS stock over the immediately preceding five-minute period (except for periods following openings and reopenings, which are addressed below). If no Eligible Reported Transactions for the NMS Stock have occurred over the immediately preceding five-minute period, the previous Reference Price shall remain in effect. The Price Bands for an NMS Stock shall be calculated by applying the Percentage Parameter for such NMS Stock to the Reference Price, with the Lower Price Band being a Percentage Parameter below the Reference Price, and the Upper Price Band being a Percentage Parameter above the Reference Price. The Price Bands shall be calculated during Regular Trading Hours. Between 9:30 a.m. and 9:45 a.m. ET, and 3:35 p.m. and 4:00 p.m. ET, or in the case of an early scheduled close, during the last 25 minutes of trading before the early scheduled close, the Price Bands shall be calculated by applying double the Percentage Parameters set forth in Appendix A. If a Reopening Price does not occur within ten minutes after the beginning of a Trading Pause, the Price Band, for the first 30 seconds following the reopening after that Trading Pause, shall be calculated by applying triple the Percentage Parameters set forth in Appendix A.

(2) The Processor shall calculate a Pro-Forma Reference Price on a continuous basis during Regular Trading Hours, as specified in Section V(A)(1) of the Plan. If a Pro-Forma

Reference Price has not moved by 1% or more from the Reference Price currently in effect, no new Price Bands shall be disseminated, and the current Reference Price shall remain the effective Reference Price. When the Pro-Forma Reference Price has moved by 1% or more from the Reference Price currently in effect, the Pro-Forma Reference Price shall become the Reference Price, and the Processor shall disseminate new Price Bands based on the new Reference Price; provided, however, that each new Reference Price shall remain in effect for at least 30 seconds.

(B) Openings

(1) Except when a Regulatory Halt is in effect at the start of Regular Trading Hours, the first Reference Price for a trading day shall be the Opening Price on the Primary Listing Exchange in an NMS Stock if such Opening Price occurs less than five minutes after the start of Regular Trading Hours. During the period less than five minutes after the Opening Price, a Pro-Forma Reference Price shall be updated on a continuous basis to be the arithmetic mean price of Eligible Reported Transactions for the NMS Stock during the period following the Opening Price (including the Opening Price), and if it differs from the current Reference Price by 1% or more shall become the new Reference Price, except that a new Reference Price shall remain in effect for at least 30 seconds. Subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(2) If the Opening Price on the Primary Listing Exchange in an NMS Stock does not occur within five minutes after the start of Regular Trading Hours, the first Reference Price for a trading day shall be the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the preceding five minute time period, and subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(C) Reopenings

(1) Following a Trading Pause in an NMS Stock, and if the Primary Listing Exchange has not declared a Regulatory Halt, the next Reference Price shall be the Reopening Price on the Primary Listing Exchange if such Reopening Price occurs within ten minutes after the beginning of the Trading Pause, and subsequent Reference Prices shall be determined in the manner prescribed for normal openings, as specified in Section V(B)(1) of the Plan. If such Reopening Price does not occur within ten minutes after the beginning of the Trading Pause, the first Reference Price following the Trading Pause shall be equal to the last effective Reference Price before the Trading Pause. Subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

(2) Following a Regulatory Halt, the next Reference Price shall be the Opening or Reopening Price on the Primary Listing Exchange if such Opening or Reopening Price occurs within five minutes after the end of the Regulatory Halt, and subsequent Reference Prices shall be determined in the manner prescribed for normal openings, as specified in Section V(B)(1) of the Plan. If such Opening or Reopening Price has not occurred within five minutes after the end of the Regulatory Halt, the Reference Price shall be equal to the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the preceding five minute time period, and subsequent Reference Prices shall be calculated as specified in Section V(A) of the Plan.

VI. Limit Up-Limit Down Requirements

(A) Limitations on Trades and Quotations Outside of Price Bands

(1) All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent trades at prices that are below the

Lower Price Band or above the Upper Price Band for an NMS Stock. Single-priced opening, reopening, and closing transactions on the Primary Listing Exchange, however, shall be excluded from this limitation. In addition, any transaction that both (i) does not update the last sale price (except if solely because the transaction was reported late or because the transaction was an odd-lot sized transaction), and (ii) is excepted or exempt from Rule 611 under Regulation NMS shall be excluded from this limitation.

(2) When a National Best Bid is below the Lower Price Band or a National Best Offer is above the Upper Price Band for an NMS Stock, the Processor shall disseminate such National Best Bid or National Best Offer with an appropriate flag identifying it as non-executable. When a National Best Offer is equal to the Lower Price Band or a National Best Bid is equal to the Upper Price Band for an NMS Stock, the Processor shall distribute such National Best Bid or National Best Offer with an appropriate flag identifying it as a "Limit State Quotation".

(3) All trading centers in NMS Stocks, including both those operated by Participants and those operated by members of Participants, shall establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the display of offers below the Lower Price Band and bids above the Upper Price Band for an NMS Stock. The Processor shall disseminate an offer below the Lower Price Band or bid above the Upper Price Band that may be submitted despite such reasonable policies and procedures, but with an appropriate flag identifying it as non-executable; provided, however, that any such bid or offer shall not be included in National Best Bid or National Best Offer calculations.

(B) Entering and Exiting a Limit State

(1) All trading for an NMS Stock shall immediately enter a Limit State if the National Best Offer equals the Lower Price Band and does not cross the National Best Bid, or the National Best Bid equals the Upper Price Band and does not cross the National Best Offer.

(2) When trading for an NMS Stock enters a Limit State, the Processor shall disseminate this information by identifying the relevant quotation (i.e., a National Best Offer that equals the Lower Price Band or a National Best Bid that equals the Upper Price Band) as a Limit State Quotation. At this point, the Processor shall cease calculating and disseminating updated Reference Prices and Price Bands for the NMS Stock until either trading exits the Limit State or trading resumes with an opening or re-opening as provided in Section V.

(3) Trading for an NMS Stock shall exit a Limit State if, within 15 seconds of entering the Limit State, the entire size of all Limit State Quotations are executed or cancelled.

(4) If trading for an NMS Stock exits a Limit State within 15 seconds of entry, the Processor shall immediately calculate and disseminate updated Price Bands based on a Reference Price that equals the arithmetic mean price of Eligible Reported Transactions for the NMS Stock over the immediately preceding five-minute period (including the period of the Limit State).

(5) If trading for an NMS Stock does not exit a Limit State within 15 seconds of entry, the Limit State will terminate when the Primary Listing Exchange declares a Trading Pause pursuant to Section VII of the Plan or at the end of Regular Trading Hours.

VII. Trading Pauses

(A) Declaration of Trading Pauses

(1) If trading for an NMS Stock does not exit a Limit State within 15 seconds of entry during Regular Trading Hours, then the Primary Listing Exchange shall declare a Trading Pause for such NMS Stock and shall notify the Processor.

(2) The Primary Listing Exchange may also declare a Trading Pause for an NMS Stock when an NMS Stock is in a Straddle State, which is when National Best Bid (Offer) is below (above) the Lower (Upper) Price Band and the NMS Stock is not in a Limit State, and trading in that NMS Stock deviates from normal trading characteristics such that declaring a Trading Pause would support the Plan's goal to address extraordinary market volatility. The Primary Listing Exchange shall develop policies and procedures for determining when it would declare a Trading Pause in such circumstances. If a Trading Pause is declared for an NMS Stock under this provision, the Primary Listing Exchange shall notify the Processor.

(3) The Processor shall disseminate Trading Pause information to the public. No trades in an NMS Stock shall occur during a Trading Pause, but all bids and offers may be displayed.

(B) Reopening of Trading During Regular Trading Hours

(1) Five minutes after declaring a Trading Pause for an NMS Stock, and if the Primary Listing Exchange has not declared a Regulatory Halt, the Primary Listing Exchange shall attempt to reopen trading using its established reopening procedures. The Trading Pause shall end when the Primary Listing Exchange reports a Reopening Price.

(2) The Primary Listing Exchange shall notify the Processor if it is unable to reopen trading in an NMS Stock for any reason other than a significant order imbalance and if it has not declared a Regulatory Halt. The Processor shall disseminate this information to the public, and all trading centers may begin trading the NMS Stock at this time.

(3) If the Primary Listing Exchange does not report a Reopening Price within ten minutes after the declaration of a Trading Pause in an NMS Stock, and has not declared a Regulatory Halt, all trading centers may begin trading the NMS Stock.

(4) When trading begins after a Trading Pause, the Processor shall update the Price Bands as set forth in Section V(C)(1) of the Plan.

(C) Trading Pauses Within Five Minutes of the End of Regular Trading Hours

(1) If a Trading Pause for an NMS Stock is declared less than five minutes before the end of Regular Trading Hours, the Primary Listing Exchange shall attempt to execute a closing transaction using its established closing procedures. All trading centers may begin trading the NMS Stock when the Primary Listing Exchange executes a closing transaction.

(2) If the Primary Listing Exchange does not execute a closing transaction within five minutes after the end of Regular Trading Hours, all trading centers may begin trading the NMS Stock.

VIII. Implementation

The initial date of Plan operations shall be April 8, 2013.

(A) Phase I

(1) On the initial date of Plan operations, Phase I of Plan implementation shall begin in select symbols from the Tier 1 NMS Stocks identified in Appendix A of the Plan.

(2) Three months after the initial date of Plan operations, or such earlier date as may be announced by the Processor with at least 30 days notice, the Plan shall fully apply to all Tier 1 NMS Stocks identified in Appendix A of the Plan.

(3) During Phase I, the first Price Bands for a trading day shall be calculated and disseminated 15 minutes after the start of Regular Trading Hours as specified in Section (V)(A)

of the Plan. No Price Bands shall be calculated and disseminated and therefore trading shall not enter a Limit State less than 30 minutes before the end of Regular Trading Hours[, and trading shall not enter a Limit State less than 25 minutes before the end of Regular Trading Hours].

(B) Phase II – Full Implementation

Six months after the initial date of Plan operations, or such earlier date as may be announced by the Processor with at least 30 days notice, the Plan shall fully apply (i) to all NMS Stocks; and (ii) beginning at 9:30 a.m. ET, and ending at 4:00 p.m. ET each trading day, or earlier in the case of an early scheduled close.

(C) Pilot

The Plan shall be implemented on a one-year pilot basis.

IX. Withdrawal from Plan

If a Participant obtains SEC approval to withdraw from the Plan, such Participant may withdraw from the Plan at any time on not less than 30 days' prior written notice to each of the other Participants. At such time, the withdrawing Participant shall have no further rights or obligations under the Plan.

X. Counterparts and Signatures

The Plan may be executed in any number of counterparts, no one of which need contain all signatures of all Participants, and as many of such counterparts as shall together contain all such signatures shall constitute one and the same instrument.

IN WITNESS THEREOF, this Plan has been executed as of the ___ day of _____ 2013 by each of the parties hereto.

BATS EXCHANGE, INC.

BY: _____

CHICAGO BOARD OPTIONS
EXCHANGE, INCORPORATED

BY: _____

EDGA EXCHANGE, INC.

BY: _____

FINANCIAL INDUSTRY
REGULATORY AUTHORITY, INC.

BY: _____

NASDAQ OMX PHLX LLC

BY: _____

NATIONAL STOCK EXCHANGE, INC.

BY: _____

NYSE MKT LLC

BY: _____

BATS Y-EXCHANGE, INC.

BY: _____

CHICAGO STOCK EXCHANGE, INC.

BY: _____

EDGX EXCHANGE, INC.

BY: _____

NASDAQ OMX BX, INC.

BY: _____

THE NASDAQ STOCK MARKET LLC

BY: _____

NEW YORK STOCK EXCHANGE LLC

BY: _____

NYSE ARCA, INC.

BY: _____

Appendix A – Percentage Parameters

I. Tier 1 NMS Stocks

(1) Tier 1 NMS Stocks shall include all NMS Stocks included in the S&P 500 Index, the Russell 1000 Index, and the exchange-traded products (“ETP”) listed on Schedule 1 to this Appendix. Schedule 1 to the Appendix will be reviewed and updated semi-annually based on the fiscal year by the Primary Listing Exchange to add ETPs that meet the criteria, or delete ETPs that are no longer eligible. To determine eligibility for an ETP to be included as a Tier 1 NMS Stock, all ETPs across multiple asset classes and issuers, including domestic equity, international equity, fixed income, currency, and commodities and futures will be identified. Leveraged ETPs will be excluded and the list will be sorted by notional consolidated average daily volume (“CADV”). The period used to measure CADV will be from the first day of the previous fiscal half year up until one week before the beginning of the next fiscal half year. Daily volumes will be multiplied by closing prices and then averaged over the period. ETPs, including inverse ETPs, that trade over \$2,000,000 CADV will be eligible to be included as a Tier 1 NMS Stock. To ensure that ETPs that track similar benchmarks but that do not meet this volume criterion do not become subject to pricing volatility when a component security is the subject of a trading pause, non-leveraged ETPs that have traded below this volume criterion, but that track the same benchmark as an ETP that does meet the volume criterion, will be deemed eligible to be included as a Tier 1 NMS Stock. The semi-annual updates to Schedule 1 do not require an amendment to the Plan. The Primary Listing Exchanges will maintain the updated Schedule 1 on their respective websites.

(2) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price more than \$3.00 shall be 5%.

(3) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price equal to \$0.75 and up to and including \$3.00 shall be 20%.

(4) The Percentage Parameters for Tier 1 NMS Stocks with a Reference Price less than \$0.75 shall be the lesser of (a) \$0.15 or (b) 75%.

(5) The Reference Price used for determining which Percentage Parameter shall be applicable during a trading day shall be based on the closing price of the NMS Stock on the Primary Listing Exchange on the previous trading day, or if no closing price exists, the last sale on the Primary Listing Exchange reported by the Processor.

II. Tier 2 NMS Stocks

(1) Tier 2 NMS Stocks shall include all NMS Stocks other than those in Tier 1, provided, however, that all rights and warrants are excluded from the Plan.

(2) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price more than \$3.00 shall be 10%.

(3) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price equal to \$0.75 and up to and including \$3.00 shall be 20%.

(4) The Percentage Parameters for Tier 2 NMS Stocks with a Reference Price less than \$0.75 shall be the lesser of (a) \$0.15 or (b) 75%.

(5) Notwithstanding the foregoing, the Percentage Parameters for a Tier 2 NMS Stock that is a leveraged ETP shall be the applicable Percentage Parameter set forth in clauses (2), (3), or (4) above, multiplied by the leverage ratio of such product.

(6) The Reference Price used for determining which Percentage Parameter shall be applicable during a trading day shall be based on the closing price of the NMS Stock on the

Primary Listing Exchange on the previous trading day, or if no closing price exists, the last sale on the Primary Listing Exchange reported by the Processor.

Appendix A – Schedule 1

Symbol	Name
AAVX	ETRACS Daily Short 1-Month S&P 500 VIX Futures ETN
AAXJ	iShares MSCI All Country Asia ex Japan Index Fund
ACWI	iShares MSCI ACWI Index Fund
ACWX	iShares MSCI ACWI ex US Index Fund
AGG	iShares Barclays Aggregate Bond Fund
AGZ	iShares Barclays Agency Bond Fund
ALD	WisdomTree Asia Local Debt Fund
AMJ	JPMorgan Alerian MLP Index ETN
AMLP	Alerian MLP ETF
BAB	PowerShares Build America Bond Portfolio
BDG	PowerShares DB Base Metals Long ETN
BIK	SPDR S&P BRIC 40 ETF
BIL	SPDR Barclays Capital 1-3 Month T-Bill ETF
BIV	Vanguard Intermediate-Term Bond ETF
BKF	iShares MSCI BRIC Index Fund
BKLN	PowerShares Senior Loan Portfolio
BLV	Vanguard Long-Term Bond ETF
BND	Vanguard Total Bond Market ETF
BNO	United States Brent Oil Fund LP
BOND	Pimco Total Return ETF
BOS	PowerShares DB Base Metals Short ETN
BRF	Market Vectors Brazil Small-Cap ETF
BSV	Vanguard Short-Term Bond ETF
BWX	SPDR Barclays Capital International Treasury Bond ETF
BXDB	Barclays ETN+short B Leveraged ETN Linked to S&P 500
CEW	WisdomTree Dreyfus Emerging Currency Fund
CFT	iShares Barclays Credit Bond Fund
CIU	iShares Barclays Intermediate Credit Bond Fund
CLY	iShares 10+ Year Credit Bond Fund
CORN	Teucrium Corn Fund
CSJ	iShares Barclays 1-3 Year Credit Bond Fund
CVY	Guggenheim Multi-Asset Income ETF
CWB	SPDR Barclays Capital Convertible Securities ETF
CWI	SPDR MSCI ACWI ex-US ETF
CYB	WisdomTree Dreyfus Chinese Yuan Fund
DBA	PowerShares DB Agriculture Fund
DBB	PowerShares DB Base Metals Fund
DBC	PowerShares DB Commodity Index Tracking Fund

Symbol	Name
DBE	PowerShares DB Energy Fund
DBO	PowerShares DB Oil Fund
DBP	PowerShares DB Precious Metals Fund
DBV	PowerShares DB G10 Currency Harvest Fund
DEM	WisdomTree Emerging Markets Equity Income Fund
DGL	PowerShares DB Gold Fund
DGS	WisdomTree Emerging Markets SmallCap Dividend Fund
DGZ	PowerShares DB Gold Short ETN
DHS	WisdomTree Equity Income Fund
DIA	SPDR Dow Jones Industrial Average ETF Trust
DJCI	E-TRACS UBS AG Dow Jones-UBS Commodity Index Total Return ETN
DJP	iPath Dow Jones-UBS Commodity Index Total Return ETN
DLN	WisdomTree LargeCap Dividend Fund
DOG	ProShares Short Dow30
DON	WisdomTree MidCap Dividend Fund
DOO	WisdomTree International Dividend Ex-Financials Fund
DTN	WisdomTree Dividend Ex-Financials Fund
DVY	iShares Dow Jones Select Dividend Index Fund
DWM	WisdomTree DEFA Fund
DWX	SPDR S&P International Dividend ETF
DXJ	WisdomTree Japan Hedged Equity Fund
ECH	iShares MSCI Chile Investable Market Index Fund
ECON	EGShares Emerging Markets Consumer ETF
EDIV	SPDR S&P Emerging Markets Dividend ETF
EDV	Vanguard Extended Duration Treasury ETF
EEB	Guggenheim BRIC ETF
EEM	iShares MSCI Emerging Markets Index Fund
EFA	iShares MSCI EAFE Index Fund
EFG	iShares MSCI EAFE Growth Index
EFV	iShares MSCI EAFE Value Index
EFZ	ProShares Short MSCI EAFE
EIDO	iSHARES MSCI Indonesia Investable Market Index Fund
ELD	WisdomTree Emerging Markets Local Debt Fund
ELR	SPDR Dow Jones Large Cap ETF
EMB	iShares JPMorgan USD Emerging Markets Bond Fund
EMLC	Market Vectors Emerging Markets Local Currency Bond ETF
EMM	SPDR Dow Jones Mid Cap ETF
EPHE	iShares MSCI Philippines Investable Market Index Fund
EPI	WisdomTree India Earnings Fund

Symbol	Name
EPP	iShares MSCI Pacific ex-Japan Index Fund
EPU	iShares MSCI All Peru Capped Index Fund
ERUS	iShares MSCI Russia Capped Index Fund
EUM	ProShares Short MSCI Emerging Markets
EWA	iShares MSCI Australia Index Fund
EWC	iShares MSCI Canada Index Fund
EWD	iShares MSCI Sweden Index Fund
EWG	iShares MSCI Germany Index Fund
EWH	iShares MSCI Hong Kong Index Fund
EWI	iShares MSCI Italy Index Fund
EWJ	iShares MSCI Japan Index Fund
EWL	iShares MSCI Switzerland Index Fund
EWM	iShares MSCI Malaysia Index Fund
EWP	iShares MSCI Spain Index Fund
EWQ	iShares MSCI France Index Fund
EWS	iShares MSCI Singapore Index Fund
EWT	iShares MSCI Taiwan Index Fund
EWU	iShares MSCI United Kingdom Index Fund
EWV	iShares MSCI Mexico Investable Market Index Fund
EWX	SPDR S&P Emerging Markets SmallCap ETF
EWY	iShares MSCI South Korea Index Fund
EWZ	iShares MSCI Brazil Index Fund
EZA	iShares MSCI South Africa Index Fund
EZU	iShares MSCI EMU Index Fund
FBT	First Trust NYSE Arca Biotechnology Index Fund
FCG	First Trust ISE-Revere Natural Gas Index Fund
FDL	First Trust Morningstar Dividend Leaders Index
FDN	First Trust Dow Jones Internet Index Fund
FEX	First Trust Large Cap Core AlphaDEX Fund
FEZ	SPDR EURO STOXX 50 ETF
FGD	First Trust DJ Global Select Dividend Index Fund
FLAT	iPath US Treasury Flatteners ETN
FNX	First Trust Mid Cap Core AlphaDEX Fund
FRI	First Trust S&P REIT Index Fund
FVD	First Trust Value Line Dividend Index Fund
FXA	CurrencyShares Australian Dollar Trust
FXB	CurrencyShares British Pound Sterling Trust
FXC	CurrencyShares Canadian Dollar Trust
FXD	First Trust Consumer Discretionary AlphaDEX Fund

Symbol	Name
FXE	CurrencyShares Euro Trust
FXF	CurrencyShares Swiss Franc Trust
FXG	First Trust Consumer Staples AlphaDEX Fund
FXH	First Trust Health Care AlphaDEX Fund
FXI	iShares FTSE China 25 Index Fund
FXL	First Trust Technology AlphaDEX Fund
FXU	First Trust Utilities AlphaDEX Fund
FXY	CurrencyShares Japanese Yen Trust
FXZ	First Trust Materials AlphaDEX Fund
GAZ	iPath Dow Jones-UBS Natural Gas Subindex Total Return ETN
GCC	GreenHaven Continuous Commodity Index Fund
GDX	Market Vectors Gold Miners ETF
GDXJ	Market Vectors Junior Gold Miners ETF
GIY	Guggenheim Enhanced Core Bond ETF
GLD	SPDR Gold Shares
GMF	SPDR S&P Emerging Asia Pacific ETF
GNR	SPDR S&P Global Natural Resources ETF
GOVT	iShares Barclays U.S. Treasury Bond Fund
GSG	iShares S&P GSCI Commodity Indexed Trust
GSP	iPath GSCI Total Return Index ETN
GSY	Guggenheim Enhanced Short Duration Bond ETF
GVI	iShares Barclays Intermediate Government/Credit Bond Fund
GWX	SPDR S&P International Small Cap ETF
GXC	SPDR S&P China ETF
GXG	Global X FTSE Colombia 20 ETF
HAO	Guggenheim China Small Cap ETF
HDGE	Active Bear ETF/The
HDV	iShares High Dividend Equity Fund
HYD	Market Vectors High Yield Municipal Index ETF
HYG	iShares iBoxx \$ High Yield Corporate Bond Fund
HYS	PIMCO 0-5 Year High Yield Corporate Bond Index Fund
IAU	iShares Gold Trust
IBB	iShares Nasdaq Biotechnology Index Fund
ICF	iShares Cohen & Steers Realty Majors Index Fund
ICI	iPath Optimized Currency Carry ETN
IDU	iShares Dow Jones US Utilities Sector Index Fund
IDV	iShares Dow Jones International Select Dividend Index Fund
IDX	Market Vectors Indonesia Index ETF
IEF	iShares Barclays 7-10 Year Treasury Bond Fund

Symbol	Name
IEI	iShares Barclays 3-7 Year Treasury Bond Fund
IEO	iShares Dow Jones US Oil & Gas Exploration & Production Index Fund
IEV	iShares S&P Europe 350 Index Fund
IEZ	iShares Dow Jones US Oil Equipment & Services Index Fund
IGE	iShares S&P North American Natural Resources Sector Index Fund
IGF	iShares S&P Global Infrastructure Index Fund
IGOV	iShares S&P/Citigroup International Treasury Bond Fund
IGS	ProShares Short Investment Grade Corporate
IGV	iShares S&P North American Technology-Software Index Fund
IHE	iShares Dow Jones US Pharmaceuticals Index Fund
IHF	iShares Dow Jones US Healthcare Providers Index Fund
IHI	iShares Dow Jones US Medical Devices Index Fund
IJH	iShares S&P MidCap 400 Index Fund
IJJ	iShares S&P MidCap 400/BARRA Value Index Fund
IJK	iShares S&P MidCap 400 Growth Index Fund
IJR	iShares S&P SmallCap 600 Index Fund
IJS	iShares S&P SmallCap 600 Value Index Fund
IJT	iShares S&P SmallCap 600/BARRA Growth Index Fund
ILF	iShares S&P Latin America 40 Index Fund
INDA	iShares MSCI India Index Fund
INDY	iShares S&P India Nifty 50 Index Fund
INP	iPath MSCI India Index ETN
IOO	iShares S&P Global 100 Index Fund
IPE	SPDR Barclays Capital TIPS ETF
ITB	iShares Dow Jones US Home Construction Index Fund
ITM	Market Vectors Intermediate Municipal ETF
IVE	iShares S&P 500 Value Index Fund
IVOO	Vanguard S&P Mid-Cap 400 ETF
IVOP	iPath Inverse S&P 500 VIX Short-Term Futures™ ETN II
IVV	iShares S&P 500 Index Fund/US
IWW	iShares S&P 500 Growth Index Fund
IWB	iShares Russell 1000 Index Fund
IWC	iShares Russell Microcap Index Fund
IWD	iShares Russell 1000 Value Index Fund
IWF	iShares Russell 1000 Growth Index Fund
IWM	iShares Russell 2000 Index Fund
IWN	iShares Russell 2000 Value Index Fund
IWO	iShares Russell 2000 Growth Index Fund
IWP	iShares Russell Midcap Growth Index Fund

Symbol	Name
IWR	iShares Russell Midcap Index Fund
IWS	iShares Russell Midcap Value Index Fund
IWV	iShares Russell 3000 Index Fund
IWW	iShares Russell 3000 Value Index Fund
IWY	iShares Russell Top 200 Growth Index Fund
IWZ	iShares Russell 3000 Growth Index Fund
IXC	iShares S&P Global Energy Sector Index Fund
IXG	iShares S&P Global Financials Sector Index Fund
IXJ	iShares S&P Global Healthcare Sector Index Fund
IXN	iShares S&P Global Technology Sector Index Fund
IXP	iShares S&P Global Telecommunications Sector Index Fund
IYC	iShares Dow Jones US Consumer Services Sector Index Fund
IYE	iShares Dow Jones US Energy Sector Index Fund
IYF	iShares Dow Jones US Financial Sector Index Fund
IYG	iShares Dow Jones US Financial Services Index Fund
IYH	iShares Dow Jones US Healthcare Sector Index Fund
IYJ	iShares Dow Jones US Industrial Sector Index Fund
IYK	iShares Dow Jones US Consumer Goods Sector Index Fund
IYM	iShares Dow Jones US Basic Materials Sector Index Fund
IYR	iShares Dow Jones US Real Estate Index Fund
IYT	iShares Dow Jones Transportation Average Index Fund
IYW	iShares Dow Jones US Technology Sector Index Fund
IYY	iShares Dow Jones US Index Fund
IYZ	iShares Dow Jones US Telecommunications Sector Index Fund
JJC	iPath Dow Jones-UBS Copper Subindex Total Return ETN
JJG	iPath Dow Jones-UBS Grains Subindex Total Return ETN
JNK	SPDR Barclays Capital High Yield Bond ETF
JXI	iShares S&P Global Utilities Sector Index Fund
JYN	iPath JPY/USD Exchange Rate ETN
KBE	SPDR S&P Bank ETF
KBWB	PowerShares KBW Bank Portfolio
KIE	SPDR S&P Insurance ETF
KOL	Market Vectors Coal ETF
KRE	SPDR S&P Regional Banking ETF
KXI	iShares S&P Global Consumer Staples Sector Index Fund
LAG	SPDR Barclays Capital Aggregate Bond ETF
LQD	iShares iBoxx Investment Grade Corporate Bond Fund
LTPZ	PIMCO 15+ Year US TIPS Index Fund
LWC	SPDR Barclays Capital Long Term Corporate BondETF

Symbol	Name
MBB	iShares Barclays MBS Bond Fund
MBG	SPDR Barclays Capital Mortgage Backed Bond ETF
MCHI	iShares MSCI China Index Fund
MDY	SPDR S&P MidCap 400 ETF Trust
MGC	Vanguard Mega Cap 300 ETF
MGK	Vanguard Mega Cap 300 Growth ETF
MINT	PIMCO Enhanced Short Maturity Strategy Fund
MLPI	UBS E-TRACS Alerian MLP Infrastructure ETN
MLPN	Credit Suisse Cushing 30 MLP Index ETN
MOO	Market Vectors Agribusiness ETF
MUB	iShares S&P National Municipal Bond Fund
MXI	iShares S&P Global Materials Sector Index Fund
MYY	ProShares Short MidCap 400
NKY	MAXIS Nikkei 225 Index Fund ETF
OEF	iShares S&P 100 Index Fund
OIH	Market Vectors Oil Service ETF
OIL	iPath Goldman Sachs Crude Oil Total Return Index ETN
PALL	ETFS Physical Palladium Shares
PBJ	Powershares Dynamic Food & Beverage Portfolio
PCEF	PowerShares CEF Income Composite Portfolio
PCY	PowerShares Emerging Markets Sovereign Debt Portfolio
PDP	Powershares DWA Technical Leaders Portfolio
PEY	PowerShares High Yield Equity Dividend Achievers Portfolio
PFF	iShares S&P US Preferred Stock Index Fund
PFM	PowerShares Dividend Achievers Portfolio
PGF	PowerShares Financial Preferred Portfolio
PGX	PowerShares Preferred Portfolio
PHB	PowerShares Fundamental High Yield Corporate Bond Portfolio
PHO	PowerShares Water Resources Portfolio
PHYS	Sprott Physical Gold Trust
PID	PowerShares International Dividend Achievers Portfolio
PIE	PowerShares DWA Emerging Markets Technical Leaders Portfolio
PIN	PowerShares India Portfolio
PJP	Powershares Dynamic Pharmaceuticals Portfolio
PLW	PowerShares 1-30 Laddered Treasury Portfolio
PPH	Market Vectors Pharmaceutical ETF
PPLT	ETFS Platinum Trust
PRF	Powershares FTSE RAFI US 1000 Portfolio
PRFZ	PowerShares FTSE RAFI US 1500 Small-Mid Portfolio

Symbol	Name
PSLV	Sprott Physical Silver Trust
PSP	PowerShares Global Listed Private Equity Portfolio
PSQ	ProShares Short QQQ
PVI	PowerShares VRDO Tax Free Weekly Portfolio
PXH	PowerShares FTSE RAFI Emerging Markets Portfolio
PZA	PowerShares Insured National Municipal Bond Portfolio
QQQ	Powershares QQQ Trust Series 1
REM	iShares FTSE NAREIT Mortgage Plus Capped Index Fund
REMX	Market Vectors Rare Earth/Strategic Metals ETF
REZ	iShares FTSE NAREIT Residential Plus Capped Index Fund
RFG	Guggenheim S&P Midcap 400 Pure Growth ETF
RJA	ELEMENTS Linked to the Rogers International Commodity Index - Agri Tot Return
RJI	ELEMENTS Linked to the Rogers International Commodity Index - Total Return
RJN	ELEMENTS Linked to the Rogers International Commodity Index - Energy To Return
RJZ	ELEMENTS Linked to the Rogers International Commodity Index - Metals Tot Return
RPG	Guggenheim S&P 500 Pure Growth ETF
RSP	Guggenheim S&P 500 Equal Weight ETF
RSX	Market Vectors Russia ETF
RTH	Market Vectors Retail ETF
RWM	ProShares Short Russell2000
RWO	SPDR Dow Jones Global Real Estate ETF
RWR	SPDR Dow Jones REIT ETF
RWX	SPDR Dow Jones International Real Estate ETF
RYH	Guggenheim S&P 500 Equal Weight Healthcare ETF
SAGG	Direxion Daily Total Bond Market Bear 1x Shares
SCHA	Schwab US Small-Cap ETF
SCHB	Schwab US Broad Market ETF
SCHD	Schwab US Dividend Equity ETF
SCHE	Schwab Emerging Markets Equity ETF
SCHF	Schwab International Equity ETF
SCHG	Schwab U.S. Large-Cap Growth ETF
SCHH	Schwab U.S. REIT ETF
SCHM	Schwab U.S. Mid-Cap ETF
SCHO	Schwab Short-Term U.S. Treasury ETF
SCHP	Schwab U.S. TIPs ETF
SCHR	Schwab Intermediate-Term U.S. Treasury ETF
SCHV	Schwab U.S. Large-Cap Value ETF

Symbol	Name
SCHX	Schwab US Large-Cap ETF
SCHZ	Schwab U.S. Aggregate Bond ETF
SCPB	SPDR Barclays Capital Short Term Corporate Bond ETF
SCZ	iShares MSCI EAFE Small Cap Index Fund
SDY	SPDR S&P Dividend ETF
SEF	ProShares Short Financials
SGG	iPath Dow Jones-UBS Sugar Subindex Total Return ETN
SGOL	ETFS Gold Trust
SH	ProShares Short S&P500
SHM	SPDR Nuveen Barclays Capital Short Term Municipal Bond ETF
SHV	iShares Barclays Short Treasury Bond Fund
SHY	iShares Barclays 1-3 Year Treasury Bond Fund
SIL	Global X Silver Miners ETF
SIVR	ETFS Physical Silver Shares
SJB	ProShares Short High Yield
SJNK	SPDR Barclays Capital Short Term High Yield Bond ETF
SLV	iShares Silver Trust
SLX	Market Vectors Steel Index Fund
SMH	Market Vectors Semiconductor ETF
SOXX	iShares PHLX SOX Semiconductor Sector Index Fund
SPLV	PowerShares S&P 500 Low Volatility Portfolio
SPY	SPDR S&P 500 ETF Trust
SPYG	SPDR S&P 500 Growth ETF
SPYV	SPDR S&P 500 Value ETF
STIP	iShares Barclays 0-5 Year TIPS Bond Fund
STPP	iPath US Treasury Steepener ETN
STPZ	PIMCO 1-5 Year US TIPS Index Fund
SUB	iShares S&P Short Term National AMT-Free Municipal Bond Fund
SVXY	ProShares Short VIX Short-Term Futures ETF
TAN	Guggenheim Solar ETF
TBF	ProShares Short 20+ Year Treasury
TBX	ProShares Short 7-10 Treasury
TFI	SPDR Nuveen Barclays Capital Municipal Bond ETF
THD	iShares MSCI Thailand Index Fund
TIP	iShares Barclays TIPS Bond Fund
TLH	iShares Barclays 10-20 Year Treasury Bond Fund
TLT	iShares Barclays 20+ Year Treasury Bond Fund
TUR	iShares MSCI Turkey Index Fund
UDN	PowerShares DB US Dollar Index Bearish Fund

Symbol	Name
UGA	United States Gasoline Fund LP
UNG	United States Natural Gas Fund LP
URA	Global X Uranium ETF
USCI	United States Commodity Index Fund
USL	United States 12 Month Oil Fund LP
USO	United States Oil Fund LP
UUP	PowerShares DB US Dollar Index Bullish Fund
VAW	Vanguard Materials ETF
VB	Vanguard Small-Cap ETF
VBK	Vanguard Small-Cap Growth ETF
VBR	Vanguard Small-Cap Value ETF
VCIT	Vanguard Intermediate-Term Corporate Bond ETF
VCLT	Vanguard Long-Term Corporate Bond ETF
VCR	Vanguard Consumer Discretionary ETF
VCSH	Vanguard Short-Term Corporate Bond ETF
VDC	Vanguard Consumer Staples ETF
VDE	Vanguard Energy ETF
VEA	Vanguard MSCI EAFE ETF
VEU	Vanguard FTSE All-World ex-US ETF
VFH	Vanguard Financials ETF
VGK	Vanguard MSCI European ETF
VGIT	Vanguard Information Technology ETF
VHT	Vanguard Health Care ETF
VIG	Vanguard Dividend Appreciation ETF
VIIX	VelocityShares VIX Short Term ETN
VIOO	Vanguard S&P Small-Cap 600 ETF
VIS	Vanguard Industrials ETF
VIXM	ProShares VIX Mid-Term Futures ETF
VIXY	ProShares VIX Short-Term Futures ETF
VMBS	Vanguard Mortgage-Backed Securities ETF
VNM	Market Vectors Vietnam ETF
VNQ	Vanguard REIT ETF
VO	Vanguard Mid-Cap ETF
VOE	Vanguard Mid-Cap Value Index Fund/Closed-end
VONE	Vanguard Russell 1000
VONG	Vanguard Russell 1000 Growth ETF
VONV	Vanguard Russell 1000 Value
VOO	Vanguard S&P 500 ETF
VOOG	Vanguard S&P 500 Growth ETF

Symbol	Name
VOOV	Vanguard S&P 500 Value ETF
VOT	Vanguard Mid-Cap Growth Index Fund/Closed-end
VOX	Vanguard Telecommunication Services ETF
VPL	Vanguard MSCI Pacific ETF
VPU	Vanguard Utilities ETF
VQT	Barclays ETN+ ETNs Linked to the S&P 500 Dynamic VEQTORTM Total Return Index
VSS	Vanguard FTSE All World ex-US Small-Cap ETF
VT	Vanguard Total World Stock Index Fund ETF
VTHR	Vanguard Russell 3000
VTI	Vanguard Total Stock Market ETF
VTV	Vanguard Value ETF
VTWG	Vanguard Russell 2000 Growth
VTWO	Vanguard Russell 2000
VTWV	Vanguard Russell 2000 Value
VUG	Vanguard Growth ETF
VV	Vanguard Large-Cap ETF
VWO	Vanguard MSCI Emerging Markets ETF
VXAA	ETRACS 1-Month S&P 500 VIX Futures ETN
VXEE	ETRACS 5-Month S&P 500 VIX Futures ETN
VXF	Vanguard Extended Market ETF
VXUS	Vanguard Total International Stock ETF
VXX	iPATH S&P 500 VIX Short-Term Futures ETN
VXZ	iPATH S&P 500 VIX Mid-Term Futures ETN
VYM	Vanguard High Dividend Yield ETF
VZZB	iPath Long Enhanced S&P 500 VIX Mid-Term Futures TM ETN II
WDTI	WisdomTree Managed Futures Strategy Fund
WIP	SPDR DB International Government Inflation-Protected Bond ETF
XBI	SPDR S&P Biotech ETF
XES	SPDR S&P Oil & Gas Equipment & Services ETF
XHB	SPDR S&P Homebuilders ETF
XIV	VelocityShares Daily Inverse VIX Short Term ETN
XLB	Materials Select Sector SPDR Fund
XLE	Energy Select Sector SPDR Fund
XLF	Financial Select Sector SPDR Fund
XLG	Guggenheim Russell Top 50 ETF
XLI	Industrial Select Sector SPDR Fund
XLK	Technology Select Sector SPDR Fund
XLP	Consumer Staples Select Sector SPDR Fund
XLU	Utilities Select Sector SPDR Fund

Symbol	Name
XLV	Health Care Select Sector SPDR Fund
XLY	Consumer Discretionary Select Sector SPDR Fund
XME	SPDR S&P Metals & Mining ETF
XOP	SPDR S&P Oil & Gas Exploration & Production ETF
XPH	SPDR S&P Pharmaceuticals ETF
XRT	SPDR S&P Retail ETF
XSD	SPDR S&P Semiconductor ETF
XXV	iPath Inverse S&P 500 VIX Short-Term Futures ETN
ZROZ	PIMCO 25+ Year Zero Coupon US Treasury Index Fund

Appendix B – Data

Unless otherwise specified, the following data shall be collected and transmitted to the SEC in an agreed-upon format on a monthly basis, to be provided 30 calendar days following month end. Unless otherwise specified, the Primary Listing Exchanges shall be responsible for collecting and transmitting the data to the SEC. Data collected in connection with Sections II(E) – (G) below shall be transmitted to the SEC with a request for confidential treatment under the Freedom of Information Act, 5 U.S.C. 552, and the SEC's rules and regulations thereunder.

I. Summary Statistics

A. Frequency with which NMS Stocks enter a Limit State. Such summary data shall be broken down as follows:

1. Partition stocks by category
 - a. Tier 1 non-ETP issues > \$3.00
 - b. Tier 1 non-ETP issues \geq \$0.75 and \leq \$3.00
 - c. Tier 1 non-ETP issues < \$0.75
 - d. Tier 1 non-leveraged ETPs in each of above categories
 - e. Tier 1 leveraged ETPs in each of above categories
 - f. Tier 2 non-ETPs in each of above categories
 - g. Tier 2 non-leveraged ETPs in each of above categories
 - h. Tier 2 leveraged ETPs in each of above categories
2. Partition by time of day
 - a. Opening (prior to 9:45 am ET)
 - b. Regular (between 9:45 am ET and 3:35 pm ET)
 - c. Closing (after 3:35 pm ET)

- d. Within five minutes of a Trading Pause re-open or IPO open
- 3. Track reasons for entering a Limit State, such as:
 - a. Liquidity gap –price reverts from a Limit State Quotation and returns to trading within the Price Bands
 - b. Broken trades
 - c. Primary Listing Exchange manually declares a Trading Pause pursuant to Section (VII)(2) of the Plan
 - d. Other

B. Determine (1), (2) and (3) for when a Trading Pause has been declared for an NMS Stock pursuant to the Plan.

II. **Raw Data** (*all Participants, except A-E, which are for the Primary Listing Exchanges only*)

A. Record of every Straddle State.

- 1. Ticker, date, time entered, time exited, flag for ending with Limit State, flag for ending with manual override.
- 2. Pipe delimited with field names as first record.

B. Record of every Price Band

- 1. Ticker, date, time at beginning of Price Band, Upper Price Band, Lower Price Band
- 2. Pipe delimited with field names as first record

C. Record of every Limit State

- 1. Ticker, date, time entered, time exited, flag for halt
- 2. Pipe delimited with field names as first record

D. Record of every Trading Pause or halt

- 1. Ticker, date, time entered, time exited, type of halt (i.e., regulatory halt, non-regulatory halt, Trading Pause pursuant to the Plan, other)
- 2. Pipe delimited with field names as first record

E. Data set or orders entered into reopening auctions during halts or Trading Pauses

1. Arrivals, Changes, Cancels, # shares, limit/market, side, Limit State side
 2. Pipe delimited with field name as first record
- F. Data set of order events received during Limit States
- G. Summary data on order flow of arrivals and cancellations for each 15-second period for discrete time periods and sample stocks to be determined by the SEC in subsequent data requests. Must indicate side(s) of Limit State.
1. Market/marketable sell orders arrivals and executions
 - a. Count
 - b. Shares
 - c. Shares executed
 2. Market/marketable buy orders arrivals and executions
 - a. Count
 - b. Shares
 - c. Shares executed
 3. Count arriving, volume arriving and shares executing in limit sell orders above NBBO mid-point
 4. Count arriving, volume arriving and shares executing in limit sell orders at or below NBBO mid-point (non-marketable)
 5. Count arriving, volume arriving and shares executing in limit buy orders at or above NBBO mid-point (non-marketable)
 6. Count arriving, volume arriving and shares executing in limit buy orders below NBBO mid-point
 7. Count and volume arriving of limit sell orders priced at or above NBBO mid-point plus \$0.05
 8. Count and volume arriving of limit buy orders priced at or below NBBO mid-point minus \$0.05
 9. Count and volume of (3-8) for cancels

10. Include: ticker, date, time at start, time of Limit State, all data item fields in 1, last sale prior to 15-second period (null if no trades today), range during 15-second period, last trade during 15-second period

III. **At least two months prior to the end of the Pilot Period, all Participants shall provide to the SEC assessments relating to the impact of the Plan and calibration of the Percentage Parameters as follows:**

- A. Assess the statistical and economic impact on liquidity of approaching Price Bands.
- B. Assess the statistical and economic impact of the Price Bands on erroneous trades.
- C. Assess the statistical and economic impact of the appropriateness of the Percentage Parameters used for the Price Bands.
- D. Assess whether the Limit State is the appropriate length to allow for liquidity replenishment when a Limit State is reached because of a temporary liquidity gap.
- E. Evaluate concerns from the options markets regarding the statistical and economic impact of Limit States on liquidity and market quality in the options markets. (Participants that operate options exchange should also prepare such assessment reports.)
- F. Assess whether the process for entering a Limit State should be adjusted and whether Straddle States are problematic.
- G. Assess whether the process for exiting a Limit State should be adjusted.
- H. Assess whether the Trading Pauses are too long or short and whether the reopening procedures should be adjusted.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69065 / March 7, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15232

In the Matter of

Billy Wayne McClintock,

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 Billy Wayne McClintock ("McClintock" 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.

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III.

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

1. McClintock, age 70, is a Florida resident. McClintock has never been registered with the Commission in any capacity or associated with a broker or dealer registered with the Commission.

2. On December 6, 2012, an Order of Permanent Injunction was entered by consent against McClintock, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Billy Wayne McClintock, et al., Civil Action Number 1:12-CV-4028, in the United States District Court for the Northern District of Georgia.

3. The Commission's complaint alleges that, since at least 2004 McClintock has been conducting a Prime Bank-type investment fraud. The scheme involves the offer and sale of over \$15 million of securities in an unregistered offering to more than 220 investors and prospective investors in Georgia and at least 20 other states. The securities are in the form of investments in a purportedly highly clandestine Trust based in Europe that purportedly has the power to create money through fractional banking and bank debentures. Investors allegedly loan money to the Trust for automatically renewable terms of one year and one day, in exchange for 38% annual interest. Investors must follow the Trust's strict rules to participate in the investment. Among other things, investors must keep the Trust a secret and, if they request a return of their principal, they are banned from further participation in the Trust. The complaint alleges that McClintock conducted an unregistered offering of securities and acted as an unregistered broker-dealer. Respondent received transaction based compensation for effecting transactions on behalf of investors in connection with the purported loans to the Trust. The complaint further alleges that McClintock knowingly or recklessly made material misrepresentations and omissions of fact to investors and prospective investors concerning, among other things, the expected returns, the use of investor funds, and investment risks, and engaged in conduct which operated as a fraud and deceit on investors.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent McClintock 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


By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 8, 2013

IN THE MATTER OF

Endeavor Power 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 Endeavor Power Corp. ("Endeavor Power"), quoted under the ticker symbol EDVP, because of questions regarding the accuracy of assertions in Endeavor Power's public filings and press releases relating to, among other things, patents.

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EST on March 8, 2013 through 11:59 p.m. EDT on March 21, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski
By: Lynn M. Powalski
Deputy Secretary

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 242 and 249

Release No. 34-69077; File No. S7-01-13

RIN 3235-AL43

Regulation Systems Compliance and Integrity

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule and form; proposed rule amendment.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing Regulation Systems Compliance and Integrity ("Regulation SCI") under the Securities Exchange Act of 1934 ("Exchange Act") and conforming amendments to Regulation ATS under the Exchange Act. Proposed Regulation SCI would apply to certain self-regulatory organizations (including registered clearing agencies), alternative trading systems ("ATSS"), plan processors, and exempt clearing agencies subject to the Commission's Automation Review Policy (collectively, "SCI entities"), and would require these SCI entities to comply with requirements with respect to their automated systems that support the performance of their regulated activities.

DATES: Comments should be submitted on or before [insert date 60 days after date of publication in Federal Register].

ADDRESSES: Interested persons should submit comments by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>); or

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- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-01-13 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 comment letters should refer to File No. S7-01-13. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Heidi Pilpel, Special Counsel, Office of Market Supervision, at (202) 551-5666, Sara Hawkins, Special Counsel, Office of Market Supervision, at (202) 551-5523, Jonathan Balcom, Special Counsel, Office of Market Supervision, at (202) 551-5737, Yue Ding, Attorney, Office of Market Supervision, at (202) 551-5842, Dhawal Sharma, Attorney, Office of Market Supervision, at (202) 551-5779, Elizabeth C. Badawy, Senior Accountant, Office of Market Supervision, at (202) 551-5612, and Gordon Fuller, Senior Special Counsel, Office of Market Operations, at (202) 551-5686, Division of

Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION: Proposed Regulation SCI would supersede and replace the Commission's current Automation Review Policy ("ARP"), established by the Commission's two policy statements, each titled "Automated Systems of Self-Regulatory Organizations," issued in 1989 and 1991.¹ Regulation SCI also would supersede and replace aspects of those policy statements codified in Rule 301(b)(6) under the Exchange Act,² applicable to significant-volume ATs.³ Proposed Regulation SCI would require SCI entities to establish written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability and promote the maintenance of fair and orderly markets, and that they operate in the manner intended. It would also require SCI entities to mandate participation by designated members or participants in scheduled testing of the operation of their business continuity and disaster recovery plans, including backup systems, and to coordinate such testing on an industry- or sector-wide basis with other SCI entities. In addition, proposed Regulation SCI would require notices and reports to be provided to the Commission on a new proposed Form SCI regarding, among other things, SCI events and material systems changes, and would require SCI entities to take corrective action upon any responsible SCI personnel becoming

¹ See Securities Exchange Act Release Nos. 27445 (November 16, 1989), 54 FR 48703 (November 24, 1989) ("ARP I Release" or "ARP I") and 29185 (May 9, 1991), 56 FR 22490 (May 15, 1991) ("ARP II Release" or "ARP II" and, together with ARP I, the "ARP policy statements").

² See 17 CFR 242.301(b)(6). See also Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) ("ATS Release").

³ See infra note 26.

aware of SCI events. SCI events would be defined to include systems disruptions, systems compliance issues, and systems intrusions. The proposed regulation would further require that information regarding certain types of SCI events be disseminated to members or participants of SCI entities. In addition, proposed Regulation SCI would require SCI entities to conduct a review of their systems by objective personnel at least annually, and would require SCI entities to maintain certain books and records. The Commission also is proposing to modify the volume thresholds in Regulation ATS⁴ for significant-volume ATSS, apply them to SCI ATSS (as defined below), and move this standard from Regulation ATS to proposed Regulation SCI.

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⁴ 17 CFR 242.300-303 (“Regulation ATS”).

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I. Background

A. History and Evolution of the Automation Review Policy Inspection Program

Section 11A(a)(2) of the Exchange Act,⁵ enacted as part of the Securities Acts

Amendments of 1975 (“1975 Amendments”),⁶ directs the Commission, having due regard for the

⁵ 15 U.S.C. 78k-1(a)(2).

public interest, the protection of investors, and the maintenance of fair and orderly markets, to use its authority under the Exchange Act to facilitate the establishment of a national market system for securities in accordance with the Congressional findings and objectives set forth in Section 11A(a)(1) of the Exchange Act.⁷ Among the findings and objectives in Section 11A(a)(1) is that “[n]ew data processing and communications techniques create the opportunity for more efficient and effective market operations”⁸ and “[i]t is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure . . . the economically efficient execution of securities transactions.”⁹ In addition, Sections 6(b), 15A, and 17A(b)(3) of the Exchange Act impose obligations on national securities exchanges, national securities associations, and clearing agencies, respectively, to be “so organized” and “[have] the capacity to . . . carry out the purposes of [the Exchange Act].”¹⁰

For over two decades, Commission staff has worked with SROs to assess their automated systems under the Commission’s ARP inspection program (“ARP Inspection Program”), a voluntary information technology review program created in response to the October 1987

⁶ Pub. L. 94-29, 89 Stat. 97 (1975).

⁷ 15 U.S.C. 78k-1(a)(1).

⁸ Section 11A(a)(1)(B) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(B).

⁹ Section 11A(a)(1)(C)(i) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(i). Further, the Senate Committee Report accompanying the 1975 Amendments states further that a paramount objective of a national market system is “the maintenance of stable and orderly markets with maximum capacity for absorbing trading imbalances without undue price movements.” Senate Comm. On Banking, Housing and Urban Affairs, Report to accompany S. 249, Sen. Rep. 94-75, 94th Cong., 1st Sess. at 7 (1975).

¹⁰ See Sections 6(b)(1), 15A(b)(2), and 17A(b)(3) of the Exchange Act, 15 U.S.C. 78f(b)(1), 78o-3(b)(2), 78q-1(b)(3), respectively. See also Section 2 of the Exchange Act, 15 U.S.C. 78b, and Section 19 of the Exchange Act, 15 U.S.C. 78s.

market break.¹¹ In 1989, the Commission published ARP I, its first formal policy statement regarding steps that SROs should take in connection with their automated systems.¹² In ARP I, the Commission discussed the development by SROs of automated execution, market information, and trade comparison systems to accommodate increased trading activity from the 1960s through the 1980s.¹³ The Commission acknowledged improvements in efficiency during that time period, but noted that the October 1987 market break had exposed that automated systems remained vulnerable to operational problems during extreme high volume periods. The Commission also expressed concern about the potential for systems failures to negatively impact public investors, broker-dealer risk exposure, and market efficiency.¹⁴ The Commission further stated in ARP I that market movements should be “the result of market participants’ changing expectations about the direction of the market for a particular security, or group of securities, and

¹¹ See ARP I, supra note 1, 54 FR at 48706.

¹² See ARP I, supra note 1, 54 FR at 48705-48706, stating that SROs should “take certain steps to ensure that their automated systems have the capacity to accommodate current and reasonably anticipated future trading volume levels and respond to localized emergency conditions.” In ARP I, the Commission also defined the terms “automated systems” and “automated trading systems” to refer “collectively to computer systems for listed and OTC equities, as well as options, that electronically route orders to applicable market makers and systems that electronically route and execute orders, including the data networks that feed the systems...[and encompass] systems that disseminate transaction and quotation information and conduct trade comparisons prior to settlement, including the associated communication networks.” See id. at n. 21. See also id. at n. 26 (stating that the Commission may suggest expansion of the ARP I policy statement to cover “other SRO computer-driven support systems for, among other things, clearance and settlement, and market surveillance, if the Commission finds it necessary to ensure the maintenance of fair and orderly markets”).

¹³ See id. at 48705.

¹⁴ See id. at 48705. The Commission noted that problems encountered by trading systems during the October 1987 market break included: (i) inadequate computer capacity causing queues of unprocessed orders to develop that, in turn, resulted in significant delays in order execution; (ii) inadequate contingency plans to accommodate increased order traffic; (iii) delays in the transmission of transaction reports to both member firms and markets; and (iv) delays in order processing.

not the result of investor confusion or panic resulting from operational failures or delays in SRO automated trading or market information systems.”¹⁵ The Commission issued ARP I as a result of these concerns, and stated that SROs should “establish comprehensive planning and assessment programs to test systems capacity and vulnerability.”¹⁶ In particular, the Commission recommended that each SRO should: (1) establish current and future capacity estimates for its automated order routing and execution, market information, and trade comparison systems; (2) periodically conduct capacity stress tests to determine the behavior of automated systems under a variety of simulated conditions; and (3) contract with independent reviewers to assess annually whether these systems could perform adequately at their estimated current and future capacity levels and have adequate protection against physical threat.¹⁷ In addition, ARP I called for each SRO to have its automated systems reviewed annually by an “independent reviewer.”¹⁸

In 1991, the Commission published ARP II.¹⁹ In ARP II, the Commission further articulated its views on how SROs should conduct independent reviews.²⁰ ARP II stated that

¹⁵ See id. at 48705.

¹⁶ See id. at 48705-48706.

¹⁷ See id. at 48706-48707. With respect to capacity estimates and testing, the Commission urged SROs to institute procedures for stress testing using “standards generally set by the computer industry,” and report the results of stress testing to Commission staff. The Commission also requested comment on whether it should mandate specific standards for the SROs to follow, and if so, what those standards should be. See id. With respect to vulnerability of systems to external and internal threat, the Commission requested in ARP I that SROs assess the susceptibility of automated systems to computer viruses, unauthorized use, computer vandalism, and failures as result of catastrophic events (such as fire, power outages, and earthquakes), and promptly notify Commission staff of any instances in which unauthorized persons gained or attempted to gain access to SRO systems, and follow up with a written report of the problem, its cause, and the steps taken to prevent a recurrence.

¹⁸ See id.

¹⁹ See ARP II Release, 56 FR 22490, supra note 1.

such reviews and analysis should: “(1) cover significant elements of the operations of the automation process, including the capacity planning and testing process, contingency planning, systems development methodology and vulnerability assessment; (2) be performed on a cyclical basis by competent and independent audit personnel following established audit procedures and standards; and (3) result in the presentation of a report to senior SRO management on the recommendations and conclusions of the independent reviewer, which report should be made available to Commission staff for its review and comment.”²¹

In addition, ARP II addressed how SROs should notify the Commission of material systems changes and significant systems problems. Specifically, ARP II stated that SROs should notify Commission staff of significant additions, deletions, or other changes to their automated systems on an annual and an as-needed basis, as well as provide real-time notification of unusual events, such as significant outages involving automated systems.²² Further, in ARP II, the Commission again suggested development of standards to meet the ARP policy statements, stating that “the SROs, and other interested parties should begin the process of exploring the establishment of (1) standards for determining capacity levels for the SROs’ automated trading systems; (2) generally accepted computer security standards that would be effective for SRO automated systems; and (3) additional standards regarding audits of computer systems.”²³

²⁰ See id.

²¹ See id. at 22491. In ARP II the Commission also explained that, in its view, “a critical element to the success of the capacity planning and testing, security assessment and contingency planning processes for [automated] systems is obtaining an objective review of those planning processes by persons independent of the planning process to ensure that adequate controls and procedures have been developed and implemented.” Id.

²² See id. at 22491.

²³ See id.

The current ARP Inspection Program was developed by Commission staff to implement the ARP policy statements,²⁴ and has garnered participation by all active registered clearing agencies, all registered national securities exchanges, the Financial Industry Regulatory Authority (“FINRA”), the only registered national securities association, one exempt clearing agency, and one ATS.²⁵ In 1998, the Commission adopted Regulation ATS which, among other things, imposed by rule certain aspects of ARP I and ARP II on significant-volume ATSS.²⁶

²⁴ While participation in the ARP Inspection Program is voluntary, the underpinnings of ARP I and ARP II are rooted in Exchange Act requirements. See supra notes 5-10 and accompanying text.

²⁵ See infra note 91 and accompanying text. One ATS currently complies voluntarily with the ARP Inspection Program. However, ARP staff has conducted ARP inspections of other ATSS over the course of the history of the ARP Inspection Program. See also infra notes, 134-135 and accompanying text.

²⁶ See Rule 301(b)(6) of Regulation ATS, 17 CFR 242.301(b)(6). With regard to systems that support order entry, order routing, order execution, transaction reporting, and trade comparison, Regulation ATS requires significant-volume ATSS to: establish reasonable current and future capacity estimates; conduct periodic capacity stress tests of critical systems to determine their ability to accurately, timely and efficiently process transactions; develop and implement reasonable procedures to review and keep current system development and testing methodology; review system and data center vulnerability to threats; establish adequate contingency and disaster recovery plans; perform annual independent reviews of systems to ensure compliance with the above listed requirements and perform review by senior management of reports containing the recommendations and conclusions of the independent review; and promptly notify the Commission of material systems outages and significant systems changes. See Rule 301(b)(6)(ii) of Regulation ATS, 17 CFR 242.301(b)(6)(ii). Regulation ATS defines significant-volume ATSS as ATSS that, during at least 4 of the preceding 6 calendar months, had: (i) with respect to any NMS stock, 20 percent or more of the average daily volume reported by an effective transaction reporting plan; (ii) with respect to equity securities that are not NMS stocks and for which transactions are reported to a self-regulatory organization, 20 percent or more of the average daily volume as calculated by the self-regulatory organization to which such transactions are reported; (iii) with respect to municipal securities, 20 percent or more of the average daily volume traded in the United States; or (iv) with respect to corporate debt securities, 20 percent or more of the average daily volume traded in the United States. See Rule 301(b)(6)(i) of Regulation ATS, 17 CFR 242.301(b)(6)(i).

Thereafter, administration of these aspects of Regulation ATS was incorporated into the ARP Inspection Program.

Under the ARP Inspection Program, staff in the Commission's Division of Trading and Markets ("ARP staff") conduct inspections of ARP entity systems, attend periodic technology briefings presented by ARP entity staff, monitor the progress of planned significant system changes, and respond to reports of system failures, disruptions, and other systems problems of ARP entities. An ARP inspection typically includes ARP staff review of information technology documentation, testing of selected controls, and interviews with information technology staff and management of the ARP entity.²⁷

Just as markets have become increasingly automated and information technology programs and practices at ARP entities have changed, ARP inspections also have evolved considerably over the past 20 years. Today, the ARP Inspection Program covers nine general inspection areas, or information technology "domains:" application controls; capacity planning; computer operations and production environment controls; contingency planning; information security and networking; audit; outsourcing; physical security; and systems development methodology.²⁸ The goal of an ARP inspection is to evaluate whether an ARP entity's controls over its information technology resources in each domain are consistent with ARP and industry

²⁷ ARP inspections are typically conducted independently from the inspections and examinations of SROs, ATSS, and broker-dealers conducted by staff in the Commission's Office of Compliance Inspections and Examinations ("OCIE") for compliance with the federal securities laws and rules thereunder.

²⁸ Each domain itself contains subcategories. For example, "contingency planning" includes business continuity, disaster recovery, and pandemic planning, among other things.

guidelines,²⁹ as identified by ARP staff from a variety of information technology publications that ARP staff believes reflect industry standards for securities market participants.

Most recently, these publications have included, among others, publications issued by the Federal Financial Institutions Examination Council (“FFIEC”) and the National Institute of Standards and Technology (“NIST”).³⁰ ARP staff has also relied on the 2003 Interagency White Paper on Sound Practices to Strengthen the Resiliency of the U.S. Financial System³¹ and the 2003 Policy Statement on Business Continuity Planning for Trading Markets.³² Since 2003, however, the Commission has not issued formal guidance on which publications establish the most appropriate guidelines for ARP entities. At the conclusion of an ARP inspection, ARP staff typically issues a report to the ARP entity with an assessment of its information technology program with respect to its critical systems, including any recommendations for improvement.

²⁹ The domains covered during an ARP inspection depend in part upon whether the inspection is a regular inspection or a “for-cause” inspection. Typically, however, to make the most efficient use of resources, a single ARP inspection will cover fewer than nine domains.

³⁰ Other examples of publications that ARP staff has referred to include those issued by the Center for Internet Security (<http://benchmarks.cisecurity.org/en-us/?route=downloads.benchmarks>); Information Systems Audit and Control Association (*Control Objectives for Information Technology Framework*, available at: <http://www.isaca.org/Knowledge-Center/cobit/Pages/COBIT-Online.aspx>); Defense Information Systems Agency, Security Technical Implementation Guides (available at <http://iase.disa.mil/stigs/index.html>); and Government Accountability Office (*Federal Information System Controls Audit Manual* (February 2009), available at: <http://www.gao.gov/assets/80/77142.pdf>).

³¹ See Securities Exchange Act Release No. 47638 (April 7, 2003), 68 FR 17809 (April 11, 2003) (Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial Systems) (“2003 Interagency White Paper”).

³² See Securities Exchange Act Release No. 48545 (September 25, 2003), 68 FR 56656 (October 1, 2003) (Policy Statement: Business Continuity Planning for Trading Markets) (“2003 Policy Statement on Business Continuity Planning for Trading Markets”).

Another significant aspect of the ARP Inspection Program relates to the monitoring of planned significant systems changes and reports of systems problems at ARP entities. As noted above, ARP II stated that SROs should notify Commission staff of significant additions, deletions, or other changes to their automated systems on an annual and an as-needed basis, as well as provide real-time notification of unusual events, such as significant outages involving automated systems.³³ Likewise, Regulation ATS requires significant-volume ATSS to promptly notify the Commission of material systems outages and significant systems changes.³⁴

In addition to the Commission's ARP policy statements and Rule 301(b)(6) of Regulation ATS, Commission staff has provided guidance to ARP entities on how the staff believes they should report planned systems changes and systems issues to the Commission. For example, in 2001, Commission staff sent a letter to the SROs and other participants in the ARP Inspection Program to clarify what should be considered a "significant system change" and a "significant system outage" for purposes of reporting systems changes and problems to Commission staff.³⁵

³³ See supra note 22 and accompanying text.

³⁴ See 17 CFR 242.301(b)(6)(ii)(G). See also supra note 26.

³⁵ In June 2001, staff from the Division of Market Regulation sent a letter to the SROs and other participants in the ARP Inspection Program regarding Guidance for Systems Outage and System Change Notifications ("2001 Staff ARP Interpretive Letter"), advising them that the staff considers a significant system change to include: (i) major systems architectural changes; (ii) reconfiguration of systems that cause a variance greater than five percent in throughput or storage; (iii) introduction of new business functions or services; (iv) material changes in systems; (v) changes to external interfaces; (vi) changes that could increase susceptibility to major outages; (vii) changes that could increase risks to data security; (viii) a change that was, or will be, reported or referred to the entity's board of directors or senior management; or (ix) changes that may require allocation or use of significant resources. The 2001 Staff ARP Interpretive Letter also advised that Commission staff considers a "significant system outage" to include an outage that results in: (i) failure to maintain service level agreements or constraints; (ii) disruption of normal operations, including switchover to back-up equipment with no possibility of near-term recovery of primary hardware; (iii) loss of use of any system; (iv) loss of transactions; (v) excessive back-ups or delays in processing; (vi) loss of ability to

Further, in 2009, Commission staff sent a letter to the national securities exchanges and FINRA expressing the staff's view that SROs are obligated to ensure that their systems' operations comply with the federal securities laws and rules and the SRO's rules, and that failure to satisfy this obligation could lead to sanctions under Section 19(h)(1) of the Exchange Act.³⁶ Unlike ARP I, ARP II, and Rule 301(b)(6) of Regulation ATS, the 2001 Staff ARP Interpretive Letter and 2009 Staff Systems Compliance Letter were not issued by the Commission and constitute only staff guidance. Proposed Regulation SCI, if adopted, would consolidate and supersede all such staff guidance, as well as the Commission's ARP policy statements and Rule 301(b)(6) of Regulation ATS.

disseminate vital information; (vii) communication of an outage situation to other external entities; (viii) a report or referral of an event to the entity's board of directors or senior management; (ix) a serious threat to systems operations even though systems operations are not disrupted; or (x) a queuing of data between system components or queuing of messages to or from customers of such duration that a customer's normal service delivery is affected. The 2001 Staff ARP Interpretive Letter is available at <http://www.sec.gov/divisions/marketreg/sroautomation.shtml>.

³⁶ In December 2009, staff from the Division of Trading and Markets and Office of Compliance Inspections and Examinations sent a letter ("2009 Staff Systems Compliance Letter") to each national securities exchange and FINRA reminding each of its obligation to ensure that its systems' operations are consistent with the federal securities laws and rules and the SRO's rules, and clarifying the staff's expectations regarding SRO systems compliance. The 2009 Staff Systems Compliance Letter also expressed the staff's view that SROs and other participants in the ARP Inspection Program should have effective written policies and procedures for systems development and maintenance that provide for adequate regulatory oversight, including testing of system changes, controls over system changes, and independent audits. The 2009 Staff Systems Compliance Letter also expressed the staff's expectation that, if an SRO becomes aware of a system function that could lead or has led to a failure to comply with the federal securities laws or rules, or the SRO's rules, the SRO should immediately take appropriate corrective action including, at a minimum, devoting adequate resources to remedy the issue as soon as possible, and notifying Commission staff and (if appropriate) the public of the compliance issue and efforts to rectify it. The 2009 Staff Systems Compliance Letter was sent to BATS, BATS-Y, CBOE, C2, CHX, EDGA, EDGX, FINRA, ISE, Nasdaq, Nasdaq OMX BX, Nasdaq OMX Phlx, NSX, NYSE, NYSE MKT (f/k/a NYSE Amex), NYSE Arca. See infra notes 47 and 51.

In addition, OCIE conducts inspections of SROs, as part of the Commission's oversight of them. Unlike ARP inspections, however, which focus on information technology controls, OCIE primarily conducts risk-based examinations of securities exchanges, FINRA, and other SROs to evaluate whether they and their member firms are complying with the Exchange Act and the rules thereunder, as well as SRO rules. Examples of OCIE risk-based examination areas include: governance, regulatory funding, trading regulation, member firm examination programs, disciplinary programs for member firms, and exchange programs for listing compliance. In 2011, OCIE conducted baseline assessments of all of the national securities exchanges then operating. These assessments included these areas, among others, but did not include examinations of the exchanges' systems, as systems inspections are conducted under the ARP Inspection Program.³⁷ As part of the Commission's oversight of the SROs, OCIE also reviews systems compliance issues reported to Commission staff. The information gained from OCIE's review of reported systems compliance issues helps to inform its examination risk-assessments for SROs.

B. Evolution of the Markets Since the Inception of the ARP Inspection Program

Since the inception of the ARP Inspection Program more than two decades ago, the securities markets have experienced sweeping changes, evolving from a collection of relatively few, mostly manual markets, to a larger number and broader variety of trading centers that are almost completely automated, and dependent upon sophisticated technology and extremely fast and interconnected systems. Regulatory developments, such as Regulation NMS,³⁸

³⁷ See text accompanying notes 24-29.

³⁸ 17 CFR 242.600-612. See also Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 37496 (June 29, 2005).

decimalization,³⁹ Regulation ATS,⁴⁰ and the Order Handling Rules,⁴¹ also have impacted the structure of the markets by, among other things, mandating and providing incentives that encourage automation and speed. Although some markets today retain trading floors and accommodate some degree of manual interaction, these markets also have implemented electronic trading for their products. In stock markets, for example, in almost all cases, the volume of electronic trading dominates any residual manual activity.⁴² In addition, in recent years, the new trading systems developed by existing or new exchanges and ATSs rely almost exclusively on fully-electronic, automated technology to execute trades.⁴³ As a result, the overwhelming majority of securities transactions today are executed on such automated systems.⁴⁴ A primary driver and catalyst of this transformation has been the continual evolution

³⁹ See Securities Exchange Act Release No. 42360 (January 28, 2000), 65 FR 5003 (February 2, 2000).

⁴⁰ 17 CFR 242.300-303. See also ATS Release, *supra* note 2.

⁴¹ Securities Exchange Act Release No. (September 6, 1996), 61 FR 48290 (September 12, 1996). See also Concept Release on Equity Market Structure, *supra* note 42, at 3594.

⁴² See, e.g., Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3594, 3594-95 (January 21, 2010) (Concept Release on Equity Market Structure). See also Securities Exchange Act Release No. 58845 (October 24, 2008), 73 FR 64379 (October 29, 2008) (SR-NYSE-2008-46) (order approving NYSE's New Market Model, an electronic trading system with floor-based components).

⁴³ See, e.g., Securities Exchange Act Release Nos. 62716 (August 13, 2010), 75 FR 51295 (August 19, 2010) (order approving the exchange registration application of BATS-Y Exchange, Inc.); 61698 (March 12, 2010), 75 FR 13151 (March 18, 2010) (order approving the exchange registration applications of EDGA Exchange Inc. and EDGX Exchange Inc.); 57478 (March 12, 2008), 73 FR 14521 (March 18, 2008) (order approving a proposed rule change, as amended, by the NASDAQ Stock Market LLC to establish rules governing the trading of options on the NASDAQ Options Market).

⁴⁴ For example, less than 30 percent of stock trading takes place on listing exchanges as orders are dispersed to more than 50 competing venues, almost all of which are fully electronic. See, e.g., http://www.batstrading.com/market_summary. See also Concept Release on Equity Market Structure, *supra* note 42, for a more detailed discussion of equity market structure.

of technologies for generating, routing, and executing orders. These technologies have dramatically improved the speed, capacity, and sophistication of the trading functions that are available to market participants.⁴⁵ The increased speed and capacity of automated systems in the current market structure has contributed to surging message traffic.⁴⁶

In addition to these changes, there has been an increase in the number of trading venues, particularly for equities. No longer is trading in equities dominated by one or two trading venues. Today, 13 national securities exchanges trade equities, with no single stock exchange having an overall market share of greater than twenty percent of consolidated volume for all NMS stocks,⁴⁷ but each with a protected quotation⁴⁸ that may not be traded through by other

⁴⁵ For example, the speed of trading has increased to the point that the fastest traders now measure their latencies in microseconds. See Concept Release on Equity Market Structure, supra note 42, at 3598.

⁴⁶ See, e.g., "Climbing Mount Message: How Exchanges are Managing Peaks," Markets Media (posted on June 29, 2012), available at: <http://marketsmedia.com/climbing-mount-message-exchanges-managing-peaks/> (noting that message volumes across U.S. exchanges hit a daily peak of 4.47 million messages per second).

⁴⁷ See, e.g., market volume statistics reported by BATS Exchange, Inc., available at: http://www.batstrading.com/market_summary (no single national securities exchange executed more than 20 percent of volume in NMS stocks during the 5-day period ending February 7, 2013). The following national securities exchanges have equities trading platforms: (1) BATS Exchange, Inc. ("BATS"); (2) BATS Y-Exchange, Inc. ("BATS-Y"); (3) Chicago Board Options Exchange, Incorporated ("CBOE"); (4) Chicago Stock Exchange, Inc. ("CHX"); (5) EDGA Exchange, Inc. ("EDGA"); (6) EDGX Exchange, Inc. ("EDGX"); (7) NASDAQ OMX BX, Inc. ("Nasdaq OMX BX"); (8) NASDAQ OMX PHLX LLC ("Nasdaq OMX Phlx"); (9) NASDAQ Stock Market LLC ("Nasdaq"); (10) National Stock Exchange, Inc. ("NSX"); (11) New York Stock Exchange LLC ("NYSE"); (12) NYSE MKT LLC ("NYSE MKT"); and (13) NYSE Arca, Inc. ("NYSE Arca").

⁴⁸ A "protected quotation" is defined by Regulation NMS as a quotation in an NMS stock that (i) is displayed by an automated trading center; (ii) is disseminated pursuant to an effective national market system plan; and (iii) is an automated quotation that is the best bid or best offer of a national securities exchange, the best bid or best offer of The Nasdaq Stock Market, Inc., or the best bid or best offer of a national securities association

markets.⁴⁹ ATSS, including electronic communications networks (“ECNs”) and dark pools, as well as broker-dealer internalizers, also execute substantial volumes of securities transactions.⁵⁰ Each of these trading venues is connected with the others through a vast web of linkages, including those that provide connectivity, routing services, and market data. The number of venues trading options has likewise grown, with 11 national securities exchanges currently trading options, up from five as recently as 2004.⁵¹

The increased number of trading venues, dispersal of trading volume, and the resulting reliance on a variety of automated systems and intermarket linkages have increased competition and thus investor choice, but have also increased the complexity of the markets and the challenges for market participants seeking to manage their information technology programs and to ensure compliance with Commission rules.⁵² These changes have also substantially

other than the best bid or best offer of The Nasdaq Stock Market, Inc. See Rule 600(b)(57)-(58) of Regulation NMS, 17 CFR 242.600(b)(57)-(58).

⁴⁹ See Rule 611(a)(1) of Regulation NMS, 17 CFR 242.601(a)(1).

⁵⁰ See Concept Release on Equity Market Structure, supra note 42.

⁵¹ The following venues trade options today: (1) BATS Exchange Options Market; (2) Boston Options Exchange LLC (“BOX”); (3) C2 Options Exchange, Incorporated (“C2”); (4) CBOE; (5) International Securities Exchange, LLC (“ISE”); (6) Miami International Securities Exchange, LLC (“MIAX”); (7) NASDAQ Options Market; (8) NASDAQ OMX BX Options; (9) Nasdaq OMX Phlx; (10) NYSE Amex Options; and (11) NYSE Arca.

⁵² For example, one important type of linkage in the current market structure was created to comply with legal obligations to protect against trade-throughs as required by Rule 611 of Regulation NMS under the Exchange Act, 17 CFR 242.611. A trade-through is the execution of a trade at a price inferior to a protected quotation for an NMS stock. Importantly, Rule 611 applies to all trading centers, not just those that display protected quotations. Trading center is defined broadly in Rule 600(b)(78) of Regulation NMS to include, among others, all exchanges, all ATSS (including ECNs and dark pools), all OTC market makers, and any other broker-dealer that executes orders internally, whether as agent or principal. See Concept Release on Equity Market Structure, supra note 42, at 3601.

heightened the potential for systems problems originating from any number of sources to broadly affect the market. Given the increased interconnectedness of the markets, a trading venue may not always recognize the true impact and cost of a problem that originates with one of its systems.

C. Successes and Limitations of the Current ARP Inspection Program

While the Commission generally considers the ARP Inspection Program to have been successful in improving the automated systems of the SROs and other entities participating in the program over the past 20 years, the Commission is mindful of its limitations. For example, because the ARP Inspection Program is established pursuant to Commission policy statements, rather than Commission rules,⁵³ the Commission's ability to assure compliance with ARP standards with certainty or adequate thoroughness is limited. In particular, the Commission may not be able to fully address major or systemic market problems at all entities that would meet the proposed definition of SCI entity. Further, the Government Accountability Office ("GAO") has identified the voluntary nature of the ARP Inspection Program as a limitation of the program and recommended that the Commission make compliance with ARP guidelines mandatory.⁵⁴

The Commission believes that the continuing evolution of the securities markets to the current state, where they have become almost entirely electronic and highly dependent on sophisticated trading and other technology (including complex regulatory and surveillance

⁵³ As discussed in *infra* Section III.B.1, no ATS currently meets the volume thresholds in Rule 301(b)(6) of Regulation ATS.

⁵⁴ See GAO, *Financial Market Preparedness: Improvements Made, but More Action Needed to Prepare for Wide-Scale Disasters*, Report No. GAO-04-984 (September 27, 2004). GAO cited instances in which the GAO believed that entities participating in the ARP Inspection Program failed to adequately address or implement ARP staff recommendations as the reasoning behind its recommendation to make compliance with ARP guidelines mandatory. As noted in *supra* Section I.A, the obligations underlying the policy statements are statutorily mandated.

systems, as well as systems relating to the provision of market data, intermarket routing and connectivity, and a variety of other member and issuer services), has posed challenges for the ARP Inspection Program. Accordingly, the Commission believes that the guidance in the ARP policy statements should be updated and formalized, and that clarity with respect to a variety of important matters, including regarding appropriate industry practices, notice to the Commission of all SCI events and to members or participants of SCI entities of certain systems problems, Commission access to systems, and procedures designed to better ensure that SRO systems comply with the SRO's own rules, would improve the Commission's oversight capabilities. Furthermore, given the importance of ensuring that an SRO's trading and other systems are operated in accordance with its rules, the Commission believes that improvements in SRO procedures could help to ensure that such systems are operating in compliance with relevant rules, and to promptly identify and address any instances of non-compliance.⁵⁵

D. Recent Events

In the Commission's view, recent events further highlight why rulemaking in this area may be warranted. On May 6, 2010, according to a report by the staffs of the Commission and the Commodity Futures Trading Commission ("CFTC"), the prices of many U.S.-based equity products experienced an extraordinarily rapid decline and recovery, with major equity indices in both the futures and securities markets, each already down over four percent from their prior day

⁵⁵ Section 19(b)(1) of the Exchange Act requires each SRO to file with the Commission any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO (a "proposed rule change"), accompanied by a concise general statement of the basis and purpose of such proposed rule change, and provides that no proposed rule change shall take effect unless approved by the Commission or otherwise permitted in accordance with the provisions of this section. See 15 U.S.C. 78s(b)(1). An SRO's failure to file a proposed rule change when required would be a violation of Section 19(b)(1).

close, suddenly plummeting a further five to six percent in a matter of minutes before rebounding almost as quickly.⁵⁶ According to the May 6 Staff Report, many individual equity securities and exchange traded funds suffered similar price declines and reversals within a short period of time, falling 5, 10, or even 15 percent before recovering most, if not all, of their losses.⁵⁷ The May 6 Staff Report stated that some equities experienced even more severe price moves, both up and down, with over 20,000 trades in more than 300 securities executed at prices more than 60 percent away from their values just moments before.⁵⁸

Among the key findings in the May 6 Staff Report was that the interaction between automated execution programs and algorithmic trading strategies can quickly erode liquidity and result in disorderly markets, and that concerns about data integrity, especially those that involve the publication of trades and quotes to the consolidated tape, can contribute to pauses or halts in many automated trading systems and in turn lead to a reduction in general market liquidity.⁵⁹ According to the May 6 Staff Report, the events of May 6, 2010 clearly demonstrate the importance of data in today's world of fully automated trading strategies and systems, and that fair and orderly markets require the maintenance of high standards for robust, accessible, and timely market data.⁶⁰

Both before and after the May 6, 2010 incident, individual markets have also experienced other systems-related issues. In February 2011, NASDAQ OMX Group, Inc. revealed that

⁵⁶ See Findings Regarding The Market Events Of May 6, 2010, Report Of The Staffs Of The CFTC And SEC To The Joint Advisory Committee On Emerging Regulatory Issues, September 30, 2010 ("May 6 Staff Report").

⁵⁷ See *id.*

⁵⁸ These trades subsequently were broken by the exchanges and FINRA. See *id.*

⁵⁹ See *id.* at 78.

⁶⁰ See *id.* at 8.

hackers had penetrated certain of its computer networks, though Nasdaq reported that at no point did this intrusion compromise Nasdaq's trading systems.⁶¹ In October 2011, the Commission sanctioned EDGX and EDGA, two national securities exchanges, and their affiliated broker, Direct Edge ECN LLC, for violations of federal securities laws arising from systems incidents.⁶² In the Direct Edge Order, the Commission noted that the "violations occurred against the backdrop of weaknesses in Respondents' systems, processes, and controls."⁶³

More recently, in 2012, systems issues hampered the initial public offerings of BATS Global Markets, Inc. and Facebook, Inc.⁶⁴ On March 23, 2012, BATS announced that a "software bug" caused BATS to shut down the IPO of its own stock, BATS Global Markets, Inc.⁶⁵ On May 18, 2012, issues with Nasdaq's trading systems delayed the start of trading in the

⁶¹ See announcement by Nasdaq OMX (February 5, 2011), available at: <http://www.nasdaq.com/includes/announcement-2-5-11.aspx> (accessed May 20, 2011). See also Devlin Barrett, "Hackers Penetrate NASDAQ Computers," Wall St. J., February 5, 2011, at A1; Devlin Barrett et al., "NASDAQ Confirms Breach in Network," Wall St. J., February 7, 2011, at C1.

⁶² See Securities Exchange Act Release No. 65556, In the Matter of EDGX Exchange, Inc., EDGA Exchange, Inc. and Direct Edge ECN LLC (settled action: October 13, 2011), available at: <http://www.sec.gov/litigation/admin/2011/34-65556.pdf> ("Direct Edge Order"); see also Commission News Release, 2011-208, "SEC Sanctions Direct Edge Electronic Exchanges and Orders Remedial Measures to Strengthen Systems and Controls" (October 13, 2011). EDGX, EDGA, and their affiliated routing broker, Direct Edge ECN LLC (dba DE Route), consented to an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 19(h) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order.

⁶³ See Direct Edge Order, *supra* note 62, at 3.

⁶⁴ See also *infra* note 334 and accompanying text.

⁶⁵ See "BATS BZX Exchange Post-Mortem" by BATS, March 23, 2012, available at: www.batstrading.com/alerts (accessed July 2, 2012).

high-profile IPO of Facebook, Inc. and some market participants experienced delays in notifications over whether orders had been filled.⁶⁶

While these are illustrative high-profile examples, they are not the only instances of disruptions and other systems problems experienced by SROs and ATs.⁶⁷ Moreover, the risks associated with cybersecurity, and how to protect against systems intrusions, are increasingly of concern to all types of entities, including public companies.⁶⁸

On October 2, 2012, the Commission conducted a roundtable entitled “Technology and Trading: Promoting Stability in Today’s Markets” (“Roundtable”).⁶⁹ The Roundtable examined the relationship between the operational stability and integrity of the securities market and the ways in which market participants design, implement, and manage complex and interconnected trading technologies.⁷⁰ Panelists offered their views on how market participants could prevent, or at least mitigate, technology errors as well as how error response could be improved.

⁶⁶ See “Post-Mortem for NASDAQ issues related to the Facebook Inc. (FB) IPO Cross on Friday, May 18, 2012” by NASDAQ, May 18, 2012, available at: <http://www.nasdaqtrader.com/TraderNews.aspx?id=ETA2012-20> (accessed July 2, 2012).

⁶⁷ The Commission notes that outages have occurred on foreign markets recently as well. See, e.g., Kana Inagaki and Kosaku Narioka, “Tokyo Tackles Trading Glitch,” Wall St. J., February 2, 2012; and Neil Shah and Carrick Mellenkamp, “London Exchange Paralyzed by Glitch,” Wall St. J., September 9, 2008, Europe Business News. See also discussion in *infra* Section III.C.1.b regarding business continuity planning during October 2012 due to Superstorm Sandy.

⁶⁸ See, e.g., CF Disclosure Guidance: Topic No. 2, Cybersecurity (October 13, 2011), available at: <http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm> (providing the Division of Corporation Finance’s views regarding disclosure obligations relating to cybersecurity risks and cyber incidents).

⁶⁹ See Securities Exchange Act Release No. 67802 (September 7, 2012), 77 FR 56697 (September 13, 2012) (File No. 4-652). A webcast of the Roundtable is available at: www.sec.gov/news/otherwebcasts/2012/ttr100212.shtml.

⁷⁰ See Securities Exchange Act Release No. 67725 (August 24, 2012), 77 FR 52766 (August 30, 2012) (File No. 4-652). The Roundtable included panelists from academia,

Although the discussion was wide-ranging, several themes emerged, with panelists generally agreeing that areas of focus across the industry should be on adherence to best practices, improved quality assurance, more robust testing, increased pre-trade and post-trade risk controls, real-time monitoring of systems, and improved communications when systems problems occur. The panelists also discussed whether there should be regulatory or other

clearing agencies, national securities exchanges, broker-dealers, and other organizations. Panelists for the first panel were: Dr. Nancy Leveson, Professor of Aeronautics and Astronautics and Engineering Systems, MIT (“MIT”); Sudhanshu Arya, Managing Director, ITG (“ITG”); Chris Isaacson, Chief Operating Officer, BATS Exchange (“BATS”); Dave Lauer, Market Structure and HFT Consultant, Better Markets, Inc. (“Better Markets”); Jamil Nazarali, Head of Citadel Execution Services, Citadel (“Citadel”); Lou Pastina, Executive Vice President - NYSE Operations, NYSE (“NYSE”); Christopher Rigg, Partner - Financial Services Industry, IBM (“IBM”); and Jonathan Ross, Chief Technology Officer, GETCO LLC (“Getco”).

Panelists for the second panel were: Dr. M. Lynne Markus, Professor of Information and Process Management, Bentley University (“Bentley”); David Bloom, Head of UBS Group Technology (“UBS”); Chad Cook, Chief Technology Officer, Lime Brokerage LLC (“Lime”); Anna Ewing, Executive Vice President and Chief Information Officer, Nasdaq; Albert Gambale, Managing Director and Chief Development Officer, Depository Trust and Clearing Corp. (“DTCC”); Saro Jahani, Chief Information Officer, Direct Edge (“DE”); and Lou Steinberg, Chief Technology Officer, TD Ameritrade (“TDA”). See Technology and Trading: Promoting Stability in Today’s Markets Roundtable — Participant Bios, available at: <http://www.sec.gov/news/otherwebcasts/2012/ttr100212-bios.htm>.

The Roundtable was announced on August 3, 2012, following a report by Knight Capital Group, Inc. (“Knight”) that, on August 1, 2012, it “experienced a technology issue at the opening of trading at the NYSE...[which was] related to Knight’s installation of trading software and resulted in Knight sending numerous erroneous orders in NYSE-listed securities into the market...Knight...traded out of its entire erroneous trade position, which...resulted in a realized pre-tax loss of approximately \$440 million.” See Knight Capital Group Provides Update Regarding August 1st Disruption To Routing In NYSE-listed Securities (August 2, 2012), available at: <http://www.knight.com/investorRelations/pressReleases.asp?compid=105070&releaseID=1721599>.

Although the Knight incident highlights the importance of the integrity of broker-dealer systems, the focus of the Roundtable was not limited to broker-dealers. But see infra Section III.G, soliciting comment regarding the potential inclusion of broker-dealers, other than SCI ATSS, in the proposed definition of SCI entity.

mandates for quality standards and industry testing, and whether specific mechanisms, such as “kill switches,”⁷¹ would be useful to protect the markets from technology errors and to advance the goal of bolstering investor confidence in the markets.⁷² Several panelists also stated that, given the frequency of coding changes in the current market environment, testing of software changes should be far more robust.⁷³

In addition to the Roundtable panels, the Commission solicited comment with respect to the Roundtable’s topics, and received statements from some of the Roundtable panelists, as well as comment letters from the public.⁷⁴ Many comment letters specifically recommended

⁷¹ The term “kill switch” is a shorthand expression used by market participants, including Roundtable participants and Roundtable commenters, to refer to mechanisms pursuant to which one or more limits on trading could be established by a trading venue for its participants that, if exceeded, would authorize the trading venue to stop accepting incoming orders from such participant. See also infra note 76 and accompanying text.

⁷² With regard to quality assurance in particular, Roundtable panelists differed on the role of third parties in providing quality assurance, with some panelists believing that, given the difficulty for an outside party to understand the complex systems of trading firms and other market participants, such a role should be performed by internal staff who are better able to understand such systems, with other panelists opining that there it was critical that independent parties provide quality assurance.

⁷³ Panelists urging greater testing in general and industry testing in particular included those from BATS, Better Markets, DE, ITG, Getco, Nasdaq, NYSE, and TDA.

⁷⁴ See <http://www.sec.gov/comments/4-652/4-652.shtml>, listing and publishing all comment letters received by the Commission with respect to the Roundtable. The letters received cover a broad array of topics, some of which are unrelated to proposed Regulation SCI. This proposing release discusses and references the following letters when relevant to the discussion of proposed Regulation SCI: Letter dated September 5, 2012, from James J. Angel, Ph.D., CFA, Georgetown University and the Wharton School, University of Pennsylvania (“Angel”); Letter dated September 27, 2012, from Eric Swanson, BATS Global Markets, Inc.; Letter dated October 2, 2012, from Dave Lauer, Market Structure and HFT Consultant, Better Markets (“Better Markets”); Letter dated October 1, 2012, from Jamil Nazarali, Citadel (“Citadel”); Letter dated October 23, 2012, from Scott Goebel, Senior Vice President and General Counsel, Fidelity Management & Research Company (“Fidelity”); Letter dated November 1, 2012, from Arsalan Shahid, Program Director, Financial Information Forum (“FIF”); Letter dated October 19, 2012, from Courtney Doyle McGuinn, Operations Director, FIX Protocol Ltd. (“FIX”); Letter dated

improved testing as a way to aid error prevention.⁷⁵ In addition, several commenters expressed support for a “kill-switch” mechanism that would permit exchanges or other market centers to terminate a firm’s trading activity if such activity was posing a threat to market integrity.⁷⁶

October 1, 2012, from Elizabeth K. King, Head of Regulatory Affairs, GETCO LLC (“Getco”); Letter dated October 18, 2012, from Adam Nunes, President, Hudson River Trading LLC (“Hudson”); Letter dated September 23, 2012, from Patrick J. Healy, CEO, Issuer Advisory Group LLC (“IAG”); Letter dated October 23, 2012, from Karrie McMillan, General Counsel, Investment Company Institute (“ICI”); Letter dated October 22, 2012, from James P. Selway III, Managing Director, Head of Liquidity Management, and Sudhanshu Arya, Managing Director, Head of Technology for Liquidity Management, ITG Inc. (“ITG”); Letter dated September 28, 2012, from Joseph M. Mecane, NYSE Euronext; Richard G. Ketchum, FINRA; Eric Noll, Nasdaq OMX, Inc.; Christopher A. Isaacson, BATS Global Markets, Inc.; Bryan Harkins, DirectEdge; David Herron, Chicago Stock Exchange; Murray Pozmanter, The Depository Trust & Clearing Corporation; Bank of America Merrill Lynch; Citadel LLC; Citigroup Global Markets Inc.; Deutsche Bank Securities Inc.; GETCO; Goldman, Sachs & Co/Goldman Sachs Execution and Clearing; IMC Chicago LLC; ITG, Inc.; Jane Street; J.P. Morgan Securities LLC; RBC Capital Markets, LLC; RGM Advisors, LLC; Two Sigma Securities; UBS Securities LLC; Virtu Financial; Wells Fargo Securities (“Industry Working Group”); Letter dated September 25, 2012, from R. T. Leuchtkafer (“Leuchtkafer”); Letter dated August 14, 2012, from Stuart J. Kaswell, Executive Vice President, Managing Director & General Counsel, Managed Funds Association (“MFA”); Letter dated October 1, 2012, from Richard Gorelick, RGM Advisors, Cameron Smith, Quantlab, and Peter Nabicht, Allston Trading (“RGM”); Letter dated September 28, 2012, from Nasser A. Sharara, Managing Director, Product Management, Raptor Trading Systems (“Raptor”); Letter dated October 1, 2012, from Lou Steinberg, Managing Director, Chief Technology Officer, TDA (“TDA”); Letter dated October 24, 2012, from David Weisberger, Executive Principal, Two Sigma Securities, LLC (“Two Sigma”).

⁷⁵ See, e.g., letters from Angel, BATS, Better Markets, Citadel, Fidelity, FIF, FIX, Getco, Hudson, IAG, ICI, ITG, Industry Working Group, Leuchtkafer, MFA, RGM, and Two Sigma, supra note 74. Some of these commenters specifically urged greater integration testing and stated that testing with exchanges and other market centers under simulated market conditions were necessary in today’s extremely fast and interconnected markets. One commenter (Angel) suggested that exchanges operate completely from their backup data centers one day each year to test such systems and market participants’ connectivity to them.

⁷⁶ See, e.g., letters from Angel, BATS, Citadel, FIF, Getco, IAG, Industry Working Group, MFA, RGM, and Raptor, supra note 74. See also letters from Fidelity, FIX, Hudson and ITG, supra note 74, submitted after the Roundtable, suggesting possible approaches for establishing kill switch criteria. See also supra note 71, describing the use of the term “kill switch” in this release.

The Commission believes that the information presented at the Roundtable and received from commenters, as broadly outlined above, highlights that quality standards, testing, and improved error response mechanisms are among the issues needing very thoughtful and focused attention in today's securities markets.⁷⁷ In formulating proposed Regulation SCI, the Commission has considered the information and views discussed at the Roundtable and received from commenters.

Most recently, the U.S. national securities exchanges closed for two business days in the wake of Superstorm Sandy, a major storm that hit the East Coast of the United States during October 2012, and which caused significant damage in lower Manhattan, among other places.⁷⁸ Press reports stated that, while the markets planned to open on the first day of the storm (with the

⁷⁷ The Commission notes that Roundtable panelists and commenters offering their views and suggestions generally did so in the context of discussing the market as a whole, rather than focusing on the roles and regulatory status of different types of market participants. However, some commented on the utility of the ARP Inspection Program and suggested that it could be expanded. *See, e.g.*, letter from Leuchtkafer, *supra* note 74. In addition, the panelists from Getco, Nasdaq, and NYSE also suggested that ARP could be expanded, with the panelist from NYSE in particular advocating that the applicability of any new ARP-related regulations not be limited to SROs. One commenter suggested that the Commission update and formalize the ARP Inspection Program before extending it to other market participants. *See* letter from Fidelity, *supra* note 74. This commenter added further that, if the ARP program is extended to other market participants, it should not include a requirement that broker-dealers submit certain information, such as algorithmic code changes, for independent review. *See also infra* Section III.G, soliciting comment on whether the requirements of proposed Regulation SCI should apply, in whole or in part, to broker-dealers or a subset thereof.

⁷⁸ *See* "NYSE to Remain Open for Trading While Physical Trading Floor and New York Building Close in Accordance with Actions Taken by City and State Officials," (October 28, 2012) ("NYSE Floor Closure Statement"), available at: <http://www.nyse.com/press/1351243407197.html>; and "NYSE Euronext Statement on Closure of U.S. Markets on Monday Oct. 29 and Pending Confirmation on Tuesday, Oct. 30, 2012," (October 28, 2012) ("NYSE Closure Statement"), available at: <http://www.nyse.com/press/1351243418010.html>.

NYSE planning to operate under its contingency plan as an electronic-only venue),⁷⁹ after consultation with market participants, including the Commission and its staff, and in light of concerns over the physical safety of personnel and the possibility of technical issues, the national securities exchanges jointly decided not to open for trading on October 29 and October 30, 2012.⁸⁰ The market closures occurred even though the securities industry's annual test of how trading firms, market operators and their utilities could operate through an emergency using backup sites, backup communications, and disaster recovery facilities occurred on October 27, 2012, just two days before the storm.⁸¹ According to press reports, the test did not uncover issues that would preclude markets from opening two days later with backup systems, if they so chose.⁸² In addition, NYSE's contingency plan was tested seven months prior to the storm, though press reports indicate that a large number of NYSE members did not participate.⁸³ The Commission also has considered the impact of Superstorm Sandy on the securities markets,

⁷⁹ The NYSE had initially planned to act pursuant to NYSE Rule 49 (Emergency Powers), which permits a designated official of the NYSE, in the event of an emergency (as defined in Section 12(k)(7) of the Exchange Act), to designate NYSE Arca to receive and process bids and offers and to execute orders on behalf of the NYSE. See "NYSE Contingency Trading Plan in effect for Monday, October 29, 2012," (October 28, 2012) ("Market Operations Update"), available at: <http://markets.nyx.com/nyse/trader-updates/view/11503>. The Commission approved NYSE Rule 49 on December 16, 2009. See Securities Exchange Act Release No. 61177 (December 16, 2009), 74 FR 68643 (December 28, 2009) (SR-NYSE-2009-105) (approving proposed rule change by the NYSE relating to the designation of NYSE Arca as the NYSE's alternative trading facility in an emergency).

⁸⁰ See, e.g., "A giant storm and the struggle over closing Wall Street," October 31, 2012, available at: <http://www.reuters.com/article/2012/10/31/us-storm-sandy-nyse-insight-idUSBRE89T0F920121031>. See also, e.g., NYSE Closure Statement, *supra* note 78.

⁸¹ See, e.g., "Storm Over Wall Street Going Dark," November 12, 2012, available at: <http://www.tradersmagazine.com/news/storm-over-wall-street-going-dark-110526-1.html>.

⁸² See *id.* See also <http://www.sifma.org/services/bcp/industry-testing>.

⁸³ See *id.* and NYSE Floor Closure Statement, *supra* note 78.

particularly with respect to business continuity planning and testing, in formulating proposed Regulation SCI.

II. Proposed Codification and Enhancement of ARP Inspection Program

In the Commission's view, the convergence of several developments—the evolution of the markets to become significantly more dependent upon sophisticated automated systems, the limitations of the existing ARP Inspection Program, and the lessons of recent events—highlight the need to consider an updated and formalized regulatory framework for ensuring that the U.S. securities trading markets develop and maintain systems with adequate capacity, integrity, resiliency, availability, and security, and reinforce the requirement that such systems operate in compliance with the Exchange Act. The Commission is proposing new Regulation SCI because the Commission preliminarily believes that it would further the goals of the national market system and reinforce Exchange Act obligations to require entities important to the functioning of the U.S. securities markets to carefully design, develop, test, maintain, and surveil systems integral to their operations.

Proposed Regulation SCI would replace the two ARP policy statements. Although proposed Regulation SCI would codify in a Commission rule many of the principles of the ARP policy statements with which SROs and other participants in the ARP Inspection Program are familiar, the proposed rule would apply to more entities than the current ARP Inspection Program and would place obligations not currently included in the ARP policy statements on entities subject to the rule. Specifically, proposed Regulation SCI would apply to “SCI entities,” a term that would include “SCI SROs,” “SCI ATSS,” “plan processors,” and “exempt clearing agencies subject to ARP.”⁸⁴

⁸⁴ Each of these terms is discussed in detail in Section III.B.1 below.

Further, to help ensure that the proposed rule covers key systems of SCI entities, the proposed rule would define (for purposes of Regulation SCI) the term “SCI systems” to mean those systems of, or operated by or on behalf of, an SCI entity that directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance. In addition, the term “SCI security systems” would include systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to such systems.⁸⁵ The proposed rule also would define several other terms intended to specify what types of systems changes and problems (“SCI events”) the Commission considers to be most significant and, therefore, preliminarily believes should be covered by the proposed rule’s requirements.

In addition, proposed Regulation SCI would specify the obligations SCI entities would have with respect to covered systems and SCI events. Specifically, proposed Regulation SCI would require that each SCI entity: (1) establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity’s operational capability and promote the maintenance of fair and orderly markets; (2) establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended; (3) respond to SCI events with appropriate corrective action; (4) report SCI events to the Commission and submit follow-up reports, as applicable; (5) disseminate information regarding certain SCI events to members or participants of the SCI entity; (6) report material systems changes to the Commission; (7) conduct an SCI review of its systems not less than once each

⁸⁵ See *infra* Section III.B.2 for a discussion of the proposed definitions of SCI systems and SCI security systems.

calendar year; (8) submit certain periodic reports to the Commission, including a report of the SCI review, together with any response by senior management; (9) mandate participation by designated members or participants in scheduled testing of the operation of the SCI entity's business continuity and disaster recovery plans, including backup systems, and coordinate such testing on an industry- or sector-wide basis⁸⁶ with other SCI entities; and (10) make, keep, and preserve records relating to the matters covered by Regulation SCI, and provide them to Commission representatives upon request. The proposal also would require that an SCI entity submit all required written notifications and reports to the Commission electronically using new proposed Form SCI.

III. Proposed Regulation SCI

A. Overview

The purpose of proposed Regulation SCI is to enhance the Commission's regulatory supervision of SCI entities and thereby further the goals of the national market system by helping to ensure the capacity, integrity, resiliency, availability, and security, and enhance compliance with federal securities laws and regulations, of automated systems relating to the U.S. securities markets through the formalization of standards to which their automated systems would be held, and a regulatory framework for ensuring more effective Commission oversight of these systems. Proposed Rule 1000(a) sets forth several definitions designed to establish the scope of the new rule. Proposed Rule 1000(b) sets forth the obligations that would be imposed on SCI entities with respect to systems and systems issues. Proposed Rules 1000(c)-(f) set forth recordkeeping and electronic filing requirements and address certain other related matters.

⁸⁶ See infra Section III.C.7 for a discussion of the terms industry-wide and sector-wide.

B. Proposed Rule 1000(a): Definitions Establishing the Scope of Regulation SCI

A series of definitions set forth in proposed Rule 1000(a) relate to the scope of proposed Regulation SCI. These include the definitions for “SCI entity,” “SCI systems,” “SCI security systems,” “SCI event,” “systems disruption,” “systems compliance issue,” “systems intrusion,” “dissemination SCI event,” and “material systems change.”

1. SCI Entities

Although the ARP policy statements are rooted in Exchange Act requirements, the ARP Inspection Program has developed without the promulgation of Commission rules applicable to SROs or plan processors. Under the ARP Inspection Program, Commission staff conducts inspections of SROs to assess the capacity, integrity, resiliency, availability, and security of their systems. These inspections also have historically included the systems of entities that process and disseminate quotation and transaction data on behalf of the Consolidated Tape Association System (“CTA Plan”), Consolidated Quotation System (“CQS Plan”), Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis (“Nasdaq UTP Plan”), and Options Price Reporting Authority (“OPRA Plan”).⁸⁷ The ARP Inspection Program has also included one exempt clearing agency.⁸⁸

⁸⁷ See ARP I Release, *supra* note 1, at n. 8 and n. 17. Each of the CTA Plan, CQS Plan, Nasdaq UTP Plan, and OPRA Plan, is a “national market system plan” (“NMS Plan”) as defined under Rule 600(a)(43) of Regulation NMS under the Exchange Act, 17 CFR 242.600(a)(43). Rule 600(a)(55) of Regulation NMS under the Exchange Act, 17 CFR 242.600(a)(55), defines a “plan processor” as “any self-regulatory organization or securities information processor acting as an exclusive processor in connection with the development, implementation and/or operation of any facility contemplated by an effective national market system plan.” Section 3(a)(22)(B) of the Exchange Act, 15 U.S.C. 78c(22)(B), defines “exclusive processor” to mean “any securities information processor or self-regulatory organization which, directly or indirectly, engages on an exclusive basis on behalf of any national securities exchange or registered securities

Pursuant to Rule 301(b)(6) of Regulation ATS, certain aspects of the ARP policy statements apply mandatorily to significant-volume ATSS, as they are currently defined under Regulation ATS.⁸⁹ However, because no ATSS currently meet the significant-volume thresholds specified in Rule 301(b)(6) of Regulation ATS,⁹⁰ compliance with the ARP Inspection Program is not mandatory at this time for any ATS.⁹¹ Proposed Regulation SCI would provide mandatory uniform requirements for "SCI entities." Proposed Rule 1000(a) would define "SCI entity" as an "SCI self-regulatory organization, SCI alternative trading system, plan processor, or exempt clearing agency subject to ARP." The proposed rule also would define each of these terms for

association, or any national securities exchange or registered securities association which engages on an exclusive basis on its own behalf, in collecting, processing, or preparing for distribution or publication any information with respect to (i) transactions or quotations on or effected or made by means of any facility of such exchange or (ii) quotations distributed or published by means of any electronic system operated or controlled by such association."

As a processor involved in collecting, processing, and preparing for distribution transaction and quotation information, the processor of each of the CTA Plan, CQS Plan, Nasdaq UTP Plan, and OPRA Plan meets the definition of "exclusive processor;" and because each acts as an exclusive processor in connection with an NMS Plan, each also meets the definition of "plan processor" under Rule 600(a)(55) of Regulation NMS, as well as proposed Rule 1000(a) of Regulation SCI. For ease of reference, an NMS Plan having a current or future "plan processor" is referred to herein as an "SCI Plan." The Commission notes that not every processor of an NMS Plan would be a "plan processor," as proposed to be defined in Rule 1000(a), and therefore not every processor of an NMS Plan would be an SCI entity subject to the requirements of proposed Regulation SCI. For example, the processor of the Symbol Reservation System associated with the National Market System Plan for the Selection and Reservation of Securities Symbols (File No. 4-533) would not be a "plan processor" subject to Regulation SCI because it does not meet the "exclusive processor" statutory definition, as it is not involved in collecting, processing, and preparing for distribution transaction and quotation information.

⁸⁸ See *infra* notes 133-135 and accompanying text.

⁸⁹ See 17 CFR 242.301(b)(6). See also *supra* note 26.

⁹⁰ 17 CFR 242.301(b)(6).

⁹¹ One ATS currently participates voluntarily in the ARP Inspection Program, though, in the past, other ATSS have also participated in the ARP Inspection Program.

the purpose of designating specifically the entities that the Commission preliminarily believes should be subject to the rule.

Proposed Rule 1000(a) would define the term “SCI self-regulatory organization.” The definition of “SCI self-regulatory organization,” or “SCI SRO,” would be consistent with the definition of “self-regulatory organization” set forth in Section 3(a)(26) of the Exchange Act,⁹² and would cover all national securities exchanges registered under Section 6(b) of the Exchange Act,⁹³ registered securities associations,⁹⁴ registered clearing agencies,⁹⁵ and the Municipal

⁹² See 15 U.S.C. 78c(a)(26): “The term ‘self-regulatory organization’ means any national securities exchange, registered securities association, or registered clearing agency, or (solely for purposes of sections 19(b), 19(c), and 23(b) of this title) the Municipal Securities Rulemaking Board established by section 15B of this title.” See *infra* note 96.

⁹³ Currently, these registered national securities exchanges are: (1) BATS; (2) BATS-Y; (3) BOX; (4) CBOE; (5) C2; (6) CHX; (7) EDGA; (8) EDGX; (9) ISE; (10) MIAX; (11) Nasdaq OMX BX; (12) Nasdaq OMX Phlx; (13) Nasdaq; (14) NSX; (15) NYSE; (16) NYSE MKT; and (17) NYSE Arca.

⁹⁴ FINRA is the only registered national securities association.

⁹⁵ Currently, there are seven clearing agencies (Depository Trust Company (“DTC”); Fixed Income Clearing Corporation (“FICC”); National Securities Clearing Corporation (“NSCC”); Options Clearing Corporation (“OCC”); ICE Clear Credit; ICE Clear Europe; and CME) with active operations that are registered with the Commission. See also *infra* notes 133-135 and accompanying text. The Commission notes that it recently adopted Rule 17Ad-22, which requires registered clearing agencies to have effective risk management policies and procedures in place. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012). Among other things, Rule 17Ad-22(d)(4) requires that registered clearing agencies “[i]dentify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures; implement systems that are reliable, resilient and secure, and have adequate, scalable capacity; and have business continuity plans that allow for timely recovery of operations and fulfillment of a clearing agency’s obligations.” In its adopting release, the Commission stated that Rule 17Ad-22(d)(4) “...complements the existing guidance provided by the Commission in its Automation Review Policy Statements and the Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System.” Similarly, the Commission preliminarily believes that proposed Regulation SCI, to the extent it addresses areas of risk management similar to those addressed by Rule 17Ad-22(d)(4), complements Rule 17Ad-22(d)(4). See also *infra* note 203.

Securities Rulemaking Board (“MSRB”).⁹⁶ The definition would, however, exclude an exchange that lists or trades security futures products that is notice-registered with the Commission as a national securities exchange pursuant to Section 6(g) of the Exchange Act, as well as any limited purpose national securities association registered with the Commission pursuant to Exchange Act Section 15A(k).⁹⁷ Accordingly, the definition of SCI SRO in proposed Rule 1000(a) would mandate that all national securities exchanges registered under Section 6(b) of the Exchange Act,

⁹⁶ 15 U.S.C. 78c(a)(26). See also *supra* note 92. Historically, the ARP Inspection Program has not included the MSRB, but instead has focused on entities having trading, quotation and transaction reporting, and clearance and settlement systems more closely connected to the equities and options markets. In considering the entities that should be subject to proposed Regulation SCI, the Commission preliminarily believes that it would be appropriate to apply proposed Regulation SCI to all SROs (subject to the exception noted in *infra* note 97), of which the MSRB is one, particularly given the fact that the MSRB is the only SRO relating to municipal securities and is the sole provider of consolidated market data for the municipal securities market. Specifically, in 2008, the Commission amended Rule 15c2-12 to designate the MSRB as the single centralized disclosure repository for continuing municipal securities disclosure. In 2009, the MSRB established the Electronic Municipal Market Access system (“EMMA”). EMMA now serves as the official repository of municipal securities disclosure, providing the public with free access to relevant municipal securities data, and is the central database for information about municipal securities offerings, issuers, and obligors. Additionally, the MSRB’s Real-Time Transaction Reporting System (“RTRS”), with limited exceptions, requires municipal bond dealers to submit transaction data to the MSRB within 15 minutes of trade execution, and such near real-time post-trade transaction data can be accessed through the MSRB’s EMMA website. While pre-trade price information is not as readily available in the municipal securities market, the Commission’s Report on the Municipal Securities Market also recommends that the Commission and MSRB explore the feasibility of enhancing EMMA to collect best bids and offers from material ATSS and make them publicly available on fair and reasonable terms. See Report on the Municipal Securities Market (July 31, 2012), available at: <http://www.sec.gov/news/studies/2012/munireport073112.pdf>.

⁹⁷ See 15 U.S.C. 78f(g); 15 U.S.C. 78o-3(k). These entities are security futures exchanges and the National Futures Association, for which the CFTC serves as their primary regulator. The Commission preliminarily believes that it would be appropriate to defer to the CFTC regarding the systems integrity of these entities.

all registered securities associations, all registered clearing agencies, and the MSRB, comply with Regulation SCI.⁹⁸

Proposed Rule 1000(a) would define the term “SCI alternative trading system,” or “SCI ATS,” as an alternative trading system, as defined in § 242.300(a), which during at least four of the preceding six calendar months, had: (1) with respect to NMS stocks – (i) five percent or more in any single NMS stock, and 0.25 percent or more in all NMS stocks, of the average daily dollar volume reported by an effective transaction reporting plan, or (ii) one percent or more, in all NMS stocks, of the average daily dollar volume reported by an effective transaction reporting plan; (2) with respect to equity securities that are not NMS stocks and for which transactions are reported to a self-regulatory organization, five percent or more of the average daily dollar volume as calculated by the self-regulatory organization to which such transactions are reported; or (3) with respect to municipal securities or corporate debt securities, five percent or more of either – (i) the average daily dollar volume traded in the United States, or (ii) the average daily transaction volume traded in the United States.⁹⁹

⁹⁸ For any SCI SRO that is a national securities exchange, any facility of such national securities exchange, as defined in Section 3(a)(2) of the Exchange Act, 15 U.S.C. 78c(a)(2), also would be covered because such facilities are included within the definition of “exchange” in Section 3(a)(1) of the Exchange Act, 15 U.S.C. 78c(a)(1).

⁹⁹ Proposed Regulation SCI includes specific quantitative requirements, such as proposed Rule 1000(a), which would include numerical thresholds in the definition of SCI ATS. The Commission recognizes that the specificity of each such quantitative threshold could be read by some to imply a definitive conclusion based on quantitative analysis of that threshold and its alternatives. The numerical thresholds in the definition of SCI ATS have not been derived from econometric or mathematical models. Instead, they reflect a preliminary assessment by the Commission, based on qualitative and some quantitative analysis, of the likely economic consequences of the specific quantitative thresholds proposed to be included in the definition. There are a number of challenges presented in conducting such a quantitative analysis in a robust fashion as discussed in this section. Accordingly, the selection of the particular quantitative thresholds for the definition of SCI ATS reflects a qualitative and preliminary quantitative assessment by the

As proposed, ATSS would be covered if they met the proposed thresholds for at least four of the preceding six months, which the Commission preliminarily believes is an appropriate time period over which to evaluate the trading volume of an ATS.¹⁰⁰ The Commission preliminarily believes that this time period would help ensure that the standards are not so low as to capture ATSS whose volume would still be considered relatively low, but, for example, that may have had an anomalous increase in trading on a given day or small number of days.

The proposed definition would modify the thresholds currently appearing in Rule 301(b)(6) of Regulation ATS that apply to significant-volume ATSS.¹⁰¹ Specifically, the proposed definition would: use average daily dollar volume thresholds, instead of an average daily share volume threshold, for ATSS that trade NMS stocks or equity securities that are not NMS stocks (“non-NMS stocks”); use alternative average daily dollar and transaction volume-based tests for ATSS that trade municipal securities or corporate debt securities; lower the volume thresholds applicable to ATSS for each category of asset class; and move the proposed thresholds to Rule 1000(a) of proposed Regulation SCI. In particular, with respect to NMS stocks, the Commission proposes to change the volume threshold from 20 percent of average daily volume in any NMS stock such that an ATS that trades NMS stocks that meets either of the following two alternative threshold tests would be subject to the requirements of proposed Regulation SCI: (i) five percent or more in any NMS stock, and 0.25 percent or more in all

Commission regarding the appropriate thresholds. In making such assessments and, in turn, selecting the proposed quantitative thresholds, the Commission has reviewed data from OATS and other sources. The Commission emphasizes that it invites comment, including relevant data and analysis, regarding all aspects of the various quantitative standards reflected in the proposed rules.

¹⁰⁰ The proposed measurement period would remain unchanged from the period currently in Rule 301(b)(6) of Regulation ATS.

¹⁰¹ 17 CFR 242.301(b)(6). See also supra note 26.

NMS stocks, of the average daily dollar volume reported by an effective transaction reporting plan; or (ii) one percent or more, in all NMS stocks, of the average daily dollar volume reported by an effective transaction reporting plan. This change is designed to ensure that proposed Regulation SCI is applied to an ATS that could have a significant impact on the NMS stock market as a whole, as well as an ATS that could have a significant impact on a single NMS stock and some impact on the NMS stock market as a whole at the same time.¹⁰² Specifically, by imposing both a single NMS stock threshold and an all NMS stocks threshold in (i) above, proposed Regulation SCI would not apply to an ATS that has a large volume in a small NMS stock and little volume in all other NMS stocks. Based on data collected from FINRA's Order Audit Trail System ("OATS data") for one week of trading in May 2012,¹⁰³ the Commission

¹⁰² Under the proposed thresholds, inactive ATSs would not be included in the definition of SCI ATS.

The Commission has considered barriers to entry and the promotion of competition in setting the threshold (see discussion at *infra* Section V.C.4.b) such that new ATSs trading NMS stocks would be able to commence operations without, at least initially, being required to comply with – and thereby not incurring the costs associated with – proposed Regulation SCI. If the proposed thresholds are adopted, a new ATS could engage in limited trading in any one NMS stock or all NMS stocks, until it reached an average daily dollar volume of five percent or more in any one NMS stock and 0.25 percent or more in all NMS stocks, or one percent in all NMS stocks, over four of the preceding six months. Because a new ATS could begin trading in NMS stocks for at least three months (*i.e.*, less than four of the preceding six months), and conduct such trading at any dollar volume level without being subject to proposed Regulation SCI, and would have to exceed the specified volume levels for the requisite period to become so subject, the Commission preliminarily believes that these proposed thresholds should not prevent a new ATS entrant from having the opportunity to initiate and develop its business.

¹⁰³ Commission staff analyzed OATS data for the week of May 7-11, 2012, a week with average market activity and no holidays or shortened trading days, and thus intended to be a representative trading week. However, because the OATS data analysis does not consider trading volume over a six-month period and does not base the threshold test on four out of the preceding six calendar months as prescribed in proposed Rule 1000(a), it may overestimate the number of ATSs that would meet the proposed thresholds. For example, a large block trade during a single week could skew an ATS's numbers upward from what would be observed over the course of the four months with the highest

preliminarily believes that approximately 10 ATSS trading NMS stocks would exceed the proposed thresholds and fall within the definition of SCI entity, accounting for approximately 87 percent of the dollar volume market share of all ATSS trading NMS stocks.

The Commission notes that its analysis of the OATS data does not reveal an obvious threshold level above which a particular subset of ATSS may be considered to have a significant impact on individual NMS stocks or the overall market, as compared to another subset of ATSS. The Commission preliminarily believes that inclusion of the proposed dual dollar volume threshold is appropriate to help prevent an ATS from avoiding the requirements of proposed Regulation SCI by circumventing one of the two threshold tests. The Commission also preliminarily believes that a threshold that accounts for 87 percent of the dollar volume market share of all ATSS trading NMS stocks is a reasonable level that would not exclude new entrants to the ATS market.¹⁰⁴ Moreover, the Commission preliminarily believes the proposed thresholds would appropriately include ATSS having NMS stock dollar volume comparable to the NMS stock dollar volume of the equity exchanges that are SCI SROs and therefore covered by proposed Regulation SCI.¹⁰⁵

volumes during a six-month period, particularly with respect to the proposed single-stock threshold. In addition, because the OATS data does not identify all ATSS and does not identify some ATSS uniquely, some ATSS may not be accounted for in the estimated number of ATSS that would meet the proposed threshold. Nevertheless, the Commission believes the analysis of OATS data offers useful insights.

¹⁰⁴ The Commission preliminarily believes that the remaining 13 percent of the dollar volume of all ATSS trading NMS stocks is limited to trading conducted on small and new ATSS. See also supra note 102.

¹⁰⁵ For example, based on trade and quotation data published by NYSE Euronext for the period July 1, 2012 through December 31, 2012, the national securities exchanges with the smallest market shares in NMS stocks (based on average daily dollar volume) had market shares slightly above and, in one case, below, the proposed 0.25 percent threshold in all NMS stocks (the market shares of CBOE, NSX, and NYSE MKT were approximately 0.44 percent, 0.27 percent, and 0.06 percent, respectively). Further, all

Since the time that the Commission originally adopted Regulation ATS, the equity markets have evolved significantly, resulting in an increase in the number of trading centers and a reduction in the concentration of trading activity.¹⁰⁶ As such, even smaller trading centers, such as certain ATSS, now collectively represent a significant source of liquidity for NMS stocks and, by comparison, no single registered securities exchange executes more than 20 percent of volume in NMS stocks.¹⁰⁷ Given these developments in market structure, the Commission preliminarily believes that setting the average daily dollar volume threshold for NMS stocks at five percent in any NMS stock and 0.25 percent in all NMS stocks, or one percent in all NMS stocks, is appropriate to help ensure that entities that have determined to participate (in more than a limited manner) in the national market system as markets that bring buyers and sellers together, are subject to the requirements of proposed Regulation SCI. In addition, the Commission preliminarily believes that it is appropriate to propose average daily dollar volume thresholds for NMS stocks, rather than average daily share volume thresholds, because, by using dollar volume, the price level of a stock will not skew an ATS's inclusion or exclusion from the definition of SCI entity, as may be the case when using share volume, and the use of dollar thresholds may better reflect the economic impact of trading activity.¹⁰⁸

national securities exchanges that trade NMS stocks had at least 5 percent or more of the average daily dollar volume in at least one NMS stock, with most exceeding such threshold for multiple NMS stocks.

¹⁰⁶ See supra notes 47-51 and accompanying text.

¹⁰⁷ See supra note 47.

¹⁰⁸ For example, if a threshold is based on the average daily share volume in all NMS stocks, an ATS that transacts in a stock that has recently been through a stock split could experience a significant increase in its share volume (or, for reverse stock splits, a decrease in its share volume), whereas the dollar value transacted would remain the same.

In sum, the Commission preliminarily believes that the proposed dollar volume thresholds for NMS stocks would further the goals of the national market system by ensuring that ATSS that meet the thresholds are subject to the same baseline standards as other SCI entities for systems capacity, integrity, resiliency, availability, and security.

With respect to non-NMS stocks, municipal securities, and corporate debt securities, the Commission is proposing to lower the current thresholds in Rule 301(b)(6) of Regulation ATS. Specifically, the Commission is proposing to reduce the standard from 20 percent to five percent for these types of securities,¹⁰⁹ the same percentage threshold for such types of securities that triggers the fair access provisions of Rule 301(b)(5) of Regulation ATS.¹¹⁰ The Commission preliminarily believes that ATSS that trade non-NMS stocks, municipal securities, and corporate debt securities above the proposed thresholds are those that play a significant role in the market for such securities and thus preliminarily believes that the proposed thresholds are appropriately designed.

With respect to non-NMS stocks for which transactions are reported to a self-regulatory organization, the Commission proposes to lower the threshold to five percent or more of the average daily dollar volume as calculated by the self-regulatory organization to which such transactions are reported. Using data from the first six months of 2012, the Commission believes that an ATS executing transactions in non-NMS stocks at a level exceeding five percent of the average daily dollar volume traded in the United States would be executing trades at a level exceeding \$31 million daily.¹¹¹ Based on data collected from Form ATS-R for the second

¹⁰⁹ See proposed Rule 1000(a). As discussed in this Section III.B.1, the thresholds in proposed Rule 1000(a) would be based on average daily dollar or transaction volume.

¹¹⁰ See Rule 301(b)(5) of Regulation ATS under the Exchange Act. 17 CFR 242.301(b)(5).

¹¹¹ Source: data provided by OTC Markets.

quarter of 2012, the Commission estimates that two ATSS would exceed this threshold and fall within the definition of SCI entity. The Commission requests comment on the accuracy of these estimates.

With respect to municipal securities and corporate debt securities, the Commission proposes to lower the threshold to five percent or more of either: (i) the average daily dollar volume¹¹² traded in the United States; or (ii) the average daily transaction volume traded in the United States. The Commission preliminarily believes that this two-pronged threshold is appropriate for the debt market, as it should capture both ATSS that are focused on retail orders and facilitate a relatively greater number of trades with relatively lower dollar values, as well as those ATSS that are focused on institutional orders and facilitate a relatively lower number of trades with relatively greater dollar values. The Commission preliminarily believes that both of these thresholds are important in identifying ATSS that play a significant role in the debt markets for executing both retail- and institutional-sized trades.¹¹³

¹¹² As with the proposed measures for ATSS that trade NMS stocks or non-NMS stocks, the Commission is proposing to use average daily dollar volume for debt securities, which the Commission preliminarily believes is the measure most commonly used when analyzing daily trading volume in the debt markets.

¹¹³ Most corporate and municipal bond trades are small (*i.e.*, less than \$100,000), but small trades do not account for most of the dollar volume in these markets. See, *e.g.*, Edwards, Amy K., Harris, Lawrence and Piwovar, Michael S., Corporate Bond Market Transaction Costs and Transparency, *Journal of Finance*, Vol. 62, No. 3 (June 2007) and Lawrence E. Harris and Michael S. Piwovar, Secondary Trading Costs in the Municipal Bond Market, *J.FIN.* (June 2006). An ATSS that specializes in large trades may account for a small portion of the trades but a large portion of the dollar volume. Likewise, an ATSS that specializes in small trades may account for a small portion of the dollar volume but a large portion of the trades. Therefore, a systems disruption, systems compliance issue, or systems intrusion in either of these ATSS types could potentially disrupt a large portion of the market.

As the Commission stated in the ATSS Release, “many of the same concerns about the trading of equity securities on alternative trading systems apply equally to the trading of fixed income securities on alternative trading systems. Specifically, it is important that

Using data from the first six months of 2012, the Commission believes that an ATS executing transactions in municipal securities at a level exceeding five percent of the average daily dollar volume traded in the United States would be executing trades at a level of at least approximately \$550 million daily,¹¹⁴ and that an ATS executing transactions in municipal securities at a level exceeding five percent of the average daily transaction volume traded in the United States would be executing an average of at least approximately 1,900 transactions daily.¹¹⁵ Based on data collected from Form ATS-R for the second quarter of 2012, the Commission preliminarily believes that currently no ATSS executing transactions in municipal securities would exceed the proposed average daily dollar volume threshold and fall within the definition of SCI entity pursuant to that proposed prong. ATSS are not required to report transaction volume data for municipal securities on Form ATS-R. However, based on discussions with industry sources, the Commission preliminarily believes that three ATSS executing transactions in municipal securities would likely exceed the proposed average

markets with significant portions of the volume in particular instruments have adequate systems capacity, integrity, and security, regardless of whether those instruments are equity securities or debt securities. Similarly, as electronic systems for debt grow, it will become increasingly important for the fair operation of our markets for market participants to have fair access to significant market centers in debt securities. One of the consequences of the growing role of alternative trading systems in the securities markets generally is that debt securities are increasingly being traded on these systems, similar to the way equity securities are traded.” See ATS Release, *supra* note 2, at 70862.

¹¹⁴ For the period of January 1, 2012 to June 30, 2012, the average daily dollar volume of trades was over \$11 billion. See <http://emma.msrb.org/marketactivity/ViewStatistics.aspx> (accessed January 30, 2013). Five percent of this amount is approximately \$550 million.

¹¹⁵ For the period of January 1, 2012 to June 30, 2012, the average daily transaction volume was approximately 39,000. See <http://emma.msrb.org/marketactivity/ViewStatistics.aspx> (accessed January 30, 2013). Five percent of this amount is approximately 1,900 trades.

daily transaction volume threshold.¹¹⁶ The Commission requests comment on the accuracy of these estimates.

Using data from the first six months of 2012, the Commission believes that an ATS executing transactions in corporate debt at a level exceeding five percent of the average daily dollar volume traded in the United States would be executing trades at a level of at least approximately \$900 million daily,¹¹⁷ and that an ATS executing transactions in corporate debt at a level exceeding five percent of the average daily transaction volume traded in the United States would be executing an average of at least approximately 2,100 transactions daily.¹¹⁸ Based on data collected from Form ATS-R for the second quarter of 2012, the Commission preliminarily believes that currently no ATSS executing transactions in corporate debt would exceed the proposed average daily dollar volume threshold and fall within the definition of SCI entity pursuant to that proposed prong. ATSS are not required to report transaction volume data for corporate debt on Form ATS-R. However, based on discussions with industry sources, the Commission preliminarily believes that three ATSS executing transactions in corporate debt

¹¹⁶ See, e.g., the Commission's Report on the Municipal Securities Market, *supra* note 96 at n.715. The Commission preliminarily believes that the three ATSS that would likely exceed the proposed average daily transaction volume threshold for municipal securities are the same three ATSS that would likely exceed the corresponding threshold for corporate debt securities. See *infra* note 119.

¹¹⁷ For the period of January to June 2012, the average daily dollar volume was approximately \$18 billion. Five percent of this amount is approximately \$900 million. See U.S. Bond Market Trading Volume, available at: <http://www.sifma.org/research/statistics.aspx>.

¹¹⁸ Source: corporate bond transactions reported to TRACE from January through June 2012, excluding instruments subject to Rule 144A and April 6, 2012 (short trading day).

would likely exceed the proposed average daily transaction volume threshold.¹¹⁹ The Commission requests comment on the accuracy of these estimates.

The Commission is proposing these numerical thresholds as a preliminary best estimate of when a market is of sufficient significance to the trading of the relevant asset class (i.e., NMS stocks, non-NMS stocks, municipal securities, and corporate debt securities) as to warrant the protections and obligations of proposed Regulation SCI. As noted above,¹²⁰ the numerical thresholds in the definition of SCI ATS have not been derived from econometric or mathematical models. Instead, they reflect a preliminary assessment by the Commission, based on qualitative and some quantitative analysis, of the likely economic consequences of the specific quantitative thresholds proposed to be included in the definition. The Commission recognizes that there may reasonably be differing views as to what the threshold levels for inclusion should be and thus the Commission solicits comment on the appropriateness of the proposed threshold levels.

The Commission recognizes that it is proposing numerically higher thresholds for non-NMS stocks, municipal securities, and corporate debt securities as compared to NMS stocks (five percent, as compared to one percent in all NMS stocks). While the Commission preliminarily believes that similar concerns about the trading of NMS stocks on ATSs apply to the trading of non-NMS stocks and debt securities on ATSs (namely, that markets with significant portions of the volume in particular instruments have adequate systems capacity, integrity, resiliency, availability, and security), the Commission notes that it has traditionally

¹¹⁹ As noted above, the Commission preliminarily believes that the three ATSs that would likely exceed the proposed average daily transaction volume threshold for corporate debt securities are the same three ATSs that would likely exceed the corresponding threshold for municipal securities. See supra note 116.

¹²⁰ See supra note 99.

provided special safeguards with regard to NMS stocks in its rulemaking efforts relating to market structure.¹²¹

Further, in part due to the greater availability of, and reliance on, electronic trading for NMS stocks, the trading of such securities is generally more accessible to a wider range of investors and has resulted in increases in electronic trading volumes relative to 15 years ago, as compared to other markets, such as the debt markets, which still largely rely on manual trading. Because the degree of automation and electronic trading is generally lower in markets that trade non-NMS stocks and debt securities than in the markets that trade NMS stocks, the Commission preliminarily believes that a systems issue at an SCI entity that trades non-NMS stocks or debt securities would not have as significant an impact as readily as a systems issue at an SCI entity that trades NMS stocks. Therefore, the Commission preliminarily believes there is less need in the markets for those securities for more stringent thresholds that would trigger the requirements of proposed Regulation SCI.¹²² For example, the most recent widely publicized issues involving systems problems and disruptions in the securities markets have generally all been related to NMS stocks.¹²³ The Commission also believes that imposition of a threshold that is set too low in markets that lack automation could have the unintended effects of discouraging automation in these markets and discouraging new entrants into these markets. For these reasons, the Commission preliminarily believes that it is appropriate at this time to apply a different threshold to ATSS trading NMS stocks than those ATSS trading non-NMS stocks, municipal securities, and corporate debt securities.

¹²¹ See, e.g., Regulation NMS, 17 CFR 242.600-612; Securities Exchange Act Release No. 51808 (June 9, 2005), 70 FR 27496 (June 29, 2005).

¹²² See also discussion in *infra* Section V.C.3.c.

¹²³ See, e.g., *supra* notes 61-66 and accompanying text.

Under Proposed Rule 1000(a), the term “plan processor” would have the meaning set forth in Rule 600(b)(55) of Regulation NMS, which defines “plan processor” as “any self-regulatory organization or securities information processor acting as an exclusive processor in connection with the development, implementation and/or operation of any facility contemplated by an effective national market system plan.”¹²⁴ As noted above, the ARP Inspection Program has developed to include the systems of the plan processors of the four current SCI Plans.¹²⁵ Any entity selected as the processor of an SCI Plan is responsible for operating and maintaining computer and communications facilities for the receipt, processing, validating, and dissemination of quotation and/or last sale price information generated by the members of such plan.¹²⁶ Although an entity selected as the processor of an SCI Plan acts on behalf of a committee of SROs, such entity is not required to be an SRO, nor is it required to be owned or operated by an SRO.¹²⁷ The Commission believes, however, that the systems of such entities, because they deal with key market data, form the “heart of the national market system,”¹²⁸ and should be subject to

¹²⁴ See 17 CFR 242.600(b)(55).

¹²⁵ See supra note 87, defining the term “SCI Plan” and discussing plan processors.

¹²⁶ See, e.g., CTA Plan Section V(d) and CQS Plan Section V(d), available at: <http://www.nyxdata.com/cta>; see also OPRA Plan, Section V, available at: http://www.opradata.com/pdf/opra_plan.pdf; and Nasdaq UTP Plan Section IV, available at: <http://www.utpplan.com>.

¹²⁷ Pursuant to Section 11A of the Exchange Act (15 U.S.C. 78k-1), and Rule 609 of Regulation NMS thereunder (17 CFR 242.609), such entities, as “exclusive processors,” are required to register with the Commission as securities information processors on Form SIP. See 17 CFR 249.1001 (Form SIP, application for registration as a securities information processor or to amend such an application or registration).

¹²⁸ See Concept Release on Equity Market Structure, supra note 42, at 3600 (quoting H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 93 (1975)).

the same systems standards as SCI SROs, and proposes to include “plan processors” in the definition of SCI entity.¹²⁹

Pursuant to its terms, each SCI Plan is required to periodically review its selection of its processor, and may in the future select a different processor for the SCI Plan than its current processor.¹³⁰ The proposed inclusion of “plan processors” in the definition of SCI entity is designed to ensure that the processor for an SCI Plan, regardless of its identity, is independently subject to the requirements of proposed Regulation SCI. Thus, the proposed definition would cover any entity selected as the processor for a current or future SCI Plan.¹³¹ The Commission preliminarily believes that it is important for such plan processors to be subject to the requirements of proposed Regulation SCI because of the important role they serve in the national market system: operating and maintaining computer and communications facilities for the receipt, processing, validating, and dissemination of quotation and/or last sale price information generated by the members of the plan.¹³²

¹²⁹ See supra note 87.

¹³⁰ See CTA Plan Section V(d) and CQS Plan Section V(d), available at: <http://www.nyxdata.com/cta>; OPRA Plan Section V, available at: http://www.opradata.com/pdf/opra_plan.pdf; and Nasdaq UTP Plan Section V, available at: <http://www.utplan.com>.

¹³¹ Currently, the Securities Industry Automation Corporation (“SIAC”) is the processor for the CTA Plan, CQS Plan, and OPRA Plan and Nasdaq is the processor for the Nasdaq UTP Plan. SIAC is wholly owned by NYSE Euronext. Both SIAC and Nasdaq are registered with the Commission as securities information processors, as required by Section 11A(b)(1) of the Exchange Act, 15 U.S.C. 78k-1(b)(1), and in accordance with Rule 609 of Regulation NMS thereunder, 17 CFR 242.609. The Commission preliminarily believes that the proposed definition of plan processor also would include any entity selected and acting as exclusive processor of a future NMS plan, such as that contemplated by the Commission’s rules to create a consolidated audit trail. See Securities Exchange Act No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012) (“Consolidated Audit Trail Adopting Release”).

¹³² See supra note 126 and accompanying text.

Under proposed Rule 1000(a), the term “exempt clearing agency subject to ARP” would mean “an entity that has received from the Commission an exemption from registration as a clearing agency under Section 17A of the Act, and whose exemption contains conditions that relate to the Commission’s Automation Review Policies, or any Commission regulation that supersedes or replaces such policies.” This proposed definition of “exempt clearing agency subject to ARP” presently would apply to one entity, Global Joint Venture Matching Services – US, LLC (“Omgeo”).¹³³

Among the operational conditions required by the Commission in the Omgeo Exemption Order were several that directly related to the ARP policy statements.¹³⁴ For the same reasons that it required Omgeo to abide by the conditions relating to the ARP policy statements set forth in the Omgeo Exemption Order, the Commission preliminarily believes it would be appropriate that Omgeo (or any similarly situated exempt clearing agency) should be subject to the

¹³³ On April 17, 2001, the Commission issued an order granting Omgeo an exemption from registration as a clearing agency subject to certain conditions and limitations in order that Omgeo might offer electronic trade confirmation and central matching services. See Global Joint Venture Matching Services – US, LLC; Order Granting Exemption from Registration as a Clearing Agency, Securities Exchange Act Release No. 44188 (April 17, 2001), 66 FR 20494 (April 23, 2001) (File No. 600-32) (“Omgeo Exemption Order”). Because the Commission granted it an exemption from clearing agency registration, Omgeo is not a self-regulatory organization. See id. at 20498, n.41.

¹³⁴ These conditions required Omgeo to, among other things: provide the Commission with an audit report addressing all areas discussed in the Commission ARP policy statements; provide annual reports prepared by competent, independent audit personnel in accordance with the annual risk assessment of the areas set forth in the ARP policy statements; report all significant systems outages to the Commission; provide advance notice of any material changes made to its electronic trade confirmation and central matching services; and respond and require its service providers to respond to requests from the Commission for additional information relating to its electronic trade confirmation and central matching services, and provide access to the Commission to conduct inspections of its facilities, records and personnel related to such services. See id.

requirements of proposed Regulation SCI, and thus is proposing to include any “exempt clearing agency subject to ARP” as explained above, within the definition of SCI entity.¹³⁵

Request for Comment

1. The Commission requests comment generally on the proposed definition of SCI entity and its constituent parts. Do commenters believe that entities of the type that would satisfy the proposed definition of SCI entity play significant roles in the U.S. securities markets such that they should be subject to proposed Regulation SCI? Why or why not?

2. Do commenters believe the scope of the proposed definition of SCI SRO is appropriate? Does the proposed definition of SCI SRO include types of entities that should not be subject to the proposed requirements, or exclude types of entities that should be subject to the proposed requirements? If so, please identify such types of entities and explain why they should or should not be included in the definition of SCI entity or SCI SRO. Should the definition of “SCI self-regulatory organization” include exchanges notice-registered with the Commission pursuant to 15 U.S.C. 78f(g) or a limited purpose national securities association registered with the Commission pursuant to 15 U.S.C. 78o-3(k)? Do commenters believe that it is appropriate to defer to the CFTC regarding the systems compliance and integrity of such entities? Why or why not?

3. Do commenters believe that the proposed definition of “SCI alternative trading system” is appropriate? Why or why not? Do commenters believe that the proposed volume thresholds for the different asset classes under the proposed definition of SCI ATS are

¹³⁵ In the Omgeo Exemption Order, the Commission stated that, “[b]ecause these conditions are designed to promote interoperability, the Commission intends to require substantially the same conditions of other Central Matching Services that obtain an exemption from registration as a clearing agency.” See *id.*

appropriate? Specifically, are the proposed average daily dollar volume thresholds of five percent or more in any NMS stock and 0.25 percent or more in all NMS stocks, or one percent or more in all NMS stocks, appropriate? Would higher or lower daily dollar volume thresholds for NMS stocks be more appropriate?¹³⁶ Please explain and provide data in support. Alternatively, would a different threshold measurement be more appropriate (e.g., transaction volume, share volume, etc.)? If so, which and at what threshold level?¹³⁷ Please explain and provide data in support.

¹³⁶ For example, based on data from FINRA's Order Audit Trail System, if the threshold were instead to be set at five percent or more in any NMS stock and 0.5 percent or more in all NMS stocks, the Commission preliminarily estimates that approximately nine ATSS would satisfy the thresholds, accounting for approximately 84 percent of the dollar-volume market share of all ATSS trading NMS stocks (i.e., not including NMS stocks traded on SROs). If the threshold were instead to be set at five percent or more in any NMS stock and one percent or more in all NMS stocks, the Commission preliminarily estimates that approximately three ATSS would satisfy the thresholds, accounting for approximately 38 percent of the market share. Further, if the threshold were instead to be set at 0.25 percent in all NMS stocks, the Commission preliminarily estimates that approximately ten ATSS would satisfy the threshold. If the threshold were instead to be set at 0.5 percent in all NMS stocks, the Commission preliminarily estimates that approximately nine ATSS would satisfy the threshold.

¹³⁷ For example, based on data collected from Form ATS-R for the second quarter of 2012 and consolidated NMS stock share volume from the first six months of 2012, if the threshold were instead to be set at 0.25 percent of average daily NMS stock consolidated share volume, the Commission preliminarily estimates that approximately 15 ATSS would satisfy the threshold, accounting for approximately 14 percent of the total average daily consolidated share volume. If the threshold were instead to be set at 0.5 percent of average daily NMS stock consolidated share volume, the Commission preliminarily estimates that approximately 12 ATSS would satisfy the threshold, accounting for approximately 13 percent of the total average daily consolidated share volume. If the threshold were instead to be set at one percent of average daily NMS stock consolidated share volume, the Commission preliminarily estimates that approximately 6 ATSS would satisfy the threshold, accounting for approximately nine percent of the total average daily consolidated share volume. Based on consolidated NMS stock share volume from the first six months of 2012, the Commission estimates that the equity securities exchanges with the smallest volume each account for approximately 0.2 percent to 0.4 percent of the total average daily consolidated share volume.

4. The Commission notes that, unlike the threshold levels applicable to NMS stocks currently in Rule 301(b)(6) of Regulation ATS, the proposed thresholds for NMS stocks are based on average daily dollar volume in an individual NMS stock and/or all NMS stocks. Do commenters believe that these are appropriate standards? Why or why not? If not, what should be the appropriate standard, and why? Do commenters believe the proposed thresholds of five percent or more in any NMS stock and 0.25 percent or more in all NMS stocks would prevent a situation in which an ATS that has a large volume in one NMS stock and little volume in other NMS stocks would be covered by proposed Regulation SCI? How common is it for an ATS to trade illiquid NMS stocks without also trading more liquid NMS stocks? Please provide any data relevant to this question.

5. Should the SCI ATS thresholds be triggered only with respect to certain NMS stocks, for example, only with respect to the most liquid NMS stocks? If so, how should the Commission define the "most liquid" NMS stocks? For example, should the thresholds be triggered only for the 500 most liquid NMS stocks? The 100 most liquid NMS stocks? Another amount? Why or why not? Please describe your reasoning. Further, what would be the appropriate threshold measurement (e.g., average daily share volume, average daily dollar volume, or another measurement)? Please explain.

6. Is the proposed five percent threshold level appropriate for non-NMS stocks, municipal securities (approximately \$550 million in daily dollar volume or 1,900 in daily transaction volume based on data from the first six months of 2012), and corporate debt securities (approximately \$900 million in daily dollar volume or 2,100 in daily transaction volume based on data from the first six months of 2012)? Why or why not? Please explain and provide data in support. If not, what should be the appropriate thresholds and why?

7. As with NMS stocks, the proposed five percent thresholds for non-NMS stocks are to be calculated by reference to daily dollar volume, though the proposed threshold would only be with reference to all such stocks (as opposed to average daily dollar volume in individual NMS stocks and/or all NMS stocks). Do commenters believe that this is the appropriate standard for non-NMS stocks? Why or why not?

8. Do commenters agree with the Commission's assessment that there is less automation among markets that trade non-NMS stocks, municipal securities, and corporate debt securities as compared to markets that trade NMS stocks? Why or why not? What is the current level of automation in these markets?

9. Do commenters believe that there should be different thresholds for NMS stocks than non-NMS stocks, municipal securities, and corporate debt securities? Why or why not? Do commenters believe that the proposed two-pronged thresholds are appropriate for municipal securities and corporate debt securities? Why or why not? Would the proposed two-pronged approach be relevant or appropriate for securities other than municipal and corporate debt securities? Why or why not?

10. Do commenters believe that the Commission's estimates of the current number of ATSS that would meet the proposed thresholds are accurate? Why or why not? If not, please provide any data or estimates that commenters believe would more accurately reflect the number of ATSS that would meet the proposed thresholds.

11. The Commission is also considering whether it should instead adopt a definition for SCI ATSS that is based solely on a single type of threshold measurement (such as average daily dollar volume), which would be simpler and provide consistency across different asset classes, rather than the differing types of threshold tests for NMS stocks, non-NMS stocks, municipal

securities, and corporate debt securities currently proposed. In particular, the Commission is considering whether it would be appropriate to solely use a threshold based on a percentage of average daily dollar volume for all asset classes. Would a threshold based on a percentage of average daily dollar volume be an appropriate single measure that the Commission should use for all asset classes (i.e., NMS stocks, non-NMS stocks, municipal securities, and corporate debt securities) within the definition of SCI ATS? Why or why not? If so, would it be appropriate for the Commission to adopt the same dollar volume threshold measurement that applies for all of the asset classes? Why or why not? Please explain. If so, what would be an appropriate threshold measurement? For example, would five percent of the asset class's total average daily dollar volume be appropriate? Should the measurement be higher or lower? Please be specific and explain. Or, rather than a threshold measurement that is based on a percentage of the asset class's total average daily dollar volume, would a fixed average daily dollar volume threshold, such as \$500 million, be appropriate? If so, should such a threshold be higher or lower than \$500 million? Why or why not? Should such a fixed dollar threshold be different for different asset classes? Why or why not? If so, what should such thresholds be for each asset class? Please be specific. What are the advantages and disadvantages of a percentage-based threshold versus a fixed dollar threshold? Please explain.

12. Would it be appropriate for the Commission to adopt a single dollar volume threshold measurement that applies across all asset classes? For example, if an ATS trades both municipal securities and corporate debt securities, should its trading volume in both asset classes be aggregated to determine whether it exceeded the threshold measurement? Why or why not?

13. The proposed SCI ATS thresholds are to be calculated by reference to executions "during at least four of the preceding six calendar months," the measurement period and method

that is currently used in Regulation ATS. Do commenters believe this is the appropriate time frame and method to be included in Regulation SCI? Why or why not? If not, is there a more appropriate approach? If so, what should it be and why?

14. With respect to calculating the proposed thresholds for securities other than NMS stocks (*i.e.*, non-NMS stocks, municipal securities, and corporate debt securities), would ATSs have available appropriate data with which to determine whether the proposed thresholds have been met? FINRA, through its OTC Reporting Facility and its Trade Reporting and Compliance Engine (“TRACE”)¹³⁸ facility, collects data on transactions in non-NMS stocks and corporate debt securities, and the MSRB collects data on transactions in municipal securities. Do commenters believe that FINRA, the MSRB, or another appropriate entity should be required to disseminate data in a format and frequency sufficient to enable ATSs to determine if they have met the proposed thresholds? Is there another mechanism or structure that could provide data in a format and frequency sufficient to enable ATSs to determine whether the proposed thresholds have been met? Please explain.

15. Are there ATSs or types of ATSs that would satisfy the proposed definition of SCI ATS that commenters believe should not be subject to proposed Regulation SCI? If so, please explain. Are there ATSs or types of ATSs that would not satisfy the proposed definition of SCI ATS that commenters believe should be subject to proposed Regulation SCI? If so, please explain. For example, should ATSs that execute transactions in U.S. treasuries and/or repurchase agreements be subject to proposed Regulation SCI? Why or why not? If a parent company owns multiple ATSs for a given asset class (*e.g.*, NMS stocks), should the trading

¹³⁸ TRACE is an automated system that, among other things, accommodates reporting and dissemination of transaction reports for over-the-counter secondary market transactions in eligible fixed income securities, in accordance with the FINRA Rule 6700 series.

volumes of these ATSS be aggregated for purposes of determining whether the ATSS exceed the proposed thresholds? Why or why not? If so, how should such aggregation work? What are the advantages or disadvantages of such an approach? Please explain.

16. Do commenters believe that, for purposes of Regulation SCI, the proposed definition of plan processor is appropriate? Why or why not? Is it appropriate to limit the definition of plan processor to entities within the meaning of plan processor in Rule 600(b)(55) of Regulation NMS? Why or why not? Do commenters believe the proposed definition is sufficiently clear? Are there any other entities similar to the plan processors of SCI Plans that commenters believe should be made subject to the requirements of proposed Regulation SCI? If so, please describe and explain why.

17. Do commenters believe that the proposed definition of “exempt clearing agency subject to ARP” is appropriate? Why or why not? Are there other exempt clearing agencies that should be included in the proposed definition of SCI entity? Why or why not? Is it appropriate to limit the definition of SCI entity with respect to exempt clearing agencies to those with exemptions that contain conditions that relate to the Commission’s Automation Review Policies or any Commission regulation that supersedes or replaces such policies? Why or why not?

18. What are the current practices of the proposed SCI entities with respect to the subject matter covered by the ARP policy statements? How many of them have practices that are consistent with ARP? How do they differ? Please be specific.

2. Definition of SCI Systems and SCI Security Systems

The Commission is proposing that Regulation SCI cover the systems of SCI entities, which would include both SCI systems and, where applicable, SCI security systems. Proposed Rule 1000(a) would define the term “SCI systems” to mean “all computer, network, electronic, technical, automated, or similar systems of, or operated by or on behalf of, an SCI entity,

whether in production, development, or testing, that directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance,” and the term “SCI security systems” to mean “any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems.”

Thus, for purposes of all of the provisions of proposed Regulation SCI, the proposed definition of SCI systems would cover all systems of an SCI entity that directly support trading, clearance and settlement, order routing, market data, regulation, and surveillance. In addition, the proposed definition of SCI security systems is designed to cover other types of systems if they share network resources with SCI systems and, if breached, would be reasonably likely to pose a security threat to SCI systems. Unlike SCI systems, only certain provisions of proposed Regulation SCI would apply to SCI security systems.¹³⁹

The Commission preliminarily believes that the proposed definition of SCI systems would reach those systems traditionally considered to be core to the functioning of the U.S. securities markets, namely trading, clearance and settlement, order routing, market data, regulation, and surveillance systems.¹⁴⁰ The proposed definition would also apply to, for example, such systems of exchange-affiliated routing brokers that are facilities of national securities exchanges or such systems operated on behalf of national securities exchanges. It

¹³⁹ Specifically, under proposed Rule 1000(a), SCI security systems are included in the proposed definitions of “material systems change,” “responsible SCI personnel,” “SCI review,” and “systems intrusion.” For purposes of security standards, proposed Rule 1000(b)(1) would also apply to SCI security systems. In addition, with respect to systems intrusions, proposed Rules 1000(b)(3)-(5) would apply to SCI security systems. Further, because of the definitions of material systems change and SCI review, proposed Rules 1000(b)(6) and (7) would apply to SCI security systems. Finally, proposed Rules 1000(c) and (f), relating to recordkeeping and access, respectively, would apply to SCI security systems.

¹⁴⁰ See ARP I, *supra* note 1.

would also apply to regulatory systems,¹⁴¹ including systems for the regulation of the over-the-counter market, systems used to carry out regulatory services agreements, and similar future systems, including the Consolidated Audit Trail repository.¹⁴² In addition, if an SCI entity contracts with a third party to operate its systems (such as those that use execution algorithms) on behalf of the SCI entity, such systems would also be covered by the proposed definition of SCI systems if they directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance. Therefore, systems covered by the proposed definition of SCI systems would not be limited only to those owned by the SCI entity, but also could include those operated by or on behalf of the SCI entity.

Based on Commission staff's experience with the ARP Inspection Program, the Commission believes that some SCI systems of SCI entities may in some cases be highly interconnected with SCI security systems because the SCI systems and SCI security systems share network resources. As a result, the Commission is concerned that a security issue or systems intrusion with respect to SCI security systems would be reasonably likely to cause an SCI event with respect to SCI systems. Because certain SCI security systems of an SCI entity may present likely vulnerable entry points to an SCI entity's network, the Commission preliminarily believes that it is important that the provisions of proposed Regulation SCI relating to security standards and systems intrusions apply to SCI security systems.¹⁴³

¹⁴¹ SCI entities that are obligated to comply with Section 31 of the Exchange Act (15 U.S.C. 78ee), and Rule 31 thereunder (17 CFR 240.31), employ various systems to generate, process, transmit, or store electronic messages related to securities transactions. Such systems may include matching engines, transaction data repositories, trade reporting systems, and clearing databases.

¹⁴² See Consolidated Audit Trail Adopting Release, supra note 131.

¹⁴³ See supra note 139.

The proposed definition of SCI security systems does not identify the types of systems that would be covered, but rather describes them in terms of their connectivity and potential ability to undermine the integrity of SCI systems. However, examples of SCI security systems that could be highly interconnected with SCI systems and therefore be reasonably likely to pose a threat to SCI systems may include systems pertaining to corporate operations (e.g., systems that support web-based services, administrative services, electronic filing, email capability and intranet sites, as well as financial and accounting systems) that are typically accessed by an array of users (e.g., employees or executives of the SCI entity) authorized to view non-public information. In certain cases, such systems would likely offer insight into the vulnerabilities of an SCI entity if they were, for example, accessed by a hacker. The Commission is concerned that the breach of such systems would likely lead to disruption of an SCI entity's general operations and, ultimately, its market-related activities. Similarly, systems by which an SCI entity provides a service to issuers, participants, or clients (e.g., transaction services, infrastructure services, and data services) may be accessed by employees or other representatives of the issuer, participant, or client organization, and may, in some instances, provide a point of access (and thus share network resources) to an SCI entity's SCI systems. Accordingly, the Commission is proposing that the term SCI security systems include any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems, but only for the limited provisions of proposed Regulation SCI noted above.¹⁴⁴

In light of the above concerns, the proposed definitions of SCI systems and SCI security systems together are intended to reach all of the systems that would be reasonably likely to

¹⁴⁴ See id.

impact an SCI entity's operational capability and the maintenance of fair and orderly markets, rather than reaching solely SCI systems. Because of the dependence of today's securities markets on highly sophisticated electronic trading and other technology, including complex regulatory and surveillance systems, as well as systems relating to clearance and settlement, the provision of market data, and order routing, the Commission preliminarily believes that the proposed definitions of SCI systems and SCI security systems are appropriate to help ensure the capacity, integrity, resiliency, availability, and security of an SCI entity's systems.

Request for Comment

19. The Commission requests comment generally on the proposed definitions of SCI systems and SCI security systems.

20. Do commenters believe that the proposed definitions appropriately capture the scope of systems of SCI entities that would be reasonably likely to impact the protection of investors and the maintenance of fair and orderly markets? Specifically, do the proposed definitions of SCI systems and SCI security systems capture the components of the critical systems infrastructure of SCI entities in a comprehensive manner? Are the proposed definitions sufficiently clear?

21. Are there any systems of SCI entities that should be included but would not be captured by the proposed definitions? Please explain. Are there any systems of SCI entities that should be excluded from the proposed definitions? Please explain.

22. By including in the proposed definition of "SCI systems" those systems operated "on behalf of" an SCI entity, systems operated by a third party under contract from an SCI entity and systems operated by affiliates of an SCI entity that are utilized by such SCI entity would also be included in the proposed definition of SCI systems. Do commenters agree that such systems

should be included? Please explain. Should the requirements under proposed Regulation SCI apply differently to systems that are operated on behalf of an SCI entity? Why or why not?

Please explain.

23. Do commenters agree with the proposal to distinguish between SCI systems and SCI security systems for purposes of triggering the various provisions of proposed Regulation SCI? For example, are the requirements that would apply to SCI security systems appropriate? Why or why not? If not, which requirements of proposed Regulation SCI should apply to SCI security systems and why? Should the requirements under proposed Regulation SCI apply differently to different types of systems, as proposed? Or, should SCI security systems be subject to all of the requirements of proposed Regulation SCI? Why or why not?

24. Alternatively, should SCI security systems be excluded entirely from the application of proposed Regulation SCI? Why or why not? The Commission is proposing its approach to distinguish between SCI systems and SCI security systems because it preliminarily believes that the interconnected nature of technology infrastructure today creates the potential for systems other than SCI systems to expose vulnerable points of entry that could lead to a security breach or intrusion into SCI systems. In light of this potential, the Commission is proposing, as discussed further below, that the following provisions of proposed Regulation SCI apply to the SCI security systems of an SCI entity: (1) for purposes only of the policies and procedures relating to systems security, proposed Rule 1000(b)(1) would apply to its SCI security systems; (2) proposed Rules 1000(b)(3)-(5) (relating to SCI events and taking corrective action, Commission notification, and dissemination of information to members or participants, respectively) would apply to SCI security systems only with respect to systems intrusions; and

(3) proposed Rule 1000(b)(6) would require an SCI entity to report a material systems change in a SCI security system only to the extent that it materially affects the security of such system.¹⁴⁵

25. The goal of this proposed approach is to ensure that SCI systems, as the core systems of an SCI entity, are adequately secure and protected from systems intrusions. However, the Commission recognizes that there may be alternative ways to achieve this goal, including those that do not extend the scope of the proposed rule beyond the core systems that are defined as “SCI systems,” and that focus the Commission’s oversight on those systems. For example, one alternative would be to limit the scope of the proposed rule to SCI systems, but clarify that policies and procedures reasonably designed to ensure that SCI systems have adequate levels of security necessarily would require an assessment of security vulnerabilities created by other systems that share network resources with SCI systems, and appropriate steps to address those vulnerabilities. Specifically, under such an alternative, the defined term “SCI security systems,” and all references to them and any associated obligations, would be eliminated from the proposed rule text described herein, and clarifying guidance would be provided with respect to the security of SCI systems as noted above. With such an alternative, consideration also would need to be given to whether or not an SCI entity should notify the Commission (and potentially its members or participants) of a systems intrusion with respect to these non-SCI systems, or a systems change that materially impacts the security of such systems. Accordingly, the Commission solicits commenters’ views on this or any other potential alternative approaches that would not include a definition of SCI security systems within the scope of the proposed rule.

¹⁴⁵ See *infra* Sections III.C.1, III.C.3, and III.C.4. In addition, the scope of the applicability of proposed Rules 1000(b)(7), 1000(b)(8), and 1000(c)-(f) to SCI security systems would be determined by the provisions of the proposed Rules 1000(b)(1), and (3)-(6). See *infra* Sections III.C.5, III.C.6, and D.

26. If the Commission were to determine to eliminate the proposed definition of SCI security systems from proposed Regulation SCI, what would be the likely effect of such elimination on the ability of proposed Regulation SCI to ensure that SCI systems are adequately secure and protected from systems intrusions? Please explain. Specifically, if the Commission eliminated the proposed definition of SCI security systems from proposed Regulation SCI, and its direct oversight of systems that share network resources with SCI systems, would the Commission's ability to assure adequate security for SCI systems be materially weakened? Why or why not? Would such an alternative reduce compliance burdens for SCI entities, and improve the efficiency of Commission oversight without materially undermining its effectiveness?

27. If the Commission were to determine to eliminate the proposed definition of SCI security systems from proposed Regulation SCI, would it be appropriate, for example, for the Commission to interpret the requirement of proposed Rule 1000(b)(1) that would require an SCI entity to have "policies and procedures reasonably designed to ensure that its SCI systems have levels of...security...adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets" to require that an SCI entity's SCI systems be protected from security threats by other systems with which they share network resources? Why or why not? Please explain.

28. If the Commission were to determine to eliminate the proposed definition of SCI security systems from proposed Regulation SCI, should the Commission still require an SCI entity to report to the Commission an intrusion into any system (and not just SCI systems) of an SCI entity? Why or why not? If the Commission were to determine to eliminate the proposed definition of SCI security systems from proposed Regulation SCI, should the Commission require an SCI entity to notify members and participants of an intrusion into any system of an

SCI entity? Why or why not? If the Commission were to determine to eliminate the proposed definition of SCI security systems from proposed Regulation SCI, are there any other changes to the rule that would be appropriate? What are they, and why would they be appropriate? Please describe in detail.

3. SCI Events

Pursuant to the current ARP policy statements and Regulation ATS, a key element of the ARP Inspection Program has been to encourage ARP participants to notify Commission staff of significant systems disruptions so that the staff can work with the affected entity to help ensure that the disruption is addressed promptly and effectively, and that appropriate steps are taken to reduce the likelihood of future problems. Commission staff has previously sought to provide guidance and clarification on what should be considered a "significant system outage" for purposes of reports to Commission staff. Specifically, in the 2001 Staff ARP Interpretive Letter, Commission staff provided examples of situations for which an outage is deemed significant and thus should be reported.¹⁴⁶ The examples listed in that letter included: (1) outages resulting in a failure to maintain any service level agreements or constraints; (2) disruptions of normal operations, e.g., switchover to back-up equipment with zero hope of near-term recovery of primary hardware; (3) the loss of use of any system; (4) the loss of transactions; (5) outages resulting in excessive back-ups or delays in processing; (6) the loss of ability to disseminate vital information; (7) outage situations communicated to other external entities; (8) events that are (or will be) reported or referred to the entity's board of directors or senior management; (9) events that threaten systems operations even though systems operations are not disrupted; for example, events that cause the entity to implement a contingency plan; and (10) the queuing of data

¹⁴⁶ See 2001 Staff ARP Interpretive Letter, supra note 35.

between system components or queuing of messages to or from customers of such duration that a customer's usual and customary service delivery is affected.¹⁴⁷

The Commission believes that guidance in the 2001 Staff ARP Interpretive Letter regarding what constitutes a significant systems outage has been useful over the years to the entities that received the 2001 Staff ARP Interpretive Letter, but understands that Commission action in this area would help SROs and other entities by providing definitive guidance through a formal rulemaking process that includes notice and comment. Furthermore, the Commission believes the term "significant systems outage" in plain usage denotes a category of systems problems that is considerably narrower than those the Commission believes could pose risks to the securities markets and market participants. Therefore, the Commission proposes to specify the types of events that would be required to be reported to the Commission and the types of systems problems that would trigger notice requirements on the part of an SCI entity. Specifically, the Commission is proposing to define the term "SCI event" in Rule 1000(a) as "an event at an SCI entity that constitutes: (1) a systems disruption; (2) a systems compliance issue; or (3) a systems intrusion." As discussed in detail below, the proposed rule would define each of these terms used in the proposed definition of SCI event.

a. Systems Disruption

The Commission proposes that the term "systems disruption" be defined to mean "an event in an SCI entity's SCI systems that results in: (1) a failure to maintain service level agreements or constraints; (2) a disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely; (3) a loss of use of any such system; (4) a loss of transaction or clearance and settlement data; (5) significant back-ups or

¹⁴⁷ See *id.*

delays in processing; (6) a significant diminution of ability to disseminate timely and accurate market data; or (7) a queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected.” The proposed definition is similar, but not identical, to the definition of “significant systems outage” in the 2001 Staff ARP Interpretive Letter.¹⁴⁸

As proposed, a systems disruption would be an event in an SCI entity’s SCI systems that manifests itself as a problem measured by reference to one or more of seven elements. The first proposed element, a failure to maintain service level agreements or constraints, is unchanged from the 2001 Staff ARP Interpretive Letter. This would include, for example, a failure or inability of the SCI entity to honor its contractual obligations to provide a specified level or speed of service to users of its SCI systems. A trading market could, for example, contract to maintain its trading system without delays over a specific threshold, e.g., 100 milliseconds, and its failure to honor that obligation would thus be a systems disruption.

The second proposed element, “a disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely” differs from the element in the 2001 Staff ARP Interpretive Letter (disruption of normal operations, e.g., switchover to back-up equipment with zero hope of near-term recovery of primary hardware). This modification is intended to convey that the Commission preliminarily believes that an SCI entity should be required to notify Commission staff of a SCI systems problem that involves a switchover to backup equipment, even if a determination that no recovery is possible has not

¹⁴⁸ See supra note 35. The Commission believes that the term “systems disruption” is a more appropriate term to describe the types of events captured within the proposed definition and thus is proposing to use the term “systems disruption,” rather than the term “systems outage,” the term used in the ARP Inspection Program.

been made because the probability that such switchover may continue indefinitely is significant. The Commission also intends that this proposed element, a “disruption of normal operations,” would capture problems with SCI systems such as programming errors, testing errors, systems failures, or if a system release is backed out after it is implemented in production.

The third proposed element, “a loss of use of any such system,” is unchanged from the 2001 Staff ARP Interpretive Letter and would cover situations in which an SCI system is broken, offline, or otherwise out of commission. For example, the Commission intends that a failure of primary trading or clearance and settlement systems, even if immediately replaced by backup systems without any disruption to normal operations, would be covered under this third proposed element. The Commission preliminarily believes the language of the fourth proposed element, “a loss of transaction or clearance and settlement data,” is more precise than the language in the 2001 Staff ARP Interpretive Letter, which lists “loss of transactions” as an example of a systems outage.

Similarly, the language of the fifth and sixth proposed elements is intended to be more precise than the comparable language in the fifth and sixth examples enumerated in the 2001 Staff ARP Interpretive Letter. The Commission is not at this time proposing to quantify what would constitute a “significant back-up or delay in processing” or a “significant diminution of ability to disseminate timely and accurate market data” because it preliminarily believes that the varying circumstances that could give rise to such events, and the range of SCI systems potentially impacted, make precise quantification impractical.¹⁴⁹ These proposed elements are intended to include, for example, circumstances in which a problem with an SCI system results

¹⁴⁹ The Commission is, however, soliciting comment on whether it would be appropriate to adopt quantitative criteria in connection with the definition of “systems disruption.”

in a slowdown or disruption of operations that would adversely affect customers, impair quotation or price transparency, or impair accurate and timely regulatory reporting. Instances in which message traffic is throttled (i.e., slowed) by an SCI entity for any market participant, without a corresponding provision in the SCI entity's rules, user agreements, or governing documents, as applicable, would also be covered here.¹⁵⁰ Further, the Commission preliminarily believes that if customers or systems users, for example, have complained or inquired about a slowdown or disruption of operations, including, for example, a slowdown or disruption in their receipt of market data, then such circumstance would be indicative of a problem at an SCI entity that results in "significant back-ups or delays in processing" or a "significant diminution of ability to disseminate timely and accurate market data," that should be considered a "systems disruption." The fifth and sixth elements of the proposed definition of systems disruption are also intended to cover the entry, processing, or transmission of erroneous or inaccurate orders, trades, price-reports, other information in the securities markets or clearance and settlement systems, or any other significant deterioration in the transmission of market data in an accurate, timely, and efficient manner. For example, it is possible that an SCI system of an SCI entity that disseminates market data could, as a result of a programming or testing error in another system of the SCI entity, be overwhelmed with erroneous market data to such an extent that the SCI entity's SCI systems are no longer able to disseminate market data in a timely and accurate manner.

¹⁵⁰ However, if an SCI entity's rules or governing documents provided for such throttling in specified scenarios as a part of normal operations, such throttling would not be covered as such a situation would not represent an unexpected back-up or delay in processing but rather would be part of the SCI entity's normal operation.

Finally, the seventh proposed element, “a queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected,” is proposed to be included because the Commission preliminarily believes that queuing of data between system components of SCI systems is often a warning signal of significant disruption of normal system operations.

Although the 2001 Staff ARP Interpretive Letter lists “a report or referral of an event to the entity’s board of directors or senior management” and “an outage situation communicated to other external entities” as examples of a significant systems outage, the Commission is not proposing to include such reports or communications in the definition of systems disruption because it preliminarily believes these examples are more likely to be indicia of whether information about a systems disruption or other systems problem warrants dissemination to the SCI entity’s members or participants.¹⁵¹ Further, although the 2001 Staff ARP Interpretive Letter lists “a serious threat to systems operations even though systems operations are not disrupted” as an example of a significant systems outage, the Commission has not included that example as an element in the proposed definition of systems disruption because it preliminarily believes that such a threat would more likely be indicative of a systems intrusion or systems compliance issue.¹⁵²

Request for Comment

29. The Commission requests comment generally on the proposed definition of “systems disruption.” Do commenters believe that it is appropriate to limit the proposed definition of

¹⁵¹ See infra Section III.B.4.d, discussing whether an SCI event is a “dissemination SCI event.”

¹⁵² See infra Sections III.B.3.b and III.B.3.c, discussing the proposed definition of systems compliance issue and systems intrusion, respectively.

“systems disruption” to SCI systems? Why or why not? Do commenters believe the proposed definition of “systems disruption” is too broad? Why or why not? Please explain.

30. Do commenters believe that there should be minimum thresholds associated with the circumstances specified in any elements of the proposed definition of systems disruption—e.g., quantitative criteria describing when an event fitting the description of one of the elements of the proposed definition would meet the definition of SCI event? If so, what should such minimum thresholds be and to which elements of the definition of “systems disruption” should such minimum thresholds apply? Please explain. Should systems disruptions affecting different types of SCI systems be treated differently? For example, should trading systems have a different quantitative criteria than systems dedicated to surveillance? Please be specific with respect to which categories of SCI systems might deserve different treatment, and what such quantitative criteria might be and why.

31. Do commenters believe the term “transaction or clearance and settlement data,” as used in paragraph (4) of the proposed definition of “systems disruption,” is appropriate? Why or why not? Should other types of data be included, in addition to transaction and clearance and settlement data? For example, should customer account data, regulatory data, and/or audit trail data be included? Why or why not?

32. Do commenters believe that there should be exceptions to the proposed definition of systems disruption? If so, what should such exceptions be and why? For example, should the proposed definition of systems disruption include a de minimis exception? If so, what types of systems problems should be considered de minimis and what criteria should be used to determine whether a systems problem is de minimis? Should the proposed definition of systems disruption include a materiality threshold? If so, what types of systems problems should be considered

material and what criteria should be used to determine whether a systems problem is material? Should the definition of systems disruption exclude regular planned outages occurring during the normal course of business?

33. Should the proposed definition be expanded, narrowed, or otherwise modified in any way? For example, should the proposed definition include quantitative criteria that establish a minimum deviation from normal performance levels, such as a tenfold increase or greater in latency for queuing of data, for an event to be considered an SCI event? Would a minimum deviation of 100 milliseconds from normal system performance levels be an appropriate indication of system degradation? Or, would a larger or smaller deviation be more appropriate? Why or why not? For example, would the choice of a specific threshold help to balance the tradeoff between the costs of over-reporting systems disruptions and the costs of failing to report systems disruptions that could lead to significant negative consequences? Should different quantitative criteria be used across different SCI systems? For example, a limited pause in the operations of a clearing system may not raise the same issues as a similar pause in the operation of a market data feed. If commenters believe that different criteria should be maintained, please be specific and provide examples of what the appropriate minimum deviations should be for such systems.

34. Are there other types of circumstances that should be included that are not part of the proposed definition? If so, please describe and explain. For example, if an SCI SRO or SCI ATS suspects a technology error originating from a third party (such as an SCI SRO's member firm or an SCI ATS's subscriber) that has the potential to disrupt the market, should that type of discovery be included in the definition of systems disruption? Why or why not? Is there

additional guidance that commenters would find helpful to determine whether an event would meet the proposed definition of systems disruption?

35. How often do SCI entities currently experience systems disruptions?

b. Systems Compliance Issue

The Commission proposes that the term “systems compliance issue” be defined as “an event at an SCI entity that has caused any SCI system of such entity to operate in a manner that does not comply with the federal securities laws and rules and regulations thereunder or the entity’s rules or governing documents, as applicable.”¹⁵³ Circumstances covered by the proposed definition would include, for example, situations in which a lack of communication between an SCI SRO’s information technology staff and its legal or regulatory staff regarding SCI systems design or requisite regulatory approvals resulted in one or more SCI systems operating in a manner not in compliance with the SCI SRO’s rules and, thus, in a manner other than how the users of the SCI SRO’s SCI systems, as well as market participants generally, have been informed that such systems would operate. Another example of a systems compliance issue could arise when a change to an SCI system is made by information technology staff that results in the system operating in a manner that fails to comply with the federal securities laws and rules thereunder.

The phrase “operate in a manner that does not comply with . . . the entity’s rules or governing documents” would mean that an SCI entity is operating in a manner that does not

¹⁵³ As discussed in *infra* Section III.C.2, one of the elements of the safe harbor in proposed Rule 1000(b)(2)(ii)(A) would require that an SCI entity establish policies and procedures that provide for ongoing monitoring of SCI systems functionality to detect whether SCI systems are operating in the manner intended. This element would require that each SCI entity establish parameters for detection of a systems compliance issue, and is not intended to suggest one set of parameters for all SCI entities.

comply with the entity's applicable rules and other documents, whether or not filed with the Commission. Generally, such rules or other documents are made available to the public and/or to members, clients, users, and/or participants in the SCI entity.¹⁵⁴ Specifically, for an SCI SRO, this phrase would include operating in a manner that does not comply with the SCI SRO's rules as defined in the Exchange Act and the rules thereunder.¹⁵⁵ For a plan processor, this phrase would include operating in a manner that does not comply with an applicable effective national market system plan. For an SCI ATS or exempt clearing agency subject to ARP, this phrase would include operating in a manner that does not comply with documents such as subscriber agreements and any rules provided to subscribers and users and, for ATSs, described in their Form ATS filings with the Commission.¹⁵⁶

Request for comment

36. The Commission requests comment generally on the proposed definition of "systems compliance issue." Do commenters believe it would be appropriate to define "systems compliance issue" to mean any instance in which an SCI system operates in a manner that does not comply with the federal securities laws and rules and regulations thereunder, or the entity's rules or governing documents, as applicable? Why or why not? If the proposed definition is not

¹⁵⁴ For example, each SCI SRO is required to publish its rules on its publicly available website. See 15 U.S.C. 78s(b)(2)(E). Each plan processor is also required to post amendments to its national market system plan on its website. See 17 CFR 242.608. Subscriber agreements and other similar documents that govern operations of SCI ATSs and exempt clearing agencies subject to ARP are generally not publicly available, but are provided to subscribers and users of such entities.

¹⁵⁵ The rules of an SCI SRO are defined in Sections 3(a)(27) and (28) of the Exchange Act to include, among other things, its constitution, articles of incorporation, and bylaws. See 15 U.S.C. 78c(a)(27)-(28). See also Exchange Act Rule 19b-4(c), 17 CFR 240.19b-4(c).

¹⁵⁶ See 17 CFR 242.301(b) for a description of the filing requirements for ATSs.

appropriate, what would be an appropriate definition? Do commenters believe that it is appropriate to limit the proposed definition of “systems compliance issue” to SCI systems? Why or why not? Please explain.

37. Do commenters believe that there should be exceptions to the proposed definition of systems compliance issue? If so, what should such exceptions be and why? For example, should the proposed definition of systems compliance issue include a de minimis exception? If so, what types of systems compliance issues should be considered de minimis and what criteria should be used to determine whether a systems compliance issue is de minimis? Should the proposed definition of systems compliance issue include a materiality threshold? If so, what types of systems compliance issues should be considered material and what criteria should be used to determine whether a systems compliance issue is material?

38. Do commenters believe other types of documents or agreements should be included in the definition? If so, please specify the types of documents or agreements and explain why.

39. How often do SCI entities currently experience systems compliance issues?

c. Systems Intrusion

The Commission proposes that “systems intrusion” be defined as “any unauthorized entry into the SCI systems or SCI security systems of an SCI entity.” The proposed definition is intended to cover all unauthorized entry into SCI systems or SCI security systems by outsiders, employees, or agents of the SCI entity, regardless of whether the intrusions were part of a cyber attack, potential criminal activity, or other unauthorized attempt to retrieve, manipulate or destroy data, or access or disrupt systems of SCI entities. The proposed definition of systems intrusion would cover the introduction of malware or other attempts to disrupt SCI systems or SCI security systems of SCI entities provided that such systems were actually breached. In addition, the proposed definition is intended to cover unauthorized access, whether intentional or

inadvertent, by employees or agents of the SCI entity that result from weaknesses in the SCI entity's access controls and/or procedures. The proposed definition would not, however, cover unsuccessful attempts at unauthorized entry. An unsuccessful systems intrusion by definition is much less likely than a successful intrusion to disrupt the systems of an SCI entity. Moreover, because it is impossible to prevent attempted intrusions, the Commission preliminarily believes at this time that the focus of this aspect of proposed Regulation SCI should be on successful unauthorized entry.

Request for Comment

40. The Commission requests comment generally on the proposed definition of "systems intrusion." Is the proposed definition sufficiently clear? If not, why not? Do commenters believe that it is appropriate to apply the proposed definition of "systems intrusion" to both SCI systems and SCI security systems? Why or why not? Please explain.

41. Do commenters believe it is appropriate to exclude from the proposed definition of systems intrusion an attempted intrusion that did not breach systems or networks? Why or why not? Should significant, sophisticated, repeated, and/or attempted intrusions, even if unsuccessful, be included? Why or why not? If yes, please explain what categories of attempted intrusions should be covered by the proposed rule and why.

42. Should the proposed definition of systems intrusion be expanded to include the unauthorized use or unintended release of information or data, for example, by an employee or agent of an SCI entity? Why or why not? If so, should the definition be limited to the unauthorized use of non-public or confidential information or should it apply to any unauthorized use of information or data? The Commission recognizes that including in the definition all instances of unauthorized use or unintended release of information or data may be

broad and solicits comment generally on how the definition might be more narrowly defined to encompass those types of events that commenters believe would be appropriate to be included in proposed Regulation SCI.

43. How often do SCI entities currently experience known systems intrusions or known attempted systems intrusions?

d. Dissemination SCI events

The Commission proposes that the term “dissemination SCI event” be defined as “an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.”¹⁵⁷

As discussed below in Section III.C.3, proposed Rule 1000(b)(5) includes requirements for disseminating information regarding certain SCI events to members or participants.¹⁵⁸ Specifically, only information relating to dissemination SCI events would be required to be disseminated to members or participants pursuant to proposed Rule 1000(b)(5).¹⁵⁹ The Commission recognizes that public disclosure of each and every systems issue (such as very brief outages or minor disruptions of normal systems operations where the effects on trading, market data, and clearance and settlement are immaterial) could be counterproductive, potentially overwhelming the public with information, masking significant issues that might arise, and thus preliminarily believes that requiring the dissemination of information about

¹⁵⁷ See proposed Rule 1000(a).

¹⁵⁸ Proposed Rule 1000(b)(5) would require the dissemination of specified information relating to dissemination SCI events and specify the nature and timing of such dissemination, with a delay in dissemination permitted for certain systems intrusions. See *infra* Section III.C.3.c.

¹⁵⁹ See *infra* note 235.

dissemination SCI events to members or participants would promote dissemination of information to persons who are most directly affected by such events and who would most naturally need, want, and be able to act on the information, without creating a separate regulatory standard governing when broader public disclosure should be made.

In the case of a dissemination SCI event, the Commission preliminarily believes that dissemination to members or participants of the nature of the event and the steps being taken to remedy it would be necessary to help ensure that potentially impacted market participants, and others that might be evaluating whether to use the affected systems, have basic information about the event so that they might be able to better assess what, if any, next steps they might deem prudent to take in light of the event.¹⁶⁰

Proposed Rule 1000(a) specifies three categories of SCI events that would constitute a dissemination SCI event. First, any SCI event that is a systems compliance issue would be a

¹⁶⁰ However, as discussed below, the Commission recognizes that, in the case of systems intrusions, there may be circumstances in which full prompt dissemination of information to members or participants of a systems intrusion could hinder an investigation into such an intrusion or an SCI entity's ability to mitigate it. As such, the Commission is proposing that dissemination of information for certain systems intrusions could be delayed in specified circumstances. Specifically, the Commission is proposing that an SCI entity disseminate information about a systems intrusion to its members or participants, unless the SCI entity determines that dissemination of such information would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, and documents the reasons for such determination. See proposed Rule 1000(b)(5)(ii) and text accompanying *infra* note 174. The Commission preliminarily believes, however, that an SCI entity should ultimately disseminate information regarding systems intrusions, and that the provisions of proposed Rule 1000(b)(5)(ii) permitting a delay in dissemination, if applicable, should only affect the timing of such dissemination.

The Commission notes that some Roundtable panelists and commenters discussed the role that communications and disclosure should play in mitigation of risk from systems issues. For example, panelists from Citadel, DE, Nasdaq, Lime, and TDA, among others, spoke about the role of communications and management involvement in responding to errors. See discussion of Roundtable, *supra* Section I.D. See also text accompanying *infra* note 238.

dissemination SCI event.¹⁶¹ The Commission preliminarily believes that, if an SCI entity's SCI systems were operating in a manner not in compliance with the federal securities laws and rules and regulations thereunder, or the entity's rules or governing documents, as applicable, the SCI entity should be required to disseminate that information to all members or participants, i.e., the users of its SCI systems. In addition, because SCI entities that are SCI SROs or plan processors are required by the Exchange Act to comply with their rules, proposing to require dissemination of information about systems compliance issues to members or participants should help to reinforce this statutory obligation.

Second, any SCI event that is a systems intrusion would also be a dissemination SCI event. The Commission preliminarily believes that a systems intrusion may represent a significant weakness in the security of an SCI entity's systems and thus warrant dissemination of information to an SCI entity's members or participants. However, because detailed information about a systems intrusion may expose an SCI entity's systems to further probing and attack, an SCI entity would only be required to provide a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion has been or is expected to be resolved.¹⁶² In addition, because immediate dissemination of information about a systems intrusion may in some cases further compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, an SCI entity in some cases may be permitted to delay the dissemination of information about such systems intrusion.¹⁶³

¹⁶¹ See supra Section III.B.3.b, discussing the definition of "systems compliance issue."

¹⁶² See infra Section III.C.3.c and proposed Rule 1000(b)(5)(ii).

¹⁶³ See id.

Finally, the Commission is proposing that any systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants would also be a dissemination SCI event. Some systems disruptions may have an immediate, obvious, and detrimental impact on market participants, hampering the ability of an SCI entity's members or participants to utilize the SCI entity's SCI systems and, in some cases, making such systems unusable. At the same time, the Commission recognizes that disseminating information relating to a single systems disruption that results in harm or loss to one or a small number of market participants that is not significant may not warrant the cost of such dissemination. Furthermore, the Commission preliminarily believes that the proposed standard is appropriate in that it does not set a specific threshold or definition of "significant harm or loss to market participants," and provides an SCI entity with reasonable discretion in estimating whether a given systems disruption has resulted, or would result, in significant harm or loss to market participants.¹⁶⁴

Although the particular facts and circumstances will differ for each systems disruption, some systems disruptions would clearly result in significant harm or loss to market participants and warrant dissemination of information regarding such systems disruption to the SCI entity's members or participants, even if the harm or loss, or the potential harm or loss, is difficult to quantify. For example, if a market experiences a problem with a trading system such that order processing and execution in certain securities is halted and members are not able to confirm transactions in such securities, the Commission preliminarily believes that such a systems disruption would be a dissemination SCI event. In contrast, if a trading market or a clearing agency experienced a momentary power disruption causing a fail over to the backup data center

¹⁶⁴ The tradeoffs of setting thresholds are discussed in the Economic Analysis Section below. See infra Section V.B.

with no customer, member, or participant impact, such SCI event would be a systems disruption requiring written notice to the Commission, but would not be a dissemination SCI event.

Request for comment

44. Do commenters believe the proposed definition of “dissemination SCI event” is appropriate? Why or why not?

45. Do commenters believe that a “systems compliance issue” should constitute a dissemination SCI event? Why or why not? Please explain.

46. Do commenters believe that a “systems intrusion” should constitute a dissemination SCI event? Why or why not? Please explain.

47. Do commenters believe that systems disruptions that meet the “significant harm or loss to market participants” standard should be included as dissemination SCI events? Why or why not? If not, what would be an appropriate threshold, and how should it be measured? Should the term “significant harm or loss to market participants” be further clarified or defined in the rule? Why or why not? If so, what should such clarification or definition be and why?

48. Would an alternative measurement, or group of alternative measurements, for systems disruptions, such as a 50 millisecond pause in service or some other nonmonetary measure (for example, out of memory situations, memory overloads, data loss due to an SCI system exceeding capacity limitations, excessive queuing or throttling), also be an appropriate and effective means to measure certain events about which an SCI entity should disseminate information to its members or participants? If so, what are they and why? Should any such measurements vary based on the type of SCI system involved? If so, how? Please be specific.

49. Are there any other types of systems disruptions that should be required to be disseminated to members or participants? If so, please explain why. Should, for example,

information relating to a systems disruptions be required to be disseminated to members or participants if it affects a certain number of market participants? If so, how should such a level (number of market participants) be determined?

4. Material Systems Changes

Rule 1000(a) of proposed Regulation SCI would define "material systems change" as "a change to one or more: (1) SCI systems of an SCI entity that: (i) materially affects the existing capacity, integrity, resiliency, availability, or security of such systems; (ii) relies upon materially new or different technology; (iii) provides a new material service or material function; or (iv) otherwise materially affects the operations of the SCI entity; or (2) SCI security systems of an SCI entity that materially affects the existing security of such systems."¹⁶⁵ This proposed definition of "material systems change" is substantively similar to the definition of "significant system change" discussed in the ARP II Release.¹⁶⁶

Item (1)(i) of the proposed definition of material systems change differs from item (1) in the definition in the ARP II Release of "significant system change," as proposed item (1)(i) refers to changes to an SCI entity's SCI systems that affect not only capacity and security, but also integrity, resiliency, and availability.¹⁶⁷ Items (1)(ii) and (1)(iii) in the proposed definition

¹⁶⁵ See proposed Rule 1000(a). See also *infra* Sections III.C.4 and III.C.6 discussing notices of material systems changes and reports of material systems changes, respectively.

¹⁶⁶ See ARP II Release, *supra* note 1, at 22592-93. See also 2001 Staff ARP Interpretive Letter, *supra* note 35 (citing ARP II, *supra* note 1, at 22492-93: "ARP II provides a non-exclusive list of factors that should be considered in determining whether a system change is significant and should be reported. The list includes a change that: (1) affects existing capacity or security; (2) in itself raises capacity or security issues, even if it does not affect other existing systems; (3) relies upon substantially new or different technology; (4) is designed to provide a new service or function for SRO members or their customers; or (5) otherwise significantly affects the operations of the entity.").

¹⁶⁷ Proposed item (1)(i) consolidates items (1) and (2) of the definition of material systems change in the 2001 Staff ARP Interpretive Letter. The Commission believes that the

of material systems change are intended to be substantively identical to items (3) and (4) of the definition of significant system change in the 2001 Staff ARP Interpretive Letter, generally covering changes to an SCI entity's SCI systems designed to advance systems development.¹⁶⁸ Proposed item (1)(iv), covering a change to an SCI entity's SCI systems that "otherwise materially affects the operations of the SCI entity," is intended to require notification of major systems changes to SCI systems that are not captured by other elements of paragraph (1) of the proposed definition. Proposed item (2), covering a change to an SCI entity's SCI security systems that "materially affects the existing security of such systems," is intended to ensure that significant changes that would affect the security of an SCI entity's SCI security systems (*i.e.*, systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems)¹⁶⁹ are reported to the Commission.

Examples that the Commission preliminarily believes could be included within the proposed definition of material systems change are: major systems architecture changes; reconfigurations of systems that would cause a variance greater than five percent in throughput or storage; the introduction of new business functions or services; changes to external interfaces; changes that could increase susceptibility to major outages; changes that could increase risks to data security; changes that were, or would be, reported to or referred to the entity's board of directors, a body performing a function similar to the board of directors, or senior management;

addition of integrity, resiliency, and availability aspects of SCI systems that are important in today's automated trading environments appropriately reflects the evolution of the types of systems issues since the 2001 Staff ARP Interpretive Letter.

¹⁶⁸ In addition, each of proposed items (1)(i) through (1)(iii) are changes that concern the adequacy of capacity estimates, testing, and security measures taken by an SCI entity, for which adequate procedures are required by proposed Rule 1000(b)(1). See infra Section III.C.1.

¹⁶⁹ See supra Section III.B.2 (discussing definition of SCI security system).

and changes that could require allocation or use of significant resources. These examples are cited in the 2001 Staff ARP Interpretive Letter.¹⁷⁰ Based on Commission staff's experience working with SROs that have relied on the guidance provided in the 2001 Staff ARP Interpretive Letter, the Commission preliminarily believes that such examples could continue to be relevant guidance to SCI SROs as well as to other SCI entities. In addition, the Commission preliminarily believes that any systems change occurring as a result of the discovery of an actual or potential systems compliance issue, as that term would be defined in proposed Rule 1000(a), would be material.

Based on its experience with SROs and other entities reporting significant systems changes in the context of the ARP Inspection Program, the Commission preliminarily believes that the proposed definition of material systems change is appropriate for all SCI entities. The Commission preliminarily believes that proposed items (1)(i)-(iv) and (2), which would cover changes affecting capacity estimates, security measures, the use of new technology and new functionality, could also highlight the need for SCI entities that are SROs, when applicable, to file a proposed rule change with the Commission under Section 19(b) of the Exchange Act and SCI entities that are SROs to file proposed amendments for SCI Plans under Rule 608 of Regulation NMS.¹⁷¹ As the Commission noted in ARP II, the purpose of urging SROs to notify

¹⁷⁰ See supra note 35.

¹⁷¹ Section 19(b)(1) of the Exchange Act requires an SRO to file proposed rules and proposed rule changes with the Commission in accordance with rules prescribed by the Commission. See 15 U.S.C. 78s(b)(1). Section 19(b)(1) further requires the Commission to solicit public comment on any proposed rule change filed by an SRO. See id.

Rule 608(a)(1) of Regulation NMS under the Exchange Act, 17 CFR 242.608(a)(1), permits "self-regulatory organizations, acting jointly, [to] file a national market system plan or [to] propose an amendment to an effective national market system plan." Rule 608(b) of Regulation NMS, 17 CFR 242.608(b), requires the Commission to publish such proposed national market system plan or national market system plan amendment for

Commission staff of significant system changes was not to supplant or provide an alternative means for SROs to satisfy their obligations to file proposed rule changes as required by the Exchange Act.¹⁷² Rather, under ARP II, the Commission was primarily concerned with fulfilling its oversight responsibilities and was also interested in obtaining a full view and understanding of systems development at SROs.¹⁷³ Likewise, the proposal to require an SCI entity to notify the Commission of material systems changes would not relieve an SCI SRO of any obligation it may have to file a proposed rule change, the participants of an SCI Plan to file a proposed amendment to such SCI Plan, or any other obligation any SCI entity may have under the Exchange Act or rules thereunder.¹⁷⁴

Request for comment

50. The Commission requests comment generally on the proposed definition of “material systems change.” Is the proposed definition of material systems change clear? Should the Commission provide additional guidance on, or further define what would constitute a “material systems change?” Are there other factors that should be included? Please be specific and give

notice and comment, and, in certain situations, approve such NMS plan or plan amendment before it may become effective.

¹⁷² See ARP II, supra note 1, at 22493. ARP II explained that because the rule change process pursuant to Section 19(b) of the Exchange Act and Rule 19b-4 thereunder “imposes shortened timeframes for action on proposed rule changes and because not all systems changes trigger the need for changes to rules of the SROs,” the rule change process was not providing staff with timely and complete detail on various significant systems changes occurring at the SROs. The policy of urging SROs to provide timely and accurate information on systems changes was intended as an adjunct to, and not a substitution for the rule change process. See id.

¹⁷³ See id. at 22493-94, n. 20.

¹⁷⁴ See infra request for comment in Section III.C.1.b, wherein the Commission solicits comment on whether SCI SROs should be required to provide notice to their members of anticipated technology deployments prior to implementation and offer their members the opportunity to test anticipated technology deployments prior to implementation.

examples of types of system changes that should be included in the proposed definition but currently are not.

51. The Commission sets forth above examples of systems changes that it preliminarily believes could be included within the proposed definition of material systems change (i.e., major systems architecture changes; reconfigurations of systems that would cause a variance greater than five percent in throughput or storage; the introduction of new business functions or services; changes to external interfaces; changes that could increase susceptibility to major outages; changes that could increase risks to data security; changes that were, or would be, reported to or referred to the entity's board of directors, a body performing a function similar to the board of directors, or senior management; and changes that could require allocation or use of significant resources). Do commenters agree each of these examples could constitute material systems changes? Why or why not?

52. Should any of the proposed factors be eliminated or refined? If so, please explain. Should material systems changes be defined to include cumulative systems changes over a specified period that might not otherwise qualify individually as a material systems change? For example, if systems changes (such as reconfigurations of systems that would cause a variance greater than five percent in throughput or storage) occurred that, on their own, each would not constitute a material systems change but, if grouped together with other similar or even identical changes (or, alternatively, that occurred repeatedly over a certain period of time such as a week or a month) could represent a material system change, should such changes together be considered a material systems change? If so, what would be the appropriate number of similar or identical systems changes that should be considered and/or what would be an appropriate time period to consider? Should all non-material systems changes count towards this threshold or

should only non-material systems changes of the same or similar type count? Would cumulative changes over a week be an appropriate measurement period? Would a 30-day measurement period be appropriate? Should the period be longer or shorter? Please explain.

53. Do commenters believe that a change to the SCI systems of an SCI entity that “materially affects the existing capacity, integrity, resiliency, availability, or security of such systems” should constitute a material systems change as proposed? Why or why not? Should a change with respect to any of the proposed characteristics of such systems (i.e., capacity, integrity, resiliency, availability, or security) be eliminated or modified? Should any be added? Please explain.

54. Should a change to the SCI systems of an SCI entity that “relies upon materially new or different technology” constitute a material systems change as proposed? Why or why not? Is the phrase “materially new or different” sufficiently clear? If not, please explain.

55. Should a change to an SCI entity’s SCI systems that “provides a new material service or material function” constitute a material systems change as proposed? Why or why not? Is the phrase “a new material service or material function” sufficiently clear? If not, please explain.

56. Do commenters believe it is appropriate to include a change to an SCI entity’s SCI systems that “otherwise materially affects the operations of the SCI entity” as proposed? Why or why not? Please explain.

57. Do commenters believe that a change to the SCI security systems of an SCI entity that “materially affects the existing security of such systems” should constitute a material systems change as proposed? Why or why not? Please explain.

58. Do commenters believe the rule should include quantitative criteria or other minimum thresholds for the effect of a change to an SCI entity’s SCI systems or SCI security

systems beyond which the Commission must be notified of the change? Why or why not? If so, what should such quantitative criteria or other minimum thresholds be and why?

59. How often do SCI entities currently make material systems changes? How often do SCI SROs make material systems changes and what percentage of the time are such changes filed with the Commission as proposed rule changes under Section 19 of the Exchange Act?

C. Proposed Rule 1000(b): Obligations of SCI Entities

Paragraph (b) of proposed Rule 1000 would set forth requirements that would apply to SCI entities relating to written policies and procedures, obligations with regard to corrective actions, reporting of SCI events to the Commission, dissemination of information relating to certain SCI events to members or participants, reporting of material systems changes, SCI reviews, and the participation of designated members or participants of SCI entities in testing the business continuity and disaster recovery plans of SCI entities.

1. Policies and Procedures to Safeguard Capacity, Integrity, Resiliency, Availability, and Security¹⁷⁵

Proposed Rule 1000(b)(1) would require each SCI entity to establish, maintain, and enforce written policies and procedures, reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets. Proposed Rule 1000(b)(1)(i) would further provide that such policies and procedures include, at a minimum: "(A) the establishment of reasonable current and future capacity planning estimates; (B) periodic capacity stress tests of such systems to determine their ability to process transactions in an accurate, timely, and

¹⁷⁵ See *infra* Sections IV.D.1.a and V.B for discussions related to current practices of SCI entities.

efficient manner; (C) a program to review and keep current systems development and testing methodology for such systems; (D) regular reviews and testing of such systems, including backup systems, to identify vulnerabilities pertaining to internal and external threats, physical hazards, and natural or manmade disasters; (E) business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption; and (F) standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data.”¹⁷⁶ Proposed Rule 1000(b)(1)(ii) would deem an SCI entity’s policies and procedures required by proposed Rule 1000(b)(1) to be reasonably designed if they are consistent with SCI industry standards.¹⁷⁷ In particular, for purposes of complying with proposed Rule 1000(b)(1), if an SCI entity has policies and procedures that are consistent with such SCI industry standards, as discussed further in Section III.C.1.b below, such policies and procedures would be deemed to be reasonably designed and thus the SCI entity would be in compliance with proposed Rule 1000(b)(1). In addition, under proposed Rule 1000(b)(1)(ii), compliance with the identified SCI industry standards would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1).

a. Proposed Rule 1000(b)(1)(i)

Proposed Rule 1000(b)(1) would require that an SCI entity have policies and procedures that address items (i)(A)-(F) for its SCI systems and, for purposes of security standards, SCI

¹⁷⁶ See proposed Rule 1000(b)(1)(i)(A)-(F).

¹⁷⁷ See infra Section III.C.1.b.

security systems. Items (A)-(C) enumerated in proposed Rule 1000(b)(1)(i) are substantively the same as the requirements of Rule 301(b)(6)(ii)(A)-(C) of Regulation ATS, applicable to significant-volume alternative trading systems, and trace their origin to the ARP I Release.¹⁷⁸ With respect to SCI systems and, as applicable, SCI security systems, proposed item (A), which would require an SCI entity to establish, maintain, and enforce policies and procedures for the establishment of reasonable current and future capacity planning estimates, and proposed item (B), which would require an SCI entity to establish, maintain, and enforce policies and procedures for periodic capacity stress tests of such systems, would help an SCI entity determine its systems' ability to process transactions in an accurate, timely, and efficient manner, and thereby help ensure market integrity. Proposed item (C), which would require an SCI entity to establish, maintain, and enforce policies and procedures that include a program to review and keep current systems development and testing methodology for such systems, would help ensure that the SCI entity continues to monitor and maintain systems capacity and availability.

Proposed item (D), which would require an SCI entity to establish, maintain, and enforce policies and procedures to review and test regularly such systems, including backup systems, to identify vulnerabilities pertaining to internal and external threats, physical hazards, and natural or manmade disasters, would likewise assist an SCI entity in ascertaining whether its SCI systems and SCI security systems are and remain sufficiently secure and resilient. Unlike Rule 301(b)(6)(ii)(D) of Regulation ATS, proposed item (D) includes "manmade disasters" in the list of vulnerabilities an SCI entity would be required to consider and protect against. The Commission proposes to add "manmade disasters" to be clear that acts of terrorism and

¹⁷⁸ See 17 CFR 242.301(b)(6)(ii)(A)-(C); see also ARP I Release, *supra* note 1, at 48706-07.

sabotage—threats that some SCI entities have faced in recent history¹⁷⁹—are threats that an SCI entity must prepare for in reviewing and testing its systems and operations.

Proposed items (B), (C), and (D) would each require, among other things, the establishment of policies and procedures relating to various aspects of systems testing, including capacity stress tests, testing methodology, and tests for systems vulnerabilities to internal and external threats, physical hazards, and natural or manmade disasters, respectively. The Commission preliminarily believes that, to help ensure an effective testing regime, such policies and procedures would need to address when testing with members, participants, and other market participants would be appropriate.¹⁸⁰

Proposed item (E), which would require SCI entities to establish, maintain, and enforce policies and procedures for business continuity and disaster recovery plans, is substantially similar to a requirement in Rule 301(b)(6)(ii) of Regulation ATS and ARP I.¹⁸¹ However, proposed item (E) would further require SCI entities to have plans for maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption. The proposed resiliency and geographic diversity requirement is designed particularly to help ensure that an SCI entity would be able to continue operations from the backup site during a wide-scale disruption resulting from natural disasters, terrorist activity, or

¹⁷⁹ See, e.g., supra note 61.

¹⁸⁰ See also the Commission's request for comment in infra Sections III.C.1.b and III.C.7, on whether proposed Regulation SCI should be more prescriptive regarding testing standards and requirements in light of comments on testing made by Roundtable panelists and commenters, and the closure of the national securities exchanges in the wake of Superstorm Sandy, as discussed in the text accompanying supra notes 78-83.

¹⁸¹ See 17 CFR 242.301(b)(6)(ii)(E); ARP I Release, supra note 1, at 48706.

other significant events. For example, the Commission preliminarily believes that backup sites should not rely on the same infrastructure components (e.g., transportation, telecommunications, water supply, and electric power) used by the primary site.¹⁸² The proposed next business day trading resumption standard reflects the Commission's preliminary view that an SCI entity, being part of the critical infrastructure of the U.S. securities markets, should have plans to limit downtime caused by a wide-scale disruption to less than one business day.¹⁸³ Likewise, the proposed two-hour resumption standard for clearance and settlement services, which traces its

¹⁸² See 2003 Interagency White Paper, *supra* note 31.

As discussed further below in Section III.C.1.b, proposed Rule 1000(b)(1) would require an SCI entity to have policies and procedures that are "reasonably designed" and "adequate to maintain [its] operational capability and promote the maintenance of fair and orderly markets." Proposed Rule 1000(b)(1)(i)(E) would require that such policies and procedures include "business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse," (emphasis added) to ensure next business day or two-hour resumption as applicable, following a wide-scale disruption. While "sufficient" geographic diversity would be a required element of reasonably designed business continuity and disaster recovery plans, the proposed rule does not specify any particular minimum distance or geographic location that would be necessary to achieve the requisite level of geographic diversity. Instead, the proposed rule focuses on the ability to achieve the goal of resuming business within the applicable time frame in the wake of a wide-scale disruption. As noted above, the Commission also preliminarily believes that an SCI entity should have a reasonable degree of flexibility to determine the precise nature and location of its backup site depending on the particular vulnerabilities associated with those sites, and the nature, size, technology, business model, and other aspects of its business.

¹⁸³ Standards with respect to resilient and geographically remote back-up sites and resumption of operations are discussed in the 2003 Interagency White Paper and the 2003 Policy Statement on Business Continuity Planning for Trading Markets, and these publications are proposed to be designated as industry standards in the context of contingency planning. See 2003 Interagency White Paper, *supra* note 31 and 2003 Policy Statement on Business Continuity Planning for Trading Markets, *supra* note 32.

In addition, the 2003 Policy Statement on Business Continuity Planning for Trading Markets urged SRO markets and ECNs to "have a business continuity plan that anticipates the resumption of trading...no later than the next business day following a wide-scale disruption." See *supra* note 32, at 56658.

origin to the 2003 Interagency White Paper,¹⁸⁴ reflects the Commission's preliminary view that an SCI entity that is a registered clearing agency or an "exempt clearing agency subject to ARP" should have contingency plans to avoid a scenario in which failure to settle transactions by the end of the day could present systemic risk to the markets.¹⁸⁵

Proposed item (F) would require SCI entities to have standards that result in systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data. As the Commission previously noted, when Congress mandated a national market system in 1975, it emphasized that the systems for collecting and distributing consolidated market data would "form the heart of the national market system."¹⁸⁶ As a result of consolidated market data, the public has ready access to a comprehensive, accurate, and reliable source of information for the prices and volume of any NMS stock at any time during the trading day.¹⁸⁷ This information helps to ensure that the public is aware of the best displayed prices for a stock, no matter where they may arise in the national market system.¹⁸⁸ It also enables investors to monitor the prices at which their orders are executed and assess whether their orders received best execution.¹⁸⁹

Further, as noted above, one of the findings of the May 6 Staff Report is that "fair and orderly

¹⁸⁴ See supra note 31. See also infra note 195, discussing further the 2003 Interagency White Paper.

¹⁸⁵ The Commission believes that all clearing agencies that would be subject to proposed Regulation SCI (i.e., all of the registered clearing agencies and the current "exempt clearing agency subject to ARP") currently strive to adhere to this standard.

¹⁸⁶ See Concept Release on Equity Market Structure, supra note 42, at 3600 (quoting H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 93 (1975)).

¹⁸⁷ See id.

¹⁸⁸ See id.

¹⁸⁹ See id. The benefits of consolidated market data discussed here are true for the options markets as well.

markets require that the standards for robust, accessible, and timely market data be set quite high.”¹⁹⁰ The Commission believes that the accurate, timely and efficient processing of data is similarly important to the proper functioning of the securities markets. For example, if a clearing agency were not able to process data accurately, settlements could potentially be impacted. Similarly, if an exchange does not process trades accurately, erroneous executions could occur.

Consistent with these goals and Congress’s statement, proposed item (F) would be a new requirement that has no precedent in either Rule 301(b)(6) of Regulation ATS or the ARP policy statements and would require SCI entities to have “standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data.”¹⁹¹ The Commission preliminarily believes that proposed item (F) would assist an SCI entity in ensuring that its market data systems are designed to maintain market integrity.

b. Proposed Rule 1000(b)(1)(ii)

Proposed Rule 1000(b)(1) would generally require that each SCI entity’s policies and procedures be reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, “have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity’s operational capability and promote the maintenance of fair and orderly markets.” As discussed above, proposed Rule 1000(b)(1)(i)

¹⁹⁰ See May 6 Staff Report, supra note 56, at 8.

¹⁹¹ This proposed requirement is consistent with Rule 603(a) of Regulation NMS, which states that any “...broker or dealer with respect to information for which it is the exclusive source, that distributes information with respect to quotations for or transactions in an NMS stock to a securities information processor shall do so on terms that are fair and reasonable.” In adopting Regulation NMS, the Commission stated that Rule 603(a) “prohibits an SRO or broker-dealer from transmitting data to a vendor or user any sooner than it transmits the data to a Network processor.” Rule 603(a) by its terms applies only to NMS stocks. See supra note 121. See also 17 CFR 242.603(a).

would also require that an SCI entity have policies and procedures that address items (A)-(F). The Commission notes that SCI entities that are ARP participants have been applying the ARP I principles underlying proposed Rule 1000(b)(1)(i)(A)-(F) for many years. However, while the items enumerated in proposed Rule 1000(b)(1)(i)(A)-(F) identify the areas that would be required to be addressed by an SCI entity's policies and procedures, the Commission is not proposing to prescribe the specific policies and procedures an SCI entity must follow to comply with the requirements of proposed Rule 1000(b)(1). Instead, the Commission intends to, and preliminarily believes that the proposed requirements as written would, provide SCI entities sufficient flexibility, based on the nature, size, technology, business model, and other aspects of their business, to identify appropriate policies and procedures that would meet the articulated standard, namely that they be reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets. However, the Commission also preliminarily believes that it would be helpful to SCI entities to provide additional guidance about one way in which they might elect to satisfy this general standard in proposed Rule 1000(b)(1). Therefore, the Commission is proposing Rule 1000(b)(1)(ii), which would provide that, for purposes of complying with proposed Rule 1000(b)(1), an SCI entity's policies and procedures would be deemed to be reasonably designed, and thus satisfy the requirements of proposed Rule 1000(b)(1), if they are consistent with current SCI industry standards. Proposed Rule 1000(b)(1)(ii) further states that such SCI industry standards shall be: (A) comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and (B) issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or

agencies, or widely recognized organization. Proposed Rule 1000(b)(1)(ii) would additionally provide that compliance with the SCI industry standards identified in the proposal would not be the exclusive means to comply with the requirements of paragraph (b)(1). As noted above, the Commission intends to, and preliminarily believes that the proposed requirements as written would, provide SCI entities sufficient flexibility, based on the nature, size, technology, business model, and other aspects of their business, to identify appropriate policies and procedures to comply with proposed Rule 1000(b)(1).

The Commission is proposing this approach because it preliminarily believes that providing additional guidance on the types of industry standards that would satisfy the requirements of proposed Rule 1000(b)(1) could assist an SCI entity in determining how to best allocate resources to maintain its systems' operational capability, and promote the maintenance of fair and orderly markets.¹⁹² The Commission acknowledges that current industry standards applicable to SCI entities have been developed in a number of areas to help ensure that systems have adequate capacity, integrity, resiliency, availability, and security. Accordingly, the current SCI industry standards that would be deemed to be reasonably designed for purposes of proposed Rule 1000(b)(1) are not limited to the SCI industry standards discussed and contained in the publications identified in Table A below, but rather may be found in a variety of publications, issued by a range of sources. The Commission acknowledges that an SCI entity's choice of a current SCI industry standard in a given domain or subcategory thereof may be different than

¹⁹² See *infra* Sections V.B and V.C, discussing market failures and the anticipated economic benefits of proposed Regulation SCI. Each SCI entity, to the extent it seeks to rely on SCI industry standards in complying with proposed Rule 1000(b)(1), would have discretion to identify those industry standards that provide an appropriate way for it to comply with the requirements set forth in the rule, given its technology, business model, and other factors.

those contained in the publications identified in Table A. Further, some of the identified standards may be more relevant for some SCI entities than others, based on the nature and amount of their respective activities. Thus, the Commission's proposed approach is designed to provide a non-exclusive method of compliance.

The Commission preliminarily believes that the publications set forth in Table A below¹⁹³ contain examples of SCI industry standards that an SCI entity may elect to look to in establishing its policies and procedures under proposed Rule 1000(b)(1). However, as proposed Rule 1000(b)(1)(ii) makes clear, compliance with such current SCI industry standards would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1). Thus, as proposed, written policies and procedures that are consistent with the relevant examples of SCI industry standards contained in the publications identified in Table A, would be deemed to be "reasonably designed" for purposes of proposed Rule 1000(b)(1). The publications identified in Table A cover nine inspection areas, or "domains," that have evolved over the past 20 years of the ARP Inspection Program and that are relevant to SCI entities' systems capacity, integrity, resiliency, availability, and security, namely: application controls; capacity planning; computer operations and production environment controls; contingency planning; information security and networking; audit; outsourcing; physical security; and systems development methodology.

The publications included in Table A set forth industry standards that the Commission understands are currently used by information technology and audit professionals in the financial and government sectors. These industry standards have been issued primarily by NIST and

¹⁹³ Each of these publications would meet the proposed criteria that they be: (i) information technology practices that are widely available for free to information technology professionals in the financial sector; and (ii) issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization. See proposed Rules 1000(b)(1)(ii).

FFIEC. NIST, an agency within the U.S. Department of Commerce, has issued special publications regarding information technology systems. The FFIEC is a U.S. intergovernmental body that prescribes uniform principles and practices for the examination of certain financial institutions by U.S. regulators, and has issued publications on numerous topics, including development and acquisition of applications, computer operations, outsourcing technology, business continuity planning, information security, and internal audits.¹⁹⁴ In addition to these standards issued by FFIEC and NIST, financial regulatory agencies, including the Commission, provided guidance on business continuity and disaster recovery plans in the 2003 Interagency White Paper¹⁹⁵ and the 2003 Policy Statement on Business Continuity Planning for Trading Markets.¹⁹⁶

¹⁹⁴ The federal agencies represented on the FFIEC are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, Office of the Comptroller of the Currency, and the Consumer Financial Protection Bureau.

¹⁹⁵ See 2003 Interagency White Paper, *supra* note 31. In the 2003 Interagency White Paper, which was issued jointly by the Commission, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency, the agencies identified a broad consensus on three important business continuity objectives: (1) rapid recovery and timely resumption of critical operations following a wide-scale disruption; (2) rapid recovery and timely resumption of critical operations following the loss or inaccessibility of staff in at least one major operating location; and (3) a high level of confidence, through ongoing use or robust testing, that critical internal and external continuity arrangements are effective and compatible. See *id.* at 17811.

The agencies also identified sound practices for core clearing and settlement organizations and firms that play significant roles in critical financial markets. They stated that in this context, “core clearing and settlement organizations” consist of market utilities that provide clearing and settlement services for critical financial markets or act as large-value payment system operators and present systemic risk to the markets should they be unable to perform. “Firms that play significant roles in critical financial markets” refers to organizations whose participation in one or more critical financial markets is significant enough that their failure to settle their own or their customers’ material pending transactions by the end of the day could present systemic risk to the markets. The sound practices address the risks of a wide-scale disruption and strengthen the resilience of the financial system. They also reduce the potential that key market

Also included in Table A is a publication issued by the Institute of Internal Auditors (“IIA”). The IIA is an international professional association that has developed and published guidance setting forth industry best practices in internal auditing for internal audit professionals. It has more than 175,000 members in 165 countries and territories around the world.¹⁹⁷ IIA is also a credentialing organization, awarding the Certified Internal Auditor (CIA), Certified

participants will present systemic risk to one or more critical markets because primary and back-up processing facilities and staffs are concentrated within the same geographic region.

The sound practices are as follows. First, identify clearing and settlement activities in support of critical financial markets. These activities include the completion of pending large-value payments; clearance and settlement of material pending transactions; meeting material end-of-day funding and collateral obligations necessary to ensure the performance of pending large-value payments and transactions; and updating records of accounts. Second, determine appropriate recovery and resumption objectives for clearing and settlement activities in support of critical markets. In this regard, core clearing and settlement organizations are expected to develop the capacity to recover and resume clearing and settlement activities within the business day on which the disruption occurs with the overall recovery goal of two hours after an event. Third, maintain sufficient geographically dispersed resources to meet recovery and resumption objectives. The 2003 Interagency White Paper states that back-up arrangements should be as far away from the primary site as necessary to avoid being subject to the same set of risks as the primary location and should not rely on the same infrastructure components used by the primary site. Fourth, routinely use or test recovery and resumption arrangements. This includes regular tests of internal recovery and resumption arrangements as well as cross-organization tests to ensure the effectiveness and compatibility of recovery and resumption strategies within and across critical markets. *See id.* at 17811-13.

¹⁹⁶ *See supra* note 32. The Commission’s policy statement applies more broadly to all “SRO markets” and ECNs, not just those that play “significant roles in critical financial markets,” as discussed in the 2003 Interagency White Paper. Each SRO market and ECN is expected to (1) have in place a business continuity plan that anticipates the resumption of trading in the securities traded by that market no later than the next business day following a wide-scale disruption; (2) maintain appropriate geographic diversity between primary and back-up sites in order to assure resumption of trading activities by the next business day; (3) assure the full resilience of shared information streams, such as the consolidated market data stream generated for the equity and options markets; and (4) confirm the effectiveness of the back-up arrangements through testing. *See id.* at 56658.

¹⁹⁷ *See* IIA’s 2011 Annual Report, available at: <https://na.theiia.org/about-us/Pages/Annual-Reports.aspx>.

Government Auditing Professional (CGAP), Certified Financial Services Auditor (CFSA), Certification in Control Self-Assessment (CCSA), and Certification in Risk Management Assurance (CRMA) certifications to those who meet the requirements.¹⁹⁸ The Commission preliminarily believes these factors support identification of IIA as an authoritative body that is a widely recognized organization.

In addition, one of the publications identified in Table A is issued by the Security Benchmarks division of the Center for Internet Security ("CIS"). The CIS is a not-for-profit organization focused on enhancing the cybersecurity readiness and response of public and private sector entities. The CIS Security Benchmarks division facilitates the development of industry best practices for security configuration, tools for measuring information security status, and resources to assist entities in making security investment decisions.¹⁹⁹ Its members include commercial organizations, academic organizations, government agencies, and security service, consulting, and software organizations.²⁰⁰ According to the CIS, its benchmarks are regularly referred to by U.S. government agencies for compliance with information security rules and regulations.²⁰¹ The Commission preliminarily believes these factors support a determination that CIS is an authoritative body that is a widely recognized organization.

Table A lists the publication(s) that the Commission has preliminarily identified as SCI industry standard(s) in each domain that an SCI entity, taking into account its nature, size,

¹⁹⁸ See *id.*

¹⁹⁹ See <http://benchmarks.cisecurity.org/en-us/?route=default.about>.

²⁰⁰ See <http://benchmarks.cisecurity.org/en-us/?route=membership>.

²⁰¹ The CIS states that its benchmarks are widely accepted by U.S. government agencies for compliance with the Federal Information Security Management Act (FISMA), Gramm-Leach-Bliley Act, Sarbanes-Oxley Act, The Health Insurance Portability and Accountability Act of 1996 (HIPAA), and other the regulatory requirements for information security. See <http://benchmarks.cisecurity.org/en-us/?route=membership>.

technology, business model, and other aspects of its business, could, but is not required to, use to establish, maintain, and enforce reasonably designed policies and procedures that satisfy the requirements of proposed Rule 1000(b)(1). Thus, the Commission is proposing that the industry standards contained in the publications identified in Table A be one example of “current SCI industry standards” for purposes of proposed Rule 1000(b)(1), and requests commenters’ views on the appropriateness of each publication identified in Table A as a “current SCI industry standard.” Each listed publication is identified with specificity, and includes the particular publication’s date, volume number, and/or publication number, as the case may be. Thus, to the extent an SCI entity seeks to rely on SCI industry standards for purposes of complying with proposed Rule 1000(b)(1)(ii), the Commission intends SCI entities that establish policies and procedures based on the SCI industry standards contained in the publications set forth in Table A to enforce written policies and procedures, taking into account their nature, size, technology, business model, and other aspects of their business, consistent with relevant standards, even if the issuing organization were to subsequently update a given industry practice, until such time as the list of SCI industry standards were to be updated, as discussed below.²⁰² Of course, SCI entities could elect to use standards contained in the publications other than those identified on Table A to satisfy the requirements of proposed Rule 1000(b)(1).

Table A – Publications Relating to Industry Standards in 9 Domains

Domain	Industry Standards
Application Controls	NIST DRAFT Security and Privacy Controls for Federal Information Systems and Organizations (Special Publication 800-53 Rev. 4) available at: http://csrc.nist.gov/publications/drafts/800-53-rev4/sp800-53-rev4-ipd.pdf .

²⁰² See discussion in this Section III.C.1.b following Table A below.

Capacity Planning	FFIEC, Operations IT Examination Handbook (July 2004), available at: http://ithandbook.ffiec.gov/ITBooklets/FFIEC_ITBooklet_Operations.pdf .
Computer Operations and Production Environment Controls	NIST DRAFT Security and Privacy Controls for Federal Information Systems and Organizations (Special Publication 800-53 Rev. 4), available at: http://csrc.nist.gov/publications/drafts/800-53-rev4/sp800-53-rev4-ipd.pdf .
Contingency Planning (BCP)²⁰³	<p>NIST Contingency Planning Guide for Federal Information Systems (Special Publication 800-34 Rev. 1), available at: http://csrc.nist.gov/publications/nistpubs/800-34-rev1/sp800-34-rev1_errata-Nov11-2010.pdf.</p> <p>2003 Interagency White Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System, Securities Exchange Act Release No. 47638 (April 8, 2003), 68 FR 17809 (April 11, 2003), available at: http://www.sec.gov/news/studies/34-47638.htm.</p> <p>2003 Policy Statement on Business Continuity Planning for Trading Markets, Securities Exchange Act Release No. 48545 (September 25, 2003), 68 FR 56656 (October 1, 2003), available at: http://www.sec.gov/rules/policy/34-48545.htm.</p>
Information Security and Networking	<p>NIST DRAFT Security and Privacy Controls for Federal Information Systems and Organizations (Special Publication 800-53 Rev. 4), available at: http://csrc.nist.gov/publications/drafts/800-53-rev4/sp800-53-rev4-ipd.pdf.</p> <p>NIST Guidelines on Security and Privacy in Public Cloud Computing (Special Publication 800-144), available at: http://csrc.nist.gov/publications/nistpubs/800-144/SP800-144.pdf.</p> <p>The Center for Internet Security Configuration Benchmarks, available at: http://benchmarks.cisecurity.org/en-us/?route=downloads.benchmarks.</p>

²⁰³ The Commission recently adopted a similar contingency planning practice in Rule 17Ad-22(d)(4) that requires registered clearing agencies to have policies and procedures designed to identify sources of operational risk and minimize those risks through the development of appropriate systems controls and procedures. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012). See also supra note 95.

Audit	FFIEC, Audit IT Examination Handbook (August 2003), available at: http://ithandbook.ffiec.gov/ITBooklets/FFIEC_ITBooklet_Audit.pdf . IIA, The Role of Internal Auditing in Enterprise-wide Risk Management, available at: http://www.theiaa.org/iaa and http://www.theiaa.org/index .
Outsourcing	FFIEC, Outsourcing Technology Services IT Examination Handbook (June 2004), available at: http://ithandbook.ffiec.gov/ITBooklets/FFIEC_ITBooklet_OutsourcingTechnologyServices.pdf .
Physical Security	NIST DRAFT Security and Privacy Controls for Federal Information Systems and Organizations (Special Publication 800-53 Rev. 4), available at: http://csrc.nist.gov/publications/drafts/800-53-rev4/sp800-53-rev4-ipd.pdf .
Systems Development Methodology	NIST Security Considerations in the System Development Life Cycle (Special Publication 800-64 Rev. 2), available at: http://csrc.nist.gov/publications/nistpubs/800-64-Rev2/SP800-64-Revision2.pdf .

As noted above, each of the publications listed in Table A is intended to identify information technology practices that are widely available for free to information technology professionals in the financial sector and are issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization.

Although the industry standards contained in the publications identified in Table A above are intended as an appropriate initial set of industry standards under proposed Regulation SCI, the Commission does not seek to foreclose the development, whether by the Commission or otherwise, of a set of industry standards that is more focused on the specific businesses and systems of SCI entities.²⁰⁴ In such a case, the Commission preliminarily believes that it would

²⁰⁴ Standards issued by the Commission itself would meet the proposed criteria in that they would be: (i) comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and (ii) issued by an

be appropriate to use the industry standards contained in the publications listed in Table A as a starting point for such development.

Further, the Commission recognizes that systems and technologies are continually evolving. As such, the standards identified in this proposal would likely be updated from time to time by the organizations issuing them. However, the Commission also preliminarily believes that, following its initial identification of one set of SCI industry standards, it may be appropriate to update the identified set of standards from time to time through the periodic issuance of Commission staff guidance. Accordingly, the Commission preliminarily believes it would be appropriate for Commission staff, from time to time, to issue notices to update the list of previously identified set of SCI industry standards after receiving appropriate input from interested persons.²⁰⁵ The Commission preliminarily believes that this approach would provide the public, including SCI entities and other market participants, an opportunity to comment on newly proposed SCI industry standards. However, until such time as Commission staff were to update the identified set of SCI industry standards, the then-current set of SCI industry standards would be the standards referred to in proposed Rule 1000(b)(1)(ii) of Regulation SCI.

As noted above, proposed Rule 1000(b)(1)(ii) would require that any SCI industry standards be: (i) comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and (ii) issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or a widely recognized organization.

authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization.

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As noted in the request for comment section below, the Commission solicits comment on the ways in which appropriate input from interested persons should be obtained for updating the SCI industry standards.

Request for comment

60. The Commission requests comment generally on proposed Rule 1000(b)(1). Do commenters believe the proposed scope of required policies and procedures is appropriate? Why or why not? Please explain.

61. Do commenters believe that it is appropriate to apply the requirements of proposed Rule 1000(b)(1) to SCI systems and, for purposes of security standards, to SCI security systems? Why or why not? Please explain.

62. Do commenters believe the enumeration of the items in proposed Rule 1000(b)(1)(i)(A)-(F) that are to be addressed in the required policies and procedures is appropriate? Why or why not? Specifically, is the proposal to require that such policies and procedures include the establishment of reasonable current and future capacity planning estimates, as provided in proposed Rule 1000(b)(1)(i)(A), appropriate? Why or why not?

63. Should the Commission specify the interval (e.g., monthly or quarterly) at which SCI entities would be required to conduct periodic capacity stress tests of relevant systems, as provided in proposed Rule 1000(b)(1)(i)(B)? Should such periodic tests be limited to a subset of systems? If so, for which systems should such tests be required and why would that limitation be appropriate?

64. Should the Commission require SCI entities to have a program to review and keep current systems development and testing methodology, as proposed to be required in proposed Rule 1000(b)(1)(i)(C)? Why or why not?

65. Should the Commission specify the interval at which SCI entities would be required to conduct reviews and tests of SCI systems and SCI security systems, including backup systems, to identify vulnerabilities pertaining to internal and external threats, physical hazards, and natural

or manmade disasters, as provided in proposed Rule 1000(b)(1)(i)(D)? Why or why not? And, if so, what would be appropriate intervals and why?

66. The Commission notes that items (i)(B), (C), and (D) would each require the establishment of policies and procedures for: testing of capacity, testing methodology, and testing for vulnerabilities, respectively. The Commission also notes that the need for improved testing was a recurring theme during the Roundtable and discussed in several comment letters.²⁰⁶ The Commission requests comment on whether the testing policies and procedures requirements in proposed Rule 1000(b)(1)(i)(B), (C), and (D) would be sufficiently comprehensive to foster development of the types of testing that Roundtable panelists and commenters recommended. Why or why not? Please be specific. Should the Commission require certain types of testing by SCI entities? Why or why not? Please be specific. If so, what specific types of testing should the Commission require in proposed Regulation SCI? Please describe in detail.

67. Should the Commission require SCI entities to have, and make available to their members or participants, certain infrastructure or mechanisms that would aid industry-wide testing or direct testing with an SCI entity, such as test facilities or test symbols? Why or why not? If so, please specify what types of infrastructures or mechanisms should be required.

68. Should the Commission require industry-wide testing for certain types of anticipated technology deployments?²⁰⁷ Why or why not? If so, what should be the criteria for identifying

²⁰⁶ See text accompanying supra note 72, discussing recommendations by Roundtable panelists and commenters to lower rates of error in software development by improving testing opportunities and participation in testing by member firms. See also text accompanying supra note 180.

²⁰⁷ See also infra Section III.C.7 (discussing, among other things, the requirement of proposed Rule 1000(b)(9)(ii) that an SCI entity coordinate the testing of the SCI entity's business continuity and disaster recovery plans, including its backup systems, with other SCI entities).

anticipated technology deployments that warrant mandatory industry-wide testing and which market participants should be required to participate? Please explain in detail.

69. Should the Commission require SCI entities to mandate that their members or participants participate in direct testing with such SCI entities for certain types of anticipated technology deployments by the members or participants?²⁰⁸ Why or why not? If so, what should be the criteria for identifying anticipated technology deployments that warrant mandatory testing with an SCI entity? Should the Commission identify such criteria, or should SCI entities identify such criteria? Please explain.

70. Similarly, would proposed item (i)(E), regarding policies and procedures for business continuity and disaster recovery plans, be sufficiently comprehensive to foster the establishment of the types of contingency plans discussed by Roundtable panelists and Roundtable commenters, such as predetermined communication plans, escalation procedures, and/or kill switches?²⁰⁹ Why or why not? Should proposed Regulation SCI expressly require that an SCI entity's contingency plans include such details?²¹⁰ Why or why not? Please explain. Should SCI entities' contingency plans and the testing of such plans be required to account for specific

²⁰⁸ See also *infra* Section III.C.7 (discussing, among other things, the requirement of proposed Rule 1000(b)(9)(i) that an SCI entity require participation by designated members or participants in scheduled functional and performance testing of the operation of the SCI entity's business continuity and disaster recovery plans, including its backup systems).

²⁰⁹ See discussion of Roundtable in *supra* Section I.D. The Commission is not proposing at this time any requirements related to kill switches.

²¹⁰ See also *infra* Section III.C.3.a, discussing proposed Rule 1000(b)(3), which would require an SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action, including, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable, and the associated request for comment.

types of disaster or threat scenarios, such as an extreme volume surge, the failure of a major market participant, and/or a terrorist or cyber attack? Why or why not? Please explain. If so, what other types of scenarios should such plans take into account? Please be specific.

71. There was considerable discussion at the Roundtable about kill switches, with several panelists advocating the kill switch proposal outlined in the Industry Working Group comment letter,²¹¹ while others expressed concerns.²¹² The Commission is not proposing at this time any requirements related to kill switches. However, do commenters believe that the implementation of kill switches, as outlined in the Industry Working Group comment letter, would assist SCI entities in maintaining the integrity of their systems? Why or why not? If so, how, if at all, should the Commission foster the development of coordinated contingency plans among SCI SROs and SCI ATs that would include such a kill switch mechanism?

72. Should the Commission include the criteria of geographic diversity in the requirement relating to business continuity and disaster recovery plans in proposed Rule 1000(b)(1)(i)(E)? Why or why not? Please explain. Should the Commission specify minimum standards for “geographically diverse” in proposed Rule 1000(b)(1)(i)(E)? Why or why not? If so, what would be an appropriate standard?

73. Is the next business day resumption of trading following a wide-scale disruption requirement in proposed Rule 1000(b)(1)(i)(E) appropriate? Why or why not? Is the two-hour resumption of clearance and settlement services following a wide-scale disruption an appropriate requirement for an SCI entity that is a registered clearing agency or “exempt clearing agency subject to ARP?” Why or why not?

²¹¹ See letter from Industry Working Group, supra note 74 and accompanying text.

²¹² See, e.g., letter from TDA, supra note 74.

74. As discussed above, the U.S. national securities exchanges closed for two business days in October 2012 in the wake of Superstorm Sandy, even though the securities industry's annual test of how trading firms, market operators, and their utilities could operate through an emergency using backup sites, backup communications, and disaster recovery facilities occurred without significant incident on October 27, 2012, just two days before the storm.²¹³ As discussed in greater detail below, proposed Rule 1000(b)(9) would require SCI entities to mandate participation by designated members or participants in scheduled testing of the operation of their business continuity and disaster recovery plans, including backup systems, and to coordinate such testing with other SCI entities.²¹⁴ Are there other industry practices related to proposed Regulation SCI that should be considered further in light of the two-day closure of the U.S. securities markets during the storm? If so, what are they? For example, for SCI entities that are trading markets, should the Commission limit the extent to which an SCI entity's business continuity and disaster recovery plans may involve changing how trading may be conducted? For example, the NYSE, pursuant to its rules, initially proposed to conduct trading only electronically on October 29, 2012, using NYSE Arca systems, rather than conduct trading both electronically as well as on a physical trading floor, as it normally does.²¹⁵ Should an SCI entity that is experiencing a wide-scale disruption be permitted to offer its members or participants an alternative that significantly differs from its usual method of operation? Please explain. What are the costs and benefits associated with each type of approach?

²¹³ See supra Section I.D.

²¹⁴ See infra Section III.C.7.

²¹⁵ See supra Section I.D.

75. Should business continuity and disaster recovery plans involving backup data centers be required to be tested in a live "production" environment on a periodic basis (e.g., annually, or at some other frequency)? Why or why not? Please explain.

76. The Commission understands that certain entities that would be defined as SCI entities (such as registered clearing agencies) are already effectively operating under business resumption requirements of less than one business day. Should the Commission consider revising the proposed next business day resumption requirement for trading to a shorter or longer period, for example, a specific number of hours less or more than one business day or within the business day for certain entities that play a significant role within the securities markets? Why or why not? Similarly, should the proposed two-hour resumption standard for clearance and settlement services be shortened or lengthened? Why or why not?

77. Following a systems disruption (including, for example, activation of an SCI entity's business continuity plan), should the Commission require user testing and certification prior to resuming operation of the affected systems? Why or why not? If so, what should the testing requirements be? Should they vary depending on the type of system(s) affected? To whom should an SCI entity certify that an affected system or group of systems is ready to resume operation?

78. Is the requirement in proposed Rule 1000(b)(1)(i)(F) for "standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data" appropriate? Are there other factors that the Commission should consider in determining whether standards to process data are adequate? Or, should some of the proposed standards be eliminated or modified? If so, please explain how and why.

79. Do commenters believe there are specific internal controls or other mechanisms that would reinforce the effectiveness of an SCI entity's reasonably designed policies and procedures under proposed Rule 1000(b)(1)? Why or why not? Please explain. How do SCI entities presently use specific internal controls or other mechanisms to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets? How do commenters generally view the advantages and disadvantages of specific internal controls or other mechanisms? The Commission is not proposing to prescribe specific internal controls under proposed Rule 1000(b)(1). Should the Commission propose that any particular internal controls or other mechanisms be required (for example, that a senior officer be designated to be responsible for the SCI entity's compliance with proposed Regulation SCI, or that personnel of the SCI entity certify that the SCI entity's policies and procedures are reasonably designed)?

80. Would any of the Commission's proposed requirements under proposed Rule 1000(b)(1) create inappropriate barriers to entry for new entities seeking to register with the Commission as an SRO, ATS, or plan processor? Would any of the proposed requirements inappropriately limit the growth or expansion of entities currently registered with the Commission as an SRO, ATS, or plan processor? Why or why not?

81. As noted above, the Commission proposes that policies and procedures would be deemed to be reasonably designed for purposes of proposed Rule 1000(b)(1) if they are consistent with current SCI industry standards. Do commenters agree with this approach? Why or why not? What are the advantages or disadvantages of such an approach?

82. Do commenters believe that the publications listed in Table A represent publications that are suitable for purposes of proposed Rule 1000(b)(1)(ii) and that should be the "current SCI industry standards" for purposes of proposed Rule 1000(b)(1)(ii)? Why or why not? If not, what

publications would be appropriate? Do commenters believe that SCI entities currently follow the industry standards contained in the publications listed in Table A?

83. Are there areas within one of the nine identified domains that these publications do not cover? For example, should the Commission identify additional publications that provide industry standards for specific areas such as personnel security or information security risk management? If so, please identify any such publications that would be appropriate for the Commission to apply to SCI entities. Are there other areas that commenters believe are not covered at all by the publications listed in Table A that should be included? If so, what publications would be appropriate for such areas? Are there any areas within one of the nine identified domains that commenters believe should not be included? If so, why not?

84. Should any of the publications listed in Table A be eliminated? If so, which ones and why? Are there any publications that should be added? If so, which ones and why? Are there industry practices that apply to, or are developed by, entities related to the securities markets that should be considered? If so, what are they and why? Are there any types of SCI entities for which the proposed publications would not be appropriate? If so, which types of entities and why? How should any such possible concerns be addressed? The Commission notes that many of the publications in Table A have been issued by either NIST or FFIEC. Do commenters believe that SCI entities generally currently follow the industry standards issued by one of these organizations more frequently than the other? If so, which one and why? Is one organization's publications more appropriate or preferable for SCI entities? If so, please explain. What are the advantages and/or disadvantages of the publications issued by each organization?

85. The Commission seeks comment on whether commenters believe that the identified publications, and the industry standards within, are adequate in terms of the detail, specificity

and scope. Are there areas in which the industry standards listed in the publications in Table A should be modified to provide adequate guidance to SCI entities? If so, please explain in detail. For example, the Commission understands that many businesses, including SCI entities, now utilize cloud computing as part of their operations, and the Commission has identified industry standards with respect to cloud computing among the publications listed in Table A. However, do commenters believe that these industry standards provide an adequate level of specificity to allow an SCI entity to ascertain how to comply with such standards? Further, do the industry standards contained in the publications in Table A cover all of the relevant areas related to a particular subject area (such as cloud computing)? Similarly, the Commission notes that it has identified publications with respect to capacity planning, but that the industry standards in such publications focus primarily on continuity of operations. As such, the Commission seeks comment on whether commenters believe that the identified publications with respect to capacity planning are adequate in terms of the detail, specificity, and scope? Specifically, do these publications provide an adequate level of specificity to allow an SCI entity to ascertain how to comply with such standards, and do the industry standards cover all of the necessary areas related to a particular subject area such as capacity planning? Why or why not? As noted above, compliance with the industry standards contained in the publications on Table A would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1).

86. Do commenters agree with the Commission's proposed policies and procedures approach to the requirements of proposed Rule 1000(b)(1)? Why or why not? If not, is there another approach that is more appropriate? If so, please describe and explain. Do commenters agree with the Commission's proposed approach to deem an SCI entity's policies and procedures to be reasonably designed if they are consistent with current SCI industry standards, as provided

for in proposed Rule 1000(b)(1)(ii)? Why or why not? How do commenters believe the actions of SCI entities might differ if such a provision were not available? What are the costs and benefits of the Commission's approach? What would be the costs and benefits of other approaches? Please explain.

87. Do commenters agree or disagree with the Commission's proposed criteria to evaluate publications suitable for inclusion on Table A as an SCI industry standard and to update such list? Do commenters agree with the proposed criteria that identified publications should be: (i) comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and (ii) issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization? Why or why not? Are there other criteria that would be more appropriate? Should the proposed criteria allow for a publication that may be available for an incidental charge rather than being required to be available for free? Why or why not? How frequently should such list of publications be updated and revised and what should the process be to update and/or revise them?

88. Are there SCI entities for which the proposed requirements in Rule 1000(b)(1) would be inappropriate (e.g., not cost effective)? If so, please identify such type of entity or entities, or the characteristics of such entity or entities, and explain which proposed requirements would be inappropriate and why. Would cost burden be an appropriate reason to omit an SCI entity or proposed requirement generally? Alternatively, would cost burden be an appropriate reason to omit an SCI entity or proposed requirement, on a case-by-case basis, as the Commission determined to be consistent with Exchange Act requirements?

89. When the Commission adopts new rules, or when SCI SROs implement rule changes, SCI SROs and their members often need to make changes to their systems to comply with such new rules. Would the requirements of proposed Rule 1000(b)(1) add additional time to this process and would the requirements increase the amount of time SCI entities would need to adjust their systems for Commission or SCI SRO rule changes? If so, how much additional time would SCI SROs need to adjust their systems? If not, should proposed Regulation SCI or another Commission rule require SCI SROs to provide minimum advance notice to their members of anticipated technology deployments prior to the implementation of any associated new rule or rule change by the SCI SRO? Why or why not? If so, how much advance notice should be required (e.g., a few days, a week, 30 days, 60 days, some other period)? Along with any such advance notice, should SCI SROs be required to offer to its members the opportunity to test such change with the SCI SRO prior to deployment of the new technology and implementation of any associated new rule or rule change? Why or why not? Should there be a similar requirement for other types of SCI entities? Why or why not? If so, what types of entities and what sorts of requirements should be included?

90. Do commenters believe the potential additional time SCI SROs allocate to this process would result in fewer SCI events by helping to ensure that SCI SROs properly implement systems changes? Why or why not? How would the benefits and costs of such potential additional time compare? Please be as specific as possible.

91. The Commission generally solicits comments on its proposed process for updating current SCI industry standards. Do commenters believe that it would be appropriate that Commission staff, from time to time, issue notices to update the list of previously identified

publications containing SCI industry standards after receiving appropriate input from interested persons? Is there a more appropriate method? If so, what would it be? If not, why not?

92. Would such a process allow for Commission staff to receive sufficient input from the public, including experts, SCI entities, and other market participants regarding the appropriate standards it should update, and how to do so? Why or why not?

93. Would it be useful, for example, to provide notice to the public that it was focusing on a given domain or standard and seek comment on a domain-by-domain, or standard-by-standard, basis? Would it be useful for the Commission to set up a committee to advise Commission staff on such standards? If so, which groups or types of market participants should be represented on such a committee and why? Is there any other process that the Commission or its staff should use to help it obtain useful input? Would it be appropriate to instead require SROs, for example, to submit an NMS plan under Rule 608 of Regulation NMS that contained standards? Why or why not?

94. If the Commission, its staff, or another entity seeks to develop a set of standards that is more focused on the specific businesses and systems of SCI entities, do commenters agree that the industry standards contained in the publications listed in Table A would be appropriate to be used as a starting point for this effort? Why or why not? If not, what publication(s) should be used as a starting point? Please describe in detail and explain.

95. Do commenters believe it would be feasible to establish industry standards through means other than identification through Table A? For example, should SCI entities take the lead in developing such standards? Why or why not? If so, how should the process be organized and what parameters should be put in place to facilitate the process? For example, should SCI entities jointly develop industry standards that apply to all SCI entities or should the various

types of SCI entities (e.g., national securities exchanges, ATSS, plan processors, clearing agencies) work separately to develop their own standards? Should one or more industry organizations take the lead in developing such standards? If so, which ones, and why? Should any such standards identified by the SCI entities and/or industry organizations be formally approved or disapproved by the Commission as part of any such process?

2. Systems Compliance

Proposed Rule 1000(b)(2)(i) would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and the entity's rules and governing documents, as applicable.²¹⁶ Whereas proposed Rule 1000(b)(1) concerns the robustness of the SCI entity's SCI systems and SCI security systems—i.e., such systems' capacity and resiliency against failures and security threats—proposed Rule 1000(b)(2) concerns the SCI entity's establishment of policies and procedures reasonably designed to ensure the operational compliance of an SCI entity's SCI systems with applicable laws, rules, and the SCI entity's governing documents. Diligent discharge of this proposed obligation to establish, maintain, and enforce written policies and procedures would establish the organizational framework for an SCI entity to meet its other obligations under proposed Regulation SCI. In particular, with respect to SCI SROs, compliance with proposed Rule 1000(b)(2)(i) should help to ensure that SCI SROs comply with Section 19(b)(1) of the Exchange Act, which requires each SRO to file with the Commission copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of the

²¹⁶ See supra Section III.B.3.b, discussing the definition of "systems compliance issue."

SRO.²¹⁷ Therefore, compliance with this proposed requirement may help ensure not only that SCI SROs operate in compliance with the Exchange Act, but also help reinforce existing processes for filing SRO rule changes in order to better assist market participants and the public in understanding how the SCI systems of SCI SROs are intended to operate.²¹⁸

Because of the complexity of SCI systems and the breadth of the federal securities laws and rules and regulations thereunder and the SCI entities' rules and governing documents, the Commission preliminarily believes that it would be appropriate to provide an explicit safe harbor for SCI entities and their employees in order to provide greater clarity as to how they can ensure that their conduct will comply with this provision. Therefore, the Commission is proposing Rules 1000(b)(2)(ii) and (iii), which would provide a safe harbor from liability under proposed Rule 1000(b)(2)(i) for SCI entities and persons employed by SCI entities, respectively, as further described below.

Specifically, proposed Rule 1000(b)(2)(ii) would provide that an SCI entity would be deemed not to have violated proposed Rule 1000(b)(2)(i) if: (A) the SCI entity has established and maintained policies and procedures reasonably designed to provide for: (1) testing of all SCI systems and any changes to such systems prior to implementation; (2) periodic testing of all such systems and any changes to such systems after their implementation; (3) a system of internal controls over changes to such systems; (4) ongoing monitoring of the functionality of such systems to detect whether they are operating in the manner intended; (5) assessments of SCI systems compliance performed by personnel familiar with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as

²¹⁷ See 15 U.S.C. 78s(b)(1).

²¹⁸ SCI SROs would similarly be assisted in meeting their obligations to file plan amendments to SCI Plans under Rule 608 of Regulation NMS.

applicable; and (6) review by regulatory personnel of SCI systems design, changes, testing, and controls to prevent, detect, and address actions that do not comply with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable; (B) the SCI entity has established and maintained a system for applying such policies and procedures which would reasonably be expected to prevent and detect, insofar as practicable, any violations of such policies and procedures by the SCI entity or any person employed by the SCI entity; and (C) the SCI entity: (1) has reasonably discharged the duties and obligations incumbent upon the SCI entity by such policies and procedures, and (2) was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect.

The Commission preliminarily believes that, if an SCI entity establishes and maintains policies and procedures reasonably designed to provide for the items in proposed Rule 1000(b)(2)(ii)(A)(1)-(6), such policies and procedures would meet the requirement articulated in proposed Rule 1000(b)(2)(i). Specifically, the Commission preliminarily believes that items (1) and (2), which, for purposes of qualifying for the safe harbor, would require SCI entities to have policies and procedures requiring the testing of SCI systems and changes to such systems before they are put into production and periodically thereafter, should help SCI entities to identify potential problems before such problems have the ability to impact markets and investors. Items (3) and (4), which, for purposes of qualifying for the safe harbor, would require a system of internal controls over changes to SCI systems and ongoing monitoring of the functionality of such systems, would provide a framework for SCI entities seeking to bring newer, faster, and more innovative SCI systems online. In conjunction with ongoing monitoring, the Commission preliminarily believes the policies and procedures proposed to be required in items (3) and (4) for

purposes of qualifying for the safe harbor, would help prevent SCI systems becoming noncompliant resulting from, for example, inattention or failure to review compliance with established written policies and procedures.

Further, the Commission preliminarily believes that item (5) (which, for purposes of qualifying for the safe harbor, would require that an SCI entity establish, maintain, and enforce written policies and procedures for assessments of SCI systems compliance by personnel familiar with applicable federal securities laws, rules and regulations thereunder, and the SCI entity's rules and governing documents), in conjunction with item (6) (which, for purposes of qualifying for the safe harbor, would require policies and procedures directing that regulatory personnel review SCI systems design, changes, testing, and controls), would help foster coordination between the information technology and regulatory staff of an SCI entity so that SCI events and other issues related to an SCI entity's SCI systems would be more likely to be addressed by a team of staff in possession of the requisite range of knowledge and skills to help ensure compliance with the SCI entity's obligations under proposed Regulation SCI.

Insofar as an SCI entity follows them to qualify for the safe harbor, proposed items (5) and (6) also are intended to help to ensure that an SCI entity's business interests do not undermine regulatory, surveillance, and compliance functions and, more broadly, the requirements of the federal securities laws, during the development, testing, implementation, and operation processes for SCI systems. Thus, proposed items (1)-(6) together, insofar as SCI entities follow them to qualify for the safe harbor, are meant to promote the development and implementation of policies and procedures consistent with the functioning of SCI systems of SCI

entities as planned and as described by the SCI entity's rules and governing documents, as well as in compliance with applicable federal securities laws and rules.²¹⁹

In addition to establishing and maintaining the policies and procedures described in proposed Rule 1000(b)(2)(ii)(A)(1)-(6), to qualify for the safe harbor, an SCI entity would also be required to satisfy two additional requirements. First, under proposed Rule 1000(b)(2)(ii)(B), it would be required to have established and maintained a system for applying such policies and procedures which would reasonably be expected to prevent and detect, insofar as practicable, any violations of such policies and procedures by the SCI entity or any person employed by the SCI entity. In addition, under proposed Rule 1000(b)(2)(ii)(C), the SCI entity would be required to: (1) have reasonably discharged the duties and obligations incumbent upon it by such policies and procedures; and (2) have been without reasonable cause to believe that such policies and procedures were not being complied with in any material respect. To the extent an SCI entity seeks to qualify for the safe harbor, the elements of proposed Rules 1000(b)(2)(ii)(B) and (C) would require not only that its policies and procedures are reasonably designed to achieve SCI systems compliance, as described in items (A)(1)-(6) above, but also that, as part of such policies and procedures, the SCI entity establishes and maintains a system for applying those policies and procedures, and enforces its policies and procedures, in a manner that would reasonably allow it to prevent and detect violations of the policies and procedures. Proposed Rules 1000(b)(2)(ii)(B) and (C) are also designed to ensure that the SCI entity reasonably discharges duties and obligations incumbent upon it by such policies and procedures and is without reasonable cause to believe that such policies and procedures were not being complied with in any material respect.

²¹⁹ See supra note 154-156 and accompanying text.

In addition, proposed Rule 1000(b)(2)(iii) would provide a safe harbor from liability for individuals. Specifically, proposed Rule 1000(b)(2)(iii) would provide that a person employed by an SCI entity shall be deemed not to have aided, abetted, counseled, commanded, caused, induced, or procured the violation by any other person of proposed Rule 1000(b)(2)(i) if the person employed by the SCI entity has reasonably discharged the duties and obligations incumbent upon such person by such policies and procedures, and was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect. The Commission preliminarily believes that the safe harbor for individuals under proposed Rule 1000(b)(2)(iii) would appropriately provide protection from liability under Rule 1000(b)(2) to employees of SCI entities who reasonably conduct their assigned responsibilities under the SCI entity's policies and procedures and do not have reasonable cause to believe the policies and procedures were not being complied with in any material respect.

In this regard, an SCI entity would not be deemed to violate proposed Rule 1000(b)(2)(i) merely because it experienced a systems compliance issue, and could take advantage of the safe harbor for SCI entities if it satisfied the elements enumerated in proposed Rule 1000(b)(2)(ii).²²⁰ Likewise, an employee of an SCI entity, including an employee involved in the design or implementation of policies and procedures under the rule, would not be deemed to have aided, abetted, counseled, commanded, caused, induced, or procured the violation by any other person of proposed Rule 1000(b)(2)(i) merely because the SCI entity at which he or she worked

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The language of proposed Rules 1000(b)(2)(ii)(B) and (C) is drawn in significant part from language in Section 15(b)(4)(E) of the Exchange Act, 15 U.S.C. 78o(b)(4)(E), which generally provides a safe harbor from liability for failure to supervise, with a view to preventing violations of the securities laws, another person who is subject to his or her supervision and who commits such a violation.

experienced a systems compliance issue, whether or not the employee was able to take advantage of the safe harbor for individuals under proposed Rule 1000(b)(2)(iii).

Request for comment

96. The Commission requests comment generally on all aspects of proposed Rule 1000(b)(2). Do commenters believe that it is appropriate to limit the application of the requirements of proposed Rule 1000(b)(2)(i) to SCI systems? Why or why not? Please explain. Do commenters agree with the requirements of the proposed safe harbor for SCI entities? Why or why not? Specifically, with respect to proposed Rule 1000(b)(2)(ii)(A)(1), which would include in the safe harbor a requirement that each SCI entity establish and maintain written policies and procedures that provide for testing of all SCI systems and any changes to such systems prior to implementation, should certain types of SCI systems be excluded from the proposed requirement? If so, please specify which types and explain.

97. Should the Commission specify the interval at which SCI entities would be required to conduct the periodic testing of all SCI systems contemplated by the safe harbor under proposed Rule 1000(b)(2)(ii)(A)(2)? Why or why not? And if so, what would be an appropriate interval? Should certain types of SCI systems be tested on a more or less frequent basis? If so, please specify which types and explain.

98. With respect to proposed Rule 1000(b)(2)(ii)(A)(3), which would include in the safe harbor a requirement that an SCI entity establish and maintain written policies and procedures that provide for a system of internal controls over changes to SCI systems, should the Commission specify minimum standards for internal controls? If so, please explain why, as well as what such standards should be.

99. With respect to proposed Rule 1000(b)(2)(ii)(A)(4), which would include in the safe harbor a requirement that an SCI entity establish and maintain written policies and procedures that provide for ongoing monitoring of the functionality of SCI systems to detect whether they are operating in the manner intended, should the Commission specify the frequency with which the monitoring of such systems' functionality should occur? If so, please explain. Should the Commission require different monitoring frequencies depending on the type of SCI system? Why or why not? If so, what should they be? Please explain.

100. For purposes of the safe harbor and proposed Rule 1000(b)(2)(ii)(A)(5), do commenters believe the Commission should require that the assessments of SCI systems compliance be performed by persons having specified qualifications? Why or why not? If so, what would be appropriate and/or necessary qualifications for such personnel?

101. Proposed Rule 1000(b)(2)(ii)(A)(6) would include in the safe harbor a requirement that each SCI entity establish and maintain policies and procedures that provide for review by regulatory personnel of SCI systems design, changes, testing, and controls to prevent, detect, and address actions that are not in compliance with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable. Do commenters believe, for purposes of qualifying for the safe harbor, the roles and allocations of responsibility for personnel in proposed Rules 1000(b)(2)(ii)(A)(5) and (6) are appropriate? Why or why not?

102. Do commenters agree that in order for an SCI entity to qualify for the safe harbor from liability under proposed Rule 1000(b)(2)(i), it should, in addition to establishing and maintaining the policies and procedures described in proposed Rule 1000(b)(2)(ii)(A)(1)-(6), be required to establish and maintain a system for applying such policies and procedures which

would reasonably be expected to prevent and detect, insofar as practicable, any violations of such policies and procedures by the SCI entity or any person employed by the SCI entity? Why or why not? To qualify for the safe harbor from liability under proposed Rule 1000(b)(2)(i), should an SCI entity be further required to: have reasonably discharged the duties and obligations incumbent upon the SCI entity by such policies and procedures; and be without reasonable cause to believe that such policies and procedures were not being complied with in any material respect? Why or why not? Please explain.

103. Do commenters agree with the requirements for the proposed safe harbor for individuals in proposed Rule 1000(b)(2)(iii), which would provide that a person employed by an SCI entity shall be deemed not to have aided, abetted, counseled, commanded, caused, induced, or procured the violation by any other person of proposed Rule 1000(b)(2)(i) if the person employed by the SCI entity: has reasonably discharged the duties and obligations incumbent upon such person by such policies and procedures; and was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect? Why or why not? Should a similar safe harbor be available to individuals other than persons employed by SCI entities? Why or why not? Please explain.

104. Do commenters agree with the Commission's proposed policies and procedures approach to the requirements of proposed Rule 1000(b)(2)? Why or why not? If not, is there another approach that is more appropriate? If so, please describe and explain. As discussed above, the Commission is proposing to include safe harbor provisions in proposed Rule 1000(b)(2) for SCI entities and employees of SCI entities. The Commission preliminarily believes that, in the context of proposed Regulation SCI, this approach may be appropriate to provide clarity and guidance to SCI entities and SCI entity employees on one method to comply

with the proposed general standard in proposed Rule 1000(b)(2)(i). The Commission solicits commenters' views on the Commission's proposed approach. Specifically, do commenters agree with the Commission's proposed approach to provide safe harbors for SCI entities and employees of SCI entities from liability under proposed Rule 1000(b)(2)(i)? Why or why not? How do commenters believe the actions of SCI entities or behavior of employees of SCI entities might differ if the safe harbors under proposed Rule 1000(b)(2) were not available? What are the costs and benefits of the Commission's approach to provide safe harbors? What would be the costs and benefits of other approaches? Please explain.

105. Do commenters believe there are specific internal controls or other mechanisms that would reinforce the effectiveness of an SCI entity's reasonably designed policies and procedures under proposed Rule 1000(b)(2)? Why or why not? Please explain. How do SCI entities presently use specific internal controls or other mechanisms to ensure that their systems operate in a manner that complies with the federal securities laws and rules and regulations thereunder and their rules and governing documents, as applicable? How do commenters generally view the advantages and disadvantages of specific internal controls or other mechanisms? The Commission is not proposing to prescribe specific internal controls related to compliance with proposed Rule 1000(b)(2). Should the Commission propose that any particular internal controls or other mechanisms be required (for example, that a senior officer be designated to be responsible for the SCI entity's compliance with proposed Regulation SCI, or that personnel of the SCI entity certify that the SCI entity's policies and procedures are reasonably designed)?

3. SCI Events—Action required; Notification

Proposed Rule 1000(b)(3)-(5) would govern the actions an SCI entity must take upon any responsible SCI personnel becoming aware of an SCI event, whether it be a systems disruption, systems compliance issue, or systems intrusion.²²¹

a. Corrective Action

Proposed Rule 1000(b)(3) would require an SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action including, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable. The Commission is proposing this requirement to make clear that, upon learning of an SCI event, an SCI entity would be required to take the steps necessary to remedy the problem or problems causing the SCI event and mitigate the effects of the SCI event, if any, on customers, market participants and the securities markets.

Proposed Rule 1000(a) would define “responsible SCI personnel” to mean, for a particular SCI system or SCI security system impacted by an SCI event, any personnel, whether an employee or agent, of an SCI entity having responsibility for such system. The proposed definition is intended to include any personnel used by the SCI entity that has responsibility for the specific system(s) impacted by a given SCI event. Thus, such personnel would include, for example, any technology, business, or operations staff with responsibility for such systems. With respect to systems compliance issues, such personnel would also include regulatory, legal, or compliance personnel with legal or compliance responsibility for such systems. In addition,

²²¹ See supra Section III.B.3 for a discussion of the proposed definition of systems disruption, systems compliance issue, and systems intrusion.

such “responsible SCI personnel” would not be limited to managerial or senior-level employees of the SCI entity. For example, the proposed definition is intended to include a junior systems analyst responsible for monitoring the operations or testing of an SCI system or SCI security system. The proposed definition would also include not only applicable employees of the SCI entity, but applicable agents of the SCI entity as well. Thus, for example, if an SCI entity were to contract the monitoring of the operations of a given SCI system to an external firm, the proposed definition of “responsible SCI personnel” would include the personnel of such firm that were responsible for the monitoring. The proposed definition, however, is not intended to include all personnel of an SCI entity. For example, personnel of the SCI entity who have no responsibility for any SCI system or SCI security system of an SCI entity are not intended to be included in the proposed definition.

b. Commission Notification

Proposed Rule 1000(b)(4) would address the obligation of an SCI entity to notify the Commission upon any responsible SCI personnel becoming aware of an SCI event.²²² Proposed Rule 1000(b)(4)(i) would require an SCI entity, upon any responsible SCI personnel²²³ becoming aware of a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion (“immediate notification SCI event”), to notify the Commission of such SCI event, which may be done orally or in writing (e.g., by email). Proposed Rule 1000(b)(4)(ii) would require an SCI entity to submit a written notification pertaining to any SCI event to the

²²² Proposed Rule 1000(b)(5), addressed in Section III.C.3.c below, would address whether and when an SCI entity would be required to disseminate information regarding an SCI event to its members or participants.

²²³ See supra III.C.3.a (discussing definition of “responsible SCI personnel”).

Commission within 24 hours of any responsible SCI personnel becoming aware of the SCI event. Proposed Rule 1000(b)(4)(iii) would require an SCI entity to submit to the Commission continuing written updates on a regular basis, or at such frequency as reasonably requested by a representative of the Commission, until such time as the SCI event is resolved.²²⁴

Proposed Rule 1000(b)(4) also would require that any written notification to the Commission made pursuant to proposed Rules 1000(b)(4)(ii) or 1000(b)(4)(iii) be made electronically on new proposed Form SCI (§249.1900), and include all information as prescribed in Form SCI and the instructions thereto.²²⁵ To help ensure that the Commission and its staff receive all information known by the SCI entity relevant to aiding the Commission's understanding of an SCI event, proposed Rule 1000(b)(4)(iv) would provide that a written notification under proposed Rule 1000(b)(4)(ii) must include all pertinent information known about an SCI event, including: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; (3) the potential impact of the SCI event on the market; and (4) the SCI entity's current assessment of the SCI event, including a discussion of the SCI entity's determination regarding whether the SCI event is a dissemination SCI event or not.²²⁶ In addition, to the extent available as of the time of the initial notification, Exhibit 1 would require inclusion of the following information: (1) a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; (2) the time the SCI event was resolved or timeframe within which the SCI event is expected to be resolved; (3) a description of the SCI entity's rule(s) and/or governing

²²⁴ See supra Section III.B.3.d, for a discussion of dissemination SCI events.

²²⁵ New proposed Form SCI is discussed in detail in Section III.E below.

²²⁶ See proposed Rule 1000(b)(4)(iv)(A)(1).

documents, as applicable, that relate to the SCI event; and (4) an analysis of the parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss.²²⁷

Proposed Rule 1000(b)(4)(iv)(B) would require an SCI entity to update any of the pertinent information contained in previous written notifications, including any information required by proposed Rule 1000(b)(4)(iv)(A)(2) that was not available at the time of initial submission. Subsequent notifications would be required to update any of the pertinent information previously provided until the SCI event is resolved.

Proposed Rule 1000(b)(4)(iv)(C) would further require an SCI entity to provide a copy of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

The Commission preliminarily believes an SCI entity's obligation to notify the Commission of significant SCI events should begin upon any responsible SCI personnel becoming aware of an SCI event. Thus, for all immediate notification SCI events, an SCI entity would be required to notify the Commission of the SCI event. Such notification could be made orally (e.g., by telephone) or in a written form (e.g., by email). The Commission preliminarily believes that, by not prescribing the precise method of communication for an initial notification of an immediate notification SCI event under proposed Rule 1000(b)(4)(i), SCI entities would have the needed flexibility to determine the most appropriate method.²²⁸ Further, if the responsible SCI personnel became aware of such an SCI event outside of normal business hours,

²²⁷ See proposed Rule 1000(b)(4)(iv)(A)(2).

²²⁸ The Commission expects that it would establish a telephone hotline, designated email accounts, or similar arrangements, to enable receipt of notifications of immediate notification SCI events.

the SCI entity would still be required to notify the Commission at that time rather than, for example, the start of the next business day. For all SCI events, including immediate notification SCI events, an SCI entity would be required to submit a written notification pertaining to such SCI event to the Commission on Form SCI, and follow up with regular written updates until the SCI event is resolved. Even if an SCI entity had notified the Commission of an immediate notification SCI event in writing as would be permitted under proposed Rule 1000(b)(4)(i), the SCI entity would still be required to submit a separate written notification on Form SCI pursuant to proposed Rule 1000(b)(4)(ii).²²⁹

The Commission preliminarily believes that the proposed notification requirement for immediate notification SCI events, the proposed 24-hour time frame for submission of written notices, and the proposed continuing update requirement, are appropriately tailored to help the Commission and its staff quickly assess the nature and scope of an SCI event, and help the SCI entity identify the appropriate response to the SCI event, including ways to mitigate the impact of the SCI event on investors and promote the maintenance of fair and orderly markets. These requirements would help to ensure not only that the Commission and its staff are kept apprised of such SCI events, including their causes and their effect on the markets, but also that the Commission is aware of the steps and resources necessary to correct such SCI events, mitigate their effects on other SCI entities and the market, and prevent recurrence to the extent possible. The Commission also preliminarily believes that the proposal to require an SCI entity to update the Commission regularly regarding an SCI event, or at such frequency as reasonably requested

²²⁹ See proposed Rule 1000(b)(4)(iv), which would require that written notifications under 1000(b)(4)(ii) be submitted on Form SCI, and which would not provide for the ability of SCI entities to submit a written notification of an immediate notification SCI event on Form SCI.

by a representative of the Commission, until the SCI event is resolved, provides appropriate flexibility to the Commission to request additional information as necessary, depending on the facts and circumstances of the SCI event and the SCI entity's progress in resolving it. At the same time, the Commission recognizes that the information required to be provided to it by an SCI entity about an immediate notification SCI event under proposed Rule 1000(b)(4)(i) would represent the SCI entity's initial assessment of the SCI event, and that even the written notification on Form SCI required under proposed Rule 1000(b)(4)(ii) may, in some cases, be a preliminary assessment of the SCI event for which the SCI entity may still be in the process of analyzing and assessing the precise facts and circumstances related to the SCI event. Thus, the Commission is proposing to only require that SCI entities provide certain key information for the written notification required under proposed Rule 1000(b)(4)(ii),²³⁰ and only provide certain additional details "to the extent available as of the time of the notification."²³¹ In addition, the Commission's proposal allows for the SCI entity to subsequently "update any information previously provided regarding the SCI event, including any information required by paragraph (b)(4)(iv)(A)(2) which was not available at the time of the notification made pursuant to paragraph (b)(4)(ii)."²³²

Comprehensive reporting of all SCI events would facilitate the Commission's regulatory oversight of the national securities markets. The proposed reporting requirements should provide the Commission with an aggregate and comprehensive set of data on SCI events, a significant improvement over the current state of administration, whereby SCI entities report

²³⁰ See proposed Rule 1000(b)(4)(iv)(A)(1).

²³¹ See proposed Rule 1000(b)(4)(iv)(A)(2).

²³² See proposed Rule 1000(b)(4)(iv)(B).

events through multiple methods and with varying consistency.²³³ The aggregated data that would result from the reporting of SCI events would also permit the Commission to analyze such data, e.g., to examine the most common types of events and the types of systems most often affected. This ability to more efficiently analyze a comprehensive set of data would help the Commission to carry out its oversight responsibilities because it would help the Commission identify more effectively, for example, areas of persistent or recurring problems across the systems of all SCI entities.

As discussed in greater detail below, the Commission also preliminarily believes that submission of required notifications by SCI entities by filing Form SCI in an electronic format would be less burdensome and a more efficient filing process for SCI entities and the Commission than the submission of such notices in non-standardized ad hoc formats, as they are currently provided under the ARP Program.²³⁴

²³³ Currently, there is no Commission rule specifically requiring SCI entities to notify the Commission of systems problems in writing or in a specific format. Nevertheless, voluntary communications of systems problems to Commission staff occur in a variety of ways, including by telephone and email. The Commission notes that proposed Rule 1000(b)(4) would impose a new reporting requirement on SCI entities, regardless of whether they currently voluntarily notify the Commission of SCI events on an ad hoc basis. As such, the Commission preliminarily believes that a history of voluntarily reporting such events to the Commission would not lessen the future burden of reporting such events to the Commission on Form SCI as required under proposed Rule 1000(b)(4).

²³⁴ See infra Section III.D.2 discussing proposed Rule 1000(d), requiring electronic filings on new proposed Form SCI, and Section III.E, discussing information proposed to be required to be submitted on new Form SCI. See also infra note 235 and accompanying text.

c. **Dissemination of Information to Members or Participants**²³⁵

Proposed Rule 1000(b)(5) would require information relating to dissemination SCI events to be disseminated to members or participants, and specify the nature and timing of such disseminations, with a limited delay permitted for certain systems intrusions, as discussed further below.²³⁶ Proposed Rule 1000(b)(5)(i)(A) would require that an SCI entity, promptly after any responsible SCI personnel²³⁷ becomes aware of a dissemination SCI event other than a systems intrusion, disseminate to its members or participants the following information about such SCI event: (1) the systems affected by the SCI event; and (2) a summary description of the SCI event. In addition, proposed Rule 1000(b)(5)(i)(B) would require an SCI entity to further disseminate to its members or participants, when known: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; and (3) a description of the progress of its corrective action for the SCI event and when the SCI event has been or is expected to be resolved. Proposed Rule 1000(b)(5)(i)(C) would further require an SCI entity to provide regular updates to members or

²³⁵ The requirements relating to dissemination of information relating to dissemination SCI events to members or participants proposed to be included in Regulation SCI relate solely to Regulation SCI. Nothing in proposed Regulation SCI should be construed as superseding, altering, or affecting the reporting obligations of SCI entities under other federal securities laws or regulations. Accordingly, in the case of an SCI event, SCI entities subject to the public company reporting requirements of Section 13 or Section 15(d) of the Exchange Act would need to ensure compliance with their disclosure obligations pursuant to those provisions (including, for example, with respect to Regulation S-K and Forms 10-K, 10-Q and 8-K) in addition to their disclosure and reporting obligations under Regulation SCI. See, e.g., CF Disclosure Guidance: Topic No. 2, Cybersecurity (October 13, 2011), available at: <http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm>. As an additional example, nothing in proposed Regulation SCI should be construed as superseding the obligations such SCI entities may have under Regulation FD.

²³⁶ See supra Section III.B.3.d for a discussion of dissemination SCI events.

²³⁷ See supra III.C.3.a (discussing definition of "responsible SCI personnel").

participants on any of the information required to be disseminated under proposed Rules 1000(b)(5)(i)(A) and (i)(B).

For the disseminations of information to members or participants to be meaningful, the Commission preliminarily believes it would be necessary for an SCI entity to describe the SCI event in sufficient detail to enable a member or participant to determine whether and how it was affected by the SCI event and make appropriate decisions based on that determination. For example, the Commission preliminarily believes that a general statement that a systems disruption occurred that impacted trading for a certain period of time would not be sufficient. The dissemination of information should, for example, specify with particularity such information as necessary to provide readers meaningful context with regard to the issue, which may include but is not limited to, details relating to, if applicable: the magnitude of the issue (such as estimates with respect to the number of shares affected, numbers of stocks affected, and total dollar volumes of the affected trades); the specific system(s) or part of the system(s) that caused the issue; the Commission and SCI entity rule(s) that relate most directly to the issue; the specific time periods in which the issue occurred, including whether the issue may be ongoing; and the specific names of the securities affected. The Commission preliminarily believes these proposed items, which concern the timing, nature, and foreseeable possible consequences of a systems problem, comprise the appropriate minimum detail that a member or participant would need to assess whether an SCI event affected or would potentially affect that member or participant, and would assist members and participants in making investment or business

decisions based on disclosed facts rather than on speculation regarding, for example, the cause of a market disruption.²³⁸

The Commission preliminarily believes that it is appropriate to require that the information specified by proposed Rule 1000(b)(5)(i)(A) be disseminated by the SCI entity to its members or participants promptly after any responsible SCI personnel becomes aware of an applicable dissemination SCI event. The Commission also preliminarily believes that it is appropriate to require the further dissemination of information specified by proposed Rule 1000(b)(5)(i)(B) "when known" by the SCI entity. These requirements reflect the Commission's preliminary view that, given the sensitivities of such dissemination of information, it is important that, before information is shared with the SCI entity's members or participants, the SCI entity be given a reasonable amount of time to gather, confirm, and preliminarily analyze facts regarding a dissemination SCI event. The Commission preliminarily believes that the value of dissemination of information to an SCI entity's members or participants in these circumstances is enhanced when the SCI entity has taken an appropriate amount of time to ensure that the information it is sharing with its members or participants is accurate, such that incorrect information does not cause or exacerbate market confusion. At the same time, the Commission preliminarily believes that it is important that basic information about dissemination SCI events, such as those items required by proposed Rule 1000(b)(5)(i)(A), be made available to members or participants promptly.

The proposed requirement relating to dissemination of information to members or participants of dissemination SCI events, other than systems intrusions as specified in proposed

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See *supra* note 160, referring to Roundtable panelists suggesting that communication and disclosure are important elements of risk mitigation.

Rule 1000(b)(5)(i), is intended to aid members or participants of SCI entities in determining whether their trading activity has been or might be impacted by the occurrence of an SCI event at an SCI entity, so that they could consider that information in making trading decisions, seeking corrective action or pursuing remedies, or taking other responsive action. Further, the requirement to disseminate information regarding dissemination SCI events could provide an incentive for SCI entities to devote more resources and attention to improving the integrity and compliance of their systems and preventing the occurrence of SCI events.

Proposed Rule 1000(b)(5)(ii) would provide a limited exception to the proposed requirement of prompt dissemination of information to members or participants for certain systems intrusions.²³⁹ Proposed Rule 1000(b)(5)(ii) would require an SCI entity, promptly after any responsible SCI personnel becomes aware of a systems intrusion, to disseminate to its members or participants a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion was resolved or an estimate of when the systems intrusion is expected to be resolved, unless the SCI entity determines that dissemination of such information would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, and documents the reasons for such determination.²⁴⁰ The Commission preliminarily believes that information relating to all dissemination SCI events, including systems intrusions, should be

²³⁹ As noted in supra note 235, the requirements relating to information disseminations to members or participants proposed to be included in Regulation SCI, including the proposal to permit an SCI entity to delay such dissemination for certain systems intrusions, relate solely to Regulation SCI. Nothing in proposed Regulation SCI should be construed as superseding, altering, or affecting the reporting obligations of SCI entities under other federal securities laws or regulations.

²⁴⁰ Unlike proposed Rule 1000(b)(5), proposed Rule 1000(b)(4) (relating to Commission notification), discussed above in Section III.C.3.b, would not provide for a delay in reporting any systems intrusions to the Commission.

disseminated to members or participants, but that there may be circumstances in which such dissemination of information relating to a systems intrusion should be delayed, for example, to avoid compromising the investigation or resolution of a systems intrusion.²⁴¹ If an SCI entity determines to delay the dissemination of information to members or participants relating to a systems intrusion, it would be required to make an affirmative determination and document the reasons for such determination that such dissemination would likely compromise the security of its SCI systems or SCI security systems, or an investigation of the systems intrusion. If it cannot make such a determination, or at whatever point in time such a determination no longer applies, information relating to the systems intrusion would be required to be disseminated to the SCI entity's members or participants.

The information required to be disseminated to members or participants for systems intrusions by proposed Rule 1000(b)(5)(ii) is not as extensive as that required to be disseminated to members or participants for other types of dissemination SCI events. The Commission is sensitive to the fact that dissemination of too much detailed information regarding a systems intrusion may provide hackers or others seeking unauthorized entry into the systems of an SCI entity with insights into the potential vulnerabilities of the SCI entity's systems. At the same time, the occurrence of a systems intrusion may reveal a weakness in the SCI systems or SCI security systems of the SCI entity that warrants dissemination of information about such event to the SCI entity's members or participants. Proposed Rule 1000(b)(5)(ii) is therefore intended to strike an appropriate balance by requiring dissemination to members or participants, which may be delayed when necessary, of key summary information about a given systems intrusion.

Request for comment

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See supra note 239.

106. The Commission requests comment on all aspects of proposed Rules 1000(b)(3), (4), and (5).

107. Do commenters believe the proposed definition of "responsible SCI personnel" in proposed Rule 1000(a) is appropriate? Why or why not? Please explain. Is the proposed definition sufficiently clear? If not, why not? Should the proposed definition only apply to personnel of a given seniority, such as managerial personnel or officers of an SCI entity? Why or why not? Should the proposed definition include both employees and agents of an SCI entity? Why or why not?

108. As proposed to be required by Rule 1000(b)(3), do commenters believe the Commission should require an SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action including, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable? If not, why not? Should the proposed requirement that an SCI entity take corrective action be triggered by something other than awareness of an SCI event? If so, what would be an appropriate trigger, and why?

109. In addition to requiring an SCI entity to take appropriate corrective action, should the Commission also require an SCI entity to have written policies and procedures regarding how it should respond to SCI events, such as an incident response plan that, for example, would lay out in advance of any SCI event the courses of action, responsibilities of personnel, chains of command, or similar information regarding how the SCI entity and its personnel should respond to various SCI event scenarios? Why or why not? Would such a requirement be useful? What would be the potential costs and benefits of such a requirement? Would SCI entities be able to

meet the requirements of proposed Rule 1000(b)(3) without developing such response plans?²⁴²

Why or why not? Do SCI entities have such plans in place today? If so, please describe.

110. With respect to proposed Rule 1000(b)(4), do commenters believe the proposal to require an SCI entity to report all SCI events to the Commission is appropriate?

111. Are there SCI events that should not be required to be reported to the Commission? If so, what are they, and why should reporting of such SCI events not be required? Or, as an alternative, would it be appropriate for the Commission to require SCI entities to keep and preserve the documentation relating to certain types of SCI events without sending that documentation to the Commission? Why or why not? If so, how would commenters recommend the Commission distinguish between SCI events that should be reported to the Commission and those that should only be subject to a recordkeeping requirement? What do commenters believe might be the advantages or disadvantages of such an alternative approach? Do commenters believe proposed Rule 1000(b)(4) may require the reporting of types of issues or types of information that may not be critical to the goals of proposed Regulation SCI? Please be specific and describe such situations.

112. What criteria do ARP participants currently use for reporting ARP events? How many SCI events would an SCI entity expect to report each year?

113. For immediate notification SCI events, is the initial notification requirement in proposed Rule 1000(b)(4)(i) to the Commission appropriate? Why or why not? If so, should this requirement apply to such SCI events that occur outside normal business hours as well? If

²⁴² See also *supra* Section III.C.1.a (requesting comment on proposed Rule 1000(b)(1)(i)(E) regarding policies and procedures for development of business continuity plans and on whether the Commission and/or SCI SROs should propose rules governing how such plans are tested).

not, what should be the requirement? Should the Commission require a different notification procedure for immediate notifications that might occur outside normal business hours? What are the advantages and disadvantages of different methods of immediate notifications? Please describe. Do commenters agree that those systems disruptions that the SCI entity reasonably estimates would have a material impact on its operations or on market participants should be subject to the immediate notification requirement? Why or why not? Please explain. Do commenters agree that all systems compliance issues should be subject to the immediate notification requirement? Why or why not? Do commenters agree that all systems intrusions should be subject to the immediate notification requirement? Why or why not? Should additional types of SCI events be subject to the immediate notification requirement? If so, which types of SCI events? Please be specific.

114. Do commenters agree with the proposed 24-hour written notification requirement for all SCI events?

115. Do commenters believe it is appropriate to require that written updates be submitted regularly until an SCI event is resolved, or at such frequency as reasonably requested by a representative of the Commission?

116. Do commenters believe the proposed required dissemination of information to an SCI entity's members or participants regarding dissemination SCI events set forth in proposed Rule 1000(b)(5) are appropriate? If not, why not? Do commenters believe that requiring the dissemination of information about dissemination SCI events to members or participants would promote dissemination of information to persons who are most directly affected by such events? Why or why not? With respect to proposed Rule 1000(b)(5), should any of the proposed requirements relating to dissemination of information to members or participants be eliminated

or modified?²⁴³ Please explain. What other information, if any, should be required to be disseminated to members or participants? Please explain. Could these proposed requirements have any negative or unintended impact on the market or market participants? If so, please explain.

117. Do commenters agree with the timing requirements contained in proposed Rule 1000(b)(5)? Do commenters agree that the initial dissemination of information to members or participants should be required promptly after an SCI entity's responsible SCI personnel becomes aware of a dissemination SCI event, as would be required by proposed Rule 1000(b)(5)(i)(A)? Do commenters believe that more specific timing requirements would be more appropriate? If so, what should such requirements be? Should there be a specific time period requirement with respect to subsequent updates on the status of the dissemination SCI event? Why or why not? For example, should there be a requirement that an SCI entity provide updates daily or weekly? If so, what additional specificity should be included?

118. Do commenters believe it is appropriate to permit an SCI entity to delay the dissemination of information to members or participants for certain systems intrusions as proposed in Rule 1000(b)(5)(ii)? Should an SCI entity be required to immediately disseminate information to members or participants regarding a systems intrusion, with delays permitted only when the Commission specifically authorizes the delay? Why or why not? Should the proposed rule impose a maximum period of time that an SCI entity may delay its dissemination of information to members or participants for certain systems intrusions? Why or why not? If so,

²⁴³ See also *infra* Section III.E.1, discussing proposed Exhibit 3 to Form SCI, which would require that an SCI entity provide a copy of any information disseminated to date regarding an SCI event to its members or participants or on the SCI entity's publicly available website.

what should such a maximum period of time be and should the rule set forth a specific maximum time period applicable to all instances? Please explain.

119. Are there types of dissemination SCI events that should not be required to be disseminated to members or participants? If so, what are they, and why should it not be required?

120. Should dissemination of information to members or participants of any types of dissemination SCI events, other than those that are systems intrusions, be delayed? If so, please describe the types of SCI events and explain why. In addition, please describe the time period within which commenters believe such types of dissemination SCI events should be disseminated and why such time period would be appropriate.

121. For any types of dissemination SCI events for which commenters believe information should either not be required to be disseminated to members or participants or be permitted to have a delay in dissemination in certain circumstances (such as for systems intrusions), what might be the impact of such non-dissemination or delay in dissemination with respect to different types of market participants?

122. Are there SCI entities for which the proposed requirements in Rules 1000(b)(3), (b)(4), and (b)(5) would not be appropriate (e.g., not cost-effective)? If so, please identify such entity or entities, or the characteristics of such entity or entities, and explain which proposed requirements would be inappropriate and why. Is the fact that they might not be cost-effective an appropriate reason to omit them generally for those SCI entities, or on a case-by-case basis, as the Commission determined to be consistent with Exchange Act requirements?

123. What are the current practices of SCI entities with respect to the dissemination of information about systems issues to members or participants? What type of information do SCI entities currently disseminate? Please describe.

4. Notification of Material Systems Changes

Proposed Rule 1000(b)(6) addresses notification to the Commission regarding planned material systems changes,²⁴⁴ which the Commission believes is important to help ensure it has information about important changes at an SCI entity that may affect the SCI entity's ability to effectively oversee the operations of its systems. Proposed Rule 1000(b)(6) would require an SCI entity, absent exigent circumstances, to notify the Commission in writing at least 30 calendar days before implementation of any planned material systems changes including a description of the planned material systems changes as well as the expected dates of commencement and completion of implementation of such changes. A written notification to the Commission made pursuant to paragraph (b)(6) would be required to be made electronically on Form SCI and include all information as prescribed in Form SCI and the instructions thereto.²⁴⁵

The Commission preliminarily believes that the proposed 30 calendar day requirement regarding pre-implementation written notification to the Commission of planned material systems changes would be an appropriate time period. The Commission has found through its experience with the current ARP Inspection Program that this amount of advance notice typically is needed to allow Commission staff to effectively monitor technology developments associated with a planned material systems change. A shorter timeframe might not provide sufficient time for Commission staff to understand the impact of the systems change; a longer time frame might

²⁴⁴ See supra Section III.B.4 (discussing the proposed definition of material systems change).

²⁴⁵ See infra Section III.E.2, discussing proposed new Form SCI and electronic submission of the notices required by proposed Rule 1000(b)(6).

unnecessarily interfere with SCI entities' flexibility in planning and implementing systems changes.

If exigent circumstances existed, or if the information previously provided to the Commission regarding any planned material systems change has become materially inaccurate, the SCI entity would be required to notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable.²⁴⁶ The existence of exigent circumstances would be determined by the SCI entity and might exist where, for example, a systems compliance issue or systems intrusion were discovered that requires immediate corrective action to ensure compliance with the Exchange Act and the rules and regulations thereunder, and/or the SCI entity's own rules and procedures. In such cases, it would not be prudent or desirable to delay corrective action simply to permit the 30 calendar days' advance notice required in non-exigent circumstances. In addition, there may be circumstances where the information previously provided to the Commission regarding a material systems change has become materially inaccurate. For example, if a material systems change's expected implementation completion date were to be substantially delayed because of an inability to procure systems components, or due to difficulties in systems programming, an update to reflect this development would enable the Commission to make further inquiry (as appropriate) in order to understand the potential consequences of the delay. Similarly, an update would be required if the SCI entity were to decide to significantly alter the scope of its planned material systems change.

²⁴⁶ See proposed Rule 1000(b)(6)(ii).

The Commission notes further that, in such cases, an SCI entity might separately be obligated to notify the Commission or its members or participants pursuant to proposed Rules 1000(b)(4) and (5), as discussed above.²⁴⁷

Request for comment

124. The Commission requests comment generally on proposed Rule 1000(b)(6). Is the proposed requirement to notify the Commission in advance of implementation of material systems changes appropriate?

125. Should the Commission provide additional guidance on, or define, what constitutes “exigent circumstances” that would obviate the need for advance notification? If so, what information, clarification, or definition would be helpful, and why?

126. Do commenters believe that an SCI entity should be required to provide updated information to the Commission regarding a planned material systems change if the information previously provided to the Commission regarding such change were to become materially inaccurate? Why or why not?

127. Do commenters believe that the proposed notification requirements would discourage an SCI entity from making necessary systems changes? Why or why not?

128. Is the proposed requirement that an SCI entity report all material systems changes too broad or too narrow? Why or why not? Should all material systems changes be reported to the Commission? If not, which systems changes should be excluded? Do commenters believe the proposed rule should specify quantitative criteria or other minimum thresholds for the effect of a change to an SCI entity’s systems on the entity’s capacity, security, and operations, beyond which the SCI entity would be required to notify the Commission of the change?

²⁴⁷ See supra Section III.B.3.

129. Do commenters believe it is appropriate for the Commission to require a standardized format for disclosing planned material systems changes on new proposed Form SCI? If not, why not? What would be a better approach?

130. Are there SCI entities for which the proposed requirements in Rule 1000(b)(6) would not be appropriate (e.g., cost-effective)? If so, please identify such entity or entities, or the characteristics of such entity or entities, and explain which proposed requirements would be inappropriate and why. If they are not cost-effective, would that be an appropriate reason to omit them generally for those SCI entities, or on a case-by-case basis, as the Commission determined to be consistent with Exchange Act requirements?

131. How often do SCI entities make material systems changes?

5. Review of Systems

Proposed Rule 1000(b)(7) would require an SCI entity to conduct an SCI review of the SCI entity's compliance with Regulation SCI not less than once each calendar year, and submit a report of the SCI review to senior management of the SCI entity no more than 30 calendar days after completion of such SCI review. Proposed Rule 1000(a) would define the term "SCI review" to mean a review, following established procedures and standards, that is performed by objective personnel having appropriate experience in conducting reviews of SCI systems and SCI security systems, and which review contains: (1) a risk assessment with respect to such systems of the SCI entity; and (2) an assessment of internal control design and effectiveness to include logical and physical security controls, development processes, and information technology governance, consistent with industry standards.²⁴⁸ In addition, such review would be

²⁴⁸ See infra discussion of proposed Rule 1000(b)(8). See also supra publications listed in Table A, Domain: Audit.

required to include penetration test reviews of the SCI entity's network, firewalls, development, testing and production systems at a frequency of not less than once every three years.²⁴⁹ The proposed requirement for an annual SCI review would formalize a practice in place under the current ARP Inspection Program in which SROs conduct annual systems reviews following established audit procedures and standards that result in the presentation of a report to senior SRO management on the recommendations and conclusions of the review.²⁵⁰

The risk assessment with respect to SCI entity's systems and assessment of internal control design and effectiveness should help an SCI entity assess the effectiveness of its information technology practices and determine where to best devote resources, including identifying instances in which the SCI entity was not in compliance with the policies and procedures required by proposed Rules 1000(b)(1) and (2). The penetration test reviews of the SCI entity's network, firewalls, and development, testing and production systems should help an SCI entity evaluate the system's security and resiliency in the face of attempted and successful systems intrusions. In requiring a frequency of not less than once every three years for penetration test reviews, the Commission seeks to balance the frequency of such tests with the costs associated with performing the tests.²⁵¹

For such assessments and reviews to be effective, the Commission preliminarily believes that it is important that they be conducted by objective personnel having appropriate experience

²⁴⁹ See proposed Rule 1000(a).

²⁵⁰ See *supra* notes 17-21 and accompanying text. Although ARP policy statements used the term "independent," the Commission is using the term "objective" in proposed Regulation SCI to distinguish the meaning of "objective" from the meaning of "independent," which may be considered a term of art in the context of financial accounting audits.

²⁵¹ See *infra* Section IV.D.2.d (estimating, among other things, the cost of conducting SCI reviews, including penetration test reviews).

performing such types of reviews. The Commission is not proposing a definition of the term “objective,” but preliminarily believes that to satisfy the criterion that an SCI review be conducted by “objective personnel,” it should be performed by persons who have not been involved in the development, testing, or implementation of the systems being reviewed.²⁵² The Commission preliminarily believes that persons who were not involved in the process for development, testing, or implementation of such systems would likely be in a better position to identify weaknesses and deficiencies that were not identified in the development, testing, and implementation stages. As proposed, the SCI review could be performed by personnel of the SCI entity (e.g., an SCI entity’s internal audit department) or an external firm with objective personnel.

In addition, proposed Rule 1000(b)(7) would require an SCI entity to submit a report of the SCI review to senior management of the SCI entity no more than 30 calendar days after completion of such SCI review.²⁵³ The proposed 30-day time frame is based on the Commission’s experience with the current ARP Inspection Program that an entity is able within 30 calendar days to consider the review and prepare a report for senior management consideration prior to submission to the Commission.

Request for comment

132. The Commission requests comment on all aspects of proposed Rule 1000(b)(7). Is the proposed definition of “SCI review” appropriate? Why or why not? And, if not, what would be an appropriate definition?

²⁵² See also supra ARP II note 1 at 22492 n.9.

²⁵³ This proposed requirement would formalize a recommendation under the current ARP Inspection Program. See supra note 21 and accompanying text.

133. Is the proposed scope of the SCI review appropriate? Why or why not? Is it sufficiently clear? Why or why not? Should the SCI review include, as proposed in Rule 1000(a), an assessment of internal control design and effectiveness to include logical and physical security controls, development processes, and information technology governance, consistent with industry standards? Why or why not? Should it include, as proposed in Rule 1000(a), penetration test reviews of the SCI entity's network, firewalls, development, testing and production systems? Is the proposed frequency of such penetration test reviews (i.e., not less than once every three years) appropriate? Why or why not? Should it be more or less frequent? Why or why not?

134. Do commenters agree with the proposed requirement that the review be performed by persons with appropriate experience conducting reviews of SCI systems and SCI security systems? Should the Commission define how it would evaluate whether a person or persons performing the review would satisfy the proposed requirement that they have appropriate systems review experience? Are there any credentials or specific qualifications that the Commission should require or specify as meeting the requirement? For example, should the Commission specify that a review be conducted by a Certified Information System Auditor (CISA) or GIAC Systems and Network Auditor (GSNA) certification?²⁵⁴

135. Should the term "objective personnel" be defined or further clarified? If so, what should be such definition?

136. Are there other elements that should be included in the scope of the SCI review? If so, which ones? For example, should the review include an assessment of the systems'

²⁵⁴ For further information regarding these certifications, see, e.g., <http://www.isaca.org/Certification/CISA-Certified-Information-Systems-Auditor/What-is-CISA/Pages/default.aspx> and <http://www.giac.org/certifications>.

compliance with the federal securities laws and rules and regulations thereunder or the entity's rules or governing documents as applicable? Why or why not?

137. Under what circumstances do SCI entities presently use outside consultants or other third parties to review their systems and controls? When such outside reviews are conducted, what is the scope and the stated purpose? How do outside reviews compare to internal reviews by audit or other staff in terms of scope or other factors? What are the considerations used by SCI entities in determining whether and when to engage outside consultants? How do commenters generally view the advantages and disadvantages of internal v. external reviews? The Commission is not proposing at this time any requirements related to third party reviews. Should the Commission propose to require that SCI review be conducted by third parties?

138. What are the current practices of SCI entities with respect to reviews of their SCI systems and SCI security systems? How often are such reviews conducted? Who conducts such reviews? What do such reviews entail? What types of assessments or tests are included in such reviews? Do such reviews include penetration test reviews? Please describe.

139. Do commenters agree with the proposal to require an SCI entity to submit a report of the SCI review to senior management of the SCI entity no more than 30 calendar days after completion of such SCI review? Why or why not? Is the 30-day time frame reasonable? Would a shorter or longer time period be more appropriate, such as 20, 45, or 60 days? If so, what should such a time period be and why? Please explain.

6. Periodic Reports

Proposed Rule 1000(b)(8)(i) would require an SCI entity to submit to the Commission a report of the SCI review required by paragraph (b)(7), together with any response by senior management, within 60 calendar days after its submission to senior management of the SCI entity.

The proposed requirement to submit a report of the SCI review required by paragraph (b)(7), together with any response by senior management, within 60 calendar days after its submission to senior management of the SCI entity, is designed to ensure that the senior management of the SCI entity is aware of any issues with its systems and promptly establishes plans for resolving such issues. The Commission preliminarily believes that the report would also help ensure that the Commission and its staff receive the report and any management response in a timely manner,²⁵⁵ would help to ensure that the Commission is aware of areas that may warrant more focused attention during its inspections (i.e., which SCI entities would already have identified for itself through its SCI review), and would allow the Commission to review the SCI entity's progress in resolving any systems issues. Further, the proposed requirement to submit the annual report within 60 calendar days after its submission to senior management is based on the Commission's experience with the current ARP Inspection Program that 60 calendar days after completion of an annual review or report is a sufficient period of time to enable senior management to consider such review or report before submitting it to the Commission.

In addition, proposed Rule 1000(b)(8)(ii) would require each SCI entity to submit a report within 30 calendar days after the end of June and December of each year containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes. The proposed requirement to submit these semi-

²⁵⁵ See infra Section III.E.3 and General Instructions to the Form, explaining that, "within 60 calendars days after its submission to senior management of the SCI entity, the SCI entity shall attach [as Exhibit 5] the report of the SCI review of the SCI entity's compliance with Regulation SCI, together with any response by senior management."

annual reports within 30 calendar days of the end of each semi-annual period is designed to ensure that the Commission would have regularly updated information with respect to the status of ongoing material systems changes that were originally reported pursuant to proposed Rule 1000(b)(6).²⁵⁶ This proposed requirement would formalize a practice in place under the current ARP Inspection Program in which senior information technology, audit, and compliance staff of certain SROs prepare such reports in advance of meeting with Commission staff periodically throughout the year to present and discuss recently completed systems projects and proposed systems projects. Further, the proposed requirement to submit the semi-annual report within 30 calendar days after the end of the applicable semi-annual period is based on the Commission's experience with the current ARP Inspection Program that 30 calendar days after completion of a report is a sufficient time period to enable senior management to consider such report before submitting it to the Commission. The Commission is proposing to require these reports to be submitted to the Commission on a semi-annual basis because the proposal would separately require information relating to planned material systems changes to be submitted (absent exigent circumstances or when information regarding any planned material systems change becomes materially inaccurate) at least 30 calendar days before their implementation²⁵⁷ and thus requiring an ongoing summary report more frequently would not, in the Commission's preliminary view, be necessary. On the other hand, the Commission is concerned that a longer period of time (such as on an annual basis) would permit significant updates and milestones relating to systems changes to occur without notice to the Commission.

²⁵⁶ As discussed above in *supra* Section III.C.4, proposed Rule 1000(b)(6)(ii) would require SCI entities to provide the Commission with an update if the information it previously provided to the Commission regarding any planned material systems change had become materially inaccurate.

²⁵⁷ See proposed Rule 1000(b)(6); *see supra* notes 244-247 and accompanying text.

Pursuant to proposed Rule 1000(b)(8)(iii), the reports required to be submitted to the Commission by proposed Rule 1000(b)(8) would be required to be submitted electronically as prescribed in Form SCI and the instructions thereto.²⁵⁸

Request for comment

140. Do commenters believe it would be appropriate to require SCI entities to submit a report of an SCI review to the Commission within 60 calendar days of its submission to senior management of the SCI entity? Should the Commission lengthen or shorten the time period for submission? Why or why not? If so, what is an appropriate period?

141. Is the proposed requirement to submit semi-annual reports on material systems changes necessary or appropriate? Do commenters believe it would be appropriate to require each SCI entity to submit a semi-annual report within 30 calendar days after the end of each semi-annual period containing a description of the progress of any material systems change during the applicable semi-annual period and the date, or expected date, of completion of implementation? Should the Commission lengthen or shorten the 30-day period for submission? Is the semi-annual submission requirement appropriate or should these reports be required to be submitted more or less frequently? If so, please state what such frequency should be and why.

142. Are there any other reports the Commission should require of SCI entities? If so, please explain.

143. Are there SCI entities for which the proposed requirements in Rule 1000(b)(8) would not be cost-effective? If so, please identify such entity or entities, or the characteristics of such entity or entities. For proposed requirements that commenters believe would not be cost-

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See infra Section III.E discussing new proposed Form SCI and its contemplated use by SCI entities to submit reports and other required information to the Commission electronically in a standardized format with attachments when and as required.

effective, would that be an appropriate reason to omit them generally for those SCI entities, or on a case-by-case basis, as the Commission determines to be consistent with Exchange Act requirements?

7. Proposed Rule 1000(b)(9): SCI Entity Business Continuity and Disaster Recovery Plans Testing Requirements for Members or Participants

The Commission is proposing Rule 1000(b)(9), which would address testing of SCI entity business continuity and disaster recovery plans, including backup systems, by SCI entity members or participants. Specifically, proposed Rule 1000(b)(9)(i) would require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans, in the manner and frequency as specified by the SCI entity, at least once every 12 months. Proposed Rule 1000(b)(9)(ii) would further require an SCI entity to coordinate such testing on an industry- or sector-wide basis with other SCI entities. Proposed Rule 1000(b)(9)(iii) would require each SCI entity to designate those members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans. Proposed Rule 1000(b)(9)(iii) would also require each SCI entity to notify the Commission of such designations and its standards for designation on Form SCI and promptly update such notification after any changes to its designations or standards.²⁵⁹

²⁵⁹ The proposed rule does not specify when the Commission would need to be notified about the designations and standards because SCI entities would be required to provide an initial notification at such point as when proposed Regulation SCI were effective, and subsequent updates only promptly after its designations and/or standards changed.

The Commission preliminarily believes that the testing participation requirement in proposed Rule 1000(b)(9) would help an SCI entity to ensure that its efforts to develop effective business continuity and disaster recovery plans are not undermined by a lack of participation by its members or participants that the SCI entity believes would be necessary to the success of such plans if they were to be put into effect. The Commission further preliminarily believes that the appropriate standard for measuring whether a business continuity and disaster recovery plans can be activated successfully is whether such activation would likely result in the maintenance of fair and orderly markets, a goal Congress found important in adopting Section 11A of the Exchange Act.²⁶⁰

The 2003 Interagency White Paper, which underlies the requirement in proposed Rule 1000(b)(1)(i)(E) pertaining to business continuity and disaster recovery plans,²⁶¹ identifies three important business continuity objectives that would apply to SCI entities: (1) rapid recovery and timely resumption of critical operations following a wide-scale disruption; (2) rapid recovery and timely resumption of critical operations following the loss or inaccessibility of staff in at least one major operating location; and (3) a high level of confidence, through ongoing use or robust testing, that critical internal and external continuity arrangements are effective and compatible.²⁶² The 2003 Interagency White Paper also states that it is a “sound practice” for organizations to “routinely use or test recovery and resumption arrangements.”²⁶³ Further, the Commission’s 2003 Policy Statement on Business Continuity Planning for Trading Markets states, among other

²⁶⁰ See Section 11A(a)(1)(C) and (a)(2), 15 U.S.C. 76k-1(a)(1)(C) and (a)(2).

²⁶¹ The 2003 Interagency White Paper is included in Table A as a proposed SCI industry standard. See *supra* Section III.C.1.b.

²⁶² See *supra* note 195.

²⁶³ See *id.*

things, that market centers, including SROs, are to: (1) have in place a business continuity plan that anticipates the resumption of trading in the securities traded by that market no later than the next business day following a wide-scale disruption; (2) maintain appropriate geographic diversity between primary and back-up sites in order to assure resumption of trading activities by the next business day; and (3) confirm the effectiveness of the backup arrangements through testing.²⁶⁴ SCI entities that currently participate in the ARP Inspection Program are familiar with the standards identified in the 2003 Interagency White Paper and the Commission's 2003 Policy Statement on Business Continuity Planning for Trading Markets.

As noted above,²⁶⁵ the experience of the equities and options markets in the wake of Superstorm Sandy demonstrates the importance of not only an SCI entity itself being able to operate following an event that triggers its business continuity and disaster recovery plans, but also that the members or participants of the SCI entity be able to conduct business with such SCI entity when its business continuity and disaster recovery plans have been activated. The Commission preliminarily believes that, even if an SCI entity is able to operate following an event that triggers its business continuity and disaster recovery plans, unless there is effective participation by certain of its members or participants in the testing of such plans, the objective of ensuring resilient and available markets in general,²⁶⁶ and the maintenance of fair and orderly markets in particular, would not be achieved. Accordingly, the Commission preliminarily believes that it is appropriate to require SCI entities to designate members or participants they believe are necessary to the successful activation of their business continuity and disaster

²⁶⁴ See supra notes 32 and 196.

²⁶⁵ See supra notes 78-83 and accompanying text.

²⁶⁶ See proposed Rule 1000(b)(1) (requiring SCI entities to have policies and procedures relating to, among other things, resiliency and availability) and supra Section III.C.1.

recovery plans, including backup systems, and require them to participate in the testing of such plans.

Under the proposed rule, each SCI entity would need to schedule, and require their designated members or participants to participate in, scheduled “functional and performance testing”²⁶⁷ of the entity’s business continuity and disaster recovery plans. Such functional and performance testing should include not only testing of connectivity, but also testing of an SCI entity’s systems, such as order entry, execution, clearance and settlement, order routing, and the transmission and/or receipt of market data, as applicable, to determine if they can operate as contemplated by its business continuity and disaster recovery plans.

Proposed Rule 1000(b)(9)(i) would require that testing of an SCI entity’s business continuity and disaster recovery plans occur at least once every 12 months. This proposed requirement reflects the Commission’s preliminary view that the testing of business continuity and disaster recovery plans, including backup systems, must occur regularly if such plans are to be effective when an actual disaster or disruption occurs. The Commission preliminarily believes that its proposed required testing frequency of at least once every 12 months is the minimum frequency that would be consistent with seeking to ensure that testing is meaningful and effective.²⁶⁸ However, the proposed rule would not prevent an SCI entity from conducting testing and requiring participation by members or participants in such testing more frequently

²⁶⁷ As commonly understood, functional testing examines whether a system operates in accordance with its specifications, whereas performance testing examines whether a system is able to perform under a particular workload.

²⁶⁸ Consistent with the frequency of testing under proposed Rule 1000(b)(9), the Securities Industry and Financial Markets Association coordinates an industry-wide business continuity test each year in October. See <http://www.sifma.org/services/bcp/industry-testing>. See also *supra* notes 81-82 and accompanying text.

than once every 12 months, if the SCI entity believes it is necessary or if, for example, it materially modifies its business continuity and disaster recovery plans.

Proposed Rule 1000(b)(9)(i) would also provide an SCI entity with discretion to determine the precise manner and content of the testing. Thus, for example, the SCI entity would have discretion to determine, for example, the duration of the testing, the sample size of transactions tested, the scenarios tested, and the scope of the test. The Commission preliminarily believes that SCI entities are in the best position to structure the details of the test in a way that would maximize its utility.

Although proposed Rule 1000(b)(9)(i) would give SCI entities discretion to determine the precise manner and content of the testing, the Commission is also proposing Rule 1000(b)(9)(ii), which would require an SCI entity to coordinate its testing on an industry- or sector-wide basis with other SCI entities.²⁶⁹ The proposed coordination requirement is designed to enhance the value of testing by requiring SCI entities to work together to schedule and conduct the testing in as efficient and effective a manner as possible. Given that trading in the U.S. securities markets today is dispersed among a wide variety of exchanges, ATSS, and other trading venues, and is often conducted through sophisticated algorithmic trading strategies that access many trading platforms simultaneously, the Commission preliminarily believes that requiring SCI entities to coordinate testing is necessary to ensure the goal of achieving robust and effective business continuity and disaster recovery plans, because it would result in testing under more realistic market conditions. In addition, the Commission is cognizant that situations that trigger

²⁶⁹ Thus, to satisfy the requirement of proposed Rule 1000(b)(9)(ii), an SCI entity could coordinate its testing with all SCI entities, or an appropriate subset of them, such as by asset class(es) (NMS stocks, non-NMS stocks, municipal debt, corporate bonds, options) or type of SCI entity (national securities exchanges, clearing agencies, plan processors).

implementation of an SCI entity's business continuity and disaster recovery plans are often not limited in scope to a single SCI entity, but may affect multiple, or even all, SCI entities at the same time. Thus, proposed Rule 1000(b)(9)(ii)'s requirement is designed to foster better coordination and cooperation across the securities industry such that the markets, investors, and all market participants may benefit from more efficient and meaningful testing. Further, the Commission preliminarily believes that it would be more cost-effective for market participants to participate in the testing of the business continuity and disaster recovery plans of SCI entities on an industry- or sector-wide basis because such coordination would likely reduce duplicative testing efforts.

While proposed Rule 1000(b)(9)(ii) would require SCI entities to coordinate testing on an industry- or sector-wide basis, it would provide discretion to SCI entities to determine how to best meet this requirement because the Commission preliminarily believes that SCI entities currently are best suited to find the most efficient and effective way to test. Of course, as noted above, each SCI entity may require its members or participants to participate in additional testing beyond the industry- or sector-wide testing under proposed Rule 1000(b)(9)(ii).

Proposed Rule 1000(b)(9)(iii) would require each SCI entity to designate those members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans. In addition, proposed Rule 1000(b)(9)(iii) would require each SCI entity to provide to the Commission on Form SCI its standards for determining which members or participants are necessary for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans and promptly update such notification following any changes to such standards. The Commission believes that the viability of an SCI entity's

business continuity and disaster recovery plans, and the usefulness of its backup systems, depend upon the ability of such members or participants to be ready, able, and willing to use such systems during an actual disaster or disruption. The proposed requirement that designated members or participants be required to test such plans in advance reflects the Commission's preliminary view that the proposed testing would enhance the value of SCI entities' business continuity and disaster recovery plans, and thereby advance the goal of achieving resilient and available markets.²⁷⁰

For SCI SROs, proposed Rule 1000(b)(9)(iii) would require SRO rules pursuant to Section 19(b) of the Exchange Act, setting forth the standards for designation. For an SCI ATS or an exempt clearing agency subject to ARP, the requirement in proposed Rule 1000(b)(9)(iii) would be satisfied by setting forth such standards in its internal procedures, as well as any subscriber or similar agreement, as applicable. For an SCI entity that is a plan processor, proposed Rule 1000(b)(9)(iii) would require an amendment to the applicable SCI Plan pursuant to Rule 608 of Regulation NMS, setting forth such standards. Further, proposed Rule 1000(b)(9)(iii) would require each SCI entity to provide to the Commission on Form SCI the list of designated members or participants and promptly update such notification following any changes to the designations.²⁷¹

Request for Comment

144. The Commission requests comment generally on proposed Rule 1000(b)(9).

²⁷⁰ See *supra* note 266.

²⁷¹ As discussed in *infra* Section III.E, Form SCI would also require SCI entities to attach the relevant provision of their rules (for SCI SROs), SCI Plans (for plan processors) or subscriber or similar agreements (for SCI ATs and exempt clearing agencies subject to ARP) that require designated members or participants to participate in the testing required by proposed Rule 1000(b)(9).

145. Do commenters believe the proposal to require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans, in the manner and frequency as specified by the SCI entity, is appropriate? Why or why not? Is the proposed requirement that SCI entities require participation in “functional and performance testing” appropriate? Why or why not? Is the term “functional and performance testing” clear? If not, why not and what would be a better description of the nature of the proposed required testing?

146. Do commenters believe it is appropriate to require that such testing occur at least once every 12 months? Why or why not? Would another minimum interval for such testing, such as bi-annually, semi-annually, or quarterly, be more appropriate? Please explain. Would it be appropriate to also require such testing to occur following a material change to the SCI entity’s business continuity and disaster recovery plans? Why or why not? If yes, would it be appropriate to require such testing within 90 days of the material change? Why or why not? Would another time period be more appropriate? If so, what should such time period be?

147. Should the Commission give SCI entities discretion in designating the members or participants that must participate in the testing of the business continuity and disaster recovery plans? Why or why not? Should the Commission instead specify standards for such designation? If so, what should the standards be based on? For example, should the standards be based on the size, volume traded or cleared, and/or geographic proximity of a member or participant to the SCI entity’s backup systems? Why or why not? Should only members or participants that execute or clear transactions above a certain volume threshold and/or that account for a certain percentage of trading volume on the SCI entity be required to participate?

Why or why not? If so, what should be such threshold or thresholds (e.g., 0.5 percent, 1 percent, 5 percent)? Should an SCI entity be required to mandate participation in testing by some other subset of members or participants? For example, should such subset comprise members or participants that account for a certain percentage of trading in each or all of the equities, options, or fixed-income markets traded through the SCI entity? Why or why not? If so, what should be such threshold (e.g., 0.5 percent, 1 percent, 5 percent)? Or, should testing be mandated only for certain types of market participants (e.g., market makers, clearing broker-dealers, retail broker-dealers)? If so, for which types of market participants should testing be mandatory and why? Please explain. Alternatively, should all members or participants of an SCI entity (or certain types of SCI entities, e.g., plan processors) be required to participate in the testing of its business continuity and disaster recovery plans? Why or why not?

148. Do commenters believe those members or participants that would likely be designated by SCI entities under proposed Rule 1000(b)(9)(iii) currently have the ability, including the infrastructure, to participate in the required testing? Do commenters believe all members or participants of SCI entities currently have the ability, including the infrastructure, to participate in such testing? What would be the costs and benefits to a member or participant of an SCI entity to participate in such testing, including for such member or participant to establish and maintain connectivity to an SCI entity's backup systems? What would be the economic effect of this proposed rule, particularly with regard to a member or participant? Please describe in detail and provide data to support your views if possible.

149. Should an SCI entity be required to notify the Commission on Form SCI of its standards for designating members or participants for testing and its list of designated members or participants? Why or why not? Should an SCI entity be required to promptly update such

Commission notification if its standards for designation or list of designated members or participants change? Why or why not? Is there a more appropriate time period for updating Commission notifications (e.g., 7 days following a change, 30 days following a change, quarterly)? Please explain.

150. Proposed Rule 1000(b)(9)(i) would require each SCI entity to mandate participation by designated members or participants in “functional and performance testing” of its business continuity and disaster recovery plans, including its backup systems, but would leave to the discretion of the SCI entity the details regarding the manner of testing. Should the Commission be more prescriptive with respect to such testing? For example, should the Commission require that SCI entities periodically operate from their backup facilities during regular trading hours? Why or why not? Please explain. Are there other details that the Commission should prescribe in relation to the proposed rule? If so, please explain.

151. Proposed Rule 1000(b)(9)(ii) would require SCI entities to coordinate testing on an industry- or sector-wide basis, but would not specify how or the parameters. Do commenters believe it is appropriate to leave such discretion to SCI entities? Why or why not? Are the terms “industry-wide” and “sector-wide” clear? Should the Commission define these terms? If so, what would be appropriate definitions? Would such an approach foster the creation of meaningful, efficient testing of business continuity and disaster recovery plans across SCI entities and their members or participants? Why or why not? If not, what would be a more appropriate approach? Should the Commission require a minimum number of SCI entities needed to satisfy the coordination requirement of proposed Rule 1000(b)(9)(ii)? Or should that requirement only be satisfied if all SCI entities (or all SCI entities within a sector of the industry) participate? Why or why not? Should the Commission mandate a minimum list of actions that

SCI entities must take to satisfy the requirement of proposed Rule 1000(b)(9)(ii)? If so, what actions should be required and why? If not, why not?

152. Should the Commission require SCI entities to submit reports on the results of their testing of business continuity and disaster recovery plans or reports of any systems testing that was not successful? If not, why not? If so, should such reports be required to be submitted within a specified time frame or in a specified manner or format? Please explain. In addition, should the Commission require SCI entities to submit reports on systems testing opportunities required of or made available to members or subscribers and the extent to which such members or subscribers participate in such opportunities?

153. Would proposed Rule 1000(b)(9) enhance investor confidence in the integrity of the U.S. securities markets? Why or why not? Please explain. What would be the costs associated with proposed Rule 1000(b)(9)? What would be the benefits? Please be specific. What would be the potential competitive impacts of proposed Rule 1000(b)(9), including impacts on small members or small participants? To the extent possible, please provide data to support your views.

154. To help ensure that the goals of an SCI entity's business continuity and disaster recovery plans are achieved, should the Commission impose other requirements (in addition to the mandatory testing participation requirement in proposed Rule 1000(b)(9)) on the members or participants of SCI entities?²⁷² For example, proposed Rule 1000(b)(1)(i)(E) would require that an SCI entity's business continuity and disaster recovery plans allow for "maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business

²⁷² See also *infra* Section III.G (soliciting comment on whether broker-dealers, other than SCI ATSS, should be subject to some or all of the additional system safeguard rules that are proposed for SCI entities).

day resumption of trading.” Should the Commission require SCI entities to mandate that some or all of their members or participants be able to meet the next business day resumption of trading standards for SCI entities in proposed Rule 1000(b)(1)(i)(E)? Why or why not? If not all, which members or participants should be required to meet such resumption of trading standards? For example, should an SCI entity require members or participants that execute transactions above a certain volume threshold and/or that account for a certain percentage of trading on the SCI entity to meet such resumption of trading standards? Why or why not? If so, what should be such threshold or thresholds?

155. Are there other requirements that SCI entities should mandate for their members or participants to help SCI entities meet their obligations under proposed Regulation SCI? If so, what are they? Please describe. For example, should the Commission also require each SCI entity to mandate that its members or participants maintain continuous connectivity with the SCI entity’s backup data centers? Why or why not? If not all, which members or participants should be required to maintain continuous connectivity with the SCI entity’s backup data centers? For example, should an SCI entity require members or participants designated under proposed Rule 1000(b)(9)(iii), or that execute transactions above a certain volume threshold and/or that account for a certain percentage of trading on the SCI entity, to maintain such connectivity? Why or why not? If so, what should be such threshold or thresholds?

D. Proposed Rule 1000(c)-(f): Recordkeeping, Electronic Filing on Form SCI, and Access

1. Recordkeeping Requirements

The Commission notes that many SCI entities are already subject to recordkeeping

requirements,²⁷³ but that records relating to systems review and testing may not be specifically addressed in certain current recordkeeping rules. Accordingly, the Commission is proposing Rule 1000(c) to specifically address recordkeeping requirements for SCI entities with respect to records relating to Regulation SCI compliance.

Proposed Rule 1000(c)(1) would require each SCI SRO to make, keep, and preserve all documents relating to its compliance with Regulation SCI, as prescribed by Rule 17a-1 under the Exchange Act.²⁷⁴ Rule 17a-1(a) under the Exchange Act requires every national securities exchange, national securities association, registered clearing agency, and the MSRB to keep and preserve at least one copy of all documents, including all correspondence, memoranda, papers, books, notices, accounts, and other such records as shall be made and received by it in the course of its business as such and in the conduct of its self-regulatory activity.²⁷⁵ In addition, Rule 17a-1(b) requires these entities to keep all such documents for a period of not less than five years, the first two years in an easily accessible place, subject to the destruction and disposition provisions of Rule 17a-6.²⁷⁶ Rule 17a-1(c) requires these entities, upon request of any representative of the

²⁷³ See, e.g., 17 CFR 240.17a-1, applicable to SCI SROs; 17 CFR 240.17a-3, 17a-4, applicable to broker-dealers; and 17 CFR 242.301-303, applicable to ATSSs.

It has been the experience of the Commission that SCI entities presently subject to the ARP Inspection Program (nearly all of whom are SCI SROs that are also subject to the record keeping requirements of Rule 17a-1(a)) do generally keep and preserve the types of records that would be subject to the requirements of proposed Rule 1000(c). Nevertheless, the Commission preliminarily believes that Regulation SCI's codification of these preservation practices will support an accurate, timely, and efficient inspection and examination process and help ensure that all types of SCI entities keep and preserve such records.

²⁷⁴ 17 CFR 240.17a-1.

²⁷⁵ See 17 CFR 240.17a-1(a). Such records would, for example, include copies of incident reports and the results of systems testing.

²⁷⁶ See 17 CFR 240.17a-1(b). Rule 17a-6(a) under the Exchange Act states: "Any document kept by or on file with a national securities exchange, national securities

Commission, to promptly furnish to the possession of Commission representatives copies of any documents required to be kept and preserved by it pursuant to Rule 17a-1(a) and (b).²⁷⁷ The Commission believes that the breadth of Rule 17a-1 under the Exchange Act is such that it would require SCI SROs to make, keep, and preserve records relating to their compliance with proposed Regulation SCI should the Commission adopt Regulation SCI. Thus, the Commission proposes to cross-reference Rule 17a-1 in proposed Regulation SCI to be clear that it intends all SCI entities to be subject to the same recordkeeping requirements regarding compliance with proposed Regulation SCI.

For SCI entities that are not SCI SROs (i.e., SCI ATs, plan processors, and exempt clearing agencies subject to ARP), the Commission is proposing broad recordkeeping requirements relating to compliance with proposed Regulation SCI that are consistent with those applicable to SROs under Rule 17a-1 under the Exchange Act. Thus, the Commission is proposing Rule 1000(c)(2), which would require SCI entities other than SCI SROs to: (i) make, keep, and preserve at least one copy of all documents, including correspondence, memoranda, papers, books, notices, accounts, and other such records, relating to its compliance with Regulation SCI, including, but not limited to, records relating to any changes to its SCI systems and SCI security systems; (ii) keep all such documents for a period of not less than five years, the first two years in a place that is readily accessible to the Commission or its representatives

association, registered clearing agency or the Municipal Securities Rulemaking Board pursuant to the Act or any rule or regulation thereunder may be destroyed or otherwise disposed of by such exchange, association, clearing agency or the Municipal Securities Rulemaking Board at the end of five years or at such earlier date as is specified in a plan for the destruction or disposition of any such documents if such plan has been filed with the Commission by such exchange, association, clearing agency or the Municipal Securities Rulemaking Board and has been declared effective by the Commission.” 17 CFR 240.17a-6(a).

²⁷⁷ See 17 CFR 240.17a-1(c).

for inspection and examination;²⁷⁸ and (iii) upon request of any representative of the Commission, promptly furnish to the possession of such representative copies of any documents required to be kept and preserved by it pursuant to (i) and (ii) above.

Proposed Rule 1000(c)(3), applicable to all SCI entities, would require each SCI entity, upon or immediately prior to ceasing to do business or ceasing to be registered under the Exchange Act, to take all necessary action to ensure that records required to be made, kept, and preserved by proposed Rule 1000(c) would be accessible to the Commission or its representatives for the remainder of the period required by proposed Rule 1000(c). For example, an SCI entity could fulfill its obligations under proposed Rule 1000(c)(3) by delivering such records, immediately prior to deregistration, to a repository or other similar entity and by making all necessary arrangements for such records to be readily accessible to the Commission or its representative, for inspection and examination for the duration of the requirement under proposed Rule 1000(c)(3).

The Commission preliminarily believes that its ability to examine for and enforce compliance with proposed Regulation SCI could be hampered if an SCI entity were not required to adequately provide accessibility for the full proposed retention period. In addition, while many SCI events may occur, be discovered, and be resolved in a short time frame, there may be other SCI events that may not be discovered until months or years after their occurrences, or may take significant periods of time to fully resolve. In such cases, having an SCI entity's records available even after it has ceased to do business or be registered under the Exchange Act would

²⁷⁸ The proposed five-year and two-year time frames would be the same as those applicable to SCI SROs pursuant to Rule 17a-1 under the Exchange Act, and the Commission preliminarily believes it would be appropriate for all SCI entities to be subject to the same time frame requirements.

be beneficial. Because SCI events have the potential to negatively impact investor decisions, risk exposure, and market efficiency, the Commission also preliminarily believes that its ability to oversee the securities markets could be undermined if it is unable to review records to determine the causes and consequences of one or more SCI events experienced by an SCI entity that deregisters or ceases to do business. This information would provide an additional tool to help the Commission reconstruct important market events and better understand how such events impacted investor decisions, risk exposure, and market efficiency.

Proposed Rule 1000(e) would provide that, if the records required to be made or kept by an SCI entity under proposed Regulation SCI were prepared or maintained by a service bureau or other recordkeeping service on behalf of the SCI entity, the SCI entity would be required to ensure that the records are available for review by the Commission and its representatives by submitting a written undertaking, in a form acceptable to the Commission, by such service bureau or other recordkeeping service, signed by a duly authorized person at such service bureau or other recordkeeping service. The written undertaking would be required to include an agreement by the service bureau designed to permit the Commission and its representatives to examine such records at any time or from time to time during business hours, and to promptly furnish to the Commission and its representatives true, correct, and current electronic files in a form acceptable to the Commission or its representatives or hard copies of any, all, or any part of such records, upon request, periodically, or continuously and, in any case, within the same time periods as would apply to the SCI entity for such records. The preparation or maintenance of records by a service bureau or other recordkeeping service would not relieve an SCI entity from its obligation to prepare, maintain, and provide the Commission and its representatives with

access to such records. Proposed Rule 1000(e) is substantively the same as the requirement applicable to broker-dealers under Rule 17a-4(i) of the Exchange Act.²⁷⁹

The Commission is proposing this requirement for SCI entities to prevent the inability of the Commission to obtain required SCI entity records because they are held by a third party that may not otherwise have an obligation to make such records available to the Commission. In addition, the requirement that SCI entities obtain from such third parties a written undertaking would help ensure that such service bureau or other recordkeeping service is aware of this obligation with respect to records relating to proposed Regulation SCI. The Commission preliminarily believes that it is appropriate to include this requirement in proposed Regulation SCI to help ensure that the Commission would have prompt and efficient access to all required records, including those housed at a service bureau or any other recordkeeping service.²⁸⁰

Request for Comment

156. The Commission requests comment on all aspects of proposed Rule 1000(c). Specifically, do SCI entities currently make, keep, and preserve the types of records that would be required to be made, kept, and preserved by proposed Rule 1000(c)? Are there any records that could be important to make, keep, and preserve that would not be captured under proposed Rule 1000(c) or the existing recordkeeping requirements for SROs under Rule 17a-1? If so, please explain and identify the records. Should any of the records subject to proposed Rule 1000(c) not be required? If so, please explain and identify the records. Should the Commission require SCI entities to furnish records to Commission representatives electronically in a tagged data format (e.g., XML, XBRL, or similar structured data formats which may be tagged)? The

²⁷⁹ 17 CFR 240.17a-4(i).

²⁸⁰ See 17 CFR 240.17a-4(i) (records preserved or maintained by a service bureau).

Commission notes that a tagged data format would have the benefit of permitting records to be organized and searched more easily, and thereby enable more efficient analyses, but that there would also be costs associated with implementing a tagged data format requirement. Do commenters believe the benefits of using a tagged data format would justify the costs? Why or why not? Please explain. If so, should any particular electronic format be mandated? If so, please describe.

157. Should the Commission lengthen or shorten the proposed periods for SCI entities to keep and preserve records? If so, by how much and why? Is it appropriate for an SCI entity, prior to ceasing to do business or ceasing to be regulated under the Exchange Act, to be required to ensure that its records are accessible in some way to the Commission and its representatives? Why or why not? What practical steps do commenters envision an SCI entity taking to comply with this proposed requirement?

158. The Commission requests comment on all aspects of proposed Rule 1000(e). Specifically, would the written undertaking required by proposed Rule 1000(e) be sufficient to help ensure that the Commission and its representatives would be able to obtain and examine true, correct, and current records of SCI entities? Why or why not? Are the provisions of proposed Rule 1000(e) an appropriate means of addressing any potential problems with access to books and records at service bureaus? Why or why not? Are there alternatives that the Commission should consider with respect to recordkeeping requirements for SCI entities? If so, please explain your reasoning.

2. Electronic Submission of Reports, Notifications, and Other Communications on Form SCI

Proposed Rule 1000(d) provides that, except with respect to notifications to the Commission under proposed Rule 1000(b)(4)(i) (Commission notification of certain SCI events),

and oral notifications to the Commission under proposed Rule 1000(b)(6)(ii) (Commission notification of certain material systems changes), any notification, review, description, analysis, or report required to be submitted to the Commission under proposed Regulation SCI must be submitted electronically and contain an electronic signature. This proposed requirement is intended to provide a uniform manner in which the Commission would receive—and SCI entities would provide—written notifications, reviews, descriptions, analyses, or reports made pursuant to proposed Regulation SCI. The Commission preliminarily believes that such standardization would guide SCI entities in completing such submissions and make it easier and more efficient for them to draft and submit such required reports. Additionally, the standardization would make it easier and more efficient for the Commission to promptly review, analyze, and respond, as necessary, to the information proposed to be provided.²⁸¹ The electronic signature requirement is consistent with the intention of the Commission to receive documents that can be readily accessed and processed electronically.

Proposed Rule 1000(d) also would require that submissions by SCI entities be filed electronically on new proposed Form SCI, in accordance with the instructions contained in Form SCI.²⁸² The Commission's proposal contemplates the use of an online filing system, similar to the electronic form filing system ("EFFS") currently used by SCI SROs to submit Form 19b-4 filings, through which an SCI entity would be able to file a completed Form SCI.²⁸³ Based on

²⁸¹ This proposed requirement is consistent with electronic-reporting standards set forth in other Commission rules under the Exchange Act, such as Rule 17a-25 (Electronic Submission of Securities Transaction Information by Exchange Members, Brokers, and Dealers). See 17 CFR 240.17a-25.

²⁸² See proposed Rule 1000(d) and *infra* Section III.E.

²⁸³ See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004) (adopting the EFFS for use in filing Form 19b-4).

the widespread use and availability of the Internet, the Commission preliminarily believes that filing Form SCI in an electronic format would be less burdensome and a more efficient filing process for SCI entities and the Commission, as it is likely to be less expensive and cumbersome than mailing and filing paper forms to the Commission.

Request for Comment

159. The Commission requests comment on all aspects of proposed Rule 1000(d). Do commenters believe that the electronic submission requirement of proposed Rule 1000(d) is appropriate? Alternatively, would the submission of a required notification, review, description, analysis, or report via electronic mail to one or more Commission email addresses be a more appropriate way for the Commission to implement the proposed requirement? Are there other alternative methods that would be preferable? If so, please describe. Should there be any additional security requirements for such communications (e.g., password protection or encryption)? If so, please describe. Should the submissions be made in a tagged data format, e.g., XML, XBRL, or similar structured data formats which may be tagged? The Commission notes that a tagged data format would have the benefit of permitting records to be organized and searched more easily, and thereby enable more efficient analyses, but that there would also be costs associated with implementing a tagged data format requirement. Do commenters believe the benefits of using a tagged data format would justify the costs? Why or why not? Please explain. If so, should any particular electronic format be mandated? If so, please describe.

3. Access to the Systems of an SCI Entity

Proposed Rule 1000(f) would require SCI entities to provide Commission representatives reasonable access to their SCI systems and SCI security systems. Thus, the proposed rule would facilitate the access of representatives of the Commission to such systems of an SCI entity either

remotely or on site.²⁸⁴ Proposed Rule 1000(f) is intended to be consistent with the Commission's current authority with respect to access to records generally²⁸⁵ and help ensure that Commission representatives have ready access to the SCI systems and SCI security systems of SCI entities in order to evaluate an SCI entity's practices with regard to the requirements of proposed Regulation SCI.²⁸⁶

Request for comment

160. The Commission requests comment generally on proposed Rule 1000(f). Are there restrictions that should be placed on the proposed access that would still allow the Commission and its representatives to be able to evaluate an SCI entity's practices with regard to the requirements of proposed Regulation SCI? If so, what should such restrictions be and why? Please describe.

E. New Proposed Form SCI

The Commission is proposing that the notices, reports, and other information required to be provided to the Commission pursuant to proposed Rules 1000(b)(4), (6), (8), and (10) of Regulation SCI be submitted electronically on new proposed Form SCI. Proposed Form SCI would solicit information through a series of questions designed to elicit short-form answers and

²⁸⁴ For example, with access to an SCI entity's SCI systems and SCI security systems, Commission representatives could test an SCI entity's firewalls and vulnerability to intrusions.

²⁸⁵ See, e.g., Section 17(b) of the Exchange Act which states that all records of the entities listed in Section 17(a) "are subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission...as the Commission...deems necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Exchange Act]."

²⁸⁶ See 15 U.S.C. 78q(b). The Commission believes proposed Rule 1000(f) also is authorized by Sections 11A, 6(b)(1), 15A(b)(2), and 17A(b)(3)(A) of the Exchange Act, among others. See supra notes 9-11 and accompanying text.

also would require SCI entities to provide information and/or reports in narrative form by attaching specified exhibits. All filings on proposed Form SCI would require that an SCI entity identify itself and indicate the basis for submitting Form SCI, whether a: notification or update notification regarding an SCI event pursuant to proposed Rule 1000(b)(4); notice of a planned material systems change pursuant to proposed Rule 1000(b)(6); submission of a required report pursuant to proposed Rule 1000(b)(8); or notification of an SCI entity's standards for designation of members or participants to participate in required testing and the identity of such designated members or participants pursuant to proposed Rule 1000(b)(9). A filing on Form SCI required by proposed Rules 1000(b)(4), (6), (8), or (9) would require that an SCI entity provide additional information on attached exhibits, as discussed below.

1. Notice of SCI Events Pursuant to Proposed Rule 1000(b)(4)

As discussed above, proposed Rule 1000(b)(4)(i) would require an SCI entity, upon any responsible SCI personnel becoming aware of a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion, to notify the Commission of such SCI event. Proposed Rule 1000(b)(4)(ii) would require an SCI entity, upon any responsible SCI personnel becoming aware of any SCI event, to notify the Commission of the SCI event in writing within 24 hours. Proposed Rule 1000(b)(4)(iii) would require continuing written updates on a regular basis, or at such frequency as reasonably requested by a representative of the Commission, until such time as the SCI event is resolved. Proposed Rule 1000(b)(4)(iv) would direct an SCI entity to submit the required notifications on Form SCI. Further, proposed Rule 1000(b)(4)(iv) and new proposed Form SCI would specify the particular information an SCI entity would be required to provide to the Commission to comply with the Commission notification requirements of proposed Rules 1000(b)(4)(ii) and 1000(b)(4)(iii). As such, proposed Rule 1000(b)(4) would

specify when and how notices would be required to be filed, and it and new proposed Form SCI would address the content of required notices.

For a written notification to the Commission of an SCI event under proposed Rule 1000(b)(4)(ii), new proposed Form SCI would require that an SCI entity indicate that the filing is being made pursuant to proposed Rule 1000(b)(4)(ii) and provide the following information in a short, standardized format: (i) whether the filing is a Rule 1000(b)(4)(ii) notification or Rule 1000(b)(4)(iii) update of an SCI event; (ii) the SCI event type(s) (i.e., systems compliance issue, systems intrusion, and/or systems disruption); (iii) whether the event is a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants; (iv) if so, whether the Commission has been notified of the SCI event; (v) whether the SCI event has been resolved; (vi) the date/time the SCI event started; (vii) the duration of the SCI event; (viii) the date and time when responsible SCI personnel became aware of the SCI event; (ix) the estimated number of market participants impacted by the SCI event; (x) the type(s) of systems impacted;²⁸⁷ and (xi) if applicable, the type of systems disruption.²⁸⁸ In addition, proposed Form SCI would require attachment of Exhibit 1, providing a narrative description of the SCI event, including: (1) a detailed description of the SCI event; (2) the SCI

²⁸⁷ The types of systems listed on proposed Form SCI track the types of systems that make up the proposed definitions of "SCI system" and "SCI security system" in proposed Rule 1000(a).

²⁸⁸ The types of systems disruptions listed on proposed Form SCI track the provisions of the proposed definition of "system disruption" in proposed Rule 1000(a) and include, with respect to SCI systems: (1) a failure to maintain service level agreements or constraints; (2) a disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely; (3) a loss of use of any such system; (4) a loss of transaction or clearance and settlement data; (5) significant back-ups or delays in processing; (6) a significant diminution of ability to disseminate timely and accurate market data; or (7) a queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected.

entity's current assessment of the types and number of market participants potentially affected by the SCI event; (3) the potential impact of the SCI event on the market; and (4) the SCI entity's current assessment of the SCI event, including a discussion of the SCI entity's determination regarding whether the SCI event is a dissemination SCI event or not.²⁸⁹ In addition, to the extent available as of the time of the initial notification, Exhibit 1 would require inclusion of the following information: (1) a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; (2) the time the SCI event was resolved or timeframe within which the SCI event is expected to be resolved; (3) a description of the SCI entity's rule(s) and/or governing documents, as applicable, that relate to the SCI event; and (4) an analysis of the parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss.²⁹⁰

Proposed Rule 1000(b)(4)(iii) would require an SCI entity to provide continuing written updates regularly for each SCI event, or at such frequency as reasonably requested by a representative of the Commission, until such time as the SCI event is resolved.²⁹¹ Proposed Form SCI would require that an SCI entity indicate that it is providing such written update pursuant to Rule 1000(b)(4)(iii) and attach such update as Exhibit 2 to Form SCI.

If any of the foregoing information is not available for inclusion on Exhibit 1 as of the date of the initial notification, the SCI entity would be required to provide such information when it becomes available on Exhibit 2. The information proposed to be required in narrative format in Exhibit 1, and if applicable, Exhibit 2, is intended to elicit a fuller description of the

²⁸⁹ See proposed Rule 1000(b)(4)(iv)(A)(1).

²⁹⁰ See proposed Rule 1000(b)(4)(iv)(A)(2).

²⁹¹ See proposed Rule 1000(b)(4)(iv)(B).

SCI event, and would require an SCI entity to provide detail and context not easily conveyed in short-form responses.

Proposed Form SCI would further require attachment of Exhibit 3, providing a copy in pdf or html format of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.²⁹²

The Commission preliminarily believes that the proposed items of information required to be disclosed by an SCI entity on Exhibit 1 within 24 hours of any of its responsible SCI personnel becoming aware of an SCI event, or when available, on Exhibit 2, would help the Commission and its staff quickly assess the nature and scope of an SCI event, and help the SCI entity identify the appropriate response to the SCI event, including ways to mitigate the impact of the SCI event on investors and promote the maintenance of fair and orderly markets.

2. Notices of Material Changes Pursuant to Proposed Rule 1000(b)(6)

Proposed Rule 1000(b)(6) would require an SCI entity to notify the Commission of planned material systems changes on proposed Form SCI 30 calendar days in advance of such change, unless exigent circumstances exist or information previously provided regarding a material systems change has become materially inaccurate, necessitating notice regarding a material systems change with less than 30 calendar days' notice. To implement this requirement, proposed Form SCI would require an SCI entity to indicate on Form SCI that it is filing a planned material systems change notification, provide the date of the planned material systems change, indicate whether exigent circumstances exist or if the information previously provided to the Commission regarding any planned material systems change has become materially inaccurate, and, if so, whether the Commission has been notified orally, and attach as Exhibit 4 a

²⁹² See proposed Rule 1000(b)(4)(iv)(C).

description of the planned material systems change as well as the expected dates of commencement and completion of implementation of such changes, or, if applicable, a material systems change that has already been made due to exigent circumstances.

3. Reports Submitted Pursuant to Rule 1000(b)(8)

Proposed Rule 1000(b)(8) would require an SCI entity to submit to the Commission: (i) a report of the SCI review required by proposed Rule 1000(b)(7), together with any response by senior management, within 60 calendar days after submission of the SCI review to senior management; and (ii) a report within 30 calendar days after the end of June and December of each year containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes. For filings of the reports of SCI reviews, proposed Form SCI would require an SCI entity to indicate on Form SCI that it is filing a report of SCI review, indicate the date of completion of the SCI review, and date of submission of the SCI review to senior management of the SCI entity. The report of the SCI review required by proposed Rule 1000(b)(7), together with any response by senior management, would be required to be submitted as Exhibit 5 to proposed Form SCI. For filings of the semi-annual reports of material systems changes, proposed Form SCI would require an SCI entity to indicate on Form SCI that it is filing a semi-annual report of material systems changes, and attach the semi-annual report as Exhibit 6 to proposed Form SCI.

4. Notifications of Member or Participant Designation Standards and List of Designees Pursuant to Proposed Rule 1000(b)(9)

Proposed Rule 1000(b)(9) would require an SCI entity to notify the Commission of its standards for designating members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of the SCI entity's business continuity and

disaster recovery plans, to participate in the testing of such plans as well as a list of members or participants designated in accordance with such standards, and prompt updates following any changes to such standards and designations. Form SCI would require such information to be submitted as Exhibit 7 to Form SCI. Thus, an SCI SRO would be required to attach any relevant provisions of its rules, an SCI ATS or exempt clearing agency subject to ARP would be required to attach its relevant internal processes or other documents, and a plan processor would be required to attach the relevant provisions of its SCI Plan.

The Commission preliminarily believes that the proposed mechanism of submitting the reports, notices, and other information required by proposed Rules 1000(b)(4), (6), (8), and (10) by attaching them as exhibits to Form SCI would be an efficient manner for providing such information to the Commission and its staff, and that it would be more cost-effective for SCI entities as well as the Commission than requiring the submission in a paper format or using an electronic method that differs from that proposed.

5. Other Information and Electronic Signature

In addition to the foregoing, proposed Form SCI would require an SCI entity to provide Commission staff with point of contact information for systems personnel and regulatory personnel responsible for addressing an SCI event, including the name, title, telephone number and email address of such persons. Proposed Form SCI would also require the SCI entity to designate on the form contact information for a senior officer of the SCI entity responsible for matters concerning the submission of such Form SCI. Finally, proposed Form SCI would require an electronic signature to help ensure the authenticity of the Form SCI submission. The Commission preliminarily believes these proposed requirements would expedite communications between Commission staff and an SCI entity and help to ensure that only personnel authorized

by the SCI entity are submitting required filings and working with Commission staff to address an SCI event or systems issue promptly and efficiently.

To the extent that the Commission receives confidential information pursuant to these reports and submissions, such information would be kept confidential, subject to the provisions of applicable law.²⁹³

Request for Comment

161. The Commission requests comment on all aspects of proposed Form SCI. Do commenters believe proposed Form SCI would capture the information necessary to assist the Commission in obtaining relevant information about SCI events to mitigate the effects of such events on investors and the public? Specifically, do commenters believe that the proposal to elicit the following information on Form SCI within 24 hours of any responsible SCI personnel becoming aware of an SCI event is appropriate: (i) whether the filing is a Rule 1000(b)(4)(ii) notification or Rule 1000(b)(4)(iii) update of an SCI event; (ii) the SCI event type(s) (i.e., systems compliance issue, systems intrusion, and/or systems disruption); (iii) whether the event is a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants; (iv) if so, whether the Commission has been notified of the SCI event; (v) whether the SCI event has been resolved; (vi) the date/time the SCI event started; (vii) the duration of the SCI event (viii) the date and time when responsible SCI personnel became aware of the SCI event; (ix) the estimated number of market participants

²⁹³ See, e.g., 5 U.S.C. 552 (Exemption 4 of the Freedom of Information Act provides an exemption for “trade secrets and commercial or financial information obtained from a person and privileged or confidential.” 5 U.S.C. 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are “contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions.” 5 U.S.C. 552(b)(8)).

impacted by the SCI event; (x) the type(s) of systems impacted; and (xi) if applicable, the type of systems disruption.

162. Do commenters believe that all relevant information relating to a systems disruption, systems compliance issue, or systems intrusion would be captured on proposed Form SCI? If not, what additional information should be included on proposed Form SCI? For example, should proposed Form SCI require that an SCI entity specifically identify market participants that may have been affected by the SCI event? Why or why not?

163. Do commenters believe the proposed information required to be provided to the Commission regarding SCI events in the 24-hour notification on Exhibit 1 is appropriate? Do commenters believe that the proposal to require an update notification on Exhibit 2, and the information required to be provided for such updates, are appropriate? Why or why not?

164. Commenters that believe the information proposed to be required on Form SCI, whether in short form or in narrative form on proposed Exhibits 1 and 2, is not appropriate should explain their reasoning and suggest alternatives, as appropriate. Should any information proposed to be required be eliminated? Should any other information be required? Please describe and explain.

165. Do commenters believe the required contents of proposed Exhibit 3 are appropriate (i.e., a copy in pdf or html format of any information disseminated to an SCI entity's members or participants or on the SCI entity's publicly available website)? If not, why not?

166. Do commenters believe submission of proposed Form SCI and attachment of Exhibits 4, 5, 6, and 7 regarding material systems changes, SCI reviews, and notifications of standards for designations and designees for the testing of an SCI entity's business continuity and disaster recovery plans, is an appropriate method for SCI entities to provide this information

to the Commission? If not, why not? Should any information proposed to be required be eliminated? Should any other information be required? Please explain.

167. Is the proposal to require contact information for systems, regulatory, and senior officer appropriate? Should any information proposed to be required be eliminated? Is there any other type of information that proposed Form SCI should require? Is the proposal to require an electronic signature appropriate? If not, why not?

168. Would proposed Form SCI contain enough information so that the Commission and its staff would be able to accurately analyze SCI events, material changes to systems, and all other required filings?

169. Upon receiving information submitted as part of an SCI entity's electronic filing, it is the Commission's objective that such information be easily analyzed, searched, and manipulated. The Commission has designed proposed Form SCI with this objective in mind, particularly with the uniform requirements on the front of the form. The Commission, however, is cognizant that certain information, particularly with respect to the information required on the various exhibits to the proposed form, may not be as easily analyzed, searched, or manipulated. The Commission seeks comment as to whether it should mandate that proposed Form SCI as a whole, including the proposed exhibits, employ a particular structured data format that would allow the Commission and its staff to analyze, search, and manipulate the form's information. At the same time, the Commission recognizes that employing a particular tagged data format may potentially reduce the flexibility afforded to such entities to collect and report data in a manner that is more efficient and cost effective for them. The Commission requests comments as to whether there may be tagged data formats that are sufficiently flexible and that are accepted and used throughout the industry, such as XML, XBRL, or another structured data format that

could be used for proposed Form SCI. Are there different standard data formats currently in use depending on the type of SCI entity that would enable the Commission to achieve its goals? If so, what are they? Should the SCI entity have the flexibility to specify the acceptable data format for submitting information? Why or why not? Do commenters have concerns with proposed Regulation SCI requiring the use of a tagged data format, such as XML, XBRL, or some other structured data format that may be tagged, to report data? If so, what are they? Are there any licensing fees or other costs associated with the use of tagged data formats, such as XML, XBRL, or similar structured data formats that may be tagged? If so, what action should the Commission take, if any, to help ensure wide availability of a common data format by all participants?

F. Request for Comment on Applying Proposed Regulation SCI to Security-Based Swap Data Repositories and Security-Based Swap Execution Facilities

On July 21, 2010, the President signed the Dodd-Frank Act into law.²⁹⁴ The Dodd-Frank Act was enacted, among other things, to promote the financial stability of the United States by improving accountability and transparency of the nation's financial system.²⁹⁵ Title VII of the Dodd-Frank Act provides the Commission and the CFTC with the authority to regulate over-the-counter ("OTC") derivatives.

1. Proposed System Safeguard Rules for SB SDRs and SB SEFs

Section 763 of the Dodd-Frank Act amends the Exchange Act by adding various new statutory provisions to govern the regulation of various entities, including security-based swap

²⁹⁴ The Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. No. 111-203, H.R. 4173) ("Dodd-Frank Act").

²⁹⁵ See Pub. L. No. 111-203 Preamble.

data repositories and security-based swap execution facilities.²⁹⁶ Under the authority of Section 13(n) of the Exchange Act, applicable to SB SDRs, and Section 3D(d) of the Exchange Act, applicable to SB SEFs, the Commission recently proposed rules for these entities with regard to their automated systems' capacity, resiliency, and security.²⁹⁷ Specifically, in the SB SDR Proposing Release and the SB SEF Proposing Release, respectively, the Commission proposed Rule 13n-6 and Rule 822 under the Exchange Act, which would set forth the requirements for these entities with regard to their automated systems' capacity, resiliency, and security.²⁹⁸ In each release, the Commission stated that it was proposing standards comparable to the standards applicable to SROs, including exchanges and clearing agencies, and other registrants, pursuant to the Commission's ARP standards.²⁹⁹

²⁹⁶ See Pub. L. No. 111-203, § 763 (adding Sections 13(n), 3C, and 3D of the Exchange Act). The Dodd-Frank Act also directs the Commission to harmonize to the extent possible Commission regulation of SB SDRs and SB SEFs with CFTC regulation of swap data repositories ("SDRs") and swap execution facilities ("SEFs") under the CFTC's jurisdiction, an endeavor that Commission staff is undertaking as it seeks to move the SB SDR and SB SEF proposals toward adoption. See Pub. L. 111-203, § 712, directing the Commission, before commencing any rulemaking with regard to SB SDRs or SB SEFs, to consult and coordinate with the CFTC for purposes of assuring regulatory consistency and comparability to the extent possible.

²⁹⁷ See Securities Exchange Act Release Nos. 63347 (November 19, 2010), 75 FR 77306 (December 10, 2010) (proposing new Rule 13n-6 under the Exchange Act applicable to SB SDRs) ("SB SDR Proposing Release"); 63825 (February 2, 2011), 76 FR 10948 (February 28, 2011) (proposing new Rule 822 under the Exchange Act applicable to SB SEFs) ("SB SEF Proposing Release," together with the SB SDR Proposing Release, the "SBS Releases"). See also Pub. L. No. 111-203, § 761(a) (adding Section 3(a)(75) of the Exchange Act) (defining the term "security-based swap data repository"), and § 761(a) (adding Section 3(a)(77) of the Exchange Act) (defining the term "security-based swap execution facility").

²⁹⁸ See SB SDR Proposing Release and SB SEF Proposing Release, *supra* note 297.

²⁹⁹ See SB SDR Proposing Release, *supra* note 293, at 77332 and SB SEF Proposing Release, *supra* note 297, at 10987.

Proposed Rules 13n-6 and 822, applicable to SB SDRs and SB SEFs, respectively, would require these entities, “with respect to those systems that support or are integrally related to the performance of its activities” to “establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its systems provide adequate levels of capacity, resiliency, and security.”³⁰⁰ Under proposed Rules 13n-6 and 822, such policies and procedures, at a minimum, would require these SB SDRs and SB SEFs to: (i) establish reasonable current and future capacity estimates; (ii) conduct periodic capacity stress tests of critical systems to determine such systems’ ability to process transactions in an accurate, timely, and efficient manner; (iii) develop and implement reasonable procedures to review and keep current their system development and testing methodologies; (iv) review the vulnerability of their systems and data center computer operations to internal and external threats, physical hazards, and natural disasters; and (v) establish adequate contingency and disaster recovery plans.³⁰¹ Proposed Rules 13n-6 and 822 would further require SB SDRs and SB SEFs to submit, on an annual basis, an “objective review” of their systems to the Commission within 30 calendar days of its completion;³⁰² notify the Commission in writing of material systems outages; and notify the Commission in writing at least 30 calendar days before implementation of any planned material systems changes.

³⁰⁰ See SB SDR Proposing Release, 75 FR at 77370 and SB SEF Proposing Release, 76 FR at 11064, supra note 297.

³⁰¹ Id.

³⁰² Such review may be performed internally if an external firm reports on the objectivity, competency, and work performance with respect to the internal review.

To date, the Commission has received two comment letters from one commenter in response to proposed Rule 13n-6³⁰³ and four comment letters in response to proposed Rule 822.³⁰⁴ Both comment letters on proposed Rule 13n-6 expressed support for the proposed rule.³⁰⁵ Two commenters on proposed Rule 822 expressed support for the proposed rule.³⁰⁶ Two other commenters on proposed Rule 822 suggested modifications, including that the Commission (1) require SB SEFs to establish policies and procedures reasonably designed to prevent any provision in a valid swap transaction from being invalidated or modified through the utilization of, or execution on, a SB SEF;³⁰⁷ and (2) provide for the implementation of the system safeguards requirements on a staged basis.³⁰⁸

³⁰³ See Letter from Larry E. Thompson, General Counsel, The Depository Trust & Clearing Corporation to Elizabeth M. Murphy, Secretary, Commission, dated January 24, 2011 (“DTCC SB SDR Letter 1”); and Letter from Larry E. Thompson, General Counsel, Depository Trust & Clearing Corporation to Mary Shapiro, Chairman, Commission, dated June 3, 2011 (“DTCC SB SDR Letter 2”).

³⁰⁴ See Letter from American Benefits Counsel to Elizabeth M. Murphy, Secretary, Commission, dated April 8, 2011 (“ABC SB SEF Letter”); Letter from Nancy C. Gardner, Executive Vice President & General Counsel, Markets Division, Thomson Reuters to Elizabeth M. Murphy, Secretary, Commission, dated April 4, 2011 (“Thomson SB SEF Letter”); Letter from Stephen Merkel, Chairman, Wholesale Markets Brokers’ Association Americas to Elizabeth M. Murphy, Secretary, Commission, dated April 4, 2011 (“WMBAA SB SEF Letter”); and Letter from Robert Pickel, Executive Vice Chairman, International Swaps and Derivatives Association, and Kenneth E. Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association to Elizabeth M. Murphy, Secretary, Commission, dated April 4, 2011 (“ISDA SIFMA SB SEF Letter”).

³⁰⁵ See DTCC SB SDR Letter 1, *supra* note 304, at 3; DTCC SB SDR Letter 2, *supra* note 304, at 4 (recommending that SB SDRs “maintain multiple levels of operational redundancy and data security”).

³⁰⁶ See Thomson SB SEF Letter, *supra* note 304, at 8; WMBAA SB SEF Letter, *supra* note 304, at 24.

³⁰⁷ See ABC SB SEF Letter, *supra* note 304, at 10.

³⁰⁸ See ISDA SIFMA SB SEF Letter, *supra* note 304, at 12 (noting that the system safeguard requirements would require time and systems expertise to implement fully).

2. Proposed System Safeguard Rules for SB SDRs and SB SEFs as Compared to Proposed Regulation SCI

As noted above, proposed Regulation SCI is intended to build upon and update the Commission's ARP standards,³⁰⁹ which were the basis for proposed Rules 13n-6 and 822 for SB SDRs and SB SEFs, respectively. Although proposed Rules 13n-6 and 822 have much in common with proposed Regulation SCI, they differ in scope and detail from proposed Regulation SCI in a number of ways. Among the differences are certain provisions in proposed Regulation SCI that proposed Rules 13n-6 and 822 do not include. Specifically, as discussed above, proposed Regulation SCI would: (i) define the terms "SCI systems" and "SCI security systems,"³¹⁰ (ii) specifically require the establishment, maintenance, and enforcement of written policies and procedures reasonably designed to ensure that SCI systems and, for purposes of security standards, SCI security standards, have levels of capacity, integrity, resiliency, availability, and security adequate to maintain an SCI entity's operational capability and promote the maintenance of fair and orderly markets;³¹¹ (iii) require SCI entities to establish policies and procedures regarding standards that result in systems designed, developed, tested, maintained,

³⁰⁹ See supra Sections I and II.

³¹⁰ See proposed Rule 1000(a), which would define "SCI systems" as "all computer, network, electronic, technical, automated, or similar systems of, or operated by or on behalf of, an SCI entity, whether in production, development, or testing, that directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance," and "SCI security systems" as "any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems."

³¹¹ While proposed Rule 13n-6 did not specifically include such a requirement for SB SDRs, the SB SDR Proposing Release stated that "[a]s a general matter, the Commission preliminarily believes that, if an SDR's policies and procedures satisfy industry best practices standards, then these policies and procedures would be adequate." See SB SDR Proposing Release, supra note 297, at 77333. See also SB SEF Proposing Release, supra note 297, at 10988.

operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data; (iv) require SCI entities to establish, maintain, and enforce reasonably designed written policies and procedures to ensure that SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents; (v) require SCI entities to take corrective action, including devoting adequate resources, to remedy an SCI event as soon as reasonably practicable;³¹² (vi) require SCI entities to have backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading following a wide scale disruption; (vii) require an annual SCI review of the SCI entity's compliance with proposed Regulation SCI and the reporting of such review to the Commission; (viii) require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans at specified intervals, and to coordinate such required testing with other SCI entities; (ix) require all SCI events to be reported to the Commission, and certain types of SCI events to be disseminated to an SCI entity's members or participants; and (x) establish semi-annual reporting obligations for planned material systems changes. In addition, proposed Regulation SCI would establish a system for submitting required notices, reports, and other information to the Commission on proposed new Form SCI. Each of these proposed requirements goes beyond the explicit requirements in proposed Rules 13n-6 and 822.

³¹² See proposed Rule 1000(a), defining "SCI event" as an event at an SCI entity that constitutes: (1) a systems disruption; (2) a systems compliance issue; or (3) a systems intrusion.

3. Consideration of Applying the Requirements of Proposed Regulation SCI to SB SDRs and/or SB SEFs

If the Commission were to adopt Rules 13n-6 and 822 as proposed in the SBS Releases and also adopt Regulation SCI as proposed herein, there would be differences, as noted above, between the obligations imposed on SB SDRs and SB SEFs with respect to system safeguards on the one hand and the obligations imposed on SCI entities on the other. Therefore, the Commission solicits comment on whether it should propose to apply the requirements of proposed Regulation SCI, in whole or in part, to SB SDRs and/or SB SEFs. In providing views on whether the Commission should propose to apply proposed Regulation SCI to SB SDRs and/or SB SEFs, commenters are encouraged to consider the discussion regarding each provision of proposed Regulation SCI that is set forth in Sections III.B through III.E above. Should the Commission to decide to propose to apply the requirements of proposed Regulation SCI to such entities, the Commission would issue a separate release discussing such a proposal.

In enacting Title VII of the Dodd-Frank Act, Congress judged it important to increase the transparency and oversight of the OTC derivatives market. In addition, in proposing Regulation SB SEF, the Commission noted that SB SEFs are intended to “lead to a more robust, transparent, and competitive environment for the market for security-based swaps (“SBS” or “SB swaps”).”³¹³ Similarly, in proposing rules for SB SDRs, the Commission noted that “SDRs may be especially critical during times of market turmoil, both by giving relevant authorities information to help limit systemic risk and by promoting stability through enhanced

³¹³ See SB SEF Proposing Release, supra note 297, at 11035.

transparency” and that, “[b]y enhancing stability in the SBS market, SDRs may also indirectly enhance stability across markets, including equities and bond markets.”³¹⁴

The Commission notes that it may or may not be appropriate to apply the requirements of proposed Regulation SCI to SB SDRs and SB SEFs. In particular, SB SDRs will play an important role in limiting systemic risk and promoting the stability of the SBS market. SB SDRs also would serve as information disseminators³¹⁵ in a manner similar to plan processors in the equities and options markets that, under this proposal, would be subject to the requirements of proposed Regulation SCI. SB SEFs would function as trading markets, and in that respect could be viewed as analogous to national securities exchanges and SCI ATs, both of which function as trading markets and are included in the proposed definition of SCI entity.³¹⁶ The Commission preliminarily believes that the same types of concerns and issues that have resulted in the Commission previously publishing its ARP policy statements,³¹⁷ developing its ARP Inspection Program,³¹⁸ adopting certain aspects of the ARP policy statements under Regulation ATS,³¹⁹ and, ultimately, proposing Regulation SCI,³²⁰ may similarly apply to SB SDRs and SB SEFs. In proposing Rule 13n-6, the Commission noted that systems failures can limit access to data, call

³¹⁴ See SB SDR Proposing Release, supra note 297, at 77307.

³¹⁵ See Securities Exchange Act Release No. 63346 (November 19, 2010), 75 FR 75208, 75227 (December 2, 2010) (proposing Regulation SBSR).

³¹⁶ See SB SEF Proposing Release, supra note 297, at 10987, n.246 (“Because SB SEFs would be an integral part of the market for SB swaps, and therefore an integral part of the national market system, the Commission believes that it is appropriate to model a SB SEF’s rules on system safeguards on ARP.”).

³¹⁷ See supra notes 1 and 12-18 and accompanying text.

³¹⁸ See supra notes 25-26 and accompanying text.

³¹⁹ See supra note 26 and accompanying text.

³²⁰ See supra Section I.B.

into question the integrity of data, and prevent market participants from being able to report transaction data, and thereby have a large impact on market confidence, risk exposure, and market efficiency.³²¹ Similarly, in proposing Rule 822, the Commission noted that the proposed system safeguard requirements for SB SEFs are designed to prevent and minimize the impact of systems failures that might negatively impact the stability of the SB swaps market.³²² At the same time, because the Commission recognizes that there may be differences between the markets for the types of securities that would be covered by proposed Regulation SCI and the SBS market, including differing levels of automation and stages of regulatory development, the Commission requests comment on whether it would be appropriate to propose to apply the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs. As discussed further below, the Commission also requests comment on whether, if commenters believe proposed Regulation SCI should apply to SB SDRs and/or SB SEFs, the system safeguard rules currently proposed for SB SDRs and SB SEFs in the SBS Releases should, if adopted, be replaced, at some point in the future, by the requirements proposed in this release and, if so, how.

170. Are the SBS markets sufficiently similar to the markets within which the proposed SCI entities operate such that it would be appropriate to apply the same system safeguard requirements to SB SDRs and/or SB SEFs that would be applicable to SCI entities? Why or why not? Do commenters believe that there are characteristics of the SBS markets that the Commission should consider to support its applying different system safeguard rules to SB SDRs and/or SB SEFs than to SCI entities? If so, what are those characteristics, and why should different rules apply to SB SDRs and/or SB SEFs? If not, why not?

³²¹ See SB SDR Proposing Release, supra note 297, at 77332.

³²² See SB SEF Proposing Release, supra note 297, at 10987.

171. If the Commission were to propose to apply some or all of the provisions of proposed Regulation SCI to SB SDRs and/or SB SEFs, should the Commission propose to apply the provisions of proposed Regulation SCI differently to SB SDRs versus SB SEFs? For example, should the Commission propose to apply some or all of the provisions of proposed Regulation SCI to SB SDRs but not SB SEFs or vice versa? Why or why not?

172. What effect, if any, would there be of having SB SDRs and/or SB SEFs subject to different system safeguard rules than those proposed for SCI entities? Would there be any short term and/or long term impact of SB SDRs and/or SB SEFs being subject to different system safeguard rules than those proposed for SCI entities? For example, if SB SEFs were subject to different system safeguard rules than those proposed for SCI entities, would there be an impact on competition between SB SEFs and national securities exchanges that trade SB swaps? Please describe any expected impact on competition. Are there any provisions in proposed Regulation SCI that, if applied to SB SEFs, would create barriers to entry that could preclude small SB SEFs (e.g., those that do not exceed a specified volume or liquidity threshold) from entering the SBS market?

173. The Commission also requests comment on whether it should propose to apply all provisions of proposed Regulation SCI to SB SDRs and/or SB SEFs or just those provisions comparable to the proposed system safeguard rules for SB SDRs or SB SEFs.

174. Should the Commission, if it were to propose to apply some or all of the provisions of proposed Regulation SCI to SB SDRs and/or SB SEFs, propose that SB SEFs and/or SB SDRs have written policies and procedures reasonably designed to ensure that their SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain their operational capability and

promote the maintenance of fair and orderly markets? Why or why not? If the Commission were to propose such a requirement for SB SDRs and/or SB SEFs, should SCI industry standards for SB SDRs and/or SB SEFs be different from those proposed for SCI entities? If so, please explain why. What are the industry standards that should apply to SB SEFs and/or SB SDRs? Please be as specific as possible and explain why a particular industry standard would be appropriate.

175. Do the characteristics of the SBS market support a need for a mandatory requirement that SB SDRs and/or SB SEFs maintain backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading (for SB SEFs) or data repository services (for SB SDRs) following a wide scale disruption? Why or why not?

176. Should the Commission propose to require SB SEFs and/or SB SDRs to establish written policies and procedures regarding standards that result in systems designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data? Why or why not?

177. Should the Commission propose to require SB SEFs and/or SB SDRs to establish, maintain, and enforce policies and procedures reasonably designed to ensure that their SCI systems operate in the manner intended, including in a manner that complies with federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents, as proposed for SCI entities in Rule 1000(b)(2)(i)? Why or why not? Should the Commission propose a safe harbor from liability for SB SEFs and/or SB SDRs and their respective employees if they satisfy the elements of a safe harbor, similar to those for SCI entities in proposed Rules 1000(b)(2)(ii) and (iii)? Why or why not?

178. Should the Commission propose to require SB SEFs and/or SB SDRs, with respect to their business continuity and disaster recovery plans, including their backup systems, to require participation by designated participants in scheduled functional and performance testing of the operation of such plans at specified intervals, and to coordinate such required testing with other SB SEFs and/or SB SDRs, as proposed for SCI entities in Rule 1000(b)(9)? Why or why not?

179. With regard to the reporting and information dissemination requirements in proposed Rules 1000(b)(4) and Rule 1000(b)(5) of Regulation SCI, would it be appropriate to propose that an SB SDR and/or SB SEF be required to report all SCI events to the Commission, and disseminate information relating to dissemination SCI events to their participants? Why, or why not? If not, on what basis should SB SDRs and/or SB SEFs be distinguished from other SCI entities?

180. Should SB SDRs and/or SB SEFs be required to provide notice of, and file semi-annual reports for, material systems changes with the Commission, as proposed for SCI entities in Rules 1000(b)(6) and (b)(8)? Why or why not?

181. Should SB SDRs and/or SB SEFs be required to undertake an annual SCI review of systems and submit to the Commission a report of such review, together with any response of senior management, as proposed for SCI entities in Rule 1000(b)(7) and (8)? Why or why not?

182. Should SB SDRs and/or SB SEFs be required to submit any required notices, reports, and other information to the Commission on proposed new Form SCI? Why, or why not?

183. If the Commission were to determine that it would be appropriate to propose to apply some or all of the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs,

should the Commission propose to apply such requirements of proposed Regulation SCI to all SB SDRs? To all SB SEFs? Are there distinctions that should be made between different types of SB SDRs (or SB SEFs) such that some requirements of proposed Regulation SCI might be appropriate for some SB SDRs (or SB SEFs) but not others? If so, what are those distinctions and what are those requirements? For example, should any requirements be based on criteria such as number of transactions or notional volume reported to a SB SDR or executed on a SB SEF? If so, what would be an appropriate threshold for any such criteria, and why?

184. Alternatively, given the nascent stage of regulatory development of the SBS markets, would it be appropriate to create a category under proposed Regulation SCI such as “new SB SCI entity” that would, for example, be applicable to SB SDRs and/or SB SEFs for a certain period of time after such entities become registered with the Commission? If so, what period of time would be appropriate (e.g., one year, three years, or some other period)? Should there be other criteria for an SB SEF (or SB SDR) to be considered a new SB SCI entity? If so, what should be the criteria for inclusion? Would market share, number of transactions, and/or notional volume be appropriate criteria? If so, at what level should the criteria thresholds be set, and why? If not, why not? How should the requirements of proposed Regulation SCI differ for such “new SB SCI entities?”

185. The Commission notes that, if it were to adopt proposed Regulation SCI and proposed Rules 13n-6 and 822, the system safeguard rules applicable to SB SDRs and SB SEFs would diverge from those applicable to SCI entities, as well as from those the CFTC has adopted for SDRs and may adopt for SEFs.³²³ What negative effects, if any, do commenters believe

³²³ As noted above, SDRs and SEFs, entities similar to SB SDRs and SB SEFs, respectively, are subject to the CFTC’s jurisdiction. The CFTC’s system safeguards rules for SDRs,

would result from disparity in the: (1) Commission's system safeguard rules applicable to SB SDRs and/or SB SEFs; (2) requirements of Regulation SCI applicable to SCI entities; and (3) CFTC's system safeguard rules applicable to SDRs and SEFs?

186. The Commission seeks commenters' views on all aspects of whether to propose to apply Regulation SCI to SB SDRs and/or SB SEFs, taking into account the possibility that any final Commission action on proposed Rules 13n-6 and 822 could occur prior to any final Commission action on proposed Regulation SCI. The Commission seeks commenters' views on whether a proposal to extend the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs would be beneficial to help to promote the integrity, capacity, resiliency, availability, and security of their systems. The Commission notes that having comparable system safeguard requirements may be appropriate for SB SDRs and/or SB SEFs if, as noted above, the same types of concerns and issues that have resulted in the Commission previously publishing its ARP policy statements, developing its ARP Inspection Program, adopting certain aspects of the ARP policy statements under Regulation ATS, and, ultimately, proposing Regulation SCI, also apply to SB SDRs and/or SB SEFs.

187. The Commission is particularly interested in commenters' views on the different benefits and costs associated with applying proposed Regulation SCI to SB SDRs and/or SB SEFs versus the costs and benefits of applying proposed Rules 13n-6 and 822 to SB SDRs and

and those proposed for SEFs differ from those rules that the Commission is proposing in Regulation SCI. See 76 FR 54538 (September 1, 2011) (adopting 17 CFR Part 49, Swap Data Repositories: Registration Standards, Duties and Core Principles, Effective October 31, 2011); 76 FR 1214 (January 7, 2011) (proposing 17 CFR Part 37, Core Principles and Other Requirements for Swap Execution Facilities). For example, for SDRs, the CFTC requires same day recovery for "critical SDRs" whereas proposed Regulation SCI would require next business day recovery for trading services (and two-hour recovery for clearing and settlement services). See CFTC Rule 49.24.

SB SEFs, respectively. In the SBS Proposing Releases, the Commission provided aggregate estimates of the costs of its proposed rules governing SB SDRs and SB SEFs. The SB SDR Proposing Release provided an aggregate initial cost estimate of approximately \$214,913,592 to be incurred by prospective SB SDRs and an aggregate ongoing annualized cost estimate of approximately \$140,302,120, both of which estimates took account of proposed Rule 13n-6.³²⁴ Similarly, the SB SEF Proposing Release provided an aggregate initial cost estimate of approximately \$41,692,900 and an aggregate ongoing annualized cost estimate of approximately \$22,342,700 to be incurred by prospective SB SEFs, both of which estimates took account of proposed Rule 822.³²⁵

³²⁴ See SB SDR Proposing Release, *supra* note 297, at 77364. In the SB SDR Proposing Release, the Commission estimated that the paperwork burden associated with proposed Rule 13n-6 would come from preparing and implementing policies associated with SB SDR duties, data collection and maintenance, automated systems and direct electronic access, and from preparing reports and reviews. See *id.* at 77345-46. The Commission estimated that there would be up to 10 SB SDRs subject to the proposed SB SDR rules. See *id.* at 77355. Based on the information in the SB SDR Proposing Release, the Commission estimated that the aggregate burden on an estimated 10 SB SDRs to prepare and implement the policies and procedures under Rule 13n-6 would be 2100 hours along with 500 hours of outside legal services at \$400 an hour, and that the aggregate annual burden on such SB SDRs to maintain such policies would be an additional 600 hours. See *id.* at 77349. Based on the information in the SB SDR Proposing Release, the Commission estimated that the annual aggregate burden on SB SDRs to promptly notify the Commission and submit a written description and analysis of outages and any remedial measures would be 154 hours and the aggregate annual burden on SB SDRs to notify the Commission of planned material system changes would be 1200 hours. See *id.* at 77349-50. The Commission estimated that the aggregate annual burden on SB SDRs to submit an objective review would be 8250 hours and \$900,000. See *id.* at 77350.

³²⁵ See SB SEF Proposing Release, *supra* note 297, at 11034. In the SB SEF Proposing Release, the Commission estimated that the paperwork burden associated with Rule 822 would come from rule writing requirements under Rule 822(a)(1), and from reporting requirements under Rules 822(a)(2), 822(a)(3), and 822(a)(4). See *id.* at 11017-19. The Commission also estimated that there would be up to 20 SB SEFs subject to the proposed SB SEF rules. See *id.* at 11023. Based on the information in the SB SEF Proposing Release, the Commission estimated that the aggregate burden on an estimated 20 SB SEFs to draft rules to implement Rule 822 would be 200 hours, see *id.* at 11026, and that

If the Commission were to propose to apply Regulation SCI to SB SDRs and/or SB SEFs, it preliminarily believes that the initial potential costs of such application could differ from the costs to be incurred by SCI entities that currently participate in the ARP Inspection Program on a per entity basis, as described in Sections IV and V below. This is because prospective SB SDRs and prospective SB SEFs, unlike those entities, are not now subject to the ARP Inspection Program and its standards.³²⁶ However, the Commission preliminarily believes that the initial potential costs of such application to SB SDRs and SB SEFs, on a per entity basis, could be equivalent to those costs estimated below in Sections IV and V with respect to SCI entities that currently do not participate in the ARP Inspection Program. Further, as noted above, the SBS Releases have accounted for potential costs to be incurred by SB SDRs and SB SEFs in implementing the proposed system safeguard requirements in Rules 13n-6 and 822, respectively and, as discussed above, the requirements in proposed Regulation SCI could be incremental to those already proposed in Rules 13n-6 and 822. The Commission therefore preliminarily believes that, if it were to decide to propose to apply some or all of the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs, the costs of applying proposed Regulation SCI to SB SDRs and/or SB SEFs would be incremental to the costs associated with proposed Rules 13n-6 and 822.

188. The Commission seeks commenters' views regarding the prospective costs, as well as the potential benefits, of proposed Regulation SCI to SB SDRs and/or SB SEFs. Commenters

the aggregate annual burden on an estimated 20 SB SEFs to comply with the reporting requirements under Rule 822 would be 19,208 hours and \$1,800,000. See id. at 11029.

³²⁶ As stated in the SB SDR Proposing Release, "[t]he Commission believes that persons currently operating as SDRs may have developed and implemented aspects of the proposed rules already," and that "the Commission does not believe that the one-time cost of [enhancements to their information technology systems] will be significant." See supra note 297, at 77358.

should quantify the costs of applying proposed Regulation SCI to SB SDRs and/or SB SEFs, to the extent possible. As noted above, commenters are urged to address specifically each requirement of proposed Regulation SCI and note whether it would be reasonable to propose to apply each such requirement to SB SDRs and/or SB SEFs and what the benefits and costs of such application would be.

4. Timing and Implementation Considerations

As noted above, the Commission has proposed rules providing a regulatory framework for SB SDRs and SB SEFs, but has not yet adopted final rules governing these entities. To date, the Commission has not received any comments with respect to the timing of the implementation of proposed Rule 13n-6³²⁷ but has received one comment in connection with the timing of the implementation of proposed Rule 822.³²⁸

³²⁷ The Commission, however, has received comments that suggest a phase-in approach to the proposed SB SDR rules generally may be appropriate. These comments generally indicate that a phase-in approach would be necessary to enable existing swap data repositories and other market participants to make the necessary changes to their operations. See, e.g., Letter in response to a joint public roundtable conducted by Commission and CFTC staff on implementation issues raised by Title VII of the Dodd-Frank Act on May 2 and 3, 2011, from The Financial Services Roundtable, available on the Commission's website at: <http://www.sec.gov/comments/4-625/4625-1.pdf> (stating that "it may be prudent to have different portions of a single rulemaking proposal take effect at different times and with due consideration of steps that are preconditions to other steps," suggesting, as an example, that "a requirement to designate a CCO should be implemented quickly, but that the CCO be given time to design, implement, and test the compliance system before any requirement to certify as to the compliance system becomes effective" and supporting a phase-in approach "that recognizes the varying levels of sophistication, resources and scale of operations within a particular category of market participant").

³²⁸ See ISDA SIFMA SB SEF Letter at 12 ("Many of the proposed rules will pose significant operational and administrative hurdles for market participants and SB SEFs. For example, the proposed rules have requirements for system safeguards that will require time and systems expertise to implement fully. We strongly suggest that SB SEFs be allowed to adopt the rules on a staged basis so that the basic functioning of the SB SEF and the market can be established before all requirements are imposed."). As

Although the Commission has issued a policy statement regarding the anticipated sequencing of the compliance dates of final rules to be adopted by the Commission for certain provisions of Title VII of the Dodd-Frank Act,³²⁹ the precise timing for adoption of or compliance with any final rules relating to SB SDRs or SB SEFs, or for adoption of or compliance with proposed Regulation SCI, is not known at this time. In addition, as the Title VII Implementation Policy Statement notes, any final rules for SB SDRs and SB SEFs potentially would be considered by the Commission at different times.³³⁰ As such, specifying the precise timing and ordering of the implementation of any requirements of proposed Regulation SCI, or Rules 13n-6 and 822, to SB SDRs and/or SB SEFs is difficult to predict, should the Commission determine to propose to apply some or all of the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs, or adopt Rules 13n-6 and 822 to SB SDRs and SB SEFs, respectively.

189. Nonetheless, the Commission requests comment on what—if the Commission were to propose to apply some or all of the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs—would be the most appropriate way to implement such requirements for SB

with the proposed SB SDR rules, the Commission has received general comments suggesting that a phase-in approach for all SB SEF Rules may be generally appropriate. See, e.g., Thomson SB SEF Letter at 8 (stating that “in order to ensure the proper operation of these markets, it may be necessary for the SEC to adopt a phased-in approach and we would urge avoiding over-hasty rulemaking which could result in unintended consequences for the markets and the broader economy”).

³²⁹ See Securities Exchange Act Release No. 67177 (June 11, 2012), 77 FR 35625 (June 14, 2012) (Statement of General Policy on the Sequencing of the Compliance Dates for Final Rules Applicable to Security-Based Swaps Adopted Pursuant to the Securities Exchange Act of 1934 and the Dodd-Frank Wall Street Reform and Consumer Protection Act) (“Title VII Implementation Policy Statement”).

³³⁰ See id. at 35629 (noting that the rules pertaining to the registration and regulation of SB SDRs are in the second category of rules, whereas the rules pertaining to the registration and regulation of SB SEFs are in the fifth category of rules).

SDRs and/or SB SEFs. For example, should the Commission seek to implement such requirements for SB SDRs and/or SB SEFs within the same timeframe as those entities currently defined as SCI entities under the proposal? Alternatively, should the applicability of some or all of Regulation SCI to SB SDRs and/or SB SEFs be phased-in over time? If so, what provisions of proposed Regulation SCI should be phased in and what would be an appropriate phase-in period? Should there be different phase-in schedules for different SB SDRs and/or SB SEFs? Why or why not? If yes, how would the SB SDRs and/or SB SEFs be selected for different phase-in schedules? Please be specific.

190. Do commenters believe that, because the Commission's actions to implement the regulatory framework for the SB swaps market are still in progress, the Commission should not propose to apply the requirements of Regulation SCI to SB SDRs and/or SB SEFs at the same time as SCI entities, but instead should adopt the system safeguard provisions of proposed Rules 13n-6 and 822 and reconsider such requirements in the future after the SB swaps market and the Commission's regulation of such market and its participants has developed further? Why or why not? What would be the impact of this approach for SB SDRs and/or SB SEFs?

191. As discussed in the SBS Releases,³³¹ the system safeguards requirements in proposed Rules 13n-6 and 822 have their origins in the Commission's ARP standards. Though they differ in scope and detail, the provisions of proposed Regulation SCI likewise trace their origin to the Commission's ARP standards.³³² If the Commission were to adopt final rules for SB SDRs and/or SB SEFs before it were to adopt Regulation SCI, and if the Commission were to decide to propose to apply some or all of the requirements of proposed Regulation SCI to SB

³³¹ See supra note 299 and accompanying text.

³³² See supra notes 310-312 and accompanying text.

SDRs and/or SB SEFs, should the Commission require SB SDRs and/or SB SEFs to comply with the requirements of the system safeguards rules in proposed Rules 13n-6 and 822³³³ first, and apply the requirements of Regulation SCI to SB SDRs and/or SB SEFs at a specific date in the future? If the Commission were to adopt Rules 13n-6 and 822 prior to adoption of proposed Regulation SCI, and if the Commission were to decide to propose to apply some or all of the requirements of proposed Regulation SCI to SB SDRs and/or SB SEFs, should the Commission delay implementation of Rules 13n-6 and 822 and instead request that SB SDRs and/or SB SEFs comply with the Commission's voluntary ARP Inspection Program until such time as the Commission were to propose and adopt Regulation SCI for SB SDRs and SB SEFs?

G. Solicitation of Comment Regarding Potential Inclusion of Broker-Dealers, Other than SCI ATSS, and Other Types of Entities

1. Policy Considerations

As discussed above, the requirements of proposed Regulation SCI would apply to national securities exchanges, registered securities associations, registered clearing agencies, the MSRB, SCI ATSS, plan processors, and exempt clearing agencies subject to ARP. They would not apply to other types of market participants, such as market makers or other broker-dealers. This proposed scope of the definition of SCI entity in part reflects the historical reach of the ARP policy statements (which apply, for example, to national securities exchanges) and existing Rule 301 of Regulation ATS (which applies systems safeguard requirements to certain ATSS).

Recent events have highlighted the significance of systems integrity of a broader set of market participants than those proposed to be included within the definition of SCI entity.³³⁴

³³³ See supra notes 298-302 and accompanying text.

³³⁴ For example, on August 1, 2012, Knight Capital Group, Inc. ("Knight") reported that it "experienced a technology issue at the opening of trading at the NYSE...[which was]

Also, some broker-dealers have grown in size and importance to the market in recent years. For example, many orders are internalized by OTC market makers, one subset of broker-dealers, who handle a large portion of order flow in the market.³³⁵ The Commission recognizes that systems disruptions, systems compliance issues, and systems intrusions at broker-dealers, including for example OTC market makers and clearing broker-dealers, could pose a significant risk to the market. Such an occurrence could impact all orders being handled by a broker-dealer, which can be significant for larger broker-dealers. If a given broker-dealer handles a large portion of order flow and suddenly experiences a systems disruption or systems intrusion, the disruption or intrusion could cause ripple effects. For example, a systems issue at one broker-dealer could

related to Knight's installation of trading software and resulted in Knight sending numerous erroneous orders in NYSE-listed securities into the market....Knight has traded out of its entire erroneous trade position, which has resulted in a realized pre-tax loss of approximately \$440 million." See Knight Capital Group Provides Update Regarding August 1st Disruption To Routing In NYSE-listed Securities (August 2, 2012), available at:

<http://www.knight.com/investorRelations/pressReleases.asp?compid=105070&releaseID=1721599>.

Among other things, Knight provides market making services in U.S. equities and U.S. options; institutional sales and trading services; electronic execution services; and corporate and other services. See Knight Operating Subsidiaries, available at: <http://www.knight.com/ourFirm/operatingSubsidiaries.asp>. Knight also operates two registered ATSS, Knight Match and Knight Bond Point. See Knight Match, available at: <http://www.knight.com/electronicExecutionServices/knightMatch.asp>; Knight BondPoint, available at: <http://www.knight.com/electronicExecutionServices/knightBondpoint.asp>; and Alternative Trading Systems Active Filers as of April 30, 2012, available at: <http://www.sec.gov/foia/ats/atslist0412.pdf>.

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See Concept Release on Equity Market Structure, *supra* note 42, at 3600 (stating: "OTC market makers, for example, appear to handle a very large percentage of marketable (immediately executable) order flow of individual investors that is routed by retail brokerage firms. A review of the order routing disclosures required by Rule 606 of Regulation NMS of eight broker-dealers with significant retail customer accounts reveals that nearly 100% of their customer market orders are routed to OTC market makers.")

result in confusion about whether orders are handled correctly or whether the systems issue at the broker-dealer could have caused capacity issues elsewhere.³³⁶

The Commission is not at this time proposing to include some classes of registered broker-dealers (other than SCI ATSS) in the definition of SCI entity. Were the Commission to decide to propose to apply the requirements of proposed Regulation SCI to such entities, the Commission would issue a separate release discussing such a proposal. Rule 15c3-5, requiring brokers or dealers with market access to implement risk management controls and supervisory procedures to limit risk, already seeks to address certain risks posed to the markets by broker-dealer systems. Specifically, in 2010 when the Commission adopted Rule 15c3-5 regarding risk management controls and supervisory procedures for brokers or dealers with market access,³³⁷ the Commission stated that “broker-dealers, as the entities through which access to markets is obtained, should implement effective controls reasonably designed to prevent errors or other inappropriate conduct from potentially causing a significant disruption to the markets” and that

³³⁶ For example, if an e-market-maker handling 20 percent of message traffic experiences a systems issue, the order flow could be diverted elsewhere, including to entities that are unable to handle the increase in message traffic, resulting in a disruption to that entity’s systems as well. Similarly, a broker-dealer accidentally could run a test during live trading and flood markets with message traffic such that those markets hit their capacity limits, resulting in a disruption.

³³⁷ See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010) (“Market Access Release”). Rule 15c3-5(a)(1) defines “market access” to mean: (i) access to trading in securities on an exchange or ATS as a result of being a member or subscriber of the exchange or ATS, respectively; or (ii) access to trading in securities on an ATS provided by a broker-dealer operator of an ATS to a non-broker-dealer. See 17 CFR 240.15c3-5(a)(1). In adopting Rule 15c3-5(a)(1), the Commission stated that “the risks associated with market access...are present whenever a broker-dealer trades as a member of an exchange or subscriber to an ATS, whether for its own proprietary account or as agent for its customers, including traditional agency brokerage and through direct market access or sponsored access arrangements.” See Market Access Release at 69798. As such, the Commission stated that “to effectively address these risks, Rule 15c3-5 must apply broadly to all access to trading on an Exchange or ATS.” See *id.*

“risk management controls and supervisory procedures that are not applied on a pre-trade basis or that, with certain limited exceptions, are not under the exclusive control of the broker-dealer, are inadequate to effectively address the risks of market access arrangements, and pose a particularly significant vulnerability in the U.S. national market system.”³³⁸

Pursuant to Rule 15c3-5, a broker or dealer with market access, or that provides a customer or any other person with access to an exchange or ATS through use of its market participant identifier or otherwise, must establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of this business activity.³³⁹ Rule 15c3-5 also specifies the baseline standards for financial and regulatory risk management controls and supervisory procedures.³⁴⁰ The financial risk management controls and supervisory procedures must be reasonably designed to systematically limit the financial exposure of the broker or dealer that could arise as a result of market access.³⁴¹ The regulatory risk management controls and supervisory procedures must be reasonably designed to ensure compliance with all regulatory requirements.³⁴²

³³⁸ Id. at 69794.

³³⁹ See 17 CFR 240.15c3-5(b). Certain broker-dealers are exempt from some of the requirements under Rule 15c3-5. See id.

³⁴⁰ See 17 CFR 240.15c3-5(c).

³⁴¹ See 17 CFR 240.15c3-5(c)(1). Such financial risk management controls and supervisory procedures must be reasonably designed to: (i) prevent the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer, and where appropriate, more finely-tuned by sector, security or otherwise by rejecting orders if such orders would exceed the applicable credit or capital thresholds; and (ii) prevent the entry of erroneous orders, by rejecting orders that exceed appropriate price or size parameters, on an order-by-order basis or over a short period of time, or that indicate duplicative orders. See 17 CFR 240.15c3-5(c)(1).

³⁴² See 17 CFR 240.15c3-5(c)(2). Such regulatory risk management controls and supervisory procedures must be reasonably designed to: (i) prevent the entry of orders unless there has been compliance with all regulatory requirements that must be satisfied

Under the approach set out by Rule 15c3-5, broker-dealers with market access are responsible in the first instance for establishing and maintaining appropriate risk management controls, including with respect to their systems. Although Rule 15c3-5 takes a different and more limited approach with broker-dealers than proposed Regulation SCI does with SCI entities, the requirements in Rule 15c3-5 are designed to address some of the same concerns regarding systems integrity discussed in this proposal. As an example of reasonable risk control under Rule 15c3-5, the Commission stated, "a system-driven, pre-trade control designed to reject orders that are not reasonably related to the quoted price of the security would prevent erroneously entered orders from reaching the securities markets, . . . should lead to fewer broken trades and thereby enhance the integrity of trading on the securities markets."³⁴³

In light of recent events, however, the Commission believes that it is appropriate to consider whether some types or categories of broker-dealers other than SCI ATSS should also be subject to some or all of the additional system safeguard rules that are proposed for SCI entities. Such broker-dealers could include, for example, OTC market makers (either all or those that execute a significant volume of orders), exchange market makers (either all or those that trade a significant volume on exchanges), order entry firms that handle and route order flow for execution (either all or those that handle a significant volume of investor orders), clearing broker-dealers (either all or those that engage in a significant amount of clearing activities), and

on a pre-order entry basis; (ii) prevent the entry of orders for securities for a broker or dealer, customer, or other person if such person is restricted from trading those securities; (iii) restrict access to trading systems and technology that provide market access to persons and accounts pre-approved and authorized by the broker or dealer; and (iv) assure that appropriate surveillance personnel receive immediate post-trade execution reports that result from market access. See 17 CFR 240.15c3-5(c)(2).

³⁴³ See Market Access Release, supra note 337, at 69794.

large multi-service broker-dealers that engage in a variety of order handling, trading, and clearing activities.

2. Request for Comment

192. As noted above, at this time, the Commission is not proposing to apply Regulation SCI to broker-dealers other than SCI ATs or to other types of entities that are not covered by the definition of SCI entity. Were the Commission to decide to propose to apply the requirements of Regulation SCI to such entities, the Commission would issue a separate release discussing such a proposal. Nevertheless, the Commission is soliciting comment generally on whether it should apply the requirements of proposed Regulation SCI, in whole or in part, to such entities. Specifically:

193. What are the current practices of broker-dealers in relation to the requirements of proposed Regulation SCI?³⁴⁴ Would the current practices of broker-dealers that provide market access and comply with Rule 15c3-5 change if they were also subject to proposed Regulation SCI? Why or why not? If so, how? Are there broker-dealers who do not provide the services that would require compliance with Rule 15c3-5? If so, how do the practices of those broker-dealers compare to the requirements of proposed Regulation SCI?

194. In Section VI.B.2 below, the Commission discusses potential market failures that may explain why market solutions cannot solve the problems that proposed Regulation SCI is intended to address. Does the market for broker-dealer services, including client services, market maker services, or market access services, suffer from market failures that limit the ability of the market to solve the issues that proposed Regulation SCI is intended to address? For

³⁴⁴ As noted above, one ATS currently voluntarily participates in the ARP Inspection Program. See *supra* note 91.

example, are broker-dealers' clients able to easily switch broker-dealers, and how often do clients use more than one broker-dealer simultaneously (e.g., for redundancy in case of a problem at a given broker-dealer)? Are broker-dealers subject to more market discipline than SCI entities? Please explain. Conversely, does a lack of transparency regarding events like SCI events limit this market discipline? Why or why not?

195. Given the stated goals and purpose of proposed Regulation SCI and its various provisions,³⁴⁵ what are commenters' views on whether the scope of the proposed rules should be expanded to cover broker-dealers, or certain categories of broker-dealers? For example, what are commenters' views on the impact to overall market integrity or the protection of investors if an OTC market maker was no longer able to operate due to a systems disruption, systems compliance issue, or a systems intrusion? Or an exchange market maker? Or a clearing broker-dealer? What are commenters' views on the importance of different categories of broker-dealers to the stability of the overall securities market infrastructure, in the context of requiring them to comply with the proposed rules, in light of the stated goals and purpose of Regulation SCI? What risks do the systems of broker-dealers pose on the securities markets?

196. If the Commission were to subsequently propose to apply some or all of the requirements of proposed Regulation SCI to some types or categories of broker-dealers (in addition to SCI ATs), what types of broker-dealers should the requirements apply to and why? Are there distinctions that should be made between different types of broker-dealers (e.g., OTC market makers, exchange market makers, order entry firms, clearing broker-dealers, and multi-service broker-dealers) for this purpose? If so, what are those distinctions and which requirements should apply?

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See supra Section III.

197. The Commission notes that Roundtable panelists generally did not distinguish between national securities exchanges, ATSS, and different types of broker-dealers when addressing how to improve error prevention and error response strategies. Rather, Roundtable panelists and commenters referred more generally to “entities with market access” and/or “execution venues.”³⁴⁶ In this regard, should the Commission consider expanding the application of Regulation SCI to all market centers, as that term is defined in Rule 600(b)(38) of Regulation NMS,³⁴⁷ which means any exchange market maker, OTC market maker, ATS, national securities exchange, or national securities association?³⁴⁸ Why or why not? Would an expansion of proposed Regulation SCI to include all market centers (i.e., execution venues) inappropriately exclude the broader category of entities having market access? Why or why not? Alternatively, should the Commission consider applying the requirements of proposed Regulation SCI to (a) any registered market maker or (b) any broker-dealer that offers market access that, in either case, with respect to any NMS stock, has a specified percentage of average daily dollar volume? If so, what should such a percentage be? Would the levels applicable to SCI ATSS that trade NMS stocks under proposed Rule 1000(a) of Regulation SCI be appropriate

³⁴⁶ See, e.g., letter from Better Markets, *supra* note 74, arguing that regulators should encourage firms to adopt more robust software development practices and audit any firm with direct market access or require third-party certification and mandate minimum requirements for testing any application that has direct market access. In addition, the panelist from NYSE stated that common standards for technology deployment should apply across all execution venues.

³⁴⁷ 17 CFR 242.600(b)(38).

³⁴⁸ Rule 600(b)(24) defines exchange market maker to mean any member of a national securities exchange that is registered as a specialist or market maker pursuant to the rules of such exchange, and Rule 600(b)(52) defines OTC market maker to mean any dealer that holds itself out as being willing to buy from and sell to its customers, or others, in the U.S., an NMS stock for its own account on a regular or continuous basis otherwise than on a national securities exchange in amounts of less than block size. See 17 CFR 242.600(b)(24) and 17 CFR 242.600(b)(52).

for registered market makers, broker-dealers that offer market access, or other broker-dealers?

Why or why not? If not, what should such a threshold be?

198. If the Commission were to propose to expand the scope of proposed Regulation SCI to a subset of broker-dealers, what are commenters' views on whether, and if so, how, the various different proposed requirements of Regulation SCI should or should not apply to such entities?

199. If the Commission were to propose to expand the scope of proposed Regulation SCI to include a subset of broker-dealers, should the Commission require such broker-dealers to have written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability, and promote the maintenance of fair and orderly markets, as proposed in Rule 1000(b)(1) for SCI entities? Why or why not? Should SCI industry standards for broker-dealers be different from those proposed for SCI entities? If so, what are the standards that should apply to broker-dealers? Please be as specific as possible and explain why a particular standard would be appropriate.

200. Should the Commission require such broker-dealers to establish, maintain, and enforce policies and procedures reasonably designed to ensure that their systems operate in the manner intended, including in a manner that complies with federal securities laws and rules and regulations thereunder, as proposed in Rule 1000(b)(2)(i) for SCI entities? Why or why not? Should the Commission establish a safe harbor from liability for such broker-dealers and their respective employees if they satisfy the elements of a safe harbor, similar to those in proposed Rules 1000(b)(2)(ii) and (iii) for SCI entities and their employees? Why or why not?

201. Should the Commission require such broker-dealers, upon any of their responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action including, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable, as proposed in Rule 1000(b)(3) for SCI entities? Why or why not? Should such broker-dealers' corrective action be triggered by something other than awareness of an SCI event? If so, what would be an appropriate trigger?

202. With regard to the reporting and information dissemination requirements for SCI entities in proposed Rules 1000(b)(4) and 1000(b)(5), would it be appropriate to require such broker-dealers to report all SCI events to the Commission, and disclose dissemination SCI events to their customers?

203. Should such broker-dealers be required to notify the Commission of material systems changes, as proposed in Rule 1000(b)(6) for SCI entities? Why or why not?

204. Should such broker-dealers be required to undertake an annual SCI review of their systems, as proposed in Rule 1000(b)(7) for SCI entities? Should such broker-dealers also be required to provide the Commission with reports regarding the SCI review and material systems changes, as proposed in Rule 1000(b)(8) for SCI entities? Why or why not?

205. Should such broker-dealers be required to submit any required notices, reports, and other information to the Commission on proposed new Form SCI? Why or why not?

206. Alternatively, should the Commission propose to require that each SCI SRO establish rules requiring that its members adopt written policies and procedures reasonably designed to ensure that their systems have levels of capacity, integrity, resiliency, availability, and security adequate to maintain their operational capability, and promote the maintenance of

fair and orderly markets? Why or why not? Similarly, should the Commission propose to require that each SCI SRO establish rules requiring that its members adopt written policies and procedures reasonably designed to ensure that the systems of such members operate in the manner intended, including in a manner that complies with applicable federal securities laws and rules and regulations thereunder and the SCI SRO's rules? Why or why not? In either case, would such a proposal raise any competitive issues, such as between national securities exchanges and ATSS?³⁴⁹

207. In addition, should the Commission consider including other entities in the definition of SCI entity (e.g., transfer agents), thus subjecting them to some or all of the requirements under proposed Regulation SCI? If yes, to which entities should some or all of proposed Regulation SCI apply and why? If not, why not? If commenters believe other types of entities should be included in the definition of SCI entity, should the Commission include all entities of a given type in the definition? Why or why not? If not, how should the Commission distinguish those entities that should be included (e.g., size, volume, types of services performed, etc.)? Please describe and be as specific as possible.

208. If the Commission were to subsequently propose and adopt a rule applying Regulation SCI to all or certain categories of broker-dealers or other entities, what are commenters' views as to the type and scale of the costs of such application? Please explain. In addition, what are commenters' views as to the potential impact on efficiency, competition, and capital formation of such application? Please explain.

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The Commission notes that all broker-dealers are members of one or more SCI SROs (such as FINRA and/or a national securities exchange), while participants on ATSS may include non-broker-dealer market participants.

IV. Paperwork Reduction Act

Certain provisions of the proposal contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”)³⁵⁰ and the Commission will submit them to the Office of Management and Budget (“OMB”) for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title of the new collection of information is Regulation Systems Compliance and Integrity. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

A. Summary of Collection of Information

Proposed Regulation SCI would include four categories of obligations that would require a collection of information within the meaning of the PRA. Specifically, an SCI entity would be required to: (1) establish specified written policies and procedures, and mandate participation by designated members or participants in certain testing of the SCI entity’s business continuity and disaster recovery plans; (2) provide certain notifications, disseminate certain information, and create reports; (3) take corrective actions, identify certain SCI events for which immediate Commission notification is required, and identify dissemination SCI events; and (4) comply with recordkeeping and access requirements relating to its compliance with proposed Regulation SCI.

1. Requirements to Establish Written Policies and Procedures and Mandate Participation in Certain Testing

Proposed Rules 1000(b)(1) and (b)(2) would require SCI entities to establish policies and procedures with respect to various matters. Proposed Rule 1000(b)(1) would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to

³⁵⁰ 44 U.S.C. 3501 et. seq.

ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets.

Proposed Rule 1000(b)(1)(i) specifies that such policies and procedures would be required to include, at a minimum: (A) the establishment of reasonable current and future capacity planning estimates; (B) periodic capacity stress tests of such systems to determine their ability to process transactions in an accurate, timely, and efficient manner; (C) a program to review and keep current systems development and testing methodology for such systems; (D) regular reviews and testing of such systems, including backup systems, to identify vulnerabilities pertaining to internal and external threats, physical hazards, and natural or manmade disasters; (E) business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption; and (F) standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data. Proposed Rule 1000(b)(1)(ii) states that such policies and procedures would be deemed to be reasonably designed if they are consistent with current SCI industry standards, which would be required to be: (A) comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and (B) issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization. The proposed SCI industry standards contained in the publications identified on Table A are intended to serve as standards that SCI entities could use, if they so choose, to comply with the

requirements of proposed Rule 1000(b)(1), though compliance with such SCI industry standards would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1).

Proposed Rule 1000(b)(2)(i) would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and the entity's rules and governing documents, as applicable. An SCI entity would be deemed not to have violated proposed Rule 1000(b)(2)(i) if:

(A) it has established and maintained policies and procedures reasonably designed to provide for:

- (1) testing of all such systems and any changes to such systems prior to implementation;
- (2) periodic testing of all such systems and any changes to such systems after their implementation;
- (3) a system of internal controls over changes to such systems;
- (4) ongoing monitoring of the functionality of such systems to detect whether they are operating in the manner intended;
- (5) assessments of SCI systems compliance performed by personnel familiar with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable; and
- (6) review by regulatory personnel of SCI systems design, changes, testing, and controls to prevent, detect, and address actions that do not comply with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable;

(B) the SCI entity has established and maintained a system for applying such policies and procedures which would reasonably be expected to prevent and detect, insofar as practicable, any violation of such policies and procedures by the SCI entity or any person employed by the SCI entity; and

(C) the SCI entity: has reasonably discharged the duties and obligations incumbent upon it by such policies and procedures; and was without reasonable cause to believe that such policies and procedures were not being

complied with in any material respect. Further, pursuant to proposed Rule 1000(b)(2)(iii), a person employed by an SCI entity would be deemed not to have aided, abetted, counseled, commanded, caused, induced, or procured the violation by any other person of proposed Rule 1000(b)(2)(i) if the person employed by the SCI entity: (A) has reasonably discharged the duties and obligations incumbent upon such person by such policies and procedures; and (B) was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect.

Proposed Rule 1000(b)(9)(i) would require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans in the manner and frequency as specified by the SCI entity, at least once every 12 months (e.g., for SCI SROs, by submitting proposed rule changes under Section 19(b) of the Exchange Act; for SCI ATSSs, by revising membership or subscriber agreements and internal procedures; for plan processors, through an amendment to an SCI Plan under Rule 608 of Regulation NMS; and, for exempt clearing agencies subject to ARP, by revising participant agreements and internal procedures). Proposed Rule 1000(b)(9)(ii) would further require an SCI entity to coordinate such required testing on an industry- or sector-wide basis with other SCI entities. Proposed Rule 1000(b)(9)(iii) would require an SCI entity to designate members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans. It would also require the SCI entity to notify and update the Commission of its designations and standards for designation, and promptly update such notification after any changes to its designations or standards.

2. Notice, Dissemination, and Reporting Requirements for SCI Entities

A number of proposed rules under Regulation SCI would require SCI entities to notify or report information to the Commission, or disseminate information to their members or participants. Proposed Rules 1000(b)(4), (b)(5), (b)(6), (b)(7), and (b)(8) each contain a notification, dissemination, or reporting requirement.

Proposed Rule 1000(b)(4) would require notice of SCI events to the Commission. Proposed Rule 1000(b)(4)(i) would require an SCI entity to notify the Commission upon any responsible SCI personnel becoming aware of a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion.

Proposed Rule 1000(b)(4)(ii) would require an SCI entity, within 24 hours of any responsible SCI personnel becoming aware of any SCI event, to submit a written notification to the Commission on Form SCI pertaining to such SCI event.³⁵¹ Proposed Rule 1000(b)(4)(iv)(A) would specify that, for a notification made pursuant to proposed Rule 1000(b)(4)(ii), an SCI entity must include all pertinent information known about the SCI event, including: a detailed description of the SCI event; the SCI entity's current assessment of the types and number of

³⁵¹ For a written notification to the Commission of an SCI event under proposed Rule 1000(b)(4)(ii), new proposed Form SCI would require that an SCI entity indicate that the filing is being made pursuant to Rule 1000(b)(4)(ii) and provide the following information in a short, standardized format: (i) whether the filing is a Rule 1000(b)(4)(ii) notification or Rule 1000(b)(4)(iii) update of an SCI event; (ii) the SCI event type(s) (*i.e.*, systems compliance issue, systems intrusion, and/or systems disruption); (iii) whether the event is a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants; (iv) if so, whether the Commission has been notified of the SCI event; (v) whether the SCI event has been resolved; (vi) the date/time the SCI event started; (vii) the duration of the SCI event (viii) the date and time when responsible SCI personnel became aware of the SCI event; (ix) the estimated number of market participants impacted by the SCI event; (x) the type(s) of systems impacted; and (xi) if applicable, the type of systems disruption.

market participants potentially affected by the SCI event; the potential impact of the SCI event on the market; and the SCI entity's current assessment of the SCI event, including a discussion of the determination of whether the SCI event is a dissemination SCI event or not. In addition, to the extent available as of the time of the initial notification, the notification would be required to include: a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; the time the SCI event was resolved or timeframe within which the SCI event is expected to be resolved; a description of the SCI entity's rule(s) and/or governing document(s), as applicable, that relate to the SCI event; and an analysis of the parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss. Further, for a written notification to the Commission of an SCI event under proposed Rule 1000(b)(4)(ii), an SCI entity would be required to attach a copy of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

Proposed Rule 1000(b)(4)(iii) would require an SCI entity to submit written updates on Form SCI pertaining to an SCI event to the Commission on a regular basis, or at such frequency as reasonably requested by a representative of the Commission, until such time as the SCI event is resolved. Proposed Rule 1000(b)(4)(iv)(B) specifies that, for a notification made pursuant to proposed Rule 1000(b)(4)(iii), the SCI entity would be required to update any information previously provided regarding an SCI event, including any information under proposed Rule 1000(b)(4)(iv)(A)(2) that was not available at the time of submission of a notification under proposed Rule 1000(b)(4)(ii). Further, for a written notification to the Commission of an SCI event under proposed Rule 1000(b)(4)(iii), an SCI entity would be required to attach a copy of

any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

Proposed Rule 1000(b)(5) would require dissemination to members or participants of dissemination SCI events and specify the nature and timing of such required dissemination, with limited exceptions for dissemination SCI events that are systems intrusions, as discussed further below.³⁵² Proposed Rule 1000(b)(5)(i)(A) would require that an SCI entity, promptly after any responsible SCI personnel becomes aware of a dissemination SCI event, disseminate to its members or participants the following information about such SCI event: (1) the systems affected by the SCI event; and (2) a summary description of the SCI event. In addition, proposed Rule 1000(b)(5)(i)(B) would require an SCI entity to, when known, further disseminate to its members or participants: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; and (3) a description of the progress of its corrective action for the SCI event and when the SCI event has been or is expected to be resolved. Proposed Rule 1000(b)(5)(i)(C) would further require that an SCI entity provide regular updates to members or participants on any of the information required to be disseminated under proposed Rules 1000(b)(5)(i)(A) and (i)(B).

Proposed Rule 1000(b)(5)(ii) would provide a limited exception to the proposed requirement of prompt dissemination to members or participants of information regarding dissemination SCI events for systems intrusion. Proposed Rule 1000(b)(5)(ii) would require an SCI entity, promptly after any responsible SCI personnel becomes aware of a systems intrusion,

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As discussed above, the Commission proposes that the term "dissemination SCI event" be defined as "an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants." See *supra* Section III.B.4.d.

to disseminate to its members or participants a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion has been or is expected to be resolved, unless the SCI entity determines that dissemination of such information would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, and documents the reasons for such determination.

Proposed Rule 1000(b)(6) would require an SCI entity, absent exigent circumstances, to notify the Commission on Form SCI at least 30 calendar days before implementation of any planned material systems change, including a description of the planned material systems change as well as the expected dates of commencement and completion of implementation of such change. If exigent circumstances exist, or if the information previously provided to the Commission regarding any material systems change has become materially inaccurate, an SCI entity would instead be required to notify the Commission, either orally or in writing on Form SCI, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable.³⁵³

Proposed Rule 1000(b)(7) would require an SCI entity to conduct an SCI review of the entity's compliance with Regulation SCI not less than once each calendar year, and to submit a report of the SCI review to senior management of the SCI entity for review no more than 30 calendar days after completion of such SCI review.

³⁵³ Form SCI would require an SCI entity to provide the date of the planned change. The SCI entity must also specify whether exigent circumstances exist, or if the information previously provided to the Commission regarding any material systems change has become materially inaccurate, and if so, whether the Commission has been orally notified. Further, the notification must include an Exhibit 4.

Proposed Rule 1000(b)(8) contains two reporting requirements. Specifically, proposed Rule 1000(b)(8) would require an SCI entity to submit as an attachment to Form SCI: (i) a report of the SCI review required by proposed Rule 1000(b)(7), together with any response by senior management, within 60 calendar days after its submission to senior management of the SCI entity;³⁵⁴ and (ii) a report within 30 calendar days after the end of June and December of each year, containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date or expected date of completion of implementation of such change.³⁵⁵

3. Requirements to Take Corrective Actions, Identify Immediate Notification SCI Events, and Identify Dissemination SCI Events

Proposed Rule 1000(b)(3) would require an SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action which would be required to include, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable. Given these requirements of proposed Rule 1000(b)(3), SCI entities would likely work to develop a process for ensuring that they are prepared to comply with the corrective action requirement and would likely also periodically review this process.

In addition, proposed Rule 1000(a) would define a “dissemination SCI event” to mean an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.

Under the proposed Commission notification and member or participant dissemination

³⁵⁴ This report would be required to be submitted as Exhibit 5 to Form SCI.

³⁵⁵ This report would be required to be submitted as Exhibit 6 to Form SCI.

requirements of proposed Rules 1000(b)(4) and (b)(5), when an SCI event occurs, an SCI entity must determine whether an SCI event is an immediate notification SCI event or a dissemination SCI event. As such, SCI entities would likely work to develop a process for ensuring that they are able to make determinations regarding the nature of the SCI event quickly and accurately, and periodically review this process.

4. Recordkeeping Requirements

Proposed Rule 1000(c) would set forth recordkeeping requirements for SCI entities. Under proposed Rule 1000(c)(1), SCI SROs would be required to make, keep, and preserve all documents relating to their compliance with Regulation SCI as prescribed in Rule 17a-1 under the Exchange Act. Under proposed Rule 1000(c)(2), each SCI entity that is not an SCI SRO would be required to make, keep, and preserve at least one copy of all documents, including correspondence, memoranda, papers, books, notices, accounts, and other such records, relating to its compliance with Regulation SCI including, but not limited to, records relating to any changes to its SCI systems and SCI security systems, for a period of not less than five years, the first two years in a place that is readily accessible to the Commission or its representatives for inspection and examination. Upon request of any representative of the Commission, such SCI entities would be required to promptly furnish to the possession of such representative copies of any documents required to be kept and preserved by it under proposed Rule 1000(c)(2). Under proposed Rule 1000(c)(3), upon or immediately prior to ceasing to do business or ceasing to be registered under the Exchange Act, an SCI entity must take all necessary action to ensure that the records required to be made, kept, and preserved by this section will be accessible to the Commission and its representatives in the manner required by proposed Rule 1000(c) and for the remainder of the period required by proposed Rule 1000(c).

In addition, proposed Rule 1000(e) would provide that, if the records required to be filed or kept by an SCI entity under proposed Regulation SCI are prepared or maintained by a service bureau or other recordkeeping service on behalf of the SCI entity, the SCI entity would be required to ensure that the records are available for review by the Commission and its representatives by submitting a written undertaking, in a form acceptable to the Commission, by such service bureau or other recordkeeping service and signed by a duly authorized person at such service bureau or other recordkeeping service.

B. Proposed Use of Information

1. Requirements to Establish Written Policies and Procedures and Mandate Participation in Certain Testing

The proposed requirements that SCI entities establish certain written policies and procedures with respect to their systems, and that they require designated members or participants to participate in the testing of their business continuity and disaster recovery plans, would further the goals of the national market system and reinforce Exchange Act obligations by requiring entities important to the functioning of the U.S. securities markets to carefully design, develop, test, maintain, and surveil systems integral to their operations, and operate them in compliance with relevant federal securities laws and the rules and regulations thereunder, as well as their own rules and policies.

2. Notification, Dissemination, and Reporting Requirements for SCI Entities

The information that would be collected pursuant to the proposed requirements for notifications, disseminations of information, and reports would assist the Commission in its oversight of SCI entities and the securities markets, help ensure the orderly operation of the U.S. securities markets, and help protect investors and the public interest. In particular, the proposed requirements that SCI entities notify the Commission of all SCI events, disseminate information

to members or participants, undertake and submit to the Commission an SCI review not less than once each calendar year, and submit reports of material systems changes are designed to help ensure compliance with the other provisions of proposed Regulation SCI and accountability of SCI entities in the event of systems problems. Further, the Commission preliminarily believes that the member or participant information dissemination requirement for dissemination SCI events would make members or participants aware that their trading activity might have been or might be impacted by the occurrence of a dissemination SCI event, so that they could consider that information in making trading decisions, seeking corrective action, or pursuing remedies, among other things. The Commission also preliminarily believes that the prospect of disseminating information regarding dissemination SCI events to members or participants would provide an incentive for SCI entities to better focus on improving the integrity and compliance of their systems.

3. Requirements to Take Corrective Actions, Identify Immediate Notification Events, and Identify Dissemination SCI Events

The proposed requirement that SCI entities begin to take appropriate corrective action upon any responsible SCI personnel becoming aware of an SCI event would help ensure that SCI entities dedicate adequate resources to timely address an SCI event and place an emphasis on mitigating potential harm to investors and market integrity. The proposed threshold for notification of certain SCI events to the Commission under proposed Rule 1000(b)(4)(i) would help ensure that the Commission is made aware of significant SCI events when any responsible SCI personnel becomes aware of such events. The proposed definition of dissemination SCI event would help ensure potentially impacted members or participants have basic information

about SCI events so that they might be able to better assess whether they should use the services of an SCI entity.³⁵⁶

5. Recordkeeping Requirements

The proposed recordkeeping requirements in Rules 1000(c) and (e) would assist Commission staff during an examination of an SCI entity to assess its compliance with the proposed rules. In addition, access to the records of SCI entities would help Commission staff to carry out its oversight responsibilities of SCI entities and the securities markets. Further, the proposed recordkeeping requirements would aid SCI entities and the Commission in documenting, reviewing, and correcting any SCI event, as well as in identifying market participants that may have been harmed by such an event.

C. Respondents

The “collection of information” requirements contained in proposed Regulation SCI would apply to SCI entities, as described below. Currently, there are 26 entities that would satisfy the proposed definition of SCI SRO,³⁵⁷ 15 entities that would satisfy the proposed definition of SCI ATS,³⁵⁸ 2 entities that would satisfy the definition of plan processor,³⁵⁹ and 1 entity that would meet the definition of exempt clearing agency subject to ARP.³⁶⁰ Accordingly, the Commission estimates that there are currently 44 entities that would meet the definition of

³⁵⁶ See infra Section III.B.3.d (discussing the threshold for dissemination SCI events).

³⁵⁷ See supra notes 93-96 and accompanying text (listing 17 registered national securities exchanges, 7 registered clearing agencies, FINRA, and the MSRB).

³⁵⁸ See supra Section III.B.1.

³⁵⁹ See supra note 565.

³⁶⁰ See supra note 133 and accompanying text.

SCI entity and be subject to the collection of information requirements of proposed Regulation SCI.

The Commission requests comment on the accuracy of these estimated figures.

D. Total Initial and Annual Reporting and Recordkeeping Burdens

As discussed above, all of the national securities exchanges, national securities associations, registered clearing agencies, and plan processors currently participate on a voluntary basis in the ARP Inspection Program.³⁶¹ Under the ARP Inspection Program, Commission staff conducts on-site inspections and attends periodic technology briefings by staff of these entities, generally covering systems capacity and testing, review of systems vulnerability, review of planned systems development, and business continuity planning.³⁶² In addition, Commission staff monitors systems failures and planned major systems changes at these entities.³⁶³

Under proposed Regulation SCI, many of the principles of the ARP policy statements with which SCI SROs are familiar would be codified. However, because the proposed regulation would have a broader scope than the current ARP Inspection Program and would impose mandatory recordkeeping obligations on entities subject to the rules,³⁶⁴ proposed Regulation SCI would impose paperwork burdens on all SCI entities. The Commission's total burden estimates reflect the total burdens on all SCI entities, taking into account the extent to which some SCI

³⁶¹ See supra Section I.A.

³⁶² See id.

³⁶³ See id.

³⁶⁴ As discussed more fully in supra Section III.D and infra Section IV.D.4, SCI SROs are already subject to existing recordkeeping and retention requirements under Rule 17a-1 and thus the Commission believes that the proposed recordkeeping obligations would not impose any new burden on SCI SROs that is not already accounted for in the burden estimates for Rule 17a-1.

entities already comply with some of the proposed requirements of Regulation SCI. As discussed below, the Commission preliminarily believes that the extent of these burdens will vary for different types of SCI entities. The Commission notes that the hour figures set forth in this section are the Commission's preliminary best estimate of the paperwork burden for compliance with proposed Regulation SCI based on a variety of sources, including the Commission's experience with the current ARP Inspection Program and other similar estimated burdens for analogous rulemakings. However, the Commission recognizes that commenters may have other informed views of the actual burdens that would be imposed by these requirements and thus, the Commission solicits comment on the appropriateness and accuracy of each of the estimated burdens below.

1. Requirements to Establish Written Policies and Procedures and Mandate Participation in Certain Testing

The proposed rules that would require an SCI entity to establish policies and procedures and to mandate member or participant participation in business continuity and disaster recovery plans testing are discussed more fully in Section III.C above.

a. Policies and Procedures Required by Proposed Rule 1000(b)(1)

The Commission preliminarily estimates that an SCI entity that has not previously participated in the ARP Inspection Program would require an average of 210 burden hours to develop and draft policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets, as proposed to be required by Rule 1000(b)(1) of Regulation SCI (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that

facilitates the successful collection, processing, and dissemination of market data, which are addressed separately).³⁶⁵ The estimated 210 hours required for such entities would include the time expended to draft relevant policies and procedures and the time expended for review of the draft policies and procedures by the SCI entity's management. The Commission preliminarily believes that all SCI entities³⁶⁶ would conduct this work internally.³⁶⁷

For SCI entities that currently participate in the ARP Inspection Program (29 entities, nearly all of which are SCI SROs³⁶⁸), the Commission preliminarily believes that in developing their policies and procedures, these entities would be starting from a baseline of fifty percent, and therefore the average paperwork burden of developing the proposed policies and procedures

³⁶⁵ This estimate is based on the Commission's experience with the ARP Inspection Program and its preliminary estimate in the SB SDR Proposing Release for a similar requirement. See SB SDR Proposing Release, *supra* note 297, at 77349 (estimating the number of hours it would take to draft policies and procedures reasonably designed to ensure that the SDR's systems provide adequate levels of capacity, resiliency, and security). This estimate is for the number of hours an SCI entity would require over and above the usual and customary amount of time it would devote to developing policies and procedures designed to ensure its systems' capacity, integrity, resiliency, availability, and security. These estimated burdens may vary depending on an SCI entity's business and regulatory responsibilities.

³⁶⁶ The Commission estimates that there are 44 SCI entities. Of these, 29 entities currently participate in the ARP Inspection Program and 15 do not. Because the MSRB is not currently a participant in the ARP Inspection Program, the estimated burden hours for the MSRB to develop policies and procedures as required by proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) is 210 hours, which is higher than the number estimated for all other SCI SROs that currently participate in the ARP Inspection Program, as discussed below.

³⁶⁷ But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

³⁶⁸ 17 registered national securities exchanges + 7 registered clearing agencies + 1 national securities association + 2 plan processors + 1 exempt clearing agency subject to ARP + 1 ATS = 29 entities.

would be 105 burden hours.³⁶⁹ The Commission preliminarily believes that a fifty percent baseline for SCI entities that participate in the ARP Inspection Program is appropriate because, although these entities already have substantial policies and procedures in place, proposed Rule 1000(b)(1) would require these entities to devote substantial time to reviewing and revising their existing policies and procedures to ensure that they are sufficiently robust in the context of a new and expanded regulatory regime. The Commission preliminarily believes that these entities would conduct this work internally.³⁷⁰

With regard to the proposed requirement in Rule 1000(b)(1) that an SCI entity's policies and procedures include standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data, the Commission preliminarily estimates that each SCI entity would spend an average of 130 hours annually to comply with this requirement.³⁷¹ As this proposed requirement is not currently addressed by the ARP Inspection Program, the Commission preliminarily estimates that the total initial and ongoing burden would be the same for all SCI entities and SCI entities would conduct this work internally.³⁷²

³⁶⁹ In establishing this baseline estimate, the Commission has considered what the entities do today; that is, in the absence of the proposed rule.

³⁷⁰ But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

³⁷¹ This estimate is based on the Commission's experience with the ARP Inspection Program, and includes the time necessary to program systems to meet the proposed standard.

³⁷² But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

As noted above, the Commission preliminarily believes that SCI entities would handle internally most of the work associated with establishing, maintaining, and enforcing written policies and procedures as proposed to be required by Rule 1000(b)(1). However, based on its experience with the ARP Inspection Program, the Commission preliminarily believes that SCI entities also would seek outside legal and/or consulting services in the initial preparation of such policies and procedures, and that the average cost of such outside legal and/or consulting advice would be \$20,000 per respondent,³⁷³ for a total of \$880,000 for all respondents.³⁷⁴

As noted above, the Commission preliminarily estimates that the average initial number of burden hours per respondent to comply with proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would be 105 hours for SCI entities that are current ARP Inspection Program participants and 210 hours for SCI entities that are not current ARP Inspection Program participants, for a total of 6,195 hours.³⁷⁵ In addition, the Commission

³⁷³ This estimate is based on the Commission's experience with the ARP Inspection Program, as well as industry sources. In addition, the Commission has considered its estimate of the cost burden under Regulation SDR in connection with the establishment of certain policies and procedures. See SB SDR Proposing Release, *supra* note 297, at 77349 (preliminarily estimating that it would cost \$100,000 to establish, maintain, and enforce five sets of written policies and procedures, one of which requires policies and procedures reasonably designed to ensure that the SDR's systems provide adequate levels of capacity, resiliency, and security).

³⁷⁴ (\$20,000 outside legal cost) × (44 SCI entities) = \$880,000.

³⁷⁵ The Commission preliminarily believes that an Attorney and a Compliance Manager working in collaboration would develop and draft the required policies and procedures, assisted by, and in consultation with, Senior Systems Analysts and Operational Specialists. Thus, the Commission estimates: (Compliance Manager (including Senior Management Review) at 80 hours + Attorney at 80 hours + Senior Systems Analyst at 25 hours + Operations Specialist at 25 hours) × (15 potential respondents) + (Compliance Manager (including Senior Management Review) at 40 hours + Attorney at 40 hours +

preliminarily estimates that the average initial number of burden hours per respondent to comply with the requirement for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data would be 130 hours for a total of 5,720 hours for all respondents.³⁷⁶

The Commission preliminarily estimates that, once an SCI entity has drafted the policies and procedures proposed to be required by Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data), it would spend on average approximately 60 hours annually to review its written policies and procedures to ensure that they are up-to-date and to prepare any necessary new or amended policies and procedures.³⁷⁷ Using a fifty percent baseline for SCI entities that participate in the ARP Inspection Program and therefore currently review and revise policies and procedures from time to time, the Commission preliminarily estimates that the total annual ongoing burden to comply with proposed Rule 1000(b)(1) (except for policies and

Senior Systems Analyst at 12.5 hours + Operations Specialist at 12.5 hours) × (29 potential respondents) = 6,195 burden hours.

³⁷⁶ Based on its experience with the ARP Inspection Program, the Commission estimates: (Compliance Attorney at 30 hours + Senior Systems Analyst at 100 hours) × (44 potential respondents) = 5,720 burden hours.

³⁷⁷ This estimate is based on the Commission's experience with the ARP Inspection Program. The Commission has also considered its preliminary estimate in the SB SDR Proposing Release for a similar requirement. See SB SDR Proposing Release, *supra* note 297, at 77349 (estimating the ongoing burden associated with maintaining policies and procedures reasonably designed to ensure that the SDR's systems provide adequate levels of capacity, resiliency, and security). This estimate is for the number of hours an SCI entity would require over and above the usual and customary amount of time it would devote to maintaining policies and procedures designed to ensure its systems' capacity, integrity, resiliency, availability, and security.

procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would be 30 hours per respondent for this group of respondents. The Commission therefore estimates the ongoing burden to comply with proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) to be 870 hours³⁷⁸ for SCI entities that are current ARP Inspection Program participants and 900 hours³⁷⁹ for SCI entities that are not ARP Inspection Program participants, for a total of 1,770 hours for all respondents.³⁸⁰ As noted above, the Commission preliminarily estimates that the average ongoing number of burden hours per respondent to comply with the proposed requirement for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data would be 130 hours for each respondent, for a total of 5,720 hours for all respondents.³⁸¹ The Commission preliminarily believes that the work

³⁷⁸ (Compliance Manager at 15 hours + Attorney at 15 hours) × (29 potential respondents currently participating in the ARP Inspection Program) = 870 hours.

³⁷⁹ (Compliance Manager at 30 hours + Attorney at 30 hours) × (15 potential respondents not currently participating in the ARP inspection Program) = 900 hours.

³⁸⁰ 870 hours for SCI entities that are current ARP Inspection Program participants + 900 hours for SCI entities that are not current ARP Inspection Program participants = 1,770 burden hours.

³⁸¹ (Compliance Attorney at 30 hours + Senior Systems Analyst at 100 hours) × (44 potential respondents) = 5,720 burden hours.

associated with updating the policies and procedures proposed to be required by proposed Rule 1000(b)(1) would be done internally.³⁸²

b. Policies and Procedures Required by Proposed Rule 1000(b)(2)

With regard to proposed Rule 1000(b)(2)(i), which would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents, the Commission preliminarily believes that each SCI entity would elect to comply with the safe harbor provisions in proposed Rules 1000(b)(2)(ii) and (iii), and preliminarily estimates that each SCI entity would initially spend approximately 180 hours to design their policies and procedures accordingly. This estimate would include the time necessary to review and revise any existing policies and procedures to ensure that they satisfy the proposed safe harbor provisions, and the Commission preliminarily believes this estimate would be the same for all SCI entities.³⁸³ Therefore, the Commission preliminarily estimates that

³⁸² But see *infra* Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

³⁸³ This estimate is based on the Commission's experience with the ARP Inspection Program and OCIE examinations, which review policies and procedures of registered entities in conjunction with examinations of such entities for compliance with the federal securities laws. Although not currently explicitly required under the existing ARP Inspection Program or other laws or regulations, the Commission expects that most, if not all, SCI entities already voluntarily have certain policies and procedures in place as part of good business management and oversight to ensure that their SCI systems operate in the manner intended. However, proposed Rule 1000(b)(2)(i) would set forth specific new requirements with respect to such policies and procedures, and proposed Rules 1000(b)(2)(ii) and (iii) would specify how an SCI entity and its employees could satisfy the new requirement through safe harbors. Because proposed Rule 1000(b)(2)(i) has no analogue in the ARP Inspection Program and would create a new requirement for all SCI entities, for purposes of the PRA, the Commission preliminarily estimates that all SCI

proposed Rule 1000(b)(2) would carry an initial one-time burden of 180 hours per respondent, for a total initial one-time burden of 7,920 hours for all respondents.³⁸⁴ The Commission also preliminarily estimates that each SCI entity that is an SRO would spend approximately 120 hours annually to review these written policies and procedures to ensure that they are up-to-date and to prepare any necessary new or amended policies and procedures, and that other types of SCI entities would spend approximately 60 hours to do this work.³⁸⁵ Therefore, the Commission preliminarily estimates that proposed Rule 1000(b)(2) would carry an ongoing annual burden of 120 hours per SRO respondent and 60 hours per non-SRO respondent, for a total ongoing annual burden of 4,200 hours for all respondents.³⁸⁶ These estimated burdens per respondent also would

entities would elect to comply with the proposed safe harbor of proposed Rule 1000(b)(2)(ii) and be subject to the same initial burden to ensure that their policies and procedures satisfy the requirements of the proposed safe harbor.

³⁸⁴ Based on its experience with OCIE examinations and the ARP Inspection Program, the Commission estimates: (Compliance Attorney at 30 hours + Senior Systems Analyst at 150 hours) × (44 potential respondents) = 7,920 burden hours.

³⁸⁵ These estimates are based on the Commission's experience with the ARP Inspection Program and OCIE examinations. The Commission notes that its estimate of 120 hours for SCI SROs to annually review and update the written policies and procedures proposed to be required by Rule 1000(b)(2)(i), to satisfy the elements of the safe harbor provisions in proposed Rules 1000(b)(2)(ii) and (iii), is higher than its estimate for SCI SROs to review and update the policies and procedures proposed to be required by Rule 1000(b)(1) and its estimate for SCI entities that are not SCI SROs to review and update the policies and procedures proposed to be required by Rule 1000(b)(2)(i), to satisfy the elements of the safe harbor provisions in proposed Rules 1000(b)(2)(ii) and (iii). This higher estimate is based on the Commission's preliminary belief that the burden for SCI SROs would be greater because the rules of such entities generally change their rules with greater frequency. The Commission solicits comment on the accuracy of this information.

³⁸⁶ Based on its experience with OCIE examinations and the ARP Inspection Program, the Commission estimates: (Compliance Attorney at 20 hours + Senior Systems Analyst at 100 hours) × (26 potential SCI SRO respondents) + (Compliance Attorney at 10 hours + Senior Systems Analyst at 50 hours) × (18 potential non-SCI SRO respondents) = 4,200 burden hours.

include the time expended for the review of the draft policies and procedures by the SCI entity's management.

As with proposed Rule 1000(b)(1), the Commission preliminarily believes that SCI entities would handle internally most of the work associated with establishing and maintaining written policies and procedures that are reasonably designed to ensure that their SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents, and that meet the requirements of the proposed safe harbor provisions of proposed Rule 1000(b)(2)(ii).³⁸⁷ However, based on its experience with the ARP Inspection Program, the Commission preliminarily believes that SCI entities also would seek outside legal and/or consulting advice in the initial preparation of such policies and procedures, and that the average cost of outside legal/consulting advice would be \$20,000 per respondent, for a total of \$880,000 for all respondents.³⁸⁸

c. Mandate Participation in Certain Testing

Proposed Rule 1000(b)(9) would require each SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans at specified intervals, and coordinate such testing on an industry- or sector-wide basis with other SCI entities. The Commission preliminarily believes that all SCI entities would be subject to this proposed requirement, and that none of these entities currently

³⁸⁷ But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

³⁸⁸ $(\$20,000 \text{ outside legal cost}) \times (44 \text{ entities}) = \$880,000.$

require participation by members or participants in scheduled functional and performance testing of their business continuity and disaster recovery plans, as proposed Rule 1000(b)(9) would have them require.

Although SCI entities may seek to implement the proposed requirements in different ways (e.g., for SCI SROs, by submitting proposed rule changes under Section 19(b) of the Exchange Act; for SCI ATSS, by revising membership or subscriber agreements and internal procedures; for plan processors, through an amendment to an SCI Plan under Rule 608 of Regulation NMS; and, for exempt clearing agencies subject to ARP, by revising participant agreements and internal procedures), the Commission preliminarily believes that the average paperwork burden associated with the proposed rule would be the same for all SCI entities because they would likely make similar changes to their rules, agreements, procedures, or SCI Plans, and would likely take similar actions to implement and coordinate mandatory testing. Based on its experience with SCI entities, the Commission preliminarily believes that SCI entities, other than plan processors, would handle this work internally.

The Commission preliminarily estimates that each SCI entity (other than plan processors) would spend approximately 130 hours initially to meet the requirements of proposed Rules 1000(b)(9)(i) and (ii). This estimate takes into consideration the requirement to mandate participation by designated members or participants in testing under proposed Rule 1000(b)(9)(i), as well as the requirement under proposed Rule 1000(b)(9)(ii) that an SCI entity coordinate required testing with other SCI entities. Specifically, the estimated 130 hours assumes that it would take an SCI entity 35 hours to write a proposed rule, or revise a membership/subscriber agreement or participant agreement, as the case may be, to establish the

participation requirement for the SCI entity's designated members or participants,³⁸⁹ and an additional 95 hours of follow-up work (e.g., notice and schedule coordination) to ensure implementation. Therefore, the Commission preliminarily estimates that proposed Rules 1000(b)(9)(i) and (ii) would carry an initial burden of 130 hours per respondent, for a total initial burden of 5,460 hours for all respondents.³⁹⁰ For plan processors, the Commission preliminarily estimates that proposed Rules 1000(b)(9)(i) and (ii) would carry an initial cost of \$52,000 per respondent,³⁹¹ for a total initial cost of \$104,000 hours for all plan processors.³⁹²

The Commission also preliminarily estimates that each SCI entity (other than plan processors) would spend approximately 95 hours annually to review the written rules or requirements to ensure that they remain up-to-date and to prepare any necessary amendments and undertake necessary coordination to ensure implementation and enforcement of the requirement.³⁹³ Therefore, the Commission preliminarily estimates that proposed Rules 1000(b)(9)(i) and (ii) would carry an ongoing annual burden of 95 hours per respondent, for a

³⁸⁹ In establishing this estimate, the Commission considered its estimate of the burden for an SRO to file an average proposed rule change. See 2012 Rule 19b-4 collection of information revision Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201207-3235-002.

³⁹⁰ Based on Commission staff experience in reviewing SRO proposed rule change filings and past estimates for Rule 19b-4 and Form 19b-4, the Commission estimates as follows: (Compliance Manager at 10 hours + Attorney at 15 hours + Compliance Clerk at 10 hours) × (42 potential respondents) + (Compliance Manager at 10 hours + Attorney at 15 hours + Operations Specialist at 70 hours) × (42 potential respondents) = 5,460 hours to comply with proposed Rules 1000(b)(9)(i) and (ii).

³⁹¹ 130 hours × \$400 per hour for outside legal services = \$52,000. See *infra* note 463.

³⁹² \$52,000 × 2 plan processors = \$104,000.

³⁹³ As noted above, the initial burden includes 35 hours to write a proposed rule, revise an agreement, or amend an SCI Plan. The Commission does not believe this 35-hour burden would be applicable on an ongoing basis.

total ongoing annual burden of 3,990 hours for all respondents.³⁹⁴ For plan processors, the Commission preliminarily estimates that proposed Rules 1000(b)(9)(i) and (ii) would carry an ongoing annual cost of \$38,000 hours per respondent,³⁹⁵ for a total ongoing annual cost of \$76,000 for all plan processors.³⁹⁶

The Commission preliminarily estimates that each SCI entity (other than plan processors) would spend approximately 35 hours initially to meet the requirements of proposed Rule 1000(b)(9)(iii). This estimate takes into consideration the burden for an SCI entity to establish standards for designating members or participants who must participate in its business continuity and disaster recovery plans testing and file such standards with the Commission on Form SCI, as well as the burden for an SCI entity to determine, compile, and submit its list of designated members or participants on Form SCI. Specifically, the Commission estimates that each SCI entity would take 35 hours to write a proposed rule or an internal procedure, as the case may be, to establish standards for designating members or participants, to apply the standards to compile the list of designees, and to file such standards and the list of designees on Form SCI.³⁹⁷ Therefore, the Commission preliminarily estimates that proposed Rule 1000(b)(9)(iii) would carry an initial burden of 35 hours per respondent, for a total initial burden of 1,470 hours for all

³⁹⁴ (Compliance Manager at 10 hours + Attorney at 15 hours + Operations Specialist at 70 hours) × (42 potential respondents) = 3,990 hours. See *supra* note 390.

³⁹⁵ 95 hours × \$400 per hour for outside legal services = \$38,000. See *infra* note 463.

³⁹⁶ \$38,000 × 2 plan processors = \$76,000.

³⁹⁷ In establishing this estimate, the Commission considered its estimate of the burden for an SRO to file an average proposed rule change. See 2012 Rule 19b-4 collection of information revision Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201207-3235-002.

respondents.³⁹⁸ For plan processors, the Commission preliminarily estimates that proposed Rule 1000(b)(9)(iii) would carry an initial cost of \$14,000 per respondent,³⁹⁹ for a total initial cost of \$28,000 hours for all plan processors.⁴⁰⁰

The Commission also preliminarily estimates that each SCI entity (other than plan processors) would spend approximately 3 hours annually to review the designation standards to ensure that they remain up-to-date and to prepare any necessary amendments, to review its list of designated members or participants, and to update prior Commission notifications with respect to the standards for designation and the list of designees.⁴⁰¹ Therefore, the Commission preliminarily estimates that proposed Rule 1000(b)(9)(iii) would carry an ongoing annual burden of 3 hours per respondent, for a total ongoing annual burden of 126 hours for all respondents.⁴⁰² For plan processors, the Commission preliminarily estimates that proposed Rule 1000(b)(9)(iii) would carry an ongoing annual cost of \$1,200 hours per respondent,⁴⁰³ for a total ongoing annual cost of \$2,400 for all plan processors.⁴⁰⁴

³⁹⁸ Based on Commission staff experience in reviewing SRO proposed rule change filings and past estimates for Rule 19b-4 and Form 19b-4, the Commission estimates as follows: (Compliance Manager at 10 hours + Attorney at 15 hours + Compliance Clerk at 10 hours) × (42 potential respondents) = 1,470 hours to comply with Rule 1000(b)(9)(iii).

³⁹⁹ 35 hours × \$400 per hour for outside legal services = \$14,000. See *infra* note 463.

⁴⁰⁰ \$14,000 × 2 plan processors = \$28,000.

⁴⁰¹ In establishing this estimate, the Commission has considered its estimate of the burden for an SRO to amend a Form 19b-4. Specifically, the Commission estimated that an amendment to Form 19b-4 would require approximately 3 hours to complete. See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287, 60294 (October 8, 2004).

⁴⁰² (Compliance Manager at 1.5 hours + Attorney at 1.5 hours) × (42 potential respondents) = 126 hours.

⁴⁰³ 3 hours × \$400 per hour for outside legal services = \$1,200. See *infra* note 463.

⁴⁰⁴ \$1,200 × 2 plan processors = \$2,400.

2. Notice, Dissemination, and Reporting Requirements for SCI Entities

The proposed rules that would require an SCI entity to notify the Commission of SCI events, disseminate certain SCI events to members or participants, and submit specified reports are discussed more fully in Section III.C above.

a. Notices Required by Proposed Rule 1000(b)(4)

Proposed Rule 1000(b)(4) would require notice of SCI events to the Commission.⁴⁰⁵ The burden estimates to comply with proposed Rule 1000(b)(4) include the burdens associated with Commission notification of immediate notification SCI events and the submission of Form SCI in accordance with the instructions thereto.

Proposed Rule 1000(b)(4)(i) would require an SCI entity, upon any responsible SCI personnel becoming aware of a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion, to notify the Commission of such SCI event. As noted above, notification required by proposed Rule 1000(b)(4)(i) may be done orally or in writing. The Commission preliminarily estimates that each SCI entity would experience an average of 40 immediate notification SCI events per year.⁴⁰⁶ The Commission further

⁴⁰⁵ See supra note 351 and accompanying text for details regarding the content of Form SCI. Currently, there is no law or rule specifically requiring SCI entities to notify the Commission of systems problems in writing or in a specific format. Nevertheless, voluntary communications of systems problems to Commission staff occur in a variety of ways, including by telephone and email. The Commission notes that proposed Rule 1000(b)(4) would impose a new reporting requirement on SCI entities, regardless of whether they currently voluntarily notify the Commission of SCI events on an ad hoc basis. As such, the Commission preliminarily believes that a history of voluntarily reporting such events to the Commission would not lessen the future burden of reporting such events to the Commission on Form SCI as required under proposed Rule 1000(b)(4).

⁴⁰⁶ Because the threshold for immediate notification SCI events is lower than the threshold for dissemination SCI events, the estimate for the number of immediate notification SCI

preliminarily estimates that one-fourth of the notifications under proposed Rule 1000(b)(4)(i) would be in writing (i.e., 10 written notifications and 30 oral notifications), and that each written notification would require an in-house attorney half an hour to prepare and submit to the Commission.⁴⁰⁷ Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the notification requirement of proposed Rule 1000(b)(4)(i) would be 5 hours annually per respondent, and 220 hours annually for all respondents.⁴⁰⁸

Proposed Rule 1000(b)(4)(ii) would require an SCI entity, within 24 hours of any responsible SCI personnel becoming aware of any SCI event, to submit a written notification to the Commission on Form SCI pertaining to such SCI event. The Commission preliminarily estimates that each SCI entity would experience an average of 65 SCI events per year.⁴⁰⁹ Thus,

events is higher than the estimate for the number of dissemination SCI events (i.e., 15 dissemination SCI events). See *infra* notes 414 and 424 and accompanying text.

⁴⁰⁷ The Commission preliminarily believes this estimate is appropriate because the notification required by proposed Rule 1000(b)(4)(i) would not be submitted through Form SCI, and is intended to be an immediate initial notification when responsible SCI personnel becomes aware of an immediate notification SCI event which contains only information known to the SCI entity at that time.

⁴⁰⁸ (Attorney at 0.5 hour for each notice) × (10 notices) = 5 hours. 5 hours × (44 potential respondents) = 220 burden hours. The Commission preliminarily believes that SCI entities would handle internally the work associated with the notification requirement of proposed Rule 1000(b)(4)(i). But see *infra* Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁰⁹ This estimate is based on Commission's experience with the ARP Inspection Program. Approximately 175 ARP incidents were reported to the Commission in 2011 by entities that currently participate in the ARP Inspection Program. Of those entities, the Commission believes that 28 would fall under the proposed definition of SCI entity (since 2011, an additional entity has become part of the ARP Inspection Program, for a total of 29 SCI entities that participate in the ARP Inspection Program). Thus, each entity reported an average of approximately 6 incidents in 2011. Because the proposed definition of "SCI event" is broader than the types of events covered by the current ARP Inspection Program, and SCI entities are not currently required by law or rule to report

the Commission preliminarily estimates that there would be an average of 65 SCI event notices per year for each respondent. The Commission preliminarily estimates that each notification under proposed Rule 1000(b)(4)(ii) would require an average of 20 burden hours,⁴¹⁰ with a compliance manager and in-house attorney each spending approximately 10 hours in collaboration to draft, review, and submit the report. Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the reporting requirement of proposed Rule 1000(b)(4)(ii) would be 1,300 hours annually per respondent, and 57,200 hours annually for all respondents.⁴¹¹

systems issues to the Commission, the Commission preliminarily believes that the number of SCI events that would be reported to the Commission would be significantly more than the number of incidents reported in 2011. The Commission acknowledges that, because these types of incidents are not required to be reported under the current ARP Inspection Program, this figure is largely an estimate and is difficult to ascertain. As such, the Commission seeks comment on the accuracy of this estimate.

⁴¹⁰ This estimate includes the burden for attaching an Exhibit 3 (i.e., a copy in pdf or html format of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website). This estimate is based on Commission staff experience with the ARP Inspection Program. The Commission has also considered its estimate of the burden to complete Form 19b-4. Specifically, the Commission has estimated that an SRO would spend approximately 39 hours to complete a Form 19b-4. See 2012 Rule 19b-4 collection of information revision Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewDocument?ref_nbr=201207-3235-002. However, the Commission notes that, unlike Form 19b-4, the information contained in Form SCI would only be factual. As such, the Commission preliminarily believes that the amount of time for an SCI entity to complete Form SCI would be less than the amount of time for an SRO to complete Form 19b-4.

⁴¹¹ (Compliance Manager at 10 hours for each notice + Attorney at 10 hours for each notice) × (65 notices) = 1,300 hours. 1,300 hours × (44 potential respondents) = 57,200 burden hours. The Commission preliminarily believes that SCI entities would handle internally the work associated with the notification requirement of proposed Rule 1000(b)(4)(ii). But see *infra* Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

Proposed Rule 1000(b)(4)(iii) would require an SCI entity to submit written updates to the Commission on Form SCI pertaining to SCI events on a regular basis, or at such frequency as reasonably requested by a representative of the Commission, until such time as the SCI event is resolved. Based on Commission staff's experience with the ARP Inspection Program, the Commission preliminarily estimates that, on average, each SCI entity would submit 5 updates per year under proposed Rule 1000(b)(4)(iii), and that each update would require an average of 3 burden hours,⁴¹² with a compliance manager and in-house attorney each spending approximately 1.5 hours in collaboration to draft, review, and submit the update. Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the continuous update requirement of proposed Rule 1000(b)(4)(iii) would be 15 hours annually per respondent, and 660 hours annually for all respondents.⁴¹³

b. Disseminations Required by Proposed Rule 1000(b)(5)

Proposed Rule 1000(b)(5) would require disseminations of information to members or participants relating to dissemination SCI events. Based on the definition of dissemination SCI event, the Commission preliminarily estimates that each SCI entity would experience an average

⁴¹² This estimate includes the burden for attaching an Exhibit 3 (i.e., a copy in pdf or html format of any information disclosed to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website). In determining this estimate, the Commission has considered its estimate of the burden for an SRO to amend a Form 19b-4. Specifically, the Commission estimated that an amendment to Form 19b-4 would require approximately 3 hours to complete. See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287, 60294 (October 8, 2004).

⁴¹³ (Compliance Manager at 1.5 hours for each update + Attorney at 1.5 hours for each update) × (5 updates) = 15 hours. 15 hours × (44 potential respondents) = 660 burden hours. The Commission preliminarily believes that SCI entities would handle internally the work associated with the reporting requirement of proposed Rule 1000(b)(4)(iii). But see *infra* Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

of 14 dissemination SCI events each year that are not systems intrusions, resulting in an average of 14 member or participant dissemination per respondent per year under proposed Rule 1000(b)(5)(i).⁴¹⁴

Proposed Rule 1000(b)(5)(i)(A) would require an SCI entity, promptly after any responsible SCI personnel becomes aware of a dissemination SCI event other than a systems intrusion, to disseminate to its members or participants the following information about such SCI event: (1) the systems affected by the SCI event; and (2) a summary description of the SCI event.

In addition to the costs for outside legal advice discussed below,⁴¹⁵ the Commission estimates that each initial member or participant dissemination would require an average of 3 hours to prepare and make available to members or participants, with an in-house attorney spending approximately 2.67 hours in drafting and reviewing the dissemination, and a webmaster spending approximately 0.33 hours in making the dissemination available to members or

⁴¹⁴ This estimate is based on the Commission's experience with the ARP Inspection Program. Specifically, as indicated in the Economic Analysis Section, approximately 175 ARP incidents were reported to the Commission in 2011 by entities that currently participate in the ARP Inspection Program. Of those entities, the Commission believes that 28 would fall under the proposed definition of SCI entity (since 2011, an additional entity has become part of the ARP Inspection Program, for a total of 29 SCI entities that participate in the ARP Inspection Program). Thus, each entity reported an average of approximately 6 incidents in 2011. Further, because proposed Rule 1000(a) would define an SCI event to mean a systems disruption, systems compliance issue, or systems intrusion, the scope of proposed Regulation SCI is broader than the scope of incidents reported to the ARP Inspection Program, which covers certain systems disruptions and intrusions. As such, the Commission preliminarily believes that an estimate of 14 dissemination SCI events per year per SCI entity (other than systems disruptions) is appropriate.

⁴¹⁵ See infra note 428.

participants.⁴¹⁶ Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the initial member or participant dissemination requirement of proposed Rule 1000(b)(5)(i)(A) would be approximately 42 hours annually per respondent, and 1,848 hours annually for all respondents.⁴¹⁷

Proposed Rule 1000(b)(5)(i)(B) would require the SCI entity to further disseminate, when known, the following information to its members or participants: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; and (3) a description of the progress of its corrective action for the SCI event and when the SCI event has been or is expected to be resolved. In addition to the outside costs discussed below,⁴¹⁸ the Commission preliminarily estimates that each update under proposed Rule 1000(b)(5)(i)(B) would require an average of 5 hours to prepare and make

⁴¹⁶ This estimate is based on Commission staff's experience with the ARP Inspection Program. The Commission estimates that each initial member or participant dissemination would require an average of 3 hours to prepare and make available the information to members or participants, instead of 20 hours as estimated for proposed Rule 1000(b)(4)(ii), because the information required to be disseminated to members or participants would have been used for the initial written notification on Form SCI. For the same reason, the Commission preliminarily believes that an in-house attorney will prepare the dissemination, which will be made available to members or participants by the webmaster.

⁴¹⁷ (Attorney at 2.67 hours for each notification + Webmaster at 0.33 hour for each notification) × (14 notifications per year) = 42 hours. 42 hours × (44 potential respondents) = 1,848 burden hours. The Commission preliminarily believes that SCI entities would handle internally most of the work associated with the notification requirement of proposed Rule 1000(b)(5)(i)(A). But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴¹⁸ See infra note 428.

available to members or participants,⁴¹⁹ with an in-house attorney spending approximately 4.67 hours in drafting and reviewing the update, and a webmaster spending approximately 0.33 hour in making the update available to members or participants. Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the update requirement of proposed Rule 1000(b)(5)(i)(B) would be approximately 70 hours annually per respondent, and 3,080 hours annually for all respondents.⁴²⁰

Proposed Rule 1000(b)(5)(i)(C) would require an SCI entity to provide regular updates to members or participants of any information required to be disseminated under proposed Rule 1000(b)(5). As noted above, there were approximately 175 ARP incidents reported to the Commission in 2011. These incidents had durations ranging from under one minute to 24 hours, with most incidents having a duration of less than 2 hours. Based on the relatively short duration of the ARP incidents reported to the Commission in 2011, the Commission preliminarily estimates that, on average, each SCI entity would provide one regular update per year per dissemination SCI event under proposed Rule 1000(b)(5)(i)(C). In addition to the costs for

⁴¹⁹ The Commission estimates that each update under proposed Rule 1000(b)(5)(i)(B) would require an average of 5 hours to prepare and make available to members or participants, instead of 20 hours as estimated for proposed Rule 1000(b)(4)(ii), because the information required to be disseminated to members or participants would have been used for the initial written notification on Form SCI.

⁴²⁰ (Attorney at 4.67 hours for each update + Webmaster at 0.33 hour for each update) × (14 updates per year) = 70 hours. 70 hours × (44 potential respondents) = 3,080 burden hours. This estimate is based on Commission staff's experience with the ARP Inspection Program. The Commission preliminarily believes that SCI entities would handle internally most of the work associated with the update requirement of proposed Rule 1000(b)(5)(i)(B). But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

outside legal advice discussed below,⁴²¹ the Commission preliminarily estimates that each update would require an average of 1 hour to prepare and make available to members or participants,⁴²² with an in-house attorney spending approximately 0.67 hour in drafting and reviewing the update, and a webmaster spending approximately 0.33 hour in making the update available to members or participants. Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with the regular update requirement of proposed Rule 1000(b)(5)(i)(C) would be approximately 14 hours annually per respondent, and 616 hours annually for all respondents.⁴²³

Under proposed Rule 1000(b)(5)(ii), promptly after any responsible SCI personnel becomes aware of a systems intrusion, the SCI entity would be required to disseminate to its members or participants a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion has been or is expected to be resolved, unless the SCI entity determines that dissemination of such information

⁴²¹ See *infra* note 428.

⁴²² This estimate is based on the estimated burden to complete and submit a written update for an SCI event on Form SCI. See *supra* note 412. The Commission estimates that each regular update to a member or participant dissemination would require an average of 1 hour to prepare and make available to members or participants, instead of 3 hours, because the information required to be provided to the Commission in the updates on Form SCI would also be used for updating the member or participation dissemination. For the same reason, the Commission preliminarily believes that an attorney will prepare the update, which will be made available by the webmaster.

⁴²³ (Attorney at 0.67 hour for each update + Webmaster at 0.33 hour for each update) × (14 updates per year) = 14 hours. 14 hours × (44 potential respondents) = 616 burden hours. This estimate is based on Commission staff's experience with the ARP Inspection Program. The Commission preliminarily believes that SCI entities would handle internally most of the work associated with the update requirement of proposed Rule 1000(b)(5)(i)(C). But see *infra* Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, and documents the reasons for such determination.

Based on the definition of dissemination SCI event, the Commission preliminarily estimates that each SCI entity would experience an average of 1 dissemination SCI event that is a systems intrusion each year, resulting in an average of 1 member or participant dissemination per respondent per year under proposed Rule 1000(b)(5)(ii).⁴²⁴ In addition to the costs for outside legal advice discussed below,⁴²⁵ the Commission estimates that each member or participant dissemination under proposed Rule 1000(b)(5)(ii) would require an average of 3 hours to prepare and make available to members or participants, with an in-house attorney spending approximately 2.67 hours in drafting and reviewing the dissemination, and a webmaster spending approximately 0.33 hours in making the dissemination available to members or participants.⁴²⁶

Thus, the Commission preliminarily estimates that the initial and ongoing burden to comply with

⁴²⁴ Based on Commission's experience with the ARP Inspection Program, the Commission preliminarily believes each SCI entity will experience on average less than one systems intrusion per year. However, for purposes of the PRA, the Commission preliminarily estimates one systems intrusion per respondent per year.

⁴²⁵ See infra note 428.

⁴²⁶ This estimate includes any burden for an SCI entity to document its reason for determining that dissemination of information regarding a systems intrusion would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion. This estimate is based on Commission staff's experience with the ARP Inspection Program. In determining this estimate, the Commission considered its burden estimate for proposed Rule 1000(b)(5)(i)(A) because both rules would require the dissemination of certain basic information about a dissemination SCI event. For the same reason, the Commission preliminarily believes that an in-house attorney will prepare the dissemination, which will be made available by the webmaster.

the member or participant dissemination requirement under proposed Rule 1000(b)(5)(ii) would be approximately 3 hours annually per respondent, and 132 hours annually for all respondents.⁴²⁷

The Commission preliminarily believes that SCI entities would internally handle most of the work associated with disseminating information on dissemination SCI events to members or participants. However, based on its experience with the ARP Inspection Program, the Commission preliminarily believes that SCI entities also would seek outside legal advice in the preparation of the disseminations required under proposed Rule 1000(b)(5), and that the average cost of outside legal advice would be \$15,000 per respondent per year, for a total of \$660,000 for all respondents per year.⁴²⁸

c. Notices Required by Proposed Rules 1000(b)(6)

Proposed Rules 1000(b)(6) would require notification to the Commission on Form SCI of material systems changes. The Commission preliminarily believes this work would be conducted internally.⁴²⁹ The burden estimates to comply with proposed Rule 1000(b)(6) include the burdens associated with submission of Form SCI in accordance with the instructions thereto.

Specifically, proposed Rule 1000(b)(6) would require the SCI entity, absent exigent circumstances, to notify the Commission on Form SCI at least 30 calendar days before the

⁴²⁷ (Attorney at 2.67 hours for each notification + Webmaster at 0.33 hour for each notification) × (1 notification per year) = 3 hours. 3 hours × (44 potential respondents) = 132 burden hours. The Commission preliminarily believes that SCI entities would handle, internally most of the work associated with the dissemination requirement of proposed Rule 1000(b)(5)(ii). But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴²⁸ (\$15,000 outside legal cost) × (44 potential respondents) = \$660,000.

⁴²⁹ But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

implementation of any planned material systems change, including a description of the planned material systems change as well as the expected dates of commencement and completion of the implementation of such change.⁴³⁰ Based on its experience with the ARP Inspection Program, Commission preliminarily estimates that there would be an average of 60 planned material systems changes per respondent per year.⁴³¹ As such, the Commission preliminarily estimates that there would be an average of 60 notifications per respondent per year, and each notification would require an average of 2 hours to prepare and submit,⁴³² with an attorney spending approximately 0.33 hours and a senior systems analyst spending approximately 1.67 hours in drafting and reviewing the notification. For the 15 SCI entity respondents that do not currently participate in the ARP Inspection Program, the Commission preliminarily estimates that the initial and ongoing burden to comply with the notice requirement of proposed Rule 1000(b)(6) would be approximately 120 hours annually per respondent, and 1,800 hours annually for all

⁴³⁰ If exigent circumstances exist, or if the information previously provided to the Commission regarding any planned material systems change becomes materially inaccurate, the SCI entity would be required to notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable.

⁴³¹ This estimate includes instances where the information previously provided to the Commission regarding any planned material systems change becomes materially inaccurate.

⁴³² In estimating the burden imposed by proposed Rule 1000(b)(6), the Commission also considered its burden estimate for the same reporting requirement that was proposed for SB SEFs. Specifically, proposed Rule 822(a)(4) in the SB SEF Proposing Release would require an SB SEF to notify the Commission in writing at least 30 calendar days before the implementation of material systems changes. The Commission estimated that there would be an average of 60 notifications per respondent per year, and that each notification would require an average of 2 internal burden hours. See SB SEF Proposing Release, supra note 297, at 11029.

respondents.⁴³³ Because SCI entities that currently participate in the ARP Inspection Program already notify the Commission of planned material systems changes, the Commission preliminarily estimates that these entities would be starting from a baseline of fifty percent, and that the increased burden for these 30 SCI entities would be 60 hours annually per respondent.⁴³⁴ The Commission preliminarily estimates that the total initial and ongoing burden for SCI entities that currently participate in the ARP Inspection Program would be 60 hours annually per respondent, for a total burden of 1,740 hours for all of these respondents.⁴³⁵ Thus, the total estimated initial and ongoing burden to comply with proposed Rule 1000(b)(6) would be 3,540 for all respondents.⁴³⁶

d. SCI Review Required by Proposed Rule 1000(b)(7)

Proposed Rule 1000(b)(7) would require each SCI entity to conduct an SCI review of its compliance with Regulation SCI not less than once each calendar year, and submit a report of the SCI review to its senior management for review no more than 30 calendar days after completion of such SCI review. The Commission preliminarily estimates that the initial and ongoing burden of conducting an SCI review and submitting the SCI review to senior management of the SCI

⁴³³ (Attorney at 0.33 hour for each notification + Senior Systems Analyst at 1.67 hours for each notification) × (60 notifications per year) = 120 hours. 120 hours × (15 potential respondents) = 1,800 burden hours.

⁴³⁴ (Attorney at 0.33 hour for each notification + Senior Systems Analyst at 1.67 hours for each notification) × (30 additional notifications per year) = 60 hours. The Commission preliminarily believes that the burden would result from the proposed broadened definitions of “SCI systems” and “SCI security systems” in Regulation SCI, as well as the shift from a voluntary to a mandatory regulatory environment.

⁴³⁵ (60 burden hours) × (29 potential respondents) = 1,740 burden hours.

⁴³⁶ (1,800 burden hours for SCI entities that do not currently participate in the ARP Inspection Program + 1,740 burden hours for SCI entities that currently participate in the ARP Inspection Program) = 3,540 burden hours.

entity for review would be approximately 625 hours for each respondent⁴³⁷ and 27,500 hours annually for all respondents.⁴³⁸

e. Reports Required by Proposed Rule 1000(b)(8)

Proposed Rule 1000(b)(8) would require each SCI entity to submit certain reports to the Commission. The burden estimates to comply with proposed Rule 1000(b)(8) include the burdens associated with submission of Form SCI in accordance with the instructions thereto.

Pursuant to proposed Rule 1000(b)(8)(i), each SCI entity would be required to submit to the Commission, as an attachment to Form SCI, a report of the SCI review required by proposed Rule 1000(b)(7), together with any response by senior management of the SCI entity, within 60 calendar days after its submission to senior management of the SCI entity. The Commission estimates that each SCI entity would require 1 hour to submit the SCI review using Form SCI, for a total annual initial and ongoing burden of 44 hours for all respondents.⁴³⁹

⁴³⁷ This estimate is the Commission's preliminary best estimate and is based on Commission staff's experience with SCI entities participating in the ARP Inspection Program. This estimate also is the same as the Commission's burden estimate for internal audits of SB SEFs. See SB SEF Proposing Release, *supra* note 297, at 11028. Proposed Rule 822 in the SB SEF Proposing Release would require an SB SEF to submit to the Commission an annual objective review of the capability of its systems that support or are integrally related to the performance of its activities, provided that if a review is performed internally, an external firm shall report on the objectivity, competency, and work performance with respect to the internal review. The Commission recognizes that the annual review requirement proposed for SB SEFs is different, in certain respects, from the requirement under proposed Rule 1000(b)(7). Specifically, the scopes of the reviews are different because proposed Rule 1000(b)(7) would require an SCI review of an SCI entity's compliance with proposed Regulation SCI. Further, proposed Rule 1000(b)(7) would not require an external review of an internal SCI review. Nevertheless, the Commission preliminarily believes that these differences should not result in differences in the burden estimate for these similar internal audits.

⁴³⁸ (Attorney at 80 hours + Manager Internal Auditor at 170 hours + Senior Systems Analyst at 375 hours) × (44 potential respondents) = 27,500 burden hours.

⁴³⁹ (Attorney at 1 hour for each submission) × (1 submission per year) = 1 burden hour. (1 burden hour) × (44 potential respondents) = 44 burden hours.

Proposed Rule 1000(b)(8)(ii) would require each SCI entity to submit, using Form SCI, a report within 30 calendar days after the end of June and December of each year, containing a summary description of the progress of any material systems changes during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of their implementation. The Commission preliminarily estimates that the initial and ongoing burden to comply with proposed Rule 1000(b)(8)(ii) would be approximately 60 hours per respondent per report or 120 hours annually,⁴⁴⁰ and 5,280 hours annually for all respondents.⁴⁴¹

3. Requirements to Take Corrective Actions, Identify Immediate Notification SCI Events, and Identify Dissemination SCI Events

The proposed rules that could result in SCI entities establishing additional processes for compliance with proposed Regulation SCI are discussed more fully in Section III.C above.

a. Requirement to Take Corrective Actions

Proposed Rule 1000(b)(3) would require an SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take corrective action which shall include, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably

⁴⁴⁰ The Commission notes that SCI entities currently do not submit to the Commission written semi-annual notifications of material systems changes. This estimate is based on Commission staff's experience with various entities through the ARP Inspection Program.

⁴⁴¹ (Attorney at 10 hours for each report + Senior Systems Analyst at 50 hours for each report) × (2 reports per year) = 120 burden hours. (120 burden hours) × (43 potential respondents) = 5,280 burden hours. The Commission preliminarily believes that SCI entities would handle internally the work associated with the reporting requirement of proposed Rule 1000(b)(8)(ii). But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

practicable. Based on its experience with the ARP Inspection Program, the Commission believes that entities that participate in the ARP Inspection Program already take corrective actions in response to a systems issue, and believes that other SCI entities also take corrective actions in response to a systems issue. Nevertheless, the Commission preliminarily believes that proposed Rule 1000(b)(3) would likely result in SCI entities revising their policies in this regard, which would help to ensure that their information technology staff has the ability to access systems in order to take appropriate corrective actions. As such, proposed Rule 1000(b)(3) may impose a one-time implementation burden on SCI entities associated with developing a process for ensuring that they are prepared for the corrective action requirement. Proposed Rule 1000(b)(3) also may impose periodic burdens on SCI entities in reviewing that process. The Commission preliminarily estimates that the initial burden to implement such a process would be 42 hours per SCI entity⁴⁴² or 1,848 hours for all SCI entities.⁴⁴³ The Commission also preliminarily estimates

⁴⁴² This estimate is based on the Commission's burden estimate for proposed Rule 1000(b)(1) because both proposed Rule 1000(b)(1) and proposed Rule 1000(b)(3) would result in certain policies and procedures or processes. Because proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would require the establishment of five policies and procedures at a minimum, the Commission preliminarily estimates that the initial burden to establish the process to comply with proposed Rule 1000(b)(3) would be one-fifth of the initial burden to comply with proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data), or 42 hours (210 hours ÷ 5). Further, the Commission preliminarily estimates that the hourly breakdown between different staff of the SCI entity would be in the same ratio as the Commission's estimate for proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) – Compliance Manager at 16 hours, Attorney at 16 hours, Senior Systems Analyst at 5 hours, and Operations Specialist at 5 hours. These estimates reflect the Commission's preliminary view that SCI entities

that the ongoing burden to review such a process would be 12 hours annually per SCI entity⁴⁴⁴ or 528 hours annually for all SCI entities.⁴⁴⁵

b. Requirements to Identify Immediate Notification SCI Events and Dissemination SCI Events

Proposed Rule 1000(a) would define a “dissemination SCI event” to mean an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that

would establish the process for compliance with proposed Rule 1000(b)(3) internally. But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁴³ (42 hours) × (44 potential respondents) = 1,848 burden hours.

⁴⁴⁴ This estimate is based on the Commission’s burden estimate for proposed Rule 1000(b)(1) because both proposed Rule 1000(b)(1) and proposed Rule 1000(b)(3) would result in certain policies and procedures or processes. Because proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would require the establishment and review of five policies and procedures at a minimum, the Commission preliminarily estimates that the ongoing burden to review the process to comply with proposed Rule 1000(b)(3) would be one-fifth of the ongoing burden to comply with proposed Rule 1000(b)(1) (except for policies and procedures for Standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data), or 12 hours (60 hours ÷ 5). Further, the Commission preliminarily estimates that the hourly breakdown between different staff of the SCI entity would be in the same ratio as the Commission’s estimate for proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) – Compliance Manager at 6 hours and Attorney at 6 hours. These estimates reflect the Commission’s preliminary view that SCI entities would review the process for compliance with proposed Rule 1000(b)(3) internally. But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁴⁵ (12 hours) × (44 potential respondents) = 528 burden hours.

results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.

When an SCI event occurs, an SCI entity would need to determine whether the event is an immediate notification SCI event or a dissemination SCI event, because the proposed rules would impose different obligations on SCI entities for these types of SCI events. As such, immediate notification SCI events and dissemination SCI events may impose an initial one-time implementation burden on SCI entities in developing a process to ensure that they are able to quickly and correctly make a determination regarding whether the SCI event is subject to proposed Rule 1000(b)(4)(i) or (b)(5). The definition may also impose periodic burdens on SCI entities in reviewing that process.

Because the ARP Inspection Program already provides for the reporting of “significant system changes” and “significant system outages” to Commission staff,⁴⁴⁶ the Commission believes that, as compared to entities that do not participate in the ARP Inspection Program, entities that currently participate in the ARP Inspection Program would already have internal processes for determining the significance of a systems issue.⁴⁴⁷ Therefore, the Commission preliminarily estimates that the proposed definition would impose half as much burden on entities that participate in the ARP Inspection Program as compared to entities that do not participate in the ARP Inspection Program.

⁴⁴⁶ See supra notes 33 and 35 and accompanying text.

⁴⁴⁷ The Commission recognizes that “significant system changes” and “significant system outages” differ from the proposed definitions of “immediate notification SCI event” and “dissemination SCI event.”

For SCI entities that currently do not participate in the ARP Inspection Program, the Commission preliminarily believes that the initial burden would be 42 hours per entity⁴⁴⁸ or 630 hours for all such entities.⁴⁴⁹ For entities that currently participate in the ARP Inspection Program, the Commission preliminarily believes that the initial burden would be 21 hours⁴⁵⁰ per

⁴⁴⁸ This estimate is based on the Commission's burden estimate for proposed Rule 1000(b)(1) because proposed Rule 1000(b)(1), the proposed definition of "immediate notification SCI event," and the definition of "dissemination SCI event" would result in certain policies and procedures or processes. Because proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would require the establishment of five policies and procedures at a minimum, the Commission preliminarily estimates that the initial burden to establish the process regarding the SCI event determinations would be one-fifth of the initial burden to comply with proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data), or 42 hours (210 hours ÷ 5). Further, the Commission preliminarily estimates that the hourly breakdown between different staff of the SCI entity would be in the same ratio as the Commission's estimate for proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) – Compliance Manager at 16 hours, Attorney at 16 hours, Senior Systems Analyst at 5 hours, and Operations Specialist at 5 hours. These estimates reflect the Commission's preliminary view that SCI entities would internally establish the process for determining whether an SCI event is an immediate notification SCI event or dissemination SCI event. But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁴⁹ (42 hours) × (15 potential respondents) = 630 burden hours.

⁴⁵⁰ 42 burden hours × 50% = 21 burden hours. These estimates reflect the Commission's preliminary view that SCI entities would internally establish the process for determining whether an SCI event is an immediate notification SCI event or dissemination SCI event. But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

entity or 609 hours for all such entities.⁴⁵¹ For SCI entities that currently do not participate in the ARP Inspection Program, the Commission preliminarily believes that ongoing burden would be 12 hours annually per entity⁴⁵² or 180 hours for all such entities.⁴⁵³ For SCI entities that currently participate in the ARP Inspection Program, the Commission preliminarily believes that ongoing burden would be 6 hours annually⁴⁵⁴ per entity or 174 hours for all such entities.⁴⁵⁵

⁴⁵¹ (21 burden hours) × (29 potential respondents) = 609 burden hours.

⁴⁵² This estimate is based on the Commission's burden estimate for proposed Rule 1000(b)(1) because proposed Rule 1000(b)(1), the proposed definition of "immediate notification SCI event," and the proposed definition of "dissemination SCI event" would result in certain policies and procedures or processes. Because proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) would require the establishment and maintenance of five policies and procedures at a minimum, the Commission preliminarily estimates that the ongoing burden to review the process regarding the SCI event determinations would be one-fifth of the ongoing burden to comply with proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data), or 12 hours (60 hours ÷ 5). Further, the Commission preliminarily estimates that the hourly breakdown between different staff of the SCI entity would be in the same ratio as the Commission's estimate for proposed Rule 1000(b)(1) (except for policies and procedures for standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data) – Compliance Manager at 6 hours and Attorney at 6 hours. These estimates reflect the Commission's preliminary view that SCI entities would internally review the process for determining whether an SCI event is an immediate notification SCI event or dissemination SCI event. But see infra Section IV.D.6, requesting comment on whether some SCI entities, particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁵³ (12 burden hours) × (15 potential respondents) = 180 burden hours.

⁴⁵⁴ 12 burden hours × 50% = 6 burden hours. These estimates reflect the Commission's preliminary view that SCI entities would internally review the process for determining whether an SCI event is an immediate notification SCI event or dissemination SCI event. But see infra Section IV.D.6, requesting comment on whether some SCI entities,

4. Recordkeeping Requirements

As more fully discussed in Section III.D above, proposed Rule 1000(c) would specifically require SCI entities other than SCI SROs to make, keep, and preserve at least one copy of all documents relating to its compliance with proposed Regulation SCI. The Commission is not proposing a new recordkeeping requirement for SCI SROs because the documents relating to compliance with proposed Regulation SCI are subject to their existing recordkeeping and retention requirements under Rule 17a-1 under the Exchange Act.⁴⁵⁶ Because Rule 17a-1 under the Exchange Act requires every SRO to keep on file for a period of not less than 5 years, the first 2 years in an easily accessible place, at least one copy of all documents that it makes or receives respecting its self-regulatory activities, and that all such documents be made available for examination by the Commission and its representatives, the Commission believes that proposed Rule 1000(c) would not result in any burden that is not already accounted for in the Commission's burden estimates for Rule 17a-1.

For SCI entities other than SCI SROs, Regulation SCI-related records would be required to be kept for a period of not less than five years, the first two years in a place that is readily accessible to the Commission or its representatives for inspection and examination.⁴⁵⁷ Upon the request of any representative of the Commission, an SCI entity would be required to promptly

particularly those that do not currently participate in the ARP Inspection Program, would seek to outsource this work and what the cost to outsource this work would be.

⁴⁵⁵ (6 burden hours) × (29 potential respondents) = 174 burden hours.

⁴⁵⁶ See 17 CFR 240.17a-1.

⁴⁵⁷ Under the proposal, upon or immediately prior to ceasing to do business or ceasing to be registered under the Exchange Act, an SCI entity would be required to take all necessary action to ensure that the records required to be made, kept, and preserved by Rule 1000(c) would be accessible to the Commission and its representatives in the manner required and for the remainder of the period required by proposed Rule 1000(c). See proposed Rule 1000(c)(3).

furnish to the possession of such representative copies of any documents required to be kept and preserved by it pursuant to proposed Rule 1000(c).

For SCI entities other than SCI SROs, the Commission preliminarily estimates that the initial and ongoing burden to make, keep, and preserve records relating to compliance with proposed Regulation SCI would be approximately 25 hours annually per respondent⁴⁵⁸ for a total annual burden of 450 hours for all respondents.⁴⁵⁹ In addition, the Commission estimates that each SCI entity other than an SCI SRO would incur a one-time burden to set up or modify an existing recordkeeping system to comply with proposed Rule 1000(c). Specifically, the Commission estimates that, for each SCI entity other than an SCI SRO, setting up or modifying a recordkeeping system would create an initial burden of 170 hours and \$900 in information

⁴⁵⁸ This estimate is based on the Commission's experience with examinations of registered entities, the Commission's estimated burden for an SRO to comply with Rule 17a-1, and the Commission's estimated burden for a SB SEF to keep and preserve documents made or received in the conduct of its business. Specifically, the Commission estimated 50 burden hours per respondent per year in connection with Rule 17a-1 and proposed Rule 818(a) and (b) in the SB SEF Proposing Release. See 2010 Extension of Rule 17a-1 Supporting Statement, Office of Management and Budget, available at: http://www.reginfo.gov/public/do/PRAViewICR?ref_nbr=201007-3235-003 and SB SEF Proposing Release, *supra* note 297, at 11029. Because the recordkeeping requirements under Rule 17a-1 and under proposed Rule 818(a) and (b) are broader than the recordkeeping requirement under proposed Rule 1000(c), the Commission preliminarily believes that an estimate of 25 burden hours per year per SCI entity is appropriate. Further, the Commission notes that this burden estimate includes the burden imposed by proposed Rule 1000(e). Specifically, proposed Rule 1000(e) would provide that, if the records required to be filed or kept by an SCI entity under proposed Regulation SCI are prepared or maintained by a service bureau or other recordkeeping service on behalf of the SCI entity, the SCI entity would be required to ensure that the records are available for review by the Commission and its representatives by submitting a written undertaking, in a form acceptable to the Commission, by such service bureau or other recordkeeping service, which is signed by a duly authorized person at such service bureau or other recordkeeping service.

⁴⁵⁹ (Compliance Clerk at 25 hours) × (18 potential respondents) = 450 burden hours.

technology costs for purchasing recordkeeping software,⁴⁶⁰ for a total initial burden of 3,060 hours⁴⁶¹ and a total initial cost of \$16,200.⁴⁶²

The Commission preliminarily believes that proposed Rule 1000(c)(3), which would require an SCI entity, upon or immediately prior to ceasing to do business or ceasing to be registered under the Exchange Act, to take all necessary action to ensure that the records required to be made, kept, and preserved by Rule 1000(c)(1) and Rule (c)(2) remain accessible to the Commission and its representatives in the manner and for the remainder of the period required by Rule 1000(c), would not result in any additional paperwork burden that is not already accounted for in the Commission's burden estimates for proposed Rule 1000(c)(1) and Rule 1000(c)(2).

6. Request for Comment on Extent and Cost of Outsourcing

209. The Commission's estimates of the hourly burdens discussed above reflect the Commission's preliminary view that SCI entities would conduct the work proposed to be required by proposed Rules 1000(a), 1000(b)(1), 1000(b)(2), 1000(b)(3), 1000(b)(4), 1000(b)(5), 1000(b)(6), 1000(b)(7), 1000(b)(8), and 1000(b)(9) internally. The Commission acknowledges, however, that some SCI entities, particularly smaller SCI entities, and/or SCI entities that do not

⁴⁶⁰ This estimate is based on the Commission's experience with examinations of registered entities and the Commission's estimated burden for an SB SEF to keep and preserve documents made or received in the conduct of its business. Specifically, the Commission estimated that setting up or modifying a recordkeeping system under proposed Rule 818 would create an initial burden of 345 hours and \$1,800 in information technology costs per respondent. See SB SEF Proposing Release, *supra* note 297, at 11030. Because the recordkeeping requirements under proposed Rule 818 are broader than the recordkeeping requirement under proposed Rule 1000(c), the Commission preliminarily believes that the estimates of 170 initial burden hours and \$900 in initial cost are appropriate.

⁴⁶¹ (170 burden hours) × (18 potential respondents) = 3,060 burden hours.

⁴⁶² (\$900) × (18 potential respondents) = \$16,200.

currently participate in the ARP Inspection Program, may elect to outsource the work if it would be more cost effective to so do. The Commission does not at this time have sufficient information to reasonably estimate the cost to outsource the work proposed to be required by proposed Rules 1000(a), 1000(b)(1), 1000(b)(2), 1000(b)(3), 1000(b)(4), 1000(b)(5), 1000(b)(6), 1000(b)(7), 1000(b)(8), and 1000(b)(9), or the number of entities that would choose to outsource this work, for purposes of the PRA. The Commission seeks comment, however, on its preliminary view that SCI entities would conduct such work internally. Further, the Commission seeks comment on whether some SCI entities would in fact find it more cost effective to outsource the work that would be required to comply with the proposed rules, and if so, how many of these SCI entities would therefore outsource this work and at what cost.

For purposes of facilitating such comment, presented below are certain preliminary assumptions and calculations regarding such potential outsourcing on which the Commission requests comment. Specifically, for purposes of soliciting comment, the Commission is assuming that it would take the same number of hours for a consultant and/or outside attorney to complete the work to be required by proposed Rules 1000(a), 1000(b)(1), 1000(b)(2), 1000(b)(3), 1000(b)(4), 1000(b)(5), 1000(b)(6), 1000(b)(7), 1000(b)(8), and 1000(b)(9), as it would take for an SCI entity to complete that work internally (using the Commission's preliminary estimates above). Further, the Commission is assuming that work would be conducted at a rate of \$400 per hour.⁴⁶³

⁴⁶³ This is based on an estimated \$400 per hour cost for outside consulting and/or legal services. This is the same estimate used for the Commission's consolidated audit trail rule. See Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (August 1, 2012).

Based on the forgoing assumptions, the estimated cost to outsource the work that the Commission preliminarily assumed would be done internally would be as follows:

For identification of immediate notification SCI events and dissemination SCI events: The initial cost would be (a) for an SCI entity that has not participated in the ARP Inspection Program, \$16,800;⁴⁶⁴ and (b) for an SCI entity that currently participates in the ARP Inspection Program, \$8,400.⁴⁶⁵ The ongoing annual cost would be (a) for an SCI entity that has not participated in the ARP Inspection Program, \$4,800;⁴⁶⁶ and (b) for an SCI entity that currently participates in the ARP Inspection Program, \$2,400.⁴⁶⁷

For proposed Rule 1000(b)(1) except proposed Rule 1000(b)(1)(i)(F): The initial cost would be (a) for an SCI entity that has not participated in the ARP Inspection Program, \$84,000;⁴⁶⁸ and (b) for an SCI entity that currently participates in the ARP Inspection Program, \$42,000.⁴⁶⁹ The ongoing annual costs would be (a) for an SCI entity that has not participated in the ARP Inspection Program, \$24,000;⁴⁷⁰ and (b) for an SCI entity that currently participates in the ARP Inspection Program, \$12,000.⁴⁷¹

For proposed Rule 1000(b)(1)(i)(F): The initial cost for each SCI entity would be \$52,000.⁴⁷² The ongoing annual cost for each SCI entity would be \$52,000.⁴⁷³

⁴⁶⁴ 42 hours × \$400 = \$16,800.

⁴⁶⁵ 21 hours × \$400 = \$8,400.

⁴⁶⁶ 12 hours × \$400 = \$4,800.

⁴⁶⁷ 6 hours × \$400 = \$2,400.

⁴⁶⁸ 210 hours × \$400 = \$84,000.

⁴⁶⁹ 105 hours × \$400 = \$42,000.

⁴⁷⁰ 60 hours × \$400 = \$24,000.

⁴⁷¹ 30 hours × \$400 = \$12,000.

⁴⁷² 130 hours × \$400 = 52,000.

For proposed Rule 1000(b)(2): The initial cost for each SCI entity would be \$72,000.⁴⁷⁴ The ongoing annual cost would be (a) for an SCI entity that is an SCI SRO, \$48,000;⁴⁷⁵ and (b) for an SCI entity that is not an SCI SRO, \$24,000.⁴⁷⁶

For proposed Rule 1000(b)(3): The initial cost for each SCI entity would be \$16,800.⁴⁷⁷ The ongoing annual cost for each SCI entity would be \$4,800.⁴⁷⁸

For proposed Rule 1000(b)(4): The initial and the ongoing annual cost for each SCI entity would be (a) for proposed Rule 1000(b)(4)(i), \$2,000;⁴⁷⁹ (b) for proposed Rule 1000(b)(4)(ii), \$520,000;⁴⁸⁰ and (c) for proposed Rule 1000(b)(4)(iii), \$6,000.⁴⁸¹

For proposed Rule 1000(b)(5): The initial and the ongoing annual cost for each SCI entity would be (a) for proposed Rule 1000(b)(5)(i)(A), \$16,800;⁴⁸² (b) for proposed Rule 1000(b)(5)(i)(B), \$28,000;⁴⁸³ (c) for proposed Rule 1000(b)(5)(i)(C), \$5,600;⁴⁸⁴ and (d) for proposed Rule 1000(b)(5)(ii), \$1,200.⁴⁸⁵

⁴⁷³ 130 hours × \$400 = 52,000.

⁴⁷⁴ 180 hours × \$400 = \$72,000.

⁴⁷⁵ 120 hours × \$400 = \$48,000.

⁴⁷⁶ 60 hours × \$400 = \$24,000.

⁴⁷⁷ 42 hours × \$400 = \$16,800.

⁴⁷⁸ 12 hours × \$400 = \$4,800.

⁴⁷⁹ 5 hours × \$400 = \$2,000.

⁴⁸⁰ 1,300 hours × \$400 = \$520,000.

⁴⁸¹ 15 hours × \$400 = \$6,000.

⁴⁸² 42 hours × \$400 = \$16,800.

⁴⁸³ 70 hours × \$400 = \$28,000.

⁴⁸⁴ 14 hours × \$400 = \$5,600.

⁴⁸⁵ 3 hours × \$400 = \$1,200.

For proposed Rule 1000(b)(6): The initial and ongoing annual cost would be (a) for SCI entities that do not currently participate in the ARP Inspection Program, \$48,000;⁴⁸⁶ and (b) for SCI entities that currently participate in the ARP Inspection Program, \$24,000.⁴⁸⁷

For proposed Rule 1000(b)(7): The initial and ongoing annual cost would be \$250,000 for each SCI entity.⁴⁸⁸

For proposed Rule 1000(b)(8): The initial and ongoing annual cost for each SCI entity would be (a) for proposed Rule 1000(b)(8)(i), \$400;⁴⁸⁹ and (b) for proposed Rule 1000(b)(8)(ii), \$48,000 for each SCI entity.⁴⁹⁰

For proposed Rule 1000(b)(9)(i) and (ii): The initial annual cost would be \$52,000 for each SCI entity.⁴⁹¹ The ongoing annual cost would be \$38,000 for each SCI entity.⁴⁹²

For proposed Rule 1000(b)(9)(iii): The initial annual cost would be \$14,000 for each SCI entity.⁴⁹³ The ongoing annual cost would be \$1,200 for each SCI entity.⁴⁹⁴

210. As discussed above, the Commission requests comment on these preliminary estimates regarding potential outsourcing and the underlying assumptions. For example, is it reasonable to assume that the number of hours for a consultant and/or outside attorney to complete the work would be the same as the number of hours for internal staff to complete the

⁴⁸⁶ 120 hours × \$400 = \$48,000.

⁴⁸⁷ 60 hours × \$400 = \$24,000.

⁴⁸⁸ 625 hours × \$400 = \$250,000.

⁴⁸⁹ 1 hour × \$400 = \$400.

⁴⁹⁰ 120 hours × \$400 = 48,000.

⁴⁹¹ 130 hours × \$400 = \$52,000.

⁴⁹² 95 hours × \$400 = \$38,000.

⁴⁹³ 35 hours × \$400 = \$14,000.

⁴⁹⁴ 3 hours × \$400 = \$1,200.

work? If not, why not? Are there certain types of SCI entities (e.g., those having relatively few employees or a smaller number of systems) that would be more likely to find it cost effective to outsource the work, either initially or an ongoing basis? Please explain. Would the cost to outsource vary depending on the extent and volume of the outsourcing, or the period of time over which such outsourcing took place? Please explain.

7. Total Paperwork Burden under Regulation SCI

Based on the foregoing, the Commission preliminarily estimates that the total one-time initial burden for all SCI entities to comply with Regulation SCI would be 133,482 hours⁴⁹⁵ and the total one-time initial cost would be \$2.6 million.⁴⁹⁶ The Commission preliminarily estimates that the total annual ongoing burden for all SCI entities to comply with Regulation SCI would be 117,258 hours⁴⁹⁷ and the total annual ongoing cost would be \$738,400.⁴⁹⁸

211. The Commission seeks comment on the collection of information burdens associated with proposed Regulation SCI. Specifically:

212. Do commenters agree with the Commission's estimate of the number of respondents required to comply with proposed Regulation SCI? Why or why not?

⁴⁹⁵ 133,482 hours = 26,765 (policies and procedures/mandatory testing requirements) + 100,120 (notification, dissemination, and reporting) + 3,087 (requirements to take corrective actions, identify immediate notification SCI events, and identify dissemination SCI events) + 3,510 (recordkeeping).

⁴⁹⁶ \$2.6 million = \$1.9 million (policies and procedures/mandatory testing requirements) + \$660,000 (notification, dissemination, and reporting) + \$16,200 (recordkeeping).

⁴⁹⁷ 117,258 hours = 15,806 (policies and procedures/mandatory testing requirements) + 100,120 (notification, dissemination, and reporting) + 882 (requirements to take corrective actions, identify immediate notification SCI events, and identify dissemination SCI events) + 450 (recordkeeping).

⁴⁹⁸ \$738,400 = \$78,400 (policies and procedures/mandatory testing requirements) + \$660,000 (notification, dissemination, and reporting).

213. Do commenters agree with the Commission's estimate of the burden for SCI entities to comply proposed Regulation SCI? Why or why not?

214. Would there be additional burdens, beyond those described here, associated with the collection of information under proposed Regulation SCI? Please explain.

215. How much additional burden would proposed Regulation SCI impose upon those SCI entities that already are voluntarily in compliance with existing ARP Policy Statements?

216. Would SCI entities generally perform the work required by proposed Regulation SCI internally or outsource the work?

E. Collection of Information is Mandatory

All collections of information pursuant to the proposed rules would be a mandatory collection of information.

F. Confidentiality

To the extent that the Commission receives confidential information pursuant to the reports and submissions that SCI entities would submit under proposed Form SCI, such information would be kept confidential, subject to the provisions of applicable law.⁴⁹⁹

G. Retention Period of Recordkeeping Requirements

SCI entities would be required to retain records and information under proposed Regulation SCI for a period of not less than five years, the first two years in a place that is readily accessible to the Commission or its representatives.⁵⁰⁰

⁴⁹⁹ See, e.g., 5 U.S.C. § 552. Exemption 4 of the Freedom of Information Act provides an exemption for "trade secrets and commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. § 552(b)(4). Exemption 8 of the Freedom of Information Act provides an exemption for matters that are "contained in or related to examination, operating, or condition reports prepared by, on behalf of, or for the use of an agency responsible for the regulation or supervision of financial institutions." 5 U.S.C. § 552(b)(8)).

H. Request for Comments

217. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comment to: (1) evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility; (2) evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information; (3) enhance the quality, utility, and clarity of the information to be collected; and (4) minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 3208, New Executive Office Building, Washington, DC 20503; and should send a copy to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-01-13. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 calendar days of publication. The Commission will submit the proposed collection of information to OMB for approval. Requests for the materials to be submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-01-13, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

⁵⁰⁰ See proposed Rule 1000(c).

I. Reduced Burdens from Proposed Repeal of Rule 301(b)(6) (OMB Control Number 3235-0509)

The instant proposal also would amend Regulation ATS under the Exchange Act, by removing paragraph (b)(6) of Rule 301 thereunder.⁵⁰¹ Removal of Rule 301(b)(6) would eliminate certain “collection of information” requirements within the meaning of the PRA that the Commission has submitted to OMB in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11, and that OMB has approved. The approved collection of information is titled “Rule 301: Requirements for Alternative Trading Systems,” and has a valid OMB control number of 3235-0509.⁵⁰² Some of the information collection burdens imposed by Regulation ATS would be reduced by the proposed repeal of Rule 301(b)(6). Specifically, the paperwork burdens that would be eliminated by the repeal of Rule 301(b)(6) would be: (i) burdens on ATSS associated with the requirement to make records relating to any steps taken to comply with systems capacity, integrity and security requirements under Rule 301 (estimated to be 20 hours and \$2,212),⁵⁰³ and (ii)

⁵⁰¹ See 17 CFR 242.301(b)(6). See also Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844 (December 22, 1998) (“ATS Release”).

⁵⁰² See Rule 301: Requirements for Alternative Trading Systems OMB Control No: 3235-0509 (Rule 301 supporting statement), available at: <http://www.reginfo.gov>. This approval has an expiration date of February 28, 2014.

⁵⁰³ The Commission estimated that two alternative trading systems that register as broker-dealers and comply with Regulation ATS would trigger this requirement, and that the average compliance burden for each response would be 10 hours of in-house professional work at \$316 per hour. Thus, the total compliance burden per year was estimated to be 20 hours (2 respondents × 10 hours = 20 hours). The total annualized cost burden was estimated to be \$2,212 ($\$316 \times 20 \text{ hours} \times 35\% = \$2,212$). See Rule 301: Requirements for Alternative Trading Systems OMB Control No: 3235-0509 (Rule 301 supporting statement), available at: <http://www.reginfo.gov>.

burdens on ATSS associated with the requirement to provide notices to the Commission to report systems outages (estimated to be 2.5 hours and \$276.50).⁵⁰⁴

The Commission will submit the proposed amended collection of information to reflect these reductions to OMB for approval. Requests for the materials to be submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-01-13, and be submitted to the Securities and Exchange Commission, Office of Investor Education and Advocacy, 100 F Street, NE, Washington, DC 20549-0213.

V. Economic Analysis

A. Background

As discussed more fully above, the Commission believes that the convergence of several developments – the evolution of the markets to become significantly more dependent upon sophisticated automated systems (driven by regulatory developments and the continual evolution of technologies for generating, routing, and executing orders), the limitations of the existing ARP Inspection Program, and the lessons of recent events (as discussed in Section I.D above) – highlight the need to consider an updated and formalized regulatory framework for ensuring that the U.S. securities trading markets develop and maintain systems with adequate capacity, integrity, resiliency, availability, and security, and reinforce the requirement that SCI systems operate in compliance with the Exchange Act. The Commission is also cognizant of the

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The Commission estimated that two alternative trading systems that register as broker-dealers and comply with Regulation ATS would meet the volume thresholds that trigger systems outage notice obligations approximately 5 times a year, and that the average compliance burden for each response would be .25 hours of in-house professional work at \$316 per hour. Thus, the total compliance burden per year was estimated to be 2.5 hours (2 respondents × 5 responses each × .25 hours = 2.5 hours). The total annualized cost burden was estimated to be \$276.50 ($\$316 \times .25 \text{ hours per response} \times 10 \text{ responses} \times 35\% = \276.50). See id.

comments made at the Roundtable and the comment letters submitted in connection with the Roundtable.⁵⁰⁵ Proposed Regulation SCI would codify and enhance the Commission's ARP Inspection Program, as well as establish specific requirements to help ensure that the SCI systems of SCI entities operate in compliance with the federal securities laws and rules.

Specifically, proposed Regulation SCI would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets, as well as written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended, including in a manner in compliance with the federal securities laws and rules, and its own rules or governing documents, as applicable. Proposed Regulation SCI also would require SCI entities to provide certain notices and reports to the Commission on Form SCI regarding, among other things, SCI events and material systems changes. Further, proposed Regulation SCI would require SCI entities to disseminate information to members or participants relating to dissemination SCI events and to begin taking appropriate corrective action upon any responsible SCI personnel becoming aware of an SCI event. Additionally, proposed Regulation SCI would require each SCI entity to conduct an SCI review at least annually, and submit a report of such review to the Commission, together with any response by senior management. Further, proposed Regulation SCI would require an SCI entity, with respect to its business continuity and disaster recovery plans, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans and coordinate such testing

⁵⁰⁵ See supra Section I.D.

with other SCI entities. Proposed Regulation SCI would also require SCI entities to make, keep, and preserve books and records related to compliance with Regulation SCI.

The Commission is sensitive to the economic effects of proposed Regulation SCI, including its costs and benefits.⁵⁰⁶ As discussed further below, the Commission requests comment on all aspects of the costs and benefits of the proposal, including any effects the proposed rules may have on efficiency, competition, and capital formation.

B. Economic Baseline

As noted in Section I.A above, all registered national securities exchanges, all active registered clearing agencies, FINRA, two plan processors, one ATS, and one exempt clearing agency participate in the current ARP Inspection Program, which covers their automated systems.⁵⁰⁷ Under the ARP policy statements and through the ARP Inspection Program, these entities, among other things, are expected to establish current and future capacity estimates, conduct capacity stress tests, conduct annual reviews of whether affected systems can perform adequately in light of estimated capacity levels, and identify possible threats to the systems.⁵⁰⁸ The ARP policy statements and Commission staff letters address, among other things,

⁵⁰⁶ See also supra Section III.F (requesting comment on applying proposed Regulation SCI to SB SDRs and/or SB SEFs and discussing the potential costs and benefits of applying proposed Regulation SCI to SB SDRs and/or SB SEFs).

⁵⁰⁷ As noted above, the Commission, in the ARP I Release, defined the term “automated systems” to refer “collectively to computer systems for listed and OTC equities, as well as options, that electronically route orders to applicable market makers and systems that electronically route and execute orders, including the data networks that feed the systems... [and encompasses] systems that disseminate transaction and quotation information and conduct trade comparisons prior to settlement, including the associated communication networks.” See supra note 12.

⁵⁰⁸ A more complete description of the history of the ARP Inspection Program is discussed in supra Section I.A.

independent reviews, the reporting of certain systems changes, intrusions, and outages, and the need to comply with relevant laws and rules.⁵⁰⁹

Trading volume in the securities markets has become increasingly dispersed across a broader range of market centers in recent years,⁵¹⁰ with ATSS accounting for a significant portion of volume.⁵¹¹ However, no ATSS currently meet or exceed the volume thresholds that would trigger compliance with the system safeguard requirements of Rule 301(b)(6) of Regulation ATS.⁵¹² Thus, while ATSS comprise a significant portion of consolidated volume, only one ATSS currently participates in the ARP Inspection Program.⁵¹³ Dark pools alone comprised approximately 13 percent of consolidated volume last spring,⁵¹⁴ but also are not part of the ARP Inspection Program. Further, ATSS that trade fixed income securities, including municipal and corporate debt securities, and non-NMS stocks (also referred to as OTC equities) are not represented in the ARP Inspection Program and do not meet the current thresholds in Regulation ATS for the application of systems safeguard rules.

Proposed Regulation SCI would apply to SROs (including national securities exchanges,⁵¹⁵ national securities associations, registered clearing agencies, and the MSRB⁵¹⁶),

⁵⁰⁹ The ARP policy statements and Commission staff letters are discussed in supra Section I.A.

⁵¹⁰ See supra notes 44, 47, and 51.

⁵¹¹ See supra note 50 and accompanying text.

⁵¹² See supra Section III.B.1.

⁵¹³ See supra note 25 and accompanying text.

⁵¹⁴ See Nina Mehta, Dark Pools Capture Record U.S. Volume Share, Bloomberg (March 1, 2012), available at: http://rbll.com/news_details.aspx?id=187.

⁵¹⁵ Proposed Regulation SCI would not apply to an exchange that lists or trades security futures products that is notice-registered with the Commission as a national securities exchange pursuant to Section 6(g) of the Exchange Act, including security futures exchanges. See supra note 97 and accompanying text.

SCI ATSS,⁵¹⁷ plan processors,⁵¹⁸ and exempt clearing agencies subject to ARP.⁵¹⁹ As such, proposed Regulation SCI would specifically cover the trading of NMS stocks, OTC equities, listed options, and debt securities. The proposed rules also would impact multiple markets for services, including the markets for trading services, listing services, regulation and surveillance services, clearing and settlement services, and market data.

As indicated above, many of the entities in these service markets are currently covered by the ARP Inspection Program. Therefore, the Commission recognizes that any economic effects, including costs and benefits, should be compared to a baseline of current practices that recognizes current practices pursuant to the ARP Inspection Program and the limitations of the ARP Inspection Program discussed in Section I.C above.⁵²⁰ In addition to the ARP Inspection Program, Commission staff has provided guidance to ARP entities on certain aspects of the ARP Inspection Program (e.g., in the 2001 Staff ARP Interpretive Letter).⁵²¹ Further, Commission staff has provided guidance on issues outside the current scope of the ARP Inspection Program (e.g., in the 2009 Staff Systems Compliance Letter), but that are proposed to be addressed by

⁵¹⁶ In 2011, the total par amount of municipal securities traded was approximately \$3.3 trillion in approximately 10.4 million trades. See MSRB 2011 Fact Book at 8-9, available at: <http://www.msrb.org/msrb1/pdfs/MSRB2011FactBook.pdf>.

⁵¹⁷ See *supra* Section III.B.1 for the discussion of SCI ATSS.

⁵¹⁸ In addition, the Commission is soliciting comment on whether, and if so how, proposed Regulation SCI should apply to SB SDRs and/or SB SEFs. See *supra* Section III.F.

⁵¹⁹ See *supra* Section III.B.1 for the discussion of exempt clearing agencies subject to ARP.

⁵²⁰ See also *supra* Section I.A for the discussion of the current scope of the ARP Inspection Program. The Commission acknowledges that, to the extent current practices of SCI entities have been informed by the ARP policy statements, such practices have not been subject to a cost-benefit analysis and that the discussion herein considers only the incremental costs and benefits (i.e., compared to current practices).

⁵²¹ See 2001 Staff ARP Interpretive Letter, *supra* note 35.

Regulation SCI.⁵²² Below, the Commission provides information on the current practices related to the types of market events addressed by proposed Regulation SCI, including, where available, information the Commission may have on the frequency of such events. In addition, the Commission describes why each relevant service market may not be structured in a way as to create a competitive incentive to prevent the occurrence of these market events.⁵²³

1. SCI Events

a. Systems Disruptions

Currently, market participants employ a variety of measures to avoid systems disruptions for a variety of reasons, including to maintain competitive advantages, to provide optimal service to members with access to the trading and/or other services provided by the entity, to comply with legal obligations and, where applicable, to participate in the ARP Inspection Program. The range of such measures are possibly highly variable among SCI entities and within the systems employed by SCI entities. For example, matching engines are likely accorded high priority given the importance of low latency in trading. Industry standards are not codified for such entities and systems, except such as in an entity's rulebook or subscriber agreement. Typically, however, market participants follow industry standards and take measures that include weekend system testing and internal performance monitoring.

When system disruptions do occur, market participants take corrective action in the interest of remaining competitive, to provide optimal service, and to comply with legal obligations. To place the effectiveness of the current ARP Inspection Program in perspective, there were approximately 175 ARP incidents reported to the Commission in 2011. These

⁵²² See 2009 Staff Systems Compliance Letter, supra note 36.

⁵²³ The Commission compares current practices to each of the proposed rules in infra Section V.B.3.

incidents had durations ranging from under one minute to 24 hours, with most incidents having a duration of less than 2 hours. As noted above, the Commission believes that clearing systems and matching engines generally are given greater priority than other systems at SCI entities with regard to corrective action. In addition, the Commission believes that SCI entities that currently participate in the ARP Inspection Program strive to adhere to the next business day resumption standard for trading and two-hour resumption standard for clearance and settlement services, standards which the proposed rule would codify for all SCI entities.

As discussed in Section I.A, participation in the ARP Inspection Program entails, among other things, conducting annual assessments of affected systems, providing notifications of significant system changes to the Commission, and reporting significant system outages to the Commission. Further, Commission staff has provided guidance to the SROs and other participants in the ARP Inspection Program on what should be considered a “significant system change” and a “significant system outage” for purposes of reporting systems changes and problems to Commission staff.⁵²⁴ As such, the Commission believes that entities that currently participate in the ARP Inspection Program have certain processes for determining whether a systems change or outage is “significant.” Specifically, the 2001 Staff ARP Interpretive Letter sets forth the types of outages and changes that should be reported to the Commission and the timing of reporting. Also, as discussed below, the ARP policy statements are focused on automated systems. Specifically, entities that participate in the ARP Inspection Program follow the ARP policy statements with respect to systems that directly support trading, clearance and settlement, order routing, and market data. While generally only trading, clearance and settlement, order routing, and market data systems follow the guidelines in the ARP policy

⁵²⁴ See supra note 35.

statements, ARP staff inspects all the categories of systems that are included in the proposed definition of “SCI systems.”⁵²⁵ However, ARP staff generally inspects systems that are not directly related to trading, clearance and settlement, order routing, or market data only if they detect red flags.

As discussed above, the ARP Inspection Program has garnered participation by all active registered clearing agencies, all registered national securities exchanges, FINRA, plan processors, one ATS, and one exempt clearing agency.⁵²⁶ Specifically, the Commission estimates that there are currently 29 SCI entities that are participants in the ARP Inspection Program.⁵²⁷ As noted, there were approximately 175 ARP incidents reported to the Commission in 2011. Although some entities provide the public with notices of outages,⁵²⁸ others may choose otherwise and are not required to do so.

Further, as discussed above, pursuant to Rule 301(b)(6) of Regulation ATS, certain aspects of the ARP policy statements apply to ATSS that meet the thresholds set forth in that rule.⁵²⁹ Currently, no ATSS meet such thresholds and, as such, none are required by Commission

⁵²⁵ See *supra* Section III.B.2.

⁵²⁶ See *supra* Section I.A.

⁵²⁷ See *supra* note 368.

⁵²⁸ See e.g., NYSE Market Status, available at: <http://usequities.nyx.com/nyse/market-status>; NYSE Amex Options Outage Update, available at: http://www.nyse.com/pdfs/Trader_Update_Amex_Outage_0928.pdf; and NYSE Arca, Recap: Exchange Outage on Monday Morning March 7, 2011, available at: <http://www.nyse.com/pdfs/2011037ExchangeOutageNotice.pdf>.

⁵²⁹ Specifically, Rule 301(b)(6) of Regulation ATS applies to ATSS that, during at least four of the preceding six months, had: (A) with respect to any NMS stock, 20 percent or more of the average daily volume reported by an effective transaction reporting plan; (B) with respect to equity securities that are not NMS stocks and for which transactions are reported to a self-regulatory organization, 20 percent or more of the average daily volume as calculated by the self-regulatory organization to which such transactions are reported; (C) with respect to municipal securities, 20 percent or more of the average daily volume

rule to implement systems safeguard measures. The Commission recognizes that it is in the interest of every market participant that does not participate in the ARP Inspection Program to try to avoid systems disruptions. Specifically, the Commission understands that generally, ATSS, like entities that currently participate in the ARP Inspection Program, employ a variety of measures to avoid systems disruptions, including systems testing, performance monitoring, and the use of fail-over back-up systems. In fact, one ATS currently voluntarily participates in the ARP Inspection Program.⁵³⁰ However, inasmuch as the ARP Inspection Program and the testing done and other measures taken by those entities that participate in the program have been beneficial to the industry, the systems of SCI entities could still be improved. For example, contingency planning in preparation of catastrophic events has not been fully adequate, as evidenced in the wake of Superstorm Sandy, when an extended shutdown of the equities and options markets resulted from, among other things, the exchanges' belief regarding the inability of some market participants to adequately operate from the backup facilities of all market centers.⁵³¹ Although testing protocols were in place and the chance to participate in such testing was available, not all members or participants participated in such testing.⁵³² Proposed Regulation SCI would require that designated members or participants of an SCI entity participate in scheduled functional and performance testing of the operation of the SCI entity's business continuity and disaster recovery plans, including its backup systems, and further require

traded in the United States; or (D) with respect to corporate debt securities, 20 percent or more of the average daily volume traded in the United States. See 17 CFR 242.301(b)(6)(i).

⁵³⁰ See supra note 91.

⁵³¹ See supra Section I.D; see also supra Section III.C.7.

⁵³² See supra Section I.D. In addition, the Commission understands that the scope of testing was limited.

that SCI entities coordinate the testing of such plans on an industry- or sector-wide basis with other SCI entities. The Commission preliminarily believes that these proposed requirements would mitigate the chances of similar disruptions in the future.⁵³³

b. Systems Compliance Issues

Currently, systems compliance issues (as proposed to be defined in Rule 1000(a)) are not covered by the ARP Inspection Program. However, national securities exchanges are subject to Section 6(b) of the Exchange Act, which requires an exchange to be organized and to have the capacity to carry out the purposes of the Exchange Act and to comply with the provisions of the Exchange Act, the rules and regulations thereunder, and its own rules.⁵³⁴ FINRA is subject to Section 15A(b) of the Exchange Act, which requires a national securities association to be organized and have the capacity to carry out the purposes of the Exchange Act and to comply with the provisions of the Exchange Act, the rules and regulations thereunder, the MSRB rules, and its own rules.⁵³⁵ Further, an ATS could face Commission sanctions if it fails to comply with relevant federal securities laws and rules and regulations thereunder. Events such as those described above have recently drawn attention to systems compliance issues.⁵³⁶ In part due to the fact that systems compliance issues are not part of the ARP Inspection Program, the Commission does not receive comprehensive data regarding such issues and, thus, their incidence cannot be concretely quantified. However, based on Commission staff's experience with SROs and the rule filing process, the Commission estimates that there are likely approximately seven systems compliance issues per SCI entity per year.

⁵³³ See proposed Rule 1000(b)(9); see also supra Section III.C.7.

⁵³⁴ See 15 U.S.C. 78f(b).

⁵³⁵ See 15 U.S.C. 78o-3(b).

⁵³⁶ See, e.g., supra notes 62-63 and accompanying text.

c. Systems Intrusions

In ARP I, the Commission stated its view that SROs should promptly notify Commission staff of any instances in which unauthorized persons gained or attempted to gain access to SRO systems.⁵³⁷ Market participants employ a wide variety of measures to prevent and respond to systems intrusions. Generally, market participants use measures such as firewalls to prevent systems intrusions, and use detection software to identify systems intrusions. Once an intrusion has been identified, the affected systems typically would be isolated and quarantined, and forensics would be performed. Several SCI entities have been the subject of security issues in recent years.⁵³⁸ The Commission believes that, currently, these events are rarely revealed to the public or to the members or participants of SCI entities.

2. Potential for Market Solutions

This section discusses potential market solutions and their shortcomings. Various SCI and non-SCI entities offer and compete to provide services in markets for trading services, listing services, regulatory services, clearance and settlement services, and market data. The markets for each of these services are regulated and competitive, which may make it difficult to determine if markets are functioning well due to competitive pressure or regulation, and how much can be attributed to each. However, there are limitations to such competition and following is a discussion of some limitations that are common to all of these markets. Notwithstanding what may be the limitations to competition in each of these markets, the Commission is also mindful, in evaluating whether, and if so, how, to regulate in this space, of

⁵³⁷ See ARP I, supra note 1. See also text accompanying supra note 17.

⁵³⁸ For example, as discussed above, in February 2011, NASDAQ OMX Group, Inc. announced that hackers had penetrated certain of its computer networks. See supra note 61 and accompanying text.

the need to craft rules that appropriately take into account the tradeoffs between the resulting costs and benefits, and the effects on efficiency, competition, and capital formation, that would accompany such regulation.

Market participants may be unaware when SCI events disrupt transactions due to, for example, a lack of timely and consistently disseminated information about SCI events. First, providers of services that experience SCI events may lack the incentive to disclose such events. Second, other providers of services may choose to not publicly comment on the identity of providers who experienced SCI events.⁵³⁹ For example, providers of trading services may choose not to point to other providers because the next SCI event may occur on their own systems. In addition, a person or entity pointing at other providers may be exposed to litigation risks.

While some SCI events may not directly impact markets, they are still an indication of the risk of SCI events at a given SCI entity. It is likely that market participants assume that services operate as promised until an SCI event occurs. Reputation and good experiences with a trading venue may cause market participants to trust its effectiveness. In the absence of problems, however, a system may be assumed to be fully functional. Once a problem occurs, market participants will update their prior assumptions and should correctly infer that the system is not as robust as previously believed.

⁵³⁹ The Commission notes, however, that certain providers of trading services do provide public disclosure of systems issues at another provider. For example, when one trading venue perceives that a second venue is non-responsive when orders are routed to that second venue, the first venue will declare self-help under Rule 611 of Regulation NMS, which permits the first venue to cease to route orders to the second venue in certain instances. Certain trading venues would provide public notification of self-help. See, e.g., NASDAQ Market System Status, available at: <http://www.nasdaqtrader.com/Trader.aspx?id=MarketSystemStatus>.

Moreover, in the case of SCI events that disrupt the entire market or large portions of it (e.g., the data outages during the flash crash on May 6, 2010), all providers of trading services may be affected at the same time and, as a result, market participants may find it challenging to identify service providers with lower risks of such SCI events. In light of the foregoing, members and participants of SCI entities would be important recipients of information disseminated about SCI events because they are the parties who would most naturally need, want, and be able to act on the information and, where applicable, share such disseminated information to other interested market participants, as discussed further below.

a. Market for Trading Services

Trading services are offered by entities that would meet the definition of SCI entity, including equities exchanges, options exchanges, and SCI ATSS, as well as by entities that would not be included in the proposed definition of SCI entity, such as ATSS that are not SCI ATSS, OTC market makers, and broker-dealers. As discussed above in Section I.B, there are currently 13 national securities exchanges that trade equity securities, with none having an overall market share of greater than 20 percent.⁵⁴⁰ There are currently 11 national securities exchanges that trade options.⁵⁴¹ Of these exchanges, CBOE, ISE, and Nasdaq OMX Phlx have the most significant market share.⁵⁴² ATSS – both ECNs and dark pools – as well as OTC market makers and broker-dealers also execute substantial volumes of stocks and bonds.⁵⁴³

⁵⁴⁰ See *supra* note 47 and accompanying text. These national securities exchanges are: BATS; BATS-Y; CBOE; CHX; EDGA; EDGX; Nasdaq OMX BX; Nasdaq OMX Phlx; Nasdaq; NSX; NYSE; NYSE MKT; and NYSE Arca.

⁵⁴¹ These national securities exchanges are: BATS Exchange Options Market; BOX; C2; CBOE; ISE; MIAX; NASDAQ Options Market; Nasdaq OMX BX Options; Nasdaq OMX Phlx; NYSE Amex Options; and NYSE Arca.

⁵⁴² Specifically, during 2012, CBOE had 26.46% of the market share, Nasdaq OMX Phlx had 19.77%, and ISE had 15.78%. Calculated using data regarding number of contracts

With respect to the competitive nature of the market for trading services, as well as the limitations to the competitive effects, all providers of trading services compete and have incentives to avoid systems disruptions, systems compliance issues, and systems intrusions because, for example, brokers and other entities will be inclined to route orders away from trading venues that have frequent systems problems. Indeed, trading service providers expend resources to provide quality services and attempt to mitigate systems disruptions, systems compliance issues, and systems intrusions; however, it is not clear how to distinguish between efforts attributable to competitive pressures, rather than existing legal requirements and regulatory programs such as the ARP Inspection Program.⁵⁴⁴

The Commission recognizes that there may be limits with respect to the extent to which competition ameliorates systems problems associated with trading services. However, the Commission remains mindful of the need to craft rules that appropriately take into account the tradeoffs between the costs and benefits, and the effects on efficiency, competition, and capital formation, associated with any such rules. The Commission preliminarily believes that it is important for SCI entity members or participants to know about risks for SCI events at a given service provider. As discussed above, if information about SCI events is not disseminated to members or participants of SCI entities or are not attributable to specific SCI entities, market participants may misjudge the quality of trading services or otherwise make decisions without

traded from Options Clearing Corporation, available at: <http://www.theocc.com/market-data/volume/>.

⁵⁴³ As discussed above in Section III.B.1, the Commission estimates that the proposed definition of “SCI entity” would capture approximately 15 SCI ATs (10 SCI ATs in NMS stocks, two SCI ATs in non-NMS stocks, and three SCI ATs in municipal securities and corporate debt securities).

⁵⁴⁴ See also *supra* Section V.B.1, noting the various reasons why SCI entities currently take action to address systems problems.

fully accounting for such risks. Furthermore, as evidenced by the extended shutdown of the equities and options markets that resulted from, among other things, the exchanges' belief regarding the inability of some market participants to adequately operate from the backup facilities of all market centers, contingency planning has not been adequate to help prevent market-wide outages.⁵⁴⁵ For example, as noted above, the NYSE offered its members the opportunity to participate in testing of its backup systems, but not all members chose to participate in such testing, and the Commission understands that the scope of the test was limited.⁵⁴⁶

In addition, even though there are multiple trading venues, suppliers of trading services may have limited ability to transact in particular securities (e.g., certain index options may only trade on one options exchange). As a result, competition in the market for trading services may not sufficiently mitigate the occurrence of SCI events, and there may be insufficient disclosure of information regarding the quality of trading services offered by SCI entities.

b. Market for Listing Services

Certain SCI entities are in the market for listing services. In this market, exchanges compete to list issuers to collect listing fees and to provide ancillary services to listed companies. The NYSE and Nasdaq are the largest U.S. exchanges in terms of the number of equity securities listed, with the NYSE and Nasdaq serving as the listing market for 3,262 and 2,691 securities, respectively, as of February 4, 2013.⁵⁴⁷ U.S. exchanges face competition from other U.S. exchanges and from non-U.S. exchanges.

⁵⁴⁵ See supra Section I.D.

⁵⁴⁶ See supra Section I.D. See also supra notes 83 and 532 and accompanying text.

⁵⁴⁷ See NASDAQ Company List, available at: <http://www.nasdaq.com/screening/company-list.aspx>, for the list of companies listed on NYSE and NASDAQ.

Competition for listings may be limited by many factors. With respect to the limitations of competitive forces in the market for listing services, first, while a company can be listed on a certain exchange, trading does not necessarily occur on that exchange. In fact, the majority of trading occurs away from the listing exchange in today's U.S. equities markets.⁵⁴⁸ Second, there are switching costs associated with moving a listing from one exchange to another, which may cause issuers to remain at their current exchange, even in response to the occurrence of some SCI events. Third, certain exchanges also may be considered more "prestigious" than others and, to this extent, they may wield market power over other exchanges when competing for issuers. As a result, these exchanges may not be properly incentivized to provide the level of service they otherwise might if they were subject to greater competition. Members and participants of SCI entities that serve as underwriters to issuers would be important recipients of information disseminated by SCI entities about dissemination SCI events, particularly if they share such information with issuers making listing decisions.

c. Market for Regulation and Surveillance Services

Regulation and surveillance are required by statutes and rules and, therefore, all regulated market participants (e.g., exchanges or ATSS) have a demand for regulation and surveillance services. Suppliers in this market may be in-house or third parties, and potentially include all of the exchanges and FINRA. Because of regulatory services agreements ("RSAs") between FINRA and several national securities exchanges, as of February 2011, FINRA's Market Regulation Department was responsible for surveillance of 80 percent of the trading volume in

⁵⁴⁸ See BATS Market Volume Summary, available at: http://www.batstrading.com/market_summary/ (displaying the dispersion of trading in equity securities, which indicates that trading occurs away from listing exchanges).

U.S. equity markets and 35 percent of the volume in U.S. options markets.⁵⁴⁹ Also, in 2011, BATS and BATS-Y entered into RSAs with CBOE as the supplier.⁵⁵⁰ On the other hand, some exchanges have not entered into RSAs.

There are other regulatory services arrangements in addition to RSAs. For example, in 2008, the Commission declared effective a plan for allocating regulatory responsibilities pursuant to Rule 17d-2,⁵⁵¹ which among other things, allocated regulatory responsibility for the surveillance, investigation, and enforcement of Common Rules⁵⁵² over Common NYSE Members,⁵⁵³ with respect to NYSE-listed stocks and NYSE Arca-listed stocks, to NYSE and over Common FINRA Members,⁵⁵⁴ with respect to NASDAQ-listed stocks, Amex-listed stocks, and any CHX solely-listed stock, to FINRA.⁵⁵⁵

⁵⁴⁹ See FINRA 2011 Annual Regulatory and Examination Priorities Letter (February 8, 2011), available at: <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p122863.pdf>.

⁵⁵⁰ See BATS Global Markets, Inc., Amendment No. 5 to Form S-1, dated March 21, 2012 (Registration No. 333-174166).

⁵⁵¹ See Securities Exchange Act Release No. 58536 (September 12, 2008), 73 FR 54646 (September 22, 2008). See also 17 CFR 240.17d-2 (permitting SROs to propose joint plans for the allocation of regulatory responsibilities with respect to their common members).

⁵⁵² Such rules include federal securities laws and rules promulgated by the Commission pertaining to insider trading, and the rules of the plan participants that are related to insider trading as provided on Exhibit A to a Rule 17d-2 Plan. See Agreement for the Allocation of Regulatory Responsibility of Surveillance, Investigation and Enforcement for Insider Trading pursuant to §17(d) of the Securities Exchange Act of 1934, 15 U.S.C. §78q(d), and Rule 17d-2 thereunder.

⁵⁵³ Common NYSE Members include those who are members of the NYSE and of at least one of the plan participants. See *id.*

⁵⁵⁴ Common FINRA Members include those who are members of FINRA and of at least one of the plan participants. See *id.*

⁵⁵⁵ Participants in this plan are: BATS, BATS-Y, CBOE, CHX, EDGA, EDGX, FINRA, Nasdaq OMX BX, Nasdaq OMX Phlx, Nasdaq, NSX, NYSE, NYSE Amex, and NYSE

With respect to limitations of competition that are specific to the market for regulatory and surveillance services, if investors, issuers, or other market participants become aware of SCI events by virtue of the members or participants of SCI entities sharing information they have received about dissemination SCI events, and such information suggests that an SRO has low-quality regulation and surveillance, they may avoid such venues since they may feel that their interests are not being adequately protected. In the case of an RSA, there is competition among providers of such services because the user of the service can enter into a contract with a different provider. An SRO that purchases regulatory and surveillance services pursuant to an RSA retains the ultimate responsibility and liability for its self-regulatory obligations, and has an interest in seeking a service provider that would provide a high level of regulatory and surveillance services.⁵⁵⁶ Since the purchaser of these services could face Commission sanctions and experience damages to their reputation for violations resulting from inadequate regulation and surveillance, providers of these services may have the incentive to ensure that they provide a high level of service.

Arca. See id. In January 2011, this Rule 17d-2 plan was amended as a result of an agreement under which FINRA assumed the responsibility for performing the market surveillance and enforcement functions previously conducted by NYSE Regulation for its U.S. equities and options markets. Under the plan, FINRA charges participants a fee for the performance of regulatory responsibilities. See Securities Exchange Act Release No. 63750 (January 21, 2011), 76 FR 4948 (January 27, 2011). There are other types of Rule 17d-2 plans, including multilateral and bilateral plans. While other SROs perform some regulatory functions under the options-related market surveillance and Regulation NMS multiparty 17d-2 plans, FINRA provides the bulk of services under all other 17d-2 plans.

⁵⁵⁶ In contrast to an RSA, under Rule 17d-2(d) under the Exchange Act, “[u]pon the effectiveness of such a plan or part thereof, any self-regulatory organization which is a party to the plan shall be relieved of responsibility as to any person for whom such responsibility is allocated under the plan to another self-regulatory organization to the extent of such allocation.” 17 CFR 240.17d-2(d).

A factor that limits competition in this market is that it is highly concentrated. As noted above, FINRA accounts for the surveillance of 80 percent of trading volume in U.S. equity markets and, although any SRO could potentially be a provider of such services, not all choose to do so, and thus there may not be many alternatives for RSAs. With respect to the market for Rule 17d-2 plans, the Commission recognizes that the level of competition may be limited, as Rule 17d-2 was intended to address regulatory duplication for broker-dealers that are members of more than one SRO, and one of which is usually FINRA.

d. Market for Clearance and Settlement Services

Certain SCI entities are in the market for clearance and settlement services. There are seven registered clearing agencies with active operations – DTC, FICC, NSCC, OCC, ICE Clear Credit, ICE Clear Europe, and CME⁵⁵⁷ – as well as one exempt clearing agency.⁵⁵⁸ An SCI event in this market could have very disruptive and widespread effects on the financial markets. Because each clearing agency has a critical role in the operation of a particular product market, clearing agencies may already have heightened incentives to ensure that their systems have adequate levels of capacity, integrity, resiliency, availability, and security.⁵⁵⁹ At the same time, one of the major impediments to competition in this market is that it is highly concentrated in particular classes of securities (e.g., equities or options). This may limit incentives for clearing agencies to have levels of capacity, integrity, resiliency, availability, and security that are appropriate for their role in the securities market. Thus, for the market for clearance and

⁵⁵⁷ As noted above, active registered clearing agencies are part of the current ARP Inspection Program. See supra note 95 and accompanying text.

⁵⁵⁸ As noted above, Omgeo is part of the current ARP Inspection Program. See supra notes 133-135 and accompanying text.

⁵⁵⁹ See generally 2003 Interagency White Paper, supra note 31.

settlement services, it is especially important for the Commission and clearing agency participants to have current and accurate information about SCI events to help ensure that the clearing agencies are properly incentivized to provide high-quality service.

e. Market for Market Data

Finally, certain SCI entities provide market data. There are two different types of market data, namely consolidated data and proprietary data. As discussed above, when Congress mandated a national market system in 1975, it emphasized that the systems for collecting and distributing consolidated market data would “form the heart of the national market system.”⁵⁶⁰ Moreover, the Commission has identified certain benefits of consolidated market data, including providing the public with access to a comprehensive, accurate, and reliable source of information for NMS stocks.⁵⁶¹ One of the Commission’s primary concerns is that the market for consolidated data functions properly.

Market data is a critical part of the investment and trading process.⁵⁶² The data is needed for pre- and post-trade transparency and allows market participants to make well-informed investment and trading decisions.⁵⁶³ Indeed, based on Commission staff experience, the Commission understands that many trading algorithms make trading decisions based primarily on market data and rely on that data being current and accurate. An SCI event in connection with market data could significantly disrupt markets.⁵⁶⁴

⁵⁶⁰ See Concept Release on Equity Market Structure, supra note 42, at 3600 (quoting H.R. Rep. No. 94-229, 94th Cong., 1st Sess. 93 (1975)).

⁵⁶¹ See supra note 187 and accompanying text.

⁵⁶² See supra notes 187-189 and accompanying text.

⁵⁶³ See id.

⁵⁶⁴ For example, on January 3, 2013, Nasdaq reported that its securities information processor (which is the plan processor of the CQS Plan, an SCI plan) experienced “an

The process of collecting and disseminating consolidated quotation and transaction data is governed by the SCI plans. For securities listed on Nasdaq, data distribution is governed by the Nasdaq UTP Plan. For securities listed on NYSE, NYSE Amex, and several other exchanges, data distribution is governed by the CTA Plan and the CQS Plan. For options, data distribution is governed by the OPRA Plan. These SCI plans also oversee the collection of fees for access to the consolidated data network, and the allocation of the resulting revenue across the exchanges. Currently, there are two entities designated as plan processors by SCI plans – SIAC and Nasdaq.⁵⁶⁵ Due to the extreme concentration in the market segment for consolidated data, there is virtually no competition between SCI plan processors which could lead to little incentive in ensuring a high-quality product with minimal disruptions.

3. Proposed Regulation SCI and its Impact on Current Practices

Proposed Regulation SCI would be a codification and enhancement of the current ARP Inspection Program. As discussed further below with respect to each of the proposed rules, proposed Regulation SCI would: (A) be mandatory and codify many aspects of the ARP policy statements; (B) expand the scope of the ARP policy statements to other types of systems and event types; and (C) expand the scope of the ARP Inspection Program to other types of entities.

issue with stale data,” which lasted approximately 10 to 15 minutes. See <http://www.nasdaq.com/article/update-traders-report-technical-issue-involving-nasdaq-listed-securities-20130103-01046#.URutFaVEHmd>. See also <http://www.reuters.com/article/2013/01/03/exchanges-data-outage-idUSL1E9C3DQL20130103>. As a result, last sale and quotation data was not available for Nasdaq-listed (“Tape C”) securities during that time. See *id.* Although proprietary data feeds were available, only subscribers receiving such feeds could continue trading with current market data during the outage. Market centers EDGA and EDGX temporarily suspended trading in all Tape C securities in response to the outage. See *id.*

⁵⁶⁵ See *supra* note 131.

With respect to different types of systems, as discussed in more detail above, the ARP policy statements are focused on automated systems.⁵⁶⁶ Specifically, entities that participate in the ARP Inspection Program follow the ARP policy statements with respect to systems that directly support trading, clearance and settlement, order routing, and market data.⁵⁶⁷ Proposed Regulation SCI, on the other hand, would apply to more types of systems than the ARP policy statements. As discussed above, in addition to the systems covered by the ARP Inspection Program, the proposed definition of “SCI systems” would also include systems that directly support regulation and surveillance that are not currently part of the ARP Inspection Program. Further, the provisions of proposed Regulation SCI relating to security standards and systems intrusions would also apply to “SCI security systems,” which would be defined to mean any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems.

⁵⁶⁶ See supra Section I.A for more discussion of the ARP policy statements and the ARP Inspection Program. According to ARP I, the term “automated systems” or “automated trading systems” means computer systems for listed and OTC equities, as well as options, that electronically route orders to applicable market makers and systems that electronically route and execute orders, including the data networks that feed the systems. The term “automated systems” also encompasses systems that disseminate transaction and quotation information and conduct trade comparisons prior to settlement, including the associated communication networks. Moreover, ARP I states that because lack of adequate communications capacity can be as damaging to the overall performance of an exchange during peak periods as poorly designed order processing, capacity tests of the data networks that feed the computer systems also should be conducted. See ARP I, supra note 1, at n.21.

⁵⁶⁷ While generally only trading, clearance and settlement, order routing, and market data systems follow the guidelines in the ARP policy statements, ARP staff inspects all the categories of systems that are included in the proposed definition of “SCI systems.” However, ARP staff generally inspects systems that do not directly support trading, clearance and settlement, order routing, or market data only if staff detects red flags.

Additionally, while the ARP Inspection Program and proposed Regulation SCI both cover certain types of systems disruptions⁵⁶⁸ and systems intrusions,⁵⁶⁹ proposed Regulation SCI also would cover systems compliance issues. Finally, the ARP Inspection Program includes 29 participants that are SCI entities, consisting of 17 registered national securities exchanges, seven registered clearing agencies, FINRA, two plan processors, one ATS, and one exempt clearing agency. Because no ATSs currently satisfy the thresholds in Rule 306(b)(6)(i) of Regulation ATS, no ATSs currently are subject to the systems safeguard requirements of Regulation ATS⁵⁷⁰ although, as noted above, one ATS voluntarily participates in the ARP Inspection Program. Proposed Regulation SCI would include all of the entities currently under the ARP Inspection Program. With respect to ATSs, proposed Regulation SCI would include an estimated 10 SCI ATSs in NMS stocks, an estimated two SCI ATSs in non-NMS stocks, an estimated three SCI ATSs in municipal securities and corporate debt securities, and one SRO (*i.e.*, the MSRB).

Proposed Rules 1000(b)(4) and (b)(5) would require, respectively, that all SCI events be reported to the Commission, and that information relating to dissemination SCI events be disseminated to members or participants of an SCI entity. Proposed Rule 1000(a) would define a dissemination SCI event to mean an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that results, or the SCI entity reasonably estimates

⁵⁶⁸ See 2001 Staff ARP Interpretive Letter, *supra* note 35. See also *supra* Section III.B.3.a for a discussion of the differences between the definition of “significant system outage” as used currently in the ARP Inspection Program and the proposed definition of “systems disruption.”

⁵⁶⁹ See ARP I, *supra* note 1, at 48707 (referring to instances where unauthorized persons gained or attempted to gain access to systems). Proposed Rule 1000(a) would define “systems intrusion” to mean any unauthorized entry into the SCI systems or SCI security systems of the SCI entity.

⁵⁷⁰ See 17 CFR 242.301(b)(6).

would result, in significant harm or loss to market participants. Under the ARP Inspection Program, only “significant” outages should be reported to the Commission, and there are no quantitative standards to define “significant” outage. Similarly, proposed Regulation SCI would not specify a quantitative standard for immediate notification SCI events or dissemination SCI events. Instead, immediate notification SCI events would include any systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, and any systems intrusion. With respect to dissemination SCI events, certain information about all systems compliance issues and systems intrusions would be required to be disseminated to members or participants, although information about systems intrusions in some cases could be delayed. Systems disruptions would also be dissemination SCI events, however, only if they result, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.

Proposed Rule 1000(b)(1) (Capacity, Integrity, Resiliency, Availability, and Security) addresses the capacity, integrity, resiliency, availability, and security of the systems of SCI entities. Rule 1000(b)(1) would require an SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity’s operational capability and promote the maintenance of fair and orderly markets.

Proposed Rule 1000(b)(1)(i) would further require that an SCI entity’s policies and procedures include the establishment of reasonable current and future capacity planning estimates, periodic capacity stress tests, a program to review and keep current systems development and testing methodology, regular reviews and testing of such systems, including

backup systems, business continuity and disaster recovery plans, and standards that result in systems that facilitate the successful collection, processing, and dissemination of market data. The items in proposed Rule 1000(b)(1)(i)(A)-(E) are the same as those in the ARP Inspection Program and Rule 301(b)(6) of Regulation ATS.⁵⁷¹

Proposed Rule 1000(b)(1)(ii) would further provide that an SCI entity's policies and procedures would be deemed to be reasonably designed if they are consistent with current SCI industry standards.⁵⁷² The Commission preliminarily believes that SCI entities would be familiar with such standards because they would be required to be widely available for free to information technology professionals in the financial sector, and must be issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization.⁵⁷³ As noted above, compliance with the identified SCI industry standards would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1).

Proposed Rule 1000(b)(2)(i) (Systems Compliance) is not currently part of the ARP Inspection program and would require each SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner

⁵⁷¹ See supra Section III.C.1 for a detailed discussion of proposed Rule 1000(b)(1), including comparisons to the provisions of the ARP Inspection Program.

⁵⁷² See proposed Rule 1000(b)(1)(ii).

⁵⁷³ See infra text commencing at note 630, discussing examples of SCI industry standards that may originate from NIST publications and/or other publications listed in Table A, and the potential costs they may impose on SCI entities.

intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and the entity's rules and governing documents, as applicable.⁵⁷⁴

Proposed Rule 1000(b)(3) (Corrective Action) would require that, upon any responsible SCI personnel becoming aware of an SCI event, an SCI entity begin to take appropriate corrective action. The Commission understands that market participants already take steps to address systems issues should they occur, but preliminarily believes that proposed Rule 1000(b)(3) may result in SCI entities incurring additional information technology costs, primarily because proposed Rule 1000(b)(3) requires each SCI entity, upon any responsible SCI personnel becoming aware of an SCI event, to begin to take appropriate corrective action. Thus, SCI entities would not be able to delay the start of taking corrective action, which in turn could result in some SCI entities potentially seeking to, for example, update their systems with newer technology earlier than they might have otherwise. As these increased costs would likely occur primarily as a result of SCI entities making usual and customary investments sooner than they would otherwise, these costs are difficult to quantify.

Proposed Rule 1000(b)(4) (Commission Notification) would require that an SCI entity notify the Commission of all SCI events. Proposed Rule 1000(b)(4) would apply to more entities, systems, and types of systems issues than the ARP policy statements (or the 2001 Staff ARP Interpretive Letter) and also require more detailed reporting to the Commission.⁵⁷⁵

⁵⁷⁴ However, as noted above in Section V.B.1.b, SCI entities are already required to comply with relevant laws and rules.

⁵⁷⁵ See discussion of proposed Rule 1000(b)(4) in supra Section III.C.4. In addition, proposed Rule 1000(d) would require, with limited exception, that any written notification, review, description, analysis, or report to the Commission be submitted electronically on Form SCI.

Proposed Rule 1000(b)(5) (Dissemination of Information to Members or Participants) would require an SCI entity to disseminate information relating to dissemination SCI events to members or participants. Proposed Rule 1000(b)(5) would impose a new requirement that is not currently part of the ARP Inspection Program. As noted above in Section V.B.1.a, some entities provide their members or participants with notices of outages currently. However, although proposed Rule 1000(b)(5) would permit information regarding some systems intrusions to be delayed,⁵⁷⁶ the Commission expects that dissemination of information to members or participants about dissemination SCI events would increase significantly.

With respect to proposed Rule 1000(b)(6) (Material Systems Changes), while entities may voluntarily submit similar material systems change notifications to the Commission under the ARP Inspection Program, proposed Regulation SCI would set forth more detailed requirements.⁵⁷⁷ Proposed Rule 1000(b)(6) would require an SCI entity to notify the Commission of planned material systems changes on proposed Form SCI at least 30 calendar days in advance of such change, unless exigent circumstances exist or information previously provided to the Commission regarding a planned material systems change has become materially inaccurate, necessitating notice regarding a material systems change with less than 30 calendar days' notice.

Proposed Rule 1000(b)(7) (SCI Review) would require an SCI entity to conduct an SCI review of its compliance with Regulation SCI at least annually, and submit a report of the SCI review to senior management of the SCI entity for review no more than 30 calendar days after completion of the SCI review. Because systems reviews have always been part of the ARP

⁵⁷⁶ See proposed Rule 1000(b)(5)(ii).

⁵⁷⁷ See *supra* Sections III.C.4 and III.E.2 discussing the reporting requirements in proposed Rule 1000(b)(6).

Inspection Program, the Commission believes that most SCI entities currently undertake annual systems reviews, reports of which the Commission understands are reviewed by senior management. The Commission believes, however, that the scope of the systems review undertaken by ARP entities, and senior management involvement in such reviews, varies among ARP entities. The Commission expects that proposed Regulation SCI, which defines the parameters of an SCI review, would foster greater consistency in the approach that SCI entities take with respect to systems reviews.

Proposed Rule 1000(b)(8) (Reports) would require an SCI entity to submit various reports to the Commission. Specifically, proposed Rule 1000(b)(8)(i) would require an SCI entity to submit a report of the SCI review required by proposed Rule 1000(b)(7), together with any response by senior management, within 60 calendar days after its submission to senior management of the SCI entity. Proposed Rule 1000(b)(8)(ii) would require an SCI entity to submit a report, within 30 calendar days after the end of June and December of each year, containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes. Such reports to be filed with the Commission pursuant to proposed Rule 1000(b)(8) would be required to be filed electronically on Form SCI. Proposed Rule 1000(b)(8) would codify current practice under the ARP Inspection Program, in which ARP entities submit reports of systems reviews and report progress on material systems changes to ARP staff. However, proposed Rule 1000(8) would specify a more detailed process for submission of such reports.

Proposed Rule 1000(b)(9) (SCI Entity Business Continuity and Disaster Recovery Plans Testing Requirements for Members or Participants) is not part of the current ARP Inspection

Program and would require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans, in the manner and frequency as specified by the SCI entity, at least once every 12 months. In addition, the proposed rule would require an SCI entity to coordinate such testing on an industry- or sector-wide basis with other SCI entities.⁵⁷⁸ Further, the proposed rule would require each SCI entity to designate those members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans. Each SCI entity would be required to notify the Commission of such designations and its standards for designation, and promptly update such notification after any changes to its designations or standards. Although nothing prevents SCI entities from doing so, the Commission currently does not mandate that members or participants of SCI entities test the business continuity and disaster recovery plans, including backup systems, of SCI entities. This proposed rule would allow greater oversight by the Commission over the business continuity and disaster recovery capabilities of SCI entities. While the Commission believes that many SCI entities currently provide the opportunity for their members or participants to test their business continuity and disaster recovery plans, the Commission believes that few require participation by all or designated members or participants in such testing.⁵⁷⁹ In addition, the Commission understands that, to the extent such participation occurs, it may in many cases be limited in nature (e.g., testing for connectivity to backup systems). Finally, while the securities industry does coordinate certain testing, the Commission

⁵⁷⁸ See supra note 269 and accompanying text.

⁵⁷⁹ See infra note 641.

believes that the two-day closure of the equities and options markets in the wake of Superstorm Sandy has shown that more significant testing and better coordination of such testing could benefit market participants.⁵⁸⁰

Proposed Rules 1000(c) and (e) relate to the recordkeeping requirements under proposed Regulation SCI. As discussed above, SCI SROs already are subject to recordkeeping requirements that would apply to all documents relating to their compliance with proposed Regulation SCI.⁵⁸¹ Further, entities that participate in the ARP Inspection Program currently keep records related to the ARP Inspection Program, and the Commission recognizes that all SCI entities are subject to some recordkeeping requirement. Nevertheless, with respect to SCI entities other than SCI SROs, proposed Rules 1000(c) and (e) would impose specific recordkeeping requirements with respect to documents related to compliance with Regulation SCI and thus would impose a burden on such entities.

Lastly, proposed Rule 1000(f) would require SCI entities to provide Commission representatives reasonable access to its SCI systems and SCI security systems to allow Commission representatives to assess the entity's compliance with proposed Regulation SCI. As discussed above, although the Commission believes that Section 17(b) of the Exchange Act already provides the Commission with authority to access the systems of SCI entities, the Commission is proposing Rule 1000(f) to highlight such authority and help ensure that Commission representatives have ready access to systems of SCI entities.⁵⁸²

⁵⁸⁰ See supra Section I.D.

⁵⁸¹ See supra Section III.D.1.

⁵⁸² See supra Section III.D.3.

C. Consideration of Costs and Benefits, and the Effect on Efficiency, Competition, and Capital Formation

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking pursuant to the Exchange Act and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation.⁵⁸³ In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact such rules would have on competition.⁵⁸⁴ Exchange Act Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.⁵⁸⁵ In considering these matters, the Commission has been mindful of the history and background discussed above and has considered the impact proposed Regulation SCI would have on competition, and preliminarily believes that proposed Regulation SCI would promote efficiency, competition, and capital formation, and would not impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

1. Summary of Benefits, Costs and Quantification

While the current practices of some SCI entities already satisfy some of the requirements of proposed Regulation SCI, the Commission preliminarily believes proposed Regulation SCI could benefit the U.S. financial markets in several ways. The Commission preliminarily believes that Regulation SCI should result in fewer systems disruptions, systems compliance issues, and systems intrusions. It should also increase the information available to the Commission

⁵⁸³ 15 U.S.C. 78c(f).

⁵⁸⁴ 15 U.S.C. 78w(a)(2).

⁵⁸⁵ 15 U.S.C. 78w(a)(2).

regarding any systems disruptions, systems compliance issues, and systems intrusions that do occur. In addition, it should increase the information available to members or participants of SCI entities regarding dissemination SCI events. As explained further below, such disseminations of information could promote the ability of market participants to assess the operation of markets because events would be more transparent. The changes also could reduce market participants' search costs, ultimately improving the ability of competition to discourage SCI events and potentially improving the allocative efficiency of capital. To the extent that Regulation SCI promotes the allocation of capital to its most efficient uses, the Commission preliminarily believes that Regulation SCI may promote capital formation.⁵⁸⁶ The potential economic costs of proposed Regulation SCI include compliance costs, which the Commission attempts to quantify, and other costs. Such other costs include costs associated with the increase in costs and time needed to make systems changes to comply with new and amended rules and regulations, the impact on innovation, and barriers to entry.⁵⁸⁷

The Commission discusses below a number of costs and benefits that are related to proposed Regulation SCI. Many of these costs and benefits are difficult to quantify with any degree of certainty, especially as the practices of market participants are expected to evolve and appropriately adapt to changes in technology and market developments. In addition, the extent to which the proposed rule's standards and the ability to enforce such standards will help reduce the frequency and severity of SCI events is unknown. Therefore, much of the discussion is qualitative in nature but, where possible, the Commission quantifies the costs.

⁵⁸⁶ The Commission notes, however, that whether there is ultimately an effect on capital formation will depend, in part, on the degree of the potential effects on allocative efficiency.

⁵⁸⁷ See infra Section V.C.3.b.

Many, but not all, of the costs of the proposed rules involve a collection of information, and these costs and burdens are discussed in the Paperwork Reduction Act Section above.⁵⁸⁸ When monetized, those estimated burdens and costs for SCI entities total approximately \$44 million in initial costs and approximately \$37 million in annual ongoing costs. In addition, in the Economic Cost Section below,⁵⁸⁹ the Commission has quantified other costs for SCI entities that total between approximately \$17.6 million⁵⁹⁰ and \$132 million⁵⁹¹ in initial costs and between \$11.7 million⁵⁹² and \$88 million⁵⁹³ in annual ongoing costs. When aggregated, the total quantified costs for SCI entities are estimated as between approximately \$61.6 million⁵⁹⁴ and \$176 million⁵⁹⁵ in initial costs and between \$48.7 million⁵⁹⁶ and \$125 million⁵⁹⁷ in annual

⁵⁸⁸ See supra Section IV.

⁵⁸⁹ See infra Section V.C.4.a (estimating the cost for: (i) complying with the substantive requirements that are the subject of the policies and procedures required by proposed Rules 1000(b)(1) and (2), including consistency with SCI industry standards (which, solely for purposes of this Economic Analysis, would be the proposed SCI industry standards contained in the publications identified in Table A); (2) establishing and maintaining a methodology for ensuring that the SCI entity is prepared for the corrective action requirement under proposed Rule 1000(b)(3); and (iii) establishing and maintaining a methodology for determining whether an SCI event is an immediate notification SCI event or a dissemination SCI event).

⁵⁹⁰ See infra note 634 (estimating cost for complying with the substantive requirements underlying policies and procedures required by proposed Rules 1000(b)(1) and (2)).

⁵⁹¹ See infra note 635 (estimating cost for complying with the substantive requirements underlying policies and procedures required by proposed Rules 1000(b)(1) and (2)).

⁵⁹² See infra note 639 (estimating cost for complying with the substantive requirements underlying policies and procedures required by proposed Rules 1000(b)(1) and (2)).

⁵⁹³ See infra note 640 (estimating cost for complying with the substantive requirements underlying policies and procedures required by proposed Rules 1000(b)(1) and (2)).

⁵⁹⁴ \$61.6 million = \$44 million (PRA cost) + \$17.6 million (other costs for SCI entities).

⁵⁹⁵ \$176 million = \$44 million (PRA cost) + \$132 million (other costs for SCI entities).

⁵⁹⁶ \$48.7 million = \$37 million (PRA cost) + \$11.7 million (other costs for SCI entities).

⁵⁹⁷ \$125 million = \$37 million (PRA cost) + \$88 million (other costs for SCI entities).

ongoing costs. In addition to the costs to SCI entities, the Commission also preliminarily estimates the total costs to members or participants of SCI entities to participate in the business continuity and disaster recovery plans testing specified by proposed Rule 1000(b)(9) to be \$66 million annually.⁵⁹⁸ Thus, the total quantified costs for SCI entities and members or participants of SCI entities are estimated as between approximately \$127.6 million⁵⁹⁹ and \$242 million⁶⁰⁰ in initial costs and between \$114.7 million⁶⁰¹ and \$191 million⁶⁰² in annual ongoing costs. A detailed discussion of other potential economic costs of the proposal, such as potential costs to the Commission and potential burdens on competition, is provided below.

2. Economic Benefits

Broadly, although the current practices of some SCI entities already satisfy some of the requirements of proposed Regulation SCI, the Commission preliminarily believes that proposed Regulation SCI would bring several overarching benefits to the securities markets. First and most significantly, the Commission preliminarily believes that proposed Regulation SCI would promote more robust systems and hence fewer systems disruptions and market-wide closures, systems compliance issues, and systems intrusions. As a result, the Commission expects fewer interruptions to SCI systems, including systems that directly support execution facilities, matching engines, and the dissemination of market data, and fewer errors with the pricing of

⁵⁹⁸ See infra note 643 and accompanying text.

⁵⁹⁹ \$127.6 million = \$44 million (PRA cost) + \$17.6 million (other costs for SCI entities) + \$66 million (costs for members or participants of SCI entities).

⁶⁰⁰ \$242 million = \$44 million (PRA cost) + \$132 million (other costs for SCI entities) + \$66 million (costs for members or participants of SCI entities).

⁶⁰¹ \$114.7 million = \$37 million (PRA cost) + \$11.7 million (other costs for SCI entities) + \$66 million (costs for members or participants of SCI entities).

⁶⁰² \$191 million = \$37 million (PRA cost) + \$88 million (other costs for SCI entities) + \$66 million (costs for members or participants of SCI entities).

securities, which should promote price efficiency. The Commission also expects fewer interruptions to other SCI systems, including systems that directly support regulatory systems and surveillance systems, which should help ensure compliance with relevant laws and rules. In addition, the Commission would expect fewer interruptions to SCI security systems, which should help prevent problems that could lead to disruption of an SCI entity's general operations and, ultimately, its market-related activities.⁶⁰³

Second, the Commission preliminarily believes that proposed Regulation SCI would enhance the availability of relevant information to members or participants of SCI entities and promote dissemination of information to persons (*i.e.*, members or participants of SCI entities) who are most directly affected by dissemination SCI events and who would most naturally need, want, and be able to act on the information. The increased availability of information regarding SCI events should reduce the costs to members or participants of SCI entities when evaluating SCI entities and improve their ability to make more informed decisions about whether or not to avoid dealing with entities that experience significant systems issues. This enhanced information, as well as the improved price efficiency, should lead to greater allocative efficiency of capital. Moreover, it is expected that the increased awareness of dissemination SCI events would enhance competition among SCI entities with respect to the maintenance of robust systems.

Third, the Commission preliminarily believes that fewer market-wide, unscheduled shutdowns would have many of the same benefits as avoidance of temporary shutdowns, but on a greater scale. Fourth, the Commission preliminarily believes that its own ability to monitor the

⁶⁰³ See *supra* Section III.B.2, discussing the Commission's proposed definitions of SCI systems and SCI security systems.

markets and ensure their smooth functioning would be significantly enhanced by proposed Regulation SCI. These potential benefits are discussed in more detail below in relation to each of the proposed rules.

a. Rule 1000(a) Definitions

In general, the definitions in Rule 1000(a) either clarify a provision or circumscribe the scope of a provision in proposed Regulation SCI. Therefore, many of the costs and benefits associated with the impacts of the definitions are incorporated in the discussion below on the costs and benefits of the substantive provisions where the definitions are used.

This section contains a discussion of the benefits of the expansion in scope that are not discussed above. In summary, the Commission preliminarily believes that the proposed definition of "SCI entity" and "SCI event," although they would broaden the scope of Regulation SCI beyond the scope of the ARP Inspection Program, are essential parts of proposed Regulation SCI.

i. SCI Entities

As explained above, the difference between the entities that currently participate in the ARP Inspection Program and the entities covered by proposed Regulation SCI is the inclusion of additional ATSS and the MSRB. Because no ATSS currently meet the thresholds specified in Rule 301(b)(6) of Regulation ATS, other than the one ATS that currently participates in the ARP Inspection Program, none are subject to the systems safeguard requirements under that rule even though they comprise a significant portion of consolidated volume.⁶⁰⁴ The Commission preliminarily believes that the inclusion of SCI ATSS under proposed Regulation SCI would help

⁶⁰⁴ As noted above, one ATS voluntarily participates in the ARP Inspection Program. See supra note 25.

ensure that ATSS, which serve as markets to bring buyers and sellers together in the national market system, are subject to rules regarding systems capacity, integrity, resiliency, availability, security, and compliance, including those rules that could help prevent SCI events and that require Commission reporting and the dissemination of information to members or participants of SCI entities.⁶⁰⁵ The Commission preliminarily believes that the inclusion of the MSRB in proposed Regulation SCI would provide benefits to the market because, as noted above, the MSRB is the only SRO relating to municipal securities and the sole provider of consolidated market data for the municipal securities market.⁶⁰⁶

ii. Systems and SCI Events

As stated above, proposed Regulation SCI would expand on current practice, would apply a broader range of systems, and would include more event types. Specifically, entities that participate in the ARP Inspection Program follow the ARP policy statements with respect to systems that directly support trading, clearance and settlement, order routing, and market data. The proposed definition of “SCI systems” would include the foregoing systems as well as those

⁶⁰⁵ Proposed Regulation SCI would not expand the types of securities currently covered by the ARP Inspection Program and Rule 301(b)(6) of Regulation ATS. The Commission recognizes that although currently no ATSS are subject to the systems safeguard requirements under Rule 301(b)(6) because they do not satisfy the thresholds in that rule, the Commission estimates that approximately 15 ATSS would be subject to proposed Regulation SCI.

⁶⁰⁶ As discussed above, in 2008, the Commission amended Rule 15c2-12 to designate the MSRB as the single centralized disclosure repository for continuing municipal securities disclosure. In 2009, the MSRB established EMMA, which serves as the official repository of municipal securities disclosure, providing the public with free access to relevant municipal securities data, and is the central database for information about municipal securities offerings, issuers, and obligors. Additionally, the MSRB’s RTRS, with limited exceptions, requires municipal bond dealers to submit transaction data to the MSRB within 15 minutes of trade execution, and such near real-time post-trade transaction data can be accessed through the MSRB’s EMMA website. See supra note 96.

that directly support regulation and surveillance. The Commission preliminarily believes that including regulation and surveillance systems could help ensure the SCI entity's ability to monitor its compliance with relevant laws, rules, and its own rules, and detect any violations of such laws or rules. Further, the provisions of proposed Regulation SCI regarding systems security and intrusions also would apply to "SCI security systems."⁶⁰⁷ Because SCI security systems may present potentially vulnerable entry points to an SCI entity's network, the Commission also preliminarily believes that it is important for proposed Regulation SCI to include those systems with respect to security standards and systems intrusions.⁶⁰⁸

By defining SCI events to include systems disruptions, systems compliance issues, and systems intrusions, proposed Regulation SCI would further assist the Commission in its oversight of SCI entities. As stated above, SCI entities already follow practices similar to parts of proposed Regulation SCI for certain systems disruptions and systems intrusions. The inclusion of systems compliance issues should help the Commission and market participants to become better informed of the efforts of the SCI entities to comply with relevant laws and rules, and their own rules as applicable, and could enhance the enforcement of such laws and rules. Further, by defining a dissemination SCI event to include a subset of SCI events (*i.e.*, a systems compliance issue, systems intrusion, or systems disruption that would result, or the SCI entity reasonably estimates would result in significant harm or loss to market participants), proposed Regulation SCI would further assist SCI entity members or participants in their decisions regarding whether or not to utilize the systems of a given SCI entity.

⁶⁰⁷ See *supra* Section III.B.2, discussing the Commission's proposed definitions of SCI systems and SCI security systems.

⁶⁰⁸ See *id.*

b. Rule 1000(b)(1)-(10) Requirements for SCI Entities

The development and growth of automated electronic trading have allowed increasing volumes of securities transactions across the multitude of trading centers that constitute the U.S. national market system. These securities transactions take place within an interconnected market where systems disruptions, systems compliance issues, and systems intrusions at one market center can impact or harm trading throughout the entire national market system. Thus, there is a need for operators of significant market systems, such as SCI entities, to have in place robust systems to prevent systems issues or, in the event that systems issues occur, to recover quickly.

Proposed Rule 1000(b)(1)-(2) would set forth requirements relating to written policies and procedures that SCI entities would be required to establish, maintain, and enforce. Proposed Rule 1000(b)(1) would require an SCI entity to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets.

The rule would further provide that an SCI entity's policies and procedures must include the establishment of reasonable current and future capacity planning estimates, periodic capacity stress tests, a program to review and keep current systems development and testing methodology of such systems, regular reviews and testing of such systems, including backup systems, business continuity and disaster recovery plans, and standards that result in such systems facilitating the successful collection, processing, and dissemination of market data.⁶⁰⁹ As discussed above, the Commission regards SCI entities as part of the critical infrastructure of the U.S. securities

⁶⁰⁹ See proposed Rule 1000(b)(1)(i)(A)-(F), discussed in supra Section III.C.1.a.

markets and therefore, although proposed Rule 1000(b)(1)(i)(A)-(E) would codify certain provisions of the ARP policy statements, the Commission preliminarily believes that specifically setting forth these requirements in a Commission rule would benefit the securities markets by helping to diminish the risks and incidences of systems intrusions, systems compliance issues, and systems disruptions. Such policies and procedures should also assist in speedy recoveries from systems intrusions, systems compliance issues, and systems disruptions. Proposed Rule 1000(b)(1)(i)(F) does not have precedent in Regulation ATS or the ARP policy statements, and would require SCI entities to have standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data. The Commission preliminarily believes that this proposal should help to ensure that timely and accurate market data is available to all market participants.

Proposed Rule 1000(b)(1)(ii) would deem an SCI entity's policies and procedures required by proposed Rule 1000(b)(1) to be reasonably designed if they are consistent with current SCI industry standards.⁶¹⁰ Thus, the SCI industry standards would provide flexibility to allow each SCI entity to determine how to best meet the requirements in proposed Rule 1000(b)(1), taking into account, for example, its nature, size, technology, business model, and other aspects of its business, because compliance with SCI industry standards would not be the exclusive means by which an SCI entity could satisfy the requirements of proposed Rule 1000(b)(1).

⁶¹⁰ Proposed SCI industry standards are contained in the publications that are set forth in Table A. See supra Section III.C.1.b.

Proposed Rule 1000(b)(2)(i), which would require written policies and procedures reasonably designed to ensure that an SCI entity's SCI systems operate in the manner intended, should help to minimize instances where systems do not operate in compliance with the federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents. In particular, the elements of the safe harbor for SCI entities in proposed Rule 1000(b)(2)(ii)(A) relating to policies and procedures on testing and monitoring also should help to ensure, on an ongoing basis, that an SCI entity's SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and, as applicable, the entity's rules and governing documents, thus minimizing systems compliance issues and consequently the total time needed to bring a system back into compliance.⁶¹¹ In addition, the elements of the safe harbor in proposed Rule 1000(b)(2)(ii)(A) relating to policies and procedures for systems compliance assessments by personnel familiar with applicable laws and rules and systems reviews by regulatory personnel should help ensure the performance of effective compliance audits and reviews, and should help provide assurance that SCI entities are operating in compliance with applicable laws and rules.

Proposed Rule 1000(b)(3), which would require an SCI entity to begin taking appropriate corrective action upon any responsible SCI personnel becoming aware of an SCI event, should further help ensure that SCI entities invest sufficient resources as soon as reasonably practicable to address systems intrusions, systems compliance issues, and systems disruptions.⁶¹²

⁶¹¹ As noted above, the Commission recognizes that SCI entities are already required to comply with federal securities laws, rules and regulations thereunder, and their own rules.

⁶¹² As noted above, the Commission believes that SCI entities already take corrective actions in response to systems issues.

Moreover, proposed Rules 1000(b)(1)-(3) should improve price efficiency by reducing the likelihood and duration of systems issues, thereby helping to avoid the price inefficiencies that occur during times when systems disruptions, systems compliance issues, or systems intrusions can make systems unavailable or unreliable. Specifically, systems issues that could impact the accuracy or the timeliness, and thus the reliability, of market data could lead to inaccuracies in pricing and slow-down pricing, and make data less reliable. Therefore, to the extent that proposed Rules 1000(b)(1)-(3) could reduce the likelihood or duration of systems issues, they may lead to more reliable market data (because there would be less inaccuracies and the market data would be more timely), which could help improve the quality of market data. This, in turn, could enhance price efficiency in the market for market data, which then could promote allocative efficiency of capital and capital formation.

Proposed Regulation SCI is intended, in part, to facilitate the Commission's ability to monitor the impact on the securities markets by SCI entities' systems that support the performance of the entities' activities. The Commission preliminarily believes that proposed Rules 1000(b)(1)-(3), as well as 1000(b)(4), would provide for more effective Commission oversight of the operation of the systems of SCI entities.

Specifically, while entities that participate in the ARP Inspection Program already notify Commission staff of certain systems issues, the Commission preliminarily believes that proposed Rule 1000(b)(4), relating to Commission notification of SCI events, should further enhance the effectiveness of Commission oversight of the operation of SCI entities. Under the proposed rule, upon any responsible SCI personnel becoming aware of an immediate notification SCI event,⁶¹³ an SCI entity would be required to notify the Commission of the SCI event. Within 24 hours of

⁶¹³ See supra Section III.C.3.b.

any responsible SCI personnel becoming aware of an SCI event, an SCI entity would be required to submit a written notification pertaining to such SCI event on Form SCI. Until such time as the SCI event is resolved, the SCI entity would be required to provide updates regularly, or at such frequency as requested by an authorized representative of the Commission. Although this process would represent costs to an SCI entity,⁶¹⁴ the documentation of SCI events will help prevent such systems failures from being dismissed or ignored as glitches or momentary issues because it would focus the SCI entity's attention on the issue and encourage allocation of SCI entity resources to resolve the issue as soon as reasonably practicable.

As noted above, the Commission is concerned that members or participants of SCI entities may be unaware of the occurrence of some SCI events, and therefore may make decisions without all relevant information. Proposed Rule 1000(b)(5) would require an SCI entity, upon any responsible SCI personnel becoming aware of a dissemination SCI event other than a systems intrusion, to disseminate certain information regarding the dissemination SCI event to its members or participants.⁶¹⁵ Such information would include the systems affected by the event and a summary description of the event. When known, the SCI entity would be required to further disseminate to its members or participants: a detailed description of the SCI event; its current assessment of the types and number of market participants potentially affected by the SCI event; and a description of the progress of its corrective action for the SCI event and when the SCI event has been or is expected to be resolved. An SCI entity also would be required

⁶¹⁴ See *supra* Section IV.D.2.a.

⁶¹⁵ For a dissemination SCI event that is a systems intrusion, an SCI entity must disseminate to members or participants a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion has been or is expected to be resolved, unless it determines that dissemination of such information would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion.

to provide regular updates to members or participants regarding the disseminated information. The Commission preliminarily believes that proposed Rule 1000(b)(5) would help market participants—specifically the members or participants of SCI entities—to better evaluate the operations of SCI entities based on more readily available information.

As discussed above,⁶¹⁶ the Commission believes that the existing competition among the markets has not sufficiently mitigated the occurrence of certain systems problems, and thus preliminarily believes that requiring the dissemination of information about certain SCI events, as described above, to members or participants could potentially further incentivize SCI entities to create more robust systems. In addition, targeting this set of market participants (*i.e.*, an SCI entity's members or participants) to receive information about dissemination SCI events has the benefit of providing the information to those that are most likely to need, want, and act on the information, without imposing the additional costs associated with requiring broader public dissemination. Moreover, another benefit of increased dissemination of information about dissemination SCI events to SCI entity members or participants would be the resultant reduction in search costs for market participants when they are gathering information to make a determination with respect to the use of an entity's services. Also, proposed Rule 1000(b)(5) would require SCI entities to disseminate specified information for dissemination SCI events, which would allow market participants to more easily compare the available information from all SCI entities for which they are members or participants. The foregoing benefits would be further enhanced to the extent information relating to dissemination SCI events is shared by members or participants of SCI entities with other market participants. Lastly, because an SCI entity would be permitted to delay dissemination of information regarding a systems intrusion to members or

⁶¹⁶ See *supra* Section V.B.2.

participants if it determines that such information would likely compromise the security of its SCI systems or SCI security systems, or an investigation of the systems intrusion, proposed Rule 1000(b)(5) would not undermine the need to maintain the non-public nature of certain systems intrusions for a temporary period (until the SCI entity determines that dissemination of such information would not likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion).

In summary, because proposed Regulation SCI would, among other things, require SCI entities to provide members and participants with more information regarding their operations, the Commission preliminarily believes that SCI entities would have additional incentives to establish and maintain more robust automated systems to minimize the occurrence of SCI events. Fewer systems issues could improve pricing efficiency which, in turn, could promote allocative efficiency of capital and thus, capital formation.

In addition to the Commission notification requirements under proposed Rule 1000(b)(4), the Commission preliminarily believes that proposed Rule 1000(b)(6) would enhance the Commission's oversight of the operation of SCI entities, even though entities participating in the ARP Inspection Program may already provide these types of notifications to Commission staff. Proposed Rule 1000(b)(6) would require an SCI entity to notify the Commission on Form SCI of material systems changes at least 30 calendar days before the implementation of any planned material systems change. In the case of exigent circumstances, or if the information previously provided regarding a planned material systems change becomes materially inaccurate, proposed Rule 1000(b)(6) would require oral or written notification as early as reasonably practicable. Any oral notification of planned material systems change must be memorialized within 24 hours by a written notification on Form SCI. The Commission preliminarily believes that this

provision would provide the Commission and its staff advance notice and time to evaluate planned material systems changes by SCI entities, thus improving the Commission's ability to oversee SCI entities.

Proposed Rule 1000(b)(7) would require an SCI entity to conduct an SCI review of its compliance with Regulation SCI not less than once each calendar year, and submit a report of the SCI review to senior management of the SCI entity for review no more than 30 calendar days after completion of such SCI review. The Commission preliminarily believes that the proposal to require SCI entities to conduct an objective assessment of their systems at least annually would result in SCI entities having an improved awareness of the relative strengths and weaknesses of their systems independent of the assessment of ARP staff, which should in turn improve the value and efficiency of an ARP inspection.

Proposed Rule 1000(b)(8) would require each SCI entity to submit certain periodic reports to the Commission through Form SCI, including annual reports on the SCI reviews of its compliance with Regulation SCI and semi-annual reports on the progress of material systems changes. These reports should keep the Commission informed, on an ongoing basis, by providing information with which the Commission could evaluate each SCI entity's compliance with Regulation SCI and the progress of its material systems changes.

The Commission preliminarily believes that proposed Rules 1000(b)(1)-(8), taken together, should result in actual systems improvements as well as enhanced availability of relevant information regarding SCI events to the Commission and members or participants of SCI entities. This, in turn, could facilitate better decisions by market participants, which could promote allocative efficiency of capital and capital formation, potentially providing an overall benefit to the securities markets and promoting the protection of investors and the public interest.

Additionally, the means by which trading is conducted may be altered as a result of Regulation SCI. For example, if an SCI entity member or participant submits orders to a particular market for execution, and subsequently learns that the execution venue's systems in use may be prone to failure, such member or participant may choose to favor another market in the future. This change would potentially enhance competition as SCI entity members or participants rely on information disseminated regarding dissemination SCI events to make more informed choices about the best venue for execution.

Proposed Rule 1000(b)(9)(i) would require an SCI entity, with respect to its business continuity and disaster recovery plans, including its backup systems, to require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans, in the manner and frequency as specified by the SCI entity, at least once every 12 months. Proposed Rule 1000(b)(9)(ii) would further require an SCI entity to coordinate such testing on an industry- or sector-wide basis with other SCI entities. The Commission expects that this proposed requirement should help ensure that the securities markets will have improved backup infrastructure and fewer market-wide shutdowns, thus helping SCI entities and other market participants to avoid lost revenues and profits that would otherwise result from such shutdowns. Further, the notifications required by proposed Rule 1000(b)(9)(iii) should keep the Commission informed, on an ongoing basis, of an SCI entity's current standards for designating members or participants and current list of designees.

c. **Rule 1000(c)-(f) – Recordkeeping, Electronic Filing, and Access**

While all SCI entities already are subject to some recordkeeping and access requirements, the Commission preliminarily believes the proposed recordkeeping and access requirements specifically related to proposed Regulation SCI would enhance the ability of the Commission to

evaluate SCI entities' compliance. Specifically, proposed Rule 1000(c) would require each SCI entity, other than an SCI SRO, to make, keep, and preserve at least one copy of all documents and records relating to its compliance with Regulation SCI for a period of not less than five years.⁶¹⁷ Each SCI entity also would be required to furnish such documents to Commission representatives upon request. Further, according to proposed Rule 1000(e), if the records required to be filed or kept by an SCI entity under proposed Regulation SCI are prepared or maintained by a service bureau or other recordkeeping service on behalf of the SCI entity, the SCI entity must ensure that such records are available to review by the Commission and its representatives by submitting a written undertaking by such service bureau or recordkeeping service to that effect. The Commission preliminarily believes that these proposed rules should allow Commission staff to perform efficient inspections and examinations of SCI entities for their compliance with the proposed rules, and should increase the likelihood that Commission staff may identify conduct inconsistent with the proposed rules at earlier stages in the inspection and examination process.

Proposed Rule 1000(d) would require SCI entities to electronically submit all written information to the Commission through Form SCI (except any written notification submitted pursuant to proposed Rule 1000(b)(4)(i)). The Commission preliminarily believes that this provision would allow the Commission to receive information in a uniform electronic format with specified content, which would enhance Commission staff's ability to review and analyze submitted information.

⁶¹⁷ As discussed above in Section III.D.1, Regulation SCI-related documents would already be included in SCI SROs' comprehensive recordkeeping requirements under Rule 17a-1 under the Exchange Act.

Finally, proposed Rule 1000(f) would require each SCI entity to give Commission representatives reasonable access to its SCI systems and SCI security systems to allow Commission representatives to assess its compliance with proposed Regulation SCI. The Commission preliminarily believes that this provision would enhance Commission oversight by specifically highlighting the Commission's authority to have its representatives directly access and examine SCI entities' systems to confirm their compliance with proposed Regulation SCI.

The Commission preliminarily believes that these requirements would place the Commission in a stronger position to assess the risks relating to SCI entities' systems and, thus, would provide the Commission with greater ability to protect investors. The Commission also preliminarily believes that its oversight should help ensure that SCI entities are reasonably equipped to handle market demand and provide liquidity, including during periods of market distress.

3. Economic Costs

a. Direct Compliance Costs

The Commission recognizes that proposed Regulation SCI would impose costs on SCI entities, as well as costs on certain members or participants of SCI entities. The Commission preliminarily believes that the majority of these costs would be direct compliance costs. SCI entities would incur costs in establishing, maintaining, and enforcing policies and procedures related to systems capacity, integrity, resiliency, availability, security, and compliance.⁶¹⁸ SCI entities also would incur costs in taking appropriate corrective actions upon any responsible SCI

⁶¹⁸ See proposed Rules 1000(b)(1) and (2). These proposed rules would also impose costs for outside legal and/or consulting advice, as set forth in the Paperwork Reduction Act Section above. See supra Section IV.

personnel becoming aware of an SCI event,⁶¹⁹ notifying and updating the Commission with respect to the occurrence of SCI events,⁶²⁰ disseminating information to members or participants regarding dissemination SCI events,⁶²¹ notifying the Commission of material systems changes,⁶²² conducting SCI reviews,⁶²³ submitting to the Commission periodic reports,⁶²⁴ requiring designated members to participate in testing of business continuity and disaster recovery plans and coordinating such testing,⁶²⁵ and complying with recordkeeping and access requirements.⁶²⁶

As stated above in Section IV.D, proposed Regulation SCI would codify many of the ARP policy statement principles familiar and applicable to current participants in the ARP Inspection Program. The Commission recognizes, however, that the proposed rules would apply to entities that are not currently covered by the ARP Inspection Program, and would cover areas not currently within the scope of the ARP Inspection Program. Thus, those costs are incremental relative to the current compliance cost of the ARP Inspection Program.

While proposed Regulation SCI would codify the provisions of the ARP policy statements, the proposed definitions of “SCI entity,” “SCI event,” “SCI systems,” and “SCI security systems” are broader than the entities, events, and systems covered by the ARP Inspection Program and, as stated above, will include more entities, events, and systems.

⁶¹⁹ See proposed Rule 1000(b)(3).

⁶²⁰ See proposed Rule 1000(b)(4).

⁶²¹ See proposed Rule 1000(b)(5). This proposed rule would also impose costs for outside legal advice, as set forth in the Paperwork Reduction Act discussion above. See *supra* Section IV.

⁶²² See proposed Rule 1000(b)(6).

⁶²³ See proposed Rule 1000(b)(7).

⁶²⁴ See proposed Rule 1000(b)(8).

⁶²⁵ See proposed Rule 1000(b)(9).

⁶²⁶ See proposed Rules 1000(c), (e), and (f).

Specifically, proposed Rule 1000(b)(1)(i) would codify aspects of the ARP policy statements⁶²⁷ with the exception of Rule 1000(b)(1)(i)(F), which would require policies and procedures regarding standards that result in systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data. In addition, because the ARP policy statements provide that SROs should promptly notify Commission staff of certain system outages and any instances in which unauthorized persons gained or attempted to gain access to their systems, proposed Rule 1000(b)(4), among other things, would codify parts of the ARP policy statements.⁶²⁸ Further, because the ARP policy statements provide that SROs should notify Commission staff of certain changes to their automated systems, proposed Rule 1000(b)(6) would codify a part of the ARP policy statements.⁶²⁹ Lastly, because the ARP policy statements provide that SROs should undertake reviews of their systems, proposed Rule 1000(b)(7), among other things, would reflect this part of the ARP policy statements. With respect to the proposed requirements that are not currently covered by the ARP Inspection Program, they include: policies and procedures in addition to those required by proposed Rule 1000(b)(1)(i)(A)-(E) that would be necessary to achieve policies and procedures reasonably designed to ensure that systems of an SCI entity have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets; policies

⁶²⁷ Rule 301(b)(6) of Regulation ATS also contains similar requirements for ATSs that meet the thresholds in that rule.

⁶²⁸ However, because of the proposed definition of "SCI event," SCI entities must also report systems compliance issues to the Commission. Proposed Regulation SCI would also set forth detailed and specific requirements with respect to Commission notifications.

⁶²⁹ Again, proposed Regulation SCI would also set forth more detailed and specific requirements with respect to such Commission notifications.

and procedures reasonably designed to ensure the operation of SCI systems in the manner intended; the initiation of appropriate corrective actions upon any responsible SCI personnel becoming aware of an SCI event; the dissemination of information to members or participants; requirements regarding member or participant testing; and recordkeeping and access with respect to Regulation SCI-related documents.

Many of these incremental costs are calculated in detail in the Paperwork Reduction Act Section above, which estimates that the total one-time initial burden for all SCI entities to comply with Regulation SCI would be approximately 133,482 hours and \$2.6 million, and that the total annual ongoing burden for all SCI entities to comply with Regulation SCI would be approximately 117,258 hours and \$738,400.

In addition to the direct cost estimates derived from the Paperwork Reduction Act burdens, the Commission preliminarily believes that SCI entities could incur costs when enforcing the policies and procedures required under proposed Rules 1000(b)(1) and (2), taking corrective action to mitigate the potential harm resulting from an SCI event under proposed Rule 1000(b)(3), and in determining whether an SCI event is an immediate notification SCI event or meets the definition of a dissemination SCI event under proposed Rule 1000(a).

As discussed in detail in Section III.C.1 above, proposed Rule 1000(b)(1) would require SCI entities to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that their SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets. In addition to the burden of establishing and maintaining such policies and procedures as set forth in the Paperwork Reduction Act Section above, the Commission preliminarily

believes that SCI entities would incur costs in enforcing the substantive requirements that are the subject of the policies and procedures.

Further, as discussed in detail in Section III.C.2 above, proposed Rule 1000(b)(2) would require SCI entities to establish, maintain, and enforce written policies and procedures reasonably designed to ensure that their SCI systems operate in the manner intended, including in a manner that complies with federal securities laws and rules and regulations thereunder and the entity's rules and governing documents, as applicable. In addition to the burden of establishing and maintaining such policies and procedures as set forth in the Paperwork Reduction Act Section above, the Commission preliminarily believes that SCI entities would incur costs in enforcing the substantive requirements that are the subject of the policies and procedures.

As noted above,⁶³⁰ NIST is an agency within the U.S. Department of Commerce that has issued numerous special publications regarding information technology systems. For example, one of the publications listed in Table A is the NIST Draft Security and Privacy Controls for Federal Information Systems and Organizations (Special Publication 800-53 Rev. 4) (February 2012) ("NIST 800-53").⁶³¹ This publication is a security controls catalog providing guidance for selecting and specifying security controls for federal information systems and organizations. NIST 800-53 addresses how federal entities should achieve secure information systems, taking into account the fundamental elements of: (i) multitiered risk management; (ii) the structure and organization of controls; (iii) security control baselines; (iv) the use of common controls and inheritance of security capabilities; (v) external environments and service providers; (vi)

⁶³⁰ See supra Section III.C.1.b.

⁶³¹ See NIST 800-53, available at: <http://csrc.nist.gov/publications/drafts/800-53-rev4/sp800-53-rev4-ipd.pdf>.

assurance and trustworthiness; and (vii) revisions and extensions to security controls and control baselines, among others. Although NIST 800-53 sets forth standards for federal agencies, it is also intended to serve a diverse audience of information system and information security professionals, including those having information system, security, and/or risk management and oversight responsibilities, information system development responsibilities, information security implementation and operational responsibilities, information security assessment and monitoring responsibilities, as well as commercial companies producing information technology products, systems, security-related technologies, and security services.⁶³²

The Commission preliminarily believes that many SCI entities will choose to establish, maintain, and enforce policies and procedures that are consistent with the proposed SCI industry standards contained in the publications set forth in Table A for purposes of satisfying the requirements of proposed Rule 1000(b)(1). However, as noted above, compliance with the identified SCI industry standards would not be the exclusive means to comply with the requirements of proposed Rule 1000(b)(1). The Commission understands that the Table A publications, including NIST 800-53, are familiar to information technology personnel employed by many SCI entities, and that some SCI entities, particularly the SCI SROs and plan processors that participate in the ARP Inspection Program, currently adhere to all or at least some of the standards in NIST 800-53, or similar standards set forth in publications issued by other standards setting bodies, with some entities fully or nearly fully implementing such standards, while other entities may not have implemented such standards as broadly. For SCI entities that are not part of the ARP Inspection Program, while such entities may be familiar with such publications and standards generally, the Commission is not certain as to the level of compliance with such

⁶³² See id. at 3.

standards, and believes that there may be some such entities that are fully or nearly fully compliant, while others may have little or no compliance with such standards.

With respect to the substantive systems requirements resulting from adherence to SCI industry standards (which, solely for purposes of this Economic Analysis Section, the Commission assumes to be the proposed SCI industry standards contained in the publications identified in Table A, or publications setting forth substantially similar standards) underlying proposed Rule 1000(b)(1), as noted above, the Commission believes that certain entities that would satisfy the definition of SCI entity, particularly some that currently participate in the ARP Inspection Program, already comply with some of the requirements. On the other hand, the Commission believes that some SCI entities, including some that currently participate in the ARP Inspection Program, do not currently comply with some or all of the proposed requirements. Further, although the Commission believes that each SCI entity would incur costs in complying with these requirements, the Commission believes that some entities already comply with SCI industry standards with respect to some of their systems. Moreover, the Commission acknowledges that certain SCI entities are larger or more complex than others, and that proposed Rule 1000(b)(1) would impose higher costs on larger and more complex systems.

Because the Commission does not at this time have sufficient information to reasonably estimate each SCI entity's current level of compliance with the proposed SCI industry standards contained in the publications set forth in Table A, the Commission estimates a range of average costs for each SCI entity to comply with such standards. The Commission acknowledges that some SCI entities would incur costs near the bottom of the range because their systems policies and procedures currently meet SCI industry standards (which, as noted above, solely for purposes of this Economic Analysis Section, the Commission assumes to be the proposed SCI

industry standards contained in the publications identified in Table A or in substantially similar publications). On the other hand, some SCI entities would incur costs near the middle or top of the range because their systems policies and procedures do not currently meet such standards. Because the Commission lacks sufficient information regarding the current practices of all SCI entities, the Commission seeks comment on the extent to which SCI entities already have in place systems policies and procedures that would meet the proposed SCI industry standards (which, solely for purposes of this Economic Analysis Section, the Commission assumes to be the proposed SCI industry standards contained in the publications identified in Table A or in substantially similar publications).

Further, unlike the Paperwork Reduction Act Section where the Commission estimates a fifty-percent baseline with respect to proposed Rule 1000(b)(1)(i)(A)-(E) for entities that currently participate in the ARP Inspection Program, the Commission preliminarily estimates the same cost range for all SCI entities for compliance with the proposed substantive requirements that are the subject of the policies and procedures. On the one hand, the Commission believes that certain SCI entities (in particular, some entities that participate in the ARP Inspection Program) may already comply with some of the substantive requirements and thus would incur less incremental cost for complying with such requirements. On the other hand, the Commission believes that some SCI entities that currently participate in the ARP Inspection Program are larger and have more complex systems than those that do not participate in the ARP Inspection Program and, therefore, would incur more incremental cost for complying with the substantive requirements. As such, the Commission preliminarily believes it is unlikely that SCI entities that do not participate in the ARP Inspection Program would incur twice the cost as SCI entities that

participate in the ARP Inspection Program to comply with the substantive systems requirements underlying the policies and procedures required by proposed Regulation SCI.

Based on discussion with industry participants, the Commission preliminarily estimates that, to comply with the substantive requirements that are the subject of the policies and procedures required by proposed Rules 1000(b)(1) and (2), including consistency with the SCI industry standards (which, solely for purposes of this Economic Analysis, the Commission assumes to be the proposed SCI industry standards contained in the publications identified in Table A or in substantially similar publications) in connection with proposed Rule 1000(b)(1), on average, each SCI entity would incur an initial cost of between approximately \$400,000 and \$3 million.⁶³³ Based on this average, the Commission preliminarily estimates that SCI entities would incur a total initial cost of between approximately \$17.6 million⁶³⁴ and \$132 million.⁶³⁵ The Commission seeks comment on the estimated average initial cost range for SCI entities to comply with the substantive requirements underlying the policies and procedures required by proposed Rules 1000(b)(1) and (2).

The preliminary cost estimates described above represent an estimated average cost range per SCI entity, and the Commission acknowledges that some of the costs to comply with the

⁶³³ The Commission preliminarily estimates a range of cost for complying with the substantive requirements that are the subject of the policies and procedures required by proposed Rules 1000(b)(1) and (2) because some SCI entities are already in compliance with some of these substantive requirements. For example, the Commission believes that many SCI SROs (e.g., certain national securities exchanges and registered clearing agencies) already have or have begun implementation of business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption.

⁶³⁴ \$17.6 million = (\$400,000) × (44 SCI entities).

⁶³⁵ \$132 million = (\$3 million) × (44 SCI entities).

substantive requirements of proposed Rules 1000(b)(1) and (2) may be significantly higher than the estimated average for some SCI entities, while some of the costs may be significantly lower for other SCI entities. In particular, the Commission preliminarily believes that the costs associated with the requirement in proposed Rule 1000(b)(1)(i)(E) that an SCI entity have policies and procedures that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption is an area in which different SCI entities may encounter significantly different compliance costs. For example, among national securities exchanges, the Commission understands that many, though not all, national securities exchanges already have or soon expect to have backup facilities that do not rely on the same infrastructure components used by their primary facility. For those national securities exchanges that do not have such backup facilities, the cost to build and maintain such facilities may result in their compliance costs being significantly higher than those of national securities exchanges that already satisfy the proposed requirement.⁶³⁶ The application of the geographic diversity requirement to other entities, such as ATSSs, under the proposed rule, would depend on the nature, size, technology, business model, and other aspects of their business.

218. The Commission requests commenters' views on how many SCI entities would not currently satisfy the proposed requirement relating to geographic diversity of backup sites. The

⁶³⁶ As noted, solely for purposes of this Economic Analysis, the Commission has assumed that the SCI industry standards would be those contained in the publications identified in Table A or in substantially similar publications. However, as proposed Rule 1000(b)(1)(ii) makes clear, compliance with such current industry standards, including the geographic diversity requirements contained in the 2003 Interagency White Paper, supra note 31, is not the exclusive means to comply with the requirements of proposed Rule 1000(b)(1). See also supra note 182.

Commission requests commenters' views on the costs of establishing backup sites to satisfy the proposed geographic diversity requirement, particularly for entities that currently would not satisfy the proposed requirement. In such a case, given the likely significant cost and time associated with building such backup sites, how long do commenters believe it would take for SCI entities to come into compliance with such a proposed requirement? Would it be appropriate for the Commission to allow an extended period prior to which compliance with this proposed requirement would be effective? Why or why not? If so, how long should such period be and why? Should such an extended period only be permitted for a subset of SCI entities. If so, how should such a subset be determined? Please describe.

As noted above, because the Commission does not at this time have sufficient information to reasonably estimate each SCI entity's current level of compliance with the substantive requirements underlying the policies and procedures, the Commission preliminarily estimates a range of average initial costs for each SCI entity to comply with the substantive requirements underlying the policies and procedures required by proposed Rules 1000(b)(1) and (2). Based on the estimates of the initial costs, Commission estimates a range of average ongoing cost for each SCI entity to comply with the requirements using two-thirds of the initial cost. The Commission preliminarily believes that a two-thirds estimate is appropriate because although proposed Rules 1000(b)(1) and (2) would require SCI entities to comply with certain systems requirements including, for example, establishing reasonable current and future capacity planning estimates on an ongoing basis, as well as conducting tests and reviews of their systems on an ongoing basis, the Commission preliminarily believes that SCI entities would incur an additional initial cost to, for example, revise the underlying software code of their systems to the extent needed to bring those systems into compliance with the requirements of the proposed

rules. Therefore, the Commission preliminarily estimates that, to comply with the substantive requirements that are the subject of the policies and procedures required by proposed Rules 1000(b)(1) and (2), including consistency with SCI industry standards in connection with proposed Rule 1000(b)(1), on average, each SCI entity would incur an ongoing annual cost of between approximately \$267,000⁶³⁷ and \$2 million.⁶³⁸ Based on this estimated range, the Commission preliminarily estimates that SCI entities would incur a total ongoing cost of between approximately \$11.7 million⁶³⁹ and \$88 million.⁶⁴⁰ The Commission seeks comment on the estimated average ongoing cost range for SCI entities to comply with the substantive requirements underlying the policies and procedures required by proposed Rules 1000(b)(1) and (2).

The mandatory testing of SCI entity business continuity and disaster recovery plans, including backup systems, as proposed to be required under proposed Rule 1000(b)(9), would place an additional burden on SCI entities. The Commission believes that some SCI entities require some or all of their members or participants to connect to their backup systems⁶⁴¹ and

⁶³⁷ $\$266,667 = \$400,000$ (estimated initial cost to comply with the substantive requirements) $\times (2/3)$.

⁶³⁸ $\$2$ million = $\$3$ million (estimated initial cost to comply with the substantive requirements) $\times (2/3)$.

⁶³⁹ $\$11.7$ million = $(\$266,667) \times (44$ SCI entities).

⁶⁴⁰ $\$88$ million = $(\$2$ million) $\times (44$ SCI entities).

⁶⁴¹ See, e.g., CBOE Rule 6.18 (requiring Trading Permit Holders to take appropriate actions as instructed by CBOE to accommodate CBOE's ability to trade options via the back-up data center); CBOE Regulatory Circular RG12-163 (stating that Trading Permit Holders are required to maintain connectivity with the back-up data center and have the ability to operate in the back-up data center should circumstances arise that require it to be used); NYSE Rule 49(b)(2)(iii) (requiring NYSE members to have contingency plans to accommodate the use of the systems and facilities of NYSE Arca, NYSE's designated backup facility). See also Securities Exchange Act Release No. 52446 (September 15, 2005), 70 FR 55435 (September 21, 2005) (approving a proposed rule change by each of

that most, if not all, SCI entities already offer their members or participants the opportunity to test such plans, although they do not currently mandate participation by all members or participants in such testing. In addition, market participants, including SCI entities, already coordinate certain business continuity plan testing to some extent. Thus, the Commission preliminarily believes that additional costs of proposed Rule 1000(b)(9) to SCI entities would be minimal. However, for SCI entity members or participants, additional costs could be significant, and highly variable depending on the business continuity and disaster recovery plans being tested. However, based on discussions with market participants, the Commission preliminarily estimates the cost of the testing of such plans to range from immaterial administrative costs (for SCI entity members and participants that currently maintain connections to SCI entity backup systems) to a range of \$24,000 to \$60,000 per year per member or participant in connection with each SCI entity. Costs at the higher end of this range would accrue for members or participants who would need to invest in additional infrastructure and to maintain connectivity with an SCI entity's backup systems in order to participate in testing.⁶⁴² The Commission is unable at this time to provide a precise cost estimate for the total aggregate cost to SCI entity members and participants of the requirements relating to proposed Rule 1000(b)(9), as it does not know how

DTC, FICC, and NSCC imposing fines on "top tier" members that fail to conduct required connectivity testing for business continuity purposes, as reflected, *e.g.*, in NSCC Rules and Procedures, Addendum P, available at: http://www.dtcc.com/legal/rules_proc/nscc_rules.pdf. *See also, e.g.*, BATS Rule 18.38, Nasdaq Options Rule 13, and BOX Rule 3180 (permitting each exchange to require members to participate in computer systems testing in the manner and frequency prescribed by such exchange).

⁶⁴² Based on industry sources, the Commission understands that most of the larger members or participants of SCI entities already maintain connectivity with the backup systems of SCI entities while, among smaller members or participants of SCI entities, there is a lower incidence of members or participants maintaining such connectivity. The Commission requests comment on the accuracy of this understanding.

each SCI entity will determine its standards for designating members or participants that it would require to participate in the testing required by proposed Rule 1000(b)(9)(i), and thus does not know the number of members or participants at each SCI entity that would be designated as required to participate in testing, and whether such designated members and participants are those that already maintain connections to SCI entity backup systems. However, the Commission preliminarily believes that an aggregate annual cost of approximately \$66 million to designated members and participants is a reasonable estimate.⁶⁴³ The Commission requests comment on these estimates and the assumptions underlying them.

The Commission preliminarily believes that the corrective action to mitigate harm resulting from SCI events would impose modest incremental costs on SCI entities because in the usual course of business, SCI entities already take corrective actions in response to systems issues. Proposed Rule 1000(b)(3) supplements the existing incentives of SCI entities to correct an SCI event quickly by focusing on potential harm to investors and market integrity and by requiring SCI entities to devote adequate resources to begin to take corrective action as soon as

⁶⁴³ This estimate assumes that 44 SCI entities would each designate an average of 150 members or participants to participate in the necessary testing. Based on industry sources, the Commission understands that many SCI entities have between 200 and 400 members or participants, though some have more and some have fewer. In addition, the Commission preliminarily believes that it is reasonable to estimate that the members or participants of SCI entities that are most likely to be designated to be required to participate in testing are those that conduct a high level of activity with the SCI entity, or that play an important role for the SCI entity (such as market makers) and that such members or participants currently are likely to already maintain connectivity with an SCI entity's backup systems. Therefore, the Commission estimates the average cost for each member or participant of an SCI entity to be \$10,000, which takes into account the fact that the Commission preliminarily believes that many members or participants of SCI entities that would be required to participate in such testing would already have such connectivity, and thus have minimal cost. Based on these assumptions, the Commission estimates that the total aggregate cost to all members or participants of all SCI entities to be approximately \$66 million (44 SCI entities × 150 members or participants × \$10,000 = \$66 million).

reasonably practicable. Based on its experience with the ARP Inspection Program, the Commission believes that entities currently participating in the ARP Inspection Program already take corrective actions in response to a systems issue, and believes that other SCI entities also take corrective actions in response to a systems issue. Nevertheless, the Commission preliminarily believes that proposed Rule 1000(b)(3) could result in modestly increased costs for SCI entities per SCI event for corrective action relative to current practice for SCI entities, as a result of undertaking corrective action sooner than they might have otherwise and/or increasing investment in newer more updated systems earlier than they might have otherwise. If, however, proposed Regulation SCI reduces the frequency and severity of SCI events, the overall costs to SCI entities of corrective action may not increase significantly from the costs incurred without proposed Regulation SCI. However, the degree to which proposed Regulation SCI will reduce the frequency and severity of SCI events is unknown. Thus, the Commission is, at this time, unable to estimate the precise impact of proposed Regulation SCI due to an SCI entity's corrective action. Thus, the Commission requests comment regarding the costs associated with proposed Regulation SCI's corrective action requirements, including what such costs would be on an annualized basis.⁶⁴⁴

When an SCI event occurs, an SCI entity needs to determine whether the event is an immediate notification SCI event or dissemination SCI event because the proposed rule would impose different obligations on SCI entities for such events. Identifying these types of SCI events may impose one-time implementation costs on SCI entities associated with developing a

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See also *supra* Section IV.D.3 (estimating paperwork burdens associated with SCI entities developing a process for ensuring that they are prepared to take corrective action as required by proposed Rule 1000(b)(3), and reviewing that process on an ongoing basis).

process for ensuring that they are able to quickly and correctly make such determinations, as well as periodic costs in reviewing the adopted process.⁶⁴⁵

The Commission notes that proposed Rule 1000(d) would require that any written notification, review, description, analysis, or report to the Commission (except any written notification submitted pursuant to proposed Rule 1000(b)(4)(i)) be submitted electronically and contain an electronic signature. This proposed rule would require that every SCI entity have the ability to submit forms electronically with an electronic signature. The Commission believes that most, if not all, SCI entities currently have the ability to access and submit an electronic form such that the requirement to submit Form SCI electronically will not impose new implementation costs. The initial and ongoing costs associated with various electronic submissions of Form SCI are discussed in the Paperwork Reduction Act Section above.⁶⁴⁶

The Commission recognizes that some of the costs imposed by proposed Regulation SCI may ultimately be transferred to intermediaries, such as market participants that access national securities exchanges or clearing agencies, for example, in the form of higher fees. The Commission recognizes that, if costs relating to compliance with proposed Regulation SCI are passed on in the form of increased prices to users of SCI entities, there may be a loss of efficiency as a result of the net increase in costs to SCI entity customers. The Commission also preliminarily believes that, for some SCI entities, the cost estimates may be lower than the actual costs to be incurred, such as for entities that are not currently part of the ARP Inspection

⁶⁴⁵ The initial and ongoing burden associated with making these determinations are discussed in the Paperwork Reduction Act Section above. See supra Section IV.D.3 (estimating burdens resulting from SCI entities determining whether an SCI event is an immediate notification SCI event or dissemination SCI event).

⁶⁴⁶ See supra Section IV.D.2 (estimating burdens resulting from notice, dissemination, and reporting requirements for SCI entities).

Program or that have complex automated systems. However, on balance, the Commission preliminarily believes that the incremental direct cost estimates above are appropriate.

b. Other Costs

The Commission recognizes that proposed Regulation SCI could have other potential costs that cannot be quantified at this time. For example, entities covered by the proposed rule frequently make systems changes to comply with new and amended rules and regulations such as rules and regulations under federal securities laws and SRO rules. The Commission recognizes that, for entities that meet the definition of SCI entities, because they must continue to comply with proposed Regulation SCI when they make systems changes, proposed Regulation SCI could increase the costs and time needed to make systems changes to comply with new and amended rules and regulations. The Commission requests comment on the nature of such additional costs and time.

The Commission also considered whether proposed Regulation SCI would impact innovation in ATSS or raise barriers to entry. The Commission recognizes that, if proposed Regulation SCI were to cause SCI entities, including ATSS, to allocate resources towards ensuring they have robust systems and the personnel necessary to comply with proposed Regulation SCI's requirements and away from new features for their systems, or investing in research and development, proposed Regulation SCI may have a negative impact on innovation among such entities and thus impact competition. Similarly, if the costs of proposed Regulation SCI were to be viewed by persons considering forming new ATSS to be so onerous so as to dissuade them from starting new ATSS, competition would also be negatively impacted. To balance any concern about discouraging innovation and raising barriers to entry against the need for regulation, the Commission proposes thresholds for SCI ATSS that are designed to include

only the ATs that are most likely to have a significant impact on markets due to an SCI event, and requests comment on the thresholds.⁶⁴⁷ The tradeoffs associated with these thresholds are discussed in more detail below.

Finally, by specifying the timing, type, and format of information to be submitted to the Commission and by requiring electronic submission of Form SCI, Commission staff should be able to more efficiently review and analyze the information submitted. It is particularly important for the Commission to be able to review and analyze filings on Form SCI efficiently because proposed Regulation SCI would require all SCI events to be reported to the Commission. The Commission is not proposing at this time to require the data to be submitted in a tagged data format (e.g., XML, XBRL, or another structured data format that may be tagged), although it has requested specific comment as to whether it should, and the costs and benefits of doing so.⁶⁴⁸ The Commission recognizes that it could more readily analyze filings submitted in a tagged data format than in PDF format, and the subsequent potential benefits to investors may be greater. However, these benefits are balanced against the costs to the SCI entities of submitting filings in a tagged format.

c. Scaling

The Commission recognizes that the benefits of every provision of proposed Regulation SCI may not justify the costs of the provision if every requirement applied to every SCI entity and SCI event. In particular, the Commission recognizes that applying each requirement to every SCI entity and every SCI event could adversely affect competition and efficiency. Therefore, the Commission has proposed that not all SCI events be subject to the same

⁶⁴⁷ See supra Section III.B.1 and supra notes 100-123 and accompanying text.

⁶⁴⁸ See, e.g., request for comment in supra Section III.D.1.

requirements as immediate notification SCI events and dissemination SCI events and that ATSS that do not meet the definition of SCI ATSS, and broker-dealers who are not ATSSs, should not be subject to same requirements as SCI entities. The discussion that follows lays out the tradeoffs associated with determining the appropriate cutoffs for determining which events are immediate notification SCI events or dissemination SCI events, and which ATSSs are SCI ATSSs. In sum, the Commission believes that the requirements balance the need for regulation against the potential efficiency, competition, and capital formation concerns of the regulation. In the Commission's judgment, the cost of complying with the proposed rules would not be so large as to significantly raise barriers to entry or otherwise alter the competitive landscape of the entities involved.

As defined in proposed Rule 1000(a), a dissemination SCI event is an SCI event that is a: systems compliance issue; systems intrusion; or system disruption that results, or the SCI entity reasonably estimate would result, in a significant harm or loss to market participants. If the criteria for dissemination SCI events is set too low, the member or participant dissemination requirements under proposed Regulation SCI could be very costly.⁶⁴⁹ Therefore, the Commission carefully considered tradeoffs in defining the term dissemination SCI event. On the one hand, the definition should ensure that SCI events that have significant impacts on the markets are captured as dissemination SCI events.⁶⁵⁰ On the other hand, not every SCI event

⁶⁴⁹ As noted above, an immediate notification SCI event includes any systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion. See *supra* Section III.C.3.b. As with dissemination SCI events, if the criteria for immediate notification SCI events is set too low, SCI entities would incur additional costs in providing immediate notification to the Commission.

⁶⁵⁰ With respect to immediate Commission notification, the Commission should be immediately notified of any systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion.

should be included. There are higher costs associated with dealing with dissemination SCI events as compared to SCI events that are not dissemination SCI events due to the additional requirements relating to dissemination of information to members or participants. Second, SCI entity members or participants may be provided with unnecessary information if information about too many SCI events that do not have significant impact on the markets is disseminated to members or participants. If there is excessive dissemination of insignificant events, truly important events may get hidden among others that do not have the same degree of significance or impact on the securities markets.⁶⁵¹ SCI entity members or participants also may not pay attention to disseminated SCI events if an excessive number of insignificant events are disseminated and notifications about SCI events may become routine. The proposed definition of dissemination SCI event is an attempt to balance these concerns.

Section III.B.1 discusses the definition of "SCI ATS" in proposed Rule 1000(a). The proposal would replace the threshold for NMS stocks of 20 percent or more of the average daily volume in any NMS stock. The proposal bases the definition of SCI ATS on average daily dollar volume and sets the threshold at five percent or more in any single NMS stock and one-quarter percent of more in all NMS stocks, or one percent or more in all NMS stocks. The proposal changes the threshold for non-NMS stocks to at least five percent of the aggregate average daily dollar volume from twenty percent of the average daily share volume. These proposed thresholds reflect developments in equities markets that resulted in a higher number of trading venues and less concentrated trading, and are designed to ensure that the proposed rule is applied to all ATSS that trade more than a limited amount of securities and for which SCI events may

⁶⁵¹ Similarly, immediate Commission notification of only immediate notification SCI events should help the Commission focus its attention on SCI events that may potentially impact an SCI entity's operations or market participants.

cause significant impact on the overall market. The main benefit of the proposed thresholds is to bring more ATs into the SCI ATS definition than currently subject to the systems safeguard provisions of Rule 301(b)(6) of Regulation ATS, which in turn would make them SCI entities. This would help ensure that SCI ATs that trade a certain amount of securities are covered by the proposed regulation. The Commission recognizes the potential for a low threshold to discourage automation and innovation but, as noted below, the Commission has balanced the concerns regarding discouraging automation and innovation against the need for regulation, and preliminarily believes that innovation is unlikely to be hampered and automation is likely to continue to increase. To that extent, the proposed rule uses a two-prong approach for NMS stocks. The threshold is based on market share in individual stocks. However, it is also required that the ATS has a certain market share of the overall market in all NMS stocks to prevent an ATS from being subject to proposed Regulation SCI for meeting the five percent threshold in any single NMS stock for a micro-cap stock, but not having significant market share in all NMS stocks. As discussed above, the Commission believes that approximately 10 NMS stock ATs and two non-NMS stock ATs would fall within the definition of SCI ATS.⁶⁵²

For municipal and corporate debt securities, the proposal would lower the threshold from 20 percent or more to five percent or more. However, the proposal contemplates a two-prong approach considering either average daily dollar volume or average daily transaction volume, and exceeding the threshold in either one would qualify an ATS as an SCI ATS. The use of the two metrics is intended to take into account the fact that ATs in the debt securities markets may handle primarily retail trades (*i.e.*, large transaction volume but small dollar volume) or institutional-sized trades (*i.e.*, large dollar volume but small transaction volume).

⁶⁵² See *supra* Section III.B.1.

The proposed thresholds for municipal and corporate debt securities are different from the proposed thresholds for NMS stocks. This difference reflects the fact that, in the debt securities markets (i.e., municipal securities and corporate debt securities), the degree of automation and electronic trading is much lower than in the markets for NMS stocks, which the Commission preliminarily believes may reduce the need for more stringent rules and regulations. In addition, the Commission preliminarily believes that the imposition of a threshold lower than five percent on the current debt securities markets could have the unintended effect of discouraging automation in these markets and discouraging new entrants into these markets. Also, due to the large number of issues outstanding in these debt securities markets, trading volume may be extremely low in a given issue, but also may fluctuate significantly from day to day and issue to issue. Therefore, the thresholds for debt securities consider aggregate volume instead of volume in an individual issue. As discussed above, the Commission preliminarily believes that three municipal securities and corporate debt securities ATSs would fall within the definition of SCI ATS.⁶⁵³

D. Request for Comment on Economic Analysis

219. The Commission is sensitive to the potential economic effects, including the costs and benefits, of proposed Regulation SCI. The Commission has identified above certain costs and benefits associated with the proposal and requests comment on all aspects of its preliminary economic analysis.⁶⁵⁴ The Commission encourages commenters to identify, discuss, analyze,

⁶⁵³ See id.

⁶⁵⁴ The Commission has also considered the views expressed in comment letters submitted in connection with the Roundtable, as well as the views expressed by Roundtable participants. See supra Section I.C.

and supply relevant data, information, or statistics regarding any such costs or benefits. In particular, the Commission seeks comment on the following:

220. Do commenters agree that the release provides a fair representation of current practices and how those current practices would change under proposed Regulation SCI? Why or why not? Please be specific in your response regarding current practices and how they would change under proposed Regulation SCI.

221. Do commenters agree with the Commission's characterization of the relevant markets in which SCI entities participate, as well as the market failures identified with respect to each of the relevant markets? Why or why not? Specifically, do commenters agree with the identified level of competition in each of the relevant markets? Why or why not?

222. What is a typical market participant's general level of expectation of how well the market operates? Do market participants currently have all the information they need to make informed decisions that manage their exposure to SCI events? If not, would proposed Regulation SCI provide the needed information? Why or why not?

223. Do commenters agree with the Commission's analysis of the costs and benefits of each provision of proposed Regulation SCI, including the definitions under proposed Rule 1000(a)? Why or why not?

224. Do commenters believe that there are additional benefits or costs that could be quantified or otherwise monetized? If so, please identify these categories and, if possible, provide specific estimates or data.

225. Are there any additional benefits that may arise from proposed Regulation SCI? Or are there benefits described above that would not likely result from proposed Regulation SCI? If so, please explain these benefits or lack of benefits in detail.

226. Are there any additional costs that may arise from proposed Regulation SCI? Are there any potential unintended consequences of proposed Regulation SCI? Or are there costs described above that would not likely result from proposed Regulation SCI? If so, please explain these costs or lack of costs in detail.

227. Do the types or extent of any anticipated benefits or costs from proposed Regulation SCI differ between the different types of SCI entities? For example, do potential benefits or costs differ with respect to SCI SROs as compared to SCI ATSS? Please explain.

228. Are there methods (including any suggested by Roundtable panelists or commenters) by which the Commission could reduce the costs imposed by Regulation SCI while still achieving the goals? Please explain.

229. Does the release appropriately describe the potential impacts of proposed Regulation SCI on the promotion of efficiency, competition, and capital formation? Why or why not?

230. To the extent that there are reasonable alternatives to any of the rules under proposed Regulation SCI, what are the potential costs and benefits of those reasonable alternatives relative to the proposed rules? What are the potential impacts on the promotion of efficiency, competition, and capital formation of those reasonable alternatives? For example, what would be the effect on the economic analysis of requiring SCI entities to conduct an SCI review that requires penetration testing annually? What would be the effect on the economic analysis of requiring SCI entities to inform members and participants of all SCI events? What would be the effect on the economic analysis of requiring filing in a tagged data format (e.g., XML, XBRL, or another structured data format that may be tagged)? What would be the effect

on the economic analysis of including broker-dealers, or a subset thereof, in the definition of SCI entities?

231. In addition, as noted above, the proposed requirement that an SCI entity disseminate information relating to dissemination SCI events to its members or participants is focused on disseminating information to those who need, want, and can act on the information disseminated. The Commission also preliminarily believes that this proposed requirement could promote competition and capital formation. Are there alternative mechanisms for achieving the Commission's goals while promoting competition and capital formation? Are there costs associated with this proposed approach that have not been considered? For example, would the requirement to disseminate information to members or participants about dissemination SCI events increase an SCI entity's litigation costs, or cause an SCI entity to lose business (e.g., if market participants misjudge the meaning of information disseminated about dissemination SCI events)? Would the benefits of the proposed information dissemination outweigh the costs? Why or why not? Please explain.

232. The Commission also generally requests comment on the competitive or anticompetitive effects, as well as the efficiency and capital formation effects, of proposed Regulation SCI on market participants if the proposed rules are adopted as proposed. Commenters should provide analysis and empirical data to support their views on the competitive or anticompetitive effects, as well as the efficiency and capital formation effects, of proposed Regulation SCI.

233. Finally, as stated above, proposed Rule 1000(b)(1) would require SCI entities to establish, maintain, and enforce written policies and procedures, reasonably designed to ensure that their SCI systems and, for purposes of security standards, SCI security systems, have levels

of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets. As discussed above, the Commission is proposing that an SCI entity's policies and procedures required by proposed Rule 1000(b)(1) be deemed to be reasonably designed if they are consistent with current SCI industry standards.⁶⁵⁵ However, the costs identified above may not fully incorporate all of the costs of adhering to initial or future SCI industry standards. For example, if a SCI industry standard is based on the standards of NIST (which issues a number of the publications listed in Table A), it could include additional requirements not otherwise required in proposed Regulation SCI such as establishment of assurance-related controls (including, for example, conduct of integrity checks on software and firmware components, or monitoring of established secure configuration settings). Any additional requirements would likely impose costs on SCI entities. Therefore, the Commission requests comment on what benefits or costs, quantifiable or otherwise, could potentially be imposed by the identification of SCI industry standards. What are market participants' current level of compliance with the industry standards contained in the publications listed in Table A? What would be the costs to SCI entities (in addition to the cost of adhering to current practice) of the Commission identifying examples of industry standards? What would be the benefits? Please explain.

VI. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"⁶⁵⁶ the Commission must advise OMB as to whether proposed Regulation SCI

⁶⁵⁵ Proposed SCI industry standards are contained in the publications identified in Table A. See *supra* Section III.C.1.b.

⁶⁵⁶ Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in: (1) an annual effect on the economy of \$100 million or more (either in the form of an increase or decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) a significant adverse effect on competition, investment or innovation.

234. The Commission requests comment on the potential impact of proposed Regulation SCI on the economy on an annual basis, on the costs or prices for consumers or individual industries, and any potential effect on competition, investment, or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. Regulatory Flexibility Act Certification

The Regulatory Flexibility Act ("RFA")⁶⁵⁷ requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)⁶⁵⁸ of the Administrative Procedure Act,⁶⁵⁹ as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."⁶⁶⁰ Section 605(b) of the RFA states

⁶⁵⁷ 5 U.S.C. 601 et seq.

⁶⁵⁸ 5 U.S.C. 603(a).

⁶⁵⁹ 5 U.S.C. 551 et seq.

⁶⁶⁰ Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term "small entity" for purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not have significant economic impact on a substantial number of small entities.

A. SCI Entities

Paragraph (a) of Rule 0-10 provides that for purposes of the RFA, a small entity when used with reference to a “person” other than an investment company means a person that, on the last day of its most recent fiscal year, had total assets of \$5 million or less.⁶⁶¹ With regard to broker-dealers, small entity means a broker or dealer that had total capital of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) under the Exchange Act, or, if not required to file such statements, total capital 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 that is not affiliated with any person that is not a small business or small organization.⁶⁶² With regard to clearing agencies, small entity means a clearing agency that compared, cleared, and settled less than \$500 million in securities transactions during the preceding fiscal year (or in the time that it has been in business, if shorter), had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or in the time that it has been in business, if shorter), and is not affiliated with any person (other than a natural person) that is not a small business or small organization.⁶⁶³ With regard to exchanges, a small entity is an exchange that has been exempt from the reporting requirements of Rule 601 under Regulation NMS, and is not affiliated with

⁶⁶¹ See 17 CFR 240.0-10(a).

⁶⁶² See 17 CFR 240.0-10(c).

⁶⁶³ See 17 CFR 240.0-10(d).

any person (other than a natural person) that is not a small business or small organization.⁶⁶⁴

With regard to securities information processors, a small entity is a securities information processor that had gross revenue of less than \$10 million during the preceding year (or in the time it has been in business, if shorter), provided service to fewer than 100 interrogation devices or moving tickers at all times during the preceding fiscal year (or in the time it has been in business, if shorter), and is not affiliated with any person (that is not a natural person) that is not a small business or small organization.⁶⁶⁵ Under the standards adopted by the Small Business Administration (“SBA”), entities engaged in financial investments and related activities are considered small entities if they have \$7 million or less in annual receipts.⁶⁶⁶

Based on the Commission’s existing information about the entities that will be subject to proposed Regulation SCI, the Commission preliminarily believes that SCI entities that are self-regulatory organizations (national securities exchanges, national securities associations, registered clearing agencies, and the MSRB) or exempt clearing agencies subject to ARP would not fall within the definition of “small entity” as described above. With regard to plan processors, which are defined under Rule 600(b)(55) of Regulation NMS to mean a self-regulatory organization or securities information processor acting as an exclusive processor in connection with the development, implementation and/or operation of any facility contemplated

⁶⁶⁴ See 17 CFR 240.0-10(e).

⁶⁶⁵ See 17 CFR 240.0-10(g).

⁶⁶⁶ See SBA’s Table of Small Business Size Standards, Subsector 523 and 13 CFR 121.201. Such entities include firms engaged in investment banking and securities dealing, securities brokerage, commodity contracts dealing, commodity contracts brokerage, securities and commodity exchanges, miscellaneous intermediation, portfolio management, investment advice, trust, fiduciary and custody activities, and miscellaneous financial investment activities.

by an effective NMS plan,⁶⁶⁷ the Commission's definition of "small entity" as it relates to self-regulatory organizations and securities information processors would apply. The Commission preliminarily does not believe that any plan processor would be a "small entity" as defined above. With regard to SCI ATSS, because they are registered as broker-dealers, the Commission's definition of "small entity" as it relates to broker-dealers would apply. As stated above, the Commission preliminarily believes that approximately 15 ATSS would satisfy the definition of SCI ATSS and would be impacted by proposed Regulation SCI.⁶⁶⁸ The Commission preliminarily does not believe that any of these 15 SCI ATSS would be a "small entity" as defined above.

B. Certification

For the foregoing reasons, the Commission certifies that proposed Regulation SCI would not have a significant economic impact on a substantial number of small entities for the purposes of the RFA.

235. The Commission requests comment regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to illustrate the extent of the impact.

VIII. Statutory Authority and Text of Proposed Amendments

Pursuant to the Exchange Act, 15 U.S.C. 78a et seq., and particularly, Sections 2, 3, 5, 6, 11A, 15, 15A, 17, 17A, and 23(a) thereof, 15 U.S.C. 78b, 78c, 78e, 78f, 78k-1, 78o, 78o-3, 78q, 78q-1, and 78w(a), the Commission proposes to adopt Regulation SCI under the Exchange Act and Form SCI under the Exchange Act, and to amend Regulation ATS under the Exchange Act.

⁶⁶⁷ See 17 CFR 242.600(b)(55).

⁶⁶⁸ See supra Section III.B.1, discussing the proposed definition of SCI entity.

List of Subjects in 17 CFR Parts 242 and 249

Securities, brokers, reporting and recordkeeping requirements.

For the reasons stated in the preamble, the Commission is proposing to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

**PART 242—REGULATIONS M, SHO, ATS, AC, NMS AND SCI AND
CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES**

1. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a23, 80a-29, and 80a-37.

* * * * *

2. Add § 242.1000 to read as follows:

* * * * *

§ 242.1000 Regulation SCI – Systems Compliance and Integrity.

(a) Definitions.

For purposes of this section, the following definitions shall apply:

The term dissemination SCI event means an SCI event that is a:

- (1) Systems compliance issue;
- (2) Systems intrusion; or
- (3) Systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.

The term electronic signature has the meaning set forth in §240.19b-4(j).

The term exempt clearing agency subject to ARP means an entity that has received from the Commission an exemption from registration as a clearing agency under Section 17A of the

Act, and whose exemption contains conditions that relate to the Commission's Automation Review Policies (ARP), or any Commission regulation that supersedes or replaces such policies.

The term material systems change means a change to one or more:

(1) SCI systems of an SCI entity that:

(i) Materially affects the existing capacity, integrity, resiliency, availability, or security of such systems;

(ii) Relies upon materially new or different technology;

(iii) Provides a new material service or material function; or

(iv) Otherwise materially affects the operations of the SCI entity; or

(2) SCI security systems of an SCI entity that materially affects the existing security of such systems.

The term plan processor has the meaning set forth in §242.600(b)(55).

The term responsible SCI personnel means, for a particular SCI system or SCI security system impacted by an SCI event, any personnel, whether an employee or agent, of the SCI entity having responsibility for such system.

The term SCI alternative trading system or SCI ATS means an alternative trading system, as defined in §242.300(a), which during at least four of the preceding six calendar months, had:

(1) With respect to NMS stocks:

(i) Five percent (5%) or more in any single NMS stock, and one-quarter percent (0.25%) or more in all NMS stocks, of the average daily dollar volume reported by an effective transaction reporting plan; or

(ii) One percent (1%) or more in all NMS stocks of the average daily dollar volume reported by an effective transaction reporting plan;

(2) With respect to equity securities that are not NMS stocks and for which transactions are reported to a self-regulatory organization, five percent (5%) or more of the average daily dollar volume as calculated by the self-regulatory organization to which such transactions are reported;

(3) With respect to municipal securities, five percent (5%) or more of either:

- (i) The average daily dollar volume traded in the United States; or
- (ii) The average daily transaction volume traded in the United States; or

(4) With respect to corporate debt securities, five percent (5%) or more of either:

- (i) The average daily dollar volume traded in the United States; or
- (ii) The average daily transaction volume traded in the United States.

The term SCI entity means an SCI self-regulatory organization, SCI alternative trading system, plan processor, or exempt clearing agency subject to ARP.

The term SCI event means an event at an SCI entity that constitutes:

- (1) A systems disruption;
- (2) A systems compliance issue; or
- (3) A systems intrusion.

The term SCI review means a review, following established procedures and standards, that is performed by objective personnel having appropriate experience in conducting reviews of SCI systems and SCI security systems, and which review contains:

- (1) A risk assessment with respect to such systems of an SCI entity; and
- (2) An assessment of internal control design and effectiveness to include logical and physical security controls, development processes, and information technology governance, consistent with industry standards; provided however, that such review shall include penetration

test reviews of the network, firewalls, development, testing, and production systems at a frequency of not less than once every three years.

The term SCI self-regulatory organization or SCI SRO means any national securities exchange, registered securities association, or registered clearing agency, or the Municipal Securities Rulemaking Board; provided however, that for purposes of this section, the term SCI self-regulatory organization shall not include an exchange that is notice registered with the Commission pursuant to 15 U.S.C. 78f(g) or a limited purpose national securities association registered with the Commission pursuant to 15 U.S.C. 78o-3(k).

The term SCI security systems means any systems that share network resources with SCI systems that, if breached, would be reasonably likely to pose a security threat to SCI systems.

The term SCI systems means all computer, network, electronic, technical, automated, or similar systems of, or operated by or on behalf of, an SCI entity, whether in production, development, or testing, that directly support trading, clearance and settlement, order routing, market data, regulation, or surveillance.

The term systems compliance issue means an event at an SCI entity that has caused any SCI system of such entity to operate in a manner that does not comply with the federal securities laws and rules and regulations thereunder or the entity's rules or governing documents, as applicable.

The term systems disruption means an event in an SCI entity's SCI systems that results in:

- (1) A failure to maintain service level agreements or constraints;
- (2) A disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely;

- (3) A loss of use of any such system;
- (4) A loss of transaction or clearance and settlement data;
- (5) Significant back-ups or delays in processing;
- (6) A significant diminution of ability to disseminate timely and accurate market data; or
- (7) A queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected.

The term systems intrusion means any unauthorized entry into the SCI systems or SCI security systems of an SCI entity.

(b) Requirements for SCI entities. Each SCI entity shall:

(1) Capacity, Integrity, Resiliency, Availability, and Security. Establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems and, for purposes of security standards, SCI security systems, have levels of capacity, integrity, resiliency, availability, and security, adequate to maintain the SCI entity's operational capability and promote the maintenance of fair and orderly markets.

(i) Such policies and procedures shall include, at a minimum:

(A) The establishment of reasonable current and future capacity planning estimates;

(B) Periodic capacity stress tests of such systems to determine their ability to process transactions in an accurate, timely, and efficient manner;

(C) A program to review and keep current systems development and testing methodology for such systems;

(D) Regular reviews and testing of such systems, including backup systems, to identify vulnerabilities pertaining to internal and external threats, physical hazards, and natural or manmade disasters;

(E) Business continuity and disaster recovery plans that include maintaining backup and recovery capabilities sufficiently resilient and geographically diverse to ensure next business day resumption of trading and two-hour resumption of clearance and settlement services following a wide-scale disruption; and

(F) Standards that result in such systems being designed, developed, tested, maintained, operated, and surveilled in a manner that facilitates the successful collection, processing, and dissemination of market data; and

(ii) For purposes of this paragraph (b)(1), such policies and procedures shall be deemed to be reasonably designed if they are consistent with current SCI industry standards, which shall be:

(A) Comprised of information technology practices that are widely available for free to information technology professionals in the financial sector; and

(B) Issued by an authoritative body that is a U.S. governmental entity or agency, association of U.S. governmental entities or agencies, or widely recognized organization. Compliance with such current SCI industry standards, however, shall not be the exclusive means to comply with the requirements of paragraph (b)(1).

(2) Systems Compliance. (i) Establish, maintain, and enforce written policies and procedures reasonably designed to ensure that its SCI systems operate in the manner intended, including in a manner that complies with the federal securities laws and rules and regulations thereunder and the entity's rules and governing documents, as applicable.

(ii) Safe harbor from liability for SCI entities. An SCI entity shall be deemed not to have violated paragraph (b)(2)(i) if:

(A) The SCI entity has established and maintained policies and procedures reasonably designed to provide for:

(1) Testing of all such systems and any changes to such systems prior to implementation;

(2) Periodic testing of all such systems and any changes to such systems after their implementation;

(3) A system of internal controls over changes to such systems;

(4) Ongoing monitoring of the functionality of such systems to detect whether they are operating in the manner intended;

(5) Assessments of SCI systems compliance performed by personnel familiar with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable; and

(6) Review by regulatory personnel of SCI systems design, changes, testing, and controls to prevent, detect, and address actions that do not comply with applicable federal securities laws and rules and regulations thereunder and the SCI entity's rules and governing documents, as applicable;

(B) The SCI entity has established and maintained a system for applying such policies and procedures which would reasonably be expected to prevent and detect, insofar as practicable, any violations of such policies and procedures by the SCI entity or any person employed by the SCI entity, and

(C) The SCI entity:

(1) Has reasonably discharged the duties and obligations incumbent upon the SCI entity by such policies and procedures; and

(2) Was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect.

(iii) Safe harbor from liability for individuals. A person employed by an SCI entity shall be deemed not to have aided, abetted, counseled, commanded, caused, induced, or procured the violation by any other person of paragraph (b)(2)(i) if the person employed by the SCI entity:

(A) Has reasonably discharged the duties and obligations incumbent upon such person by such policies and procedures; and

(B) Was without reasonable cause to believe that such policies and procedures were not being complied with in any material respect.

(3) Corrective Action. Upon any responsible SCI personnel becoming aware of an SCI event, begin to take appropriate corrective action which shall include, at a minimum, mitigating potential harm to investors and market integrity resulting from the SCI event and devoting adequate resources to remedy the SCI event as soon as reasonably practicable.

(4) Commission Notification.

(i) Upon any responsible SCI personnel becoming aware of a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants, any systems compliance issue, or any systems intrusion, notify the Commission of such SCI event.

(ii) Within 24 hours of any responsible SCI personnel becoming aware of any SCI event, submit a written notification pertaining to such SCI event to the Commission.

(iii) Until such time as the SCI event is resolved, submit written updates pertaining to such SCI event to the Commission on a regular basis, or at such frequency as reasonably requested by a representative of the Commission.

(iv) Any written notification to the Commission made pursuant to paragraphs (ii) or (iii) shall be made electronically on Form SCI (§249.1900), and shall include all information as prescribed in Form SCI and the instructions thereto, including:

(A) For a notification made pursuant to paragraph (b)(4)(ii):

(1) All pertinent information known about an SCI event, including: a detailed description of the SCI event; the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; the potential impact of the SCI event on the market; and the SCI entity's current assessment of the SCI event, including a discussion of the determination of whether the SCI event is a dissemination SCI event or not; and

(2) To the extent available as of the time of the notification: a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; the time the SCI event was resolved or timeframe within which the SCI event is expected to be resolved; a description of the SCI entity's rule(s) and/or governing document(s), as applicable, that relate to the SCI event; and an analysis of parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss.

(B) For a notification made pursuant to paragraph (b)(4)(iii), an update of any information previously provided regarding the SCI event, including any information required by paragraph (b)(4)(iv)(A)(2) which was not available at the time of submission of the notification made pursuant to paragraph (b)(4)(ii). Subsequent updates shall update any information provided regarding the SCI event until the SCI event is resolved.

(C) For notifications made pursuant to paragraphs (b)(4)(ii) or (b)(4)(iii), attach a copy of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

(5) Dissemination of information to members or participants.

(i)(A) Promptly after any responsible SCI personnel becomes aware of a dissemination SCI event other than a systems intrusion, disseminate to its members or participants the following information about such SCI event:

(1) The systems affected by the SCI event; and

(2) A summary description of the SCI event; and

(B) When known, further disseminate to its members or participants:

(1) A detailed description of the SCI event;

(2) The SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; and

(3) A description of the progress of its corrective action for the SCI event and when the SCI event has been or is expected to be resolved; and

(C) Provide regular updates to members or participants of any information required to be disseminated under paragraphs (i)(A) and (i)(B).

(ii) Promptly after any responsible SCI personnel becomes aware of a systems intrusion, disseminate to its members or participants a summary description of the systems intrusion, including a description of the corrective action taken by the SCI entity and when the systems intrusion has been or is expected to be resolved, unless the SCI entity determines that dissemination of such information would likely compromise the security of the SCI entity's SCI systems or SCI security systems, or an investigation of the systems intrusion, and documents the reasons for such determination.

(6) Material Systems Changes.

(i) Absent exigent circumstances, notify the Commission in writing at least 30 calendar days before implementation of any planned material systems change, including a description of the planned material systems change as well as the expected dates of commencement and completion of implementation of such changes.

(ii) If exigent circumstances exist, or if the information previously provided to the Commission regarding any planned material systems change has become materially inaccurate, notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable.

(iii) A written notification to the Commission made pursuant to this paragraph (b)(6) shall be made electronically on Form SCI (§249.1900), and shall include all information as prescribed in Form SCI and the instructions thereto.

(7) SCI Review. Conduct an SCI review of the SCI entity's compliance with Regulation SCI not less than once each calendar year, and submit a report of the SCI review to senior management of the SCI entity for review no more than 30 calendar days after completion of such SCI review.

(8) Reports. Submit to the Commission:

(i) A report of the SCI review required by paragraph (b)(7), together with any response by senior management, within 60 calendar days after its submission to senior management of the SCI entity;

(ii) A report, within 30 calendar days after the end of June and December of each year, containing a summary description of the progress of any material systems change during the six-

month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes; and

(iii) Any reports to be filed with the Commission pursuant to this paragraph (b)(8) shall be filed electronically on Form SCI (§249.1900), and shall include all information as prescribed in Form SCI and the instructions thereto.

(9) SCI Entity Business Continuity and Disaster Recovery Plans Testing Requirements for Members or Participants. With respect to an SCI entity's business continuity and disaster recovery plans, including its backup systems:

(i) Require participation by designated members or participants in scheduled functional and performance testing of the operation of such plans, in the manner and frequency as specified by the SCI entity, at least once every 12 months; and

(ii) Coordinate the testing of such plans on an industry- or sector-wide basis with other SCI entities.

(iii) Each SCI entity shall designate those members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans pursuant to paragraph (i) above. Each SCI entity shall notify the Commission of such designations and its standards for designation, and promptly update such notification after any changes to its designations or standards. A written notification made pursuant to this paragraph (b)(9)(iii) shall be made electronically on Form SCI (§249.1900), and shall include all information as prescribed in Form SCI and the instructions thereto.

(c) Recordkeeping Requirements Related to Compliance with Regulation SCI.

(1) An SCI SRO shall make, keep, and preserve all documents relating to its compliance with Regulation SCI as prescribed in Rule 17a-1 under the Securities Exchange Act of 1934 (§240.17a-1).

(2) An SCI entity that is not an SCI SRO shall:

(i) Make, keep, and preserve at least one copy of all documents, including correspondence, memoranda, papers, books, notices, accounts, and other such records, relating to its compliance with Regulation SCI, including, but not limited to, records relating to any changes to its SCI systems and SCI security systems;

(ii) Keep all such documents for a period of not less than five years, the first two years in a place that is readily accessible to the Commission or its representatives for inspection and examination; and

(iii) Upon request of any representative of the Commission, promptly furnish to the possession of such representative copies of any documents required to be kept and preserved by it pursuant to paragraphs (i) and (ii) of this section.

(3) Upon or immediately prior to ceasing to do business or ceasing to be registered under the Securities Exchange Act of 1934, an SCI entity shall take all necessary action to ensure that the records required to be made, kept, and preserved by this section shall be accessible to the Commission and its representatives in the manner required by this section and for the remainder of the period required by this section.

(d) Electronic Submission. (1) Except with respect to notifications to the Commission made pursuant to paragraph (b)(4)(i) or oral notifications to the Commission made pursuant to paragraph (b)(6)(ii), any notification, review, description, analysis, or report to the Commission

required under this rule shall be submitted electronically on Form SCI (§249.1900) and shall contain an electronic signature; and

(2) The signatory to an electronically submitted Form SCI shall manually sign a signature page or document, in the manner prescribed by Form SCI, authenticating, acknowledging, or otherwise adopting his or her signature that appears in typed form within the electronic filing. Such document shall be executed before or at the time Form SCI is electronically submitted and shall be retained by the SCI entity in accordance with paragraph (c).

(e) Requirements for Service Bureaus. If records required to be filed or kept by an SCI entity under this rule are prepared or maintained by a service bureau or other recordkeeping service on behalf of the SCI entity, the SCI entity shall ensure that the records are available for review by the Commission and its representatives by submitting a written undertaking, in a form acceptable to the Commission, by such service bureau or other recordkeeping service, signed by a duly authorized person at such service bureau or other recordkeeping service. Such a written undertaking shall include an agreement by the service bureau to permit the Commission and its representatives to examine such records at any time or from time to time during business hours, and to promptly furnish to the Commission and its representatives true, correct, and current electronic files in a form acceptable to the Commission or its representatives or hard copies of any or all or any part of such records, upon request, periodically, or continuously and, in any case, within the same time periods as would apply to the SCI entity for such records. The preparation or maintenance of records by a service bureau or other recordkeeping service shall not relieve an SCI entity from its obligation to prepare, maintain, and provide the Commission and its representatives access to such records.

(f) Access. Each SCI entity shall provide Commission representatives reasonable access to its SCI systems and SCI security systems to allow Commission representatives to assess the SCI entity's compliance with this rule.

Proposed Amendments to Regulation ATS – Alternative Trading Systems, 17 CFR § 242.301(b)(6)—[removed and reserved]

3. Remove and reserve § 242.301(b)(6) to Part 242.

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The general authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201; and 18 U.S.C. 1350 unless otherwise noted.

* * * * *

5. Add subpart T, consisting of § 249.1900 to read as follows:

Subpart T—Form SCI, for filing notices and reports as required by Regulation SCI.

§ 249.1900. Form SCI, for filing notices and reports as required by Regulation SCI.

Form SCI shall be used to file notice and reports as required by § 242.1000.

[**Note:** The text of Form SCI does not, and the amendments will not, appear in the Code of Federal Regulations.]

GENERAL INSTRUCTIONS FOR FORM SCI

A. Use of the Form

Except with respect to notifications to the Commission made pursuant to proposed Rule 1000(b)(4)(i) or oral notifications to the Commission made pursuant to proposed Rule 1000(b)(6)(ii), all notifications and reports required to be submitted pursuant to Rule 1000 of Regulation SCI under the Securities Exchange Act of 1934 (“Act”) shall be filed in an electronic format through an electronic form filing system (“EFFS”), a secure website operated by the Securities and Exchange Commission (“Commission”).

B. Need for Careful Preparation of the Completed Form, Including Exhibits

This form, including the exhibits, is intended to elicit information necessary for Commission staff to work with SCI self-regulatory organizations, SCI alternative trading systems, plan processors, and exempt clearing agencies subject to ARP (collectively, “SCI entities”) to ensure the capacity, integrity, resiliency, availability, and security of their automated systems. An SCI entity must provide all the information required by the form, including the exhibits, and must present the information in a clear and comprehensible manner. Form SCI shall not be considered filed unless it complies with applicable requirements.

C. When to Use the Form

Form SCI is comprised of five distinct types of filings to the Commission required by Rule 1000(b). The first type of filings is “(b)(4)” filings for notifications regarding systems disruptions, systems compliance issues, or systems intrusions (collectively, “SCI events”). The other four types of filings are: “(b)(6)” filings for notifications of planned material systems changes; “(b)(8)(i)” filings for reports of SCI reviews; “(b)(8)(ii)” filings for semi-annual reports of material systems changes; and “(b)(9)(iii)” filings for notifications of designations and

standards under Rule 1000(b)(9). In filling out Form SCI, an SCI entity shall select the type of filing and provide all information required under Rule 1000(b) specific to that type of filing.

Notifications for SCI Events

For (b)(4) filings, an SCI entity must notify the Commission using Form SCI by selecting the appropriate box in Section 1 and filling out all information required by the form. Initial notifications of an SCI event require the inclusion of an Exhibit 1 and must be submitted no later than 24 hours after any responsible SCI personnel becomes aware of the SCI event. For the initial notification of an SCI event, the SCI entity must include the information required by each item under Part 1 of Exhibit 1. To the extent available as of the time of the initial notification, the SCI entity must also include the information listed under the items under Part 2 of Exhibit 1.

If the SCI entity has not provided all the information required by Part 2 of Exhibit 1, any information required by Exhibit 1 requires updating, or the SCI event has not been resolved, the SCI entity must file one or more updates regarding the SCI event by attaching an Exhibit 2. Such updates must be submitted on a regular basis, or at such frequency as reasonably requested by a representative of the Commission. The notification to the Commission regarding an SCI event is not considered complete until all information required by Exhibit 1, including all information required by Part 2 of Exhibit 1, has been submitted to the Commission.

For each SCI event, an SCI entity must also attach an Exhibit 3 (which may be included with an Exhibit 1 or Exhibit 2, as the case may be) for any information disseminated regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

Other Notifications and Reports

For (b)(6) filings, absent exigent circumstances, an SCI entity must notify the Commission using Form SCI at least 30 calendar days before implementation of any planned

material systems change. If exigent circumstances exist, or if the information previously provided to the Commission regarding any planned material systems change has become materially inaccurate, an SCI entity must notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable. For (b)(6) filings, the SCI entity must select the appropriate box in Section 2 and fill out all information required by the form, including Exhibit 4. Exhibit 4 must include a description of the planned material systems change as well as the expected dates of commencement and completion of implementation of such change.

For (b)(8)(i) filings, an SCI entity must submit its report of its SCI review to the Commission using Form SCI. A (b)(8)(i) filing must be submitted to the Commission within 60 calendar days after the SCI review has been submitted to senior management of the SCI entity. The SCI entity must select the appropriate box in Section 2 and fill out all information required by the form, including Exhibit 5. Exhibit 5 must include the report of the SCI review, together with any response by senior management.

For (b)(8)(ii) filings, an SCI entity must submit its semi-annual report of material systems changes to the Commission using Form SCI. A (b)(8)(ii) filing must be submitted to the Commission within 30 calendar days after the end of June and December of each year. The SCI entity must select the appropriate box in Section 2 and fill out all information required by the form, including Exhibit 6. Exhibit 6 must include a report with a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes.

For (b)(9) filings, an SCI entity must notify the Commission of its designations and standards under Rule 1000(b)(9). The SCI entity must select the appropriate box in Section 2 and fill out all information required by the form, including Exhibit 7. Exhibit 7 must include the SCI entity's standards for designating members or participants that it deems necessary, for the maintenance of fair and orderly markets in the event of activation of its business continuity and disaster recovery plans, to participate in the testing of such plans pursuant to Rule 1000(b)(9)(i), as well as the SCI entity's list of designated members or participants. If an SCI entity changes its designations or standards, it must promptly notify the Commission of such changes on Exhibit 7.

D. Documents Comprising the Completed Form

The completed form filed with the Commission shall consist of Form SCI, responses to all applicable items, and any exhibits required in connection with the filing. Each filing shall be marked on Form SCI with the initials of the SCI entity, the four-digit year, and the number of the filing for the year.

E. Contact Information; Signature; and Filing of the Completed Form

Each time an SCI entity submits a filing to the Commission on Form SCI, the SCI entity must provide the contact information required by Section 4 of Form SCI. The contact information for systems personnel, regulatory personnel, and a senior officer is required. Space for additional contact information, if appropriate, is also provided.

All notifications and reports required to be submitted through Form SCI shall be filed through the EFFS. In order to file Form SCI through the EFFS, SCI entities must request access to the Commission's External Application Server by completing a request for an external account user ID and password. Initial requests will be received by contacting (202) 551-5777.

An e-mail will be sent to the requestor that will provide a link to a secure website where basic profile information will be requested.

A duly authorized individual of the SCI entity shall electronically sign the completed Form SCI as indicated in Section 5 of the form. In addition, a duly authorized individual of the SCI entity shall manually sign one copy of the completed Form SCI, and the manually signed signature page shall be preserved pursuant to the requirements of Rule 1000(c).

F. Paperwork Reduction Act Disclosure

This collection of information will be reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. 3507. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Commission estimates that the average burden to respond to Form SCI will be between one and sixty hours depending upon the purpose for which the form is being filed. Any member of the public may direct to the Commission any comments concerning the accuracy of this burden estimate and any suggestions for reducing this burden.

Except with respect to notifications to the Commission made pursuant to proposed Rule 1000(b)(4)(i) or oral notifications to the Commission made pursuant to proposed Rule 1000(b)(6)(ii), it is mandatory that an SCI entity file all notifications, updates, and reports required by Regulation SCI using Form SCI. The Commission will treat as confidential all information collected pursuant to Form SCI. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. 522 ("FOIA"), and the Commission's rules thereunder (17 CFR 200.80(b)(4)(iii)), the Commission does not generally publish or make available information contained in any reports, summaries, analyses, letters, or memoranda arising out of, in

anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

G. Exhibits

List of exhibits to be filed, as applicable:

Exhibit 1. Notification of SCI Event. The SCI entity shall include:

Part 1: All pertinent information known about the SCI event, including: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; (3) the potential impact of the SCI event on the market; and (4) the SCI entity's current assessment of the SCI event, including a discussion of the determination of whether the SCI event is a dissemination SCI event or not.

Part 2: To the extent available as of the time of the notification: (1) a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; (2) the time the SCI event was resolved or timeframe within which the SCI event is expected to be resolved; (3) a description of the SCI entity's rule(s) and/or governing document(s), as applicable, that relate to the SCI event; and (4) an analysis of parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss.

Exhibit 2. Update Notification of SCI Event. The SCI entity shall provide an update of any information previously provided regarding an SCI event on Exhibit 1, including any information under Part 2 of Exhibit 1 which was not available at the time of submission of Exhibit 1. Subsequent updates shall update any information provided regarding the SCI event until the SCI event is resolved.

Exhibit 3. Information Disseminated. The SCI entity shall attach a copy in pdf or html format of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.

Exhibit 4. Notification of Planned Material Systems Change. The SCI entity shall, absent exigent circumstances, notify the Commission in writing at least 30 calendar days before implementation of any planned material systems change, including a description of the planned material systems change as well as the expected dates of commencement and completion of implementation of such changes. If exigent circumstances exist, or if the information previously provided to the Commission regarding any planned material systems change has become materially inaccurate, the SCI entity shall notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification on Form SCI, as early as reasonably practicable.

Exhibit 5. Report of SCI Review. Within 60 calendar days after its submission to senior management of the SCI entity, the SCI entity shall attach the report of the SCI review of the SCI entity's compliance with Regulation SCI, together with any response by senior management.

Exhibit 6. Semi-Annual Report of Material Systems Changes. Within 30 calendar days after the end June and December of each year, the SCI entity shall attach the report containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes.

Exhibit 7. Notification of Designations and Standards under Rule 1000(b)(9). The SCI entity shall attach: (1) its standards for designating members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business

continuity and disaster recovery plans, to participate in the testing of such plans pursuant to Rule 1000(b)(9)(i); and (2) a list of the designated members or participants, including the name and address of such members or participants.

H. Explanation of Terms

Dissemination SCI Event means an SCI event that is a: (1) systems compliance issue; (2) systems intrusion; or (3) systems disruption that results, or the SCI entity reasonably estimates would result, in significant harm or loss to market participants.

Material Systems Change means a change to one or more: (1) SCI systems of an SCI entity that: (i) materially affects the existing capacity, integrity, resiliency, availability, or security of such systems; (ii) relies upon materially new or different technology; (iii) provides a new material service or material function; or (iv) otherwise materially affects the operations of the SCI entity; or (2) SCI security systems of an SCI entity that materially affects the existing security of such systems.

Responsible SCI personnel means, for a particular SCI system or SCI security system impacted by an SCI event, any personnel, whether an employee or agent, of the SCI entity having responsibility for such system.

SCI entity means an SCI self-regulatory organization, SCI alternative trading system, plan processor, or exempt clearing agency subject to ARP.

SCI event means an event at an SCI entity that constitutes: (1) a systems disruption; (2) a systems compliance issue; or (3) a systems intrusion.

Systems Compliance Issue means an event at an SCI entity that has caused any SCI system of such entity to operate in a manner that does not comply with the federal securities laws and rules and regulations thereunder or the entity's rules or governing documents, as applicable.

Systems Disruption means an event in an SCI entity's SCI systems or procedures that results in:
(1) a failure to maintain service level agreements or constraints; (2) a disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely; (3) a loss of use of any such system; (4) a loss of transaction or clearance and settlement data; (5) significant back-ups or delays in processing; (6) a significant diminution of ability to disseminate timely and accurate market data; or (7) a queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected.

Systems Intrusion means any unauthorized entry into the SCI systems or SCI security systems of the SCI entity.

[See attachment – proposed Form SCI]

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Date: March 8, 2013

Securities and Exchange Commission
Washington, D.C. 20549
Form SCI



SCI- { name } -YYYY####
Update No.: _____

SCI Notification and Reporting by: {SCI entity name}
Pursuant to Rule 1000(b) of Regulation SCI under the Securities Exchange Act of 1934

Section 1

Commission Notification of SCI Event – Rule 1000(b)(4)

(b)(4)(ii) Notification of SCI event (b)(4)(iii) Update notification of SCI event

SCI event type(s): Systems compliance issue Systems intrusion Systems disruption

Is the event a systems disruption that the SCI entity reasonably estimates would have a material impact on its operations or on market participants? Yes/No

If yes, has the Commission been notified of the SCI event? Yes/No

Has the SCI event been resolved? Yes/No

Date/time SCI event started: *mm/dd/yyyy* *hh:mm am/pm*:

Duration of SCI event: *hh:mm*, or *days*

Date/time responsible SCI personnel became aware of the SCI event: *mm/dd/yyyy* *hh:mm am/pm*

Estimated number of market participants impacted by the SCI event: (numeric field)

(Additional information for Section 1 continued on following page)

Section 2

Other Commission Notification and Reporting

Rule 1000(b)(6) Notification of planned material systems change Date of planned change: *mm/dd/yy*

Do exigent circumstances exist, or has the information previously provided to the Commission regarding any planned material systems change become materially inaccurate? Yes/No

If yes, has the Commission been notified orally? Yes/No

Rule 1000(b)(8)(i) Report of SCI review

Date of completion of SCI review: *mm/dd/yyyy*

Date of submission of SCI review to senior management: *mm/dd/yyyy*

Rule 1000(b)(8)(ii) Semi-annual report of material systems changes

Rule 1000(b)(9)(iii) Notification of designations and standards under Rule 1000(b)(9)

**Section 1
(cont.)**

Rule 1000(b)(4) (continued)

System Type Impacted	Production	Development	Testing
Trading	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Clearance and Settlement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Order Routing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Market Data	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Regulation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Surveillance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Any system that shares network resources with any system listed above that, if breached, would be reasonably likely to pose a security threat to such system	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Systems Disruption in SCI Systems Resulting in:	Check all that apply
Failure to maintain service level agreements or constraints	<input type="checkbox"/>
Disruption of normal operations, including switchover to back-up equipment with near-term recovery of primary hardware unlikely	<input type="checkbox"/>
Loss of use of any such system	<input type="checkbox"/>
Loss of transaction or clearance and settlement data	<input type="checkbox"/>
Significant back-ups or delays in processing	<input type="checkbox"/>
Significant diminution of ability to disseminate timely and accurate market data	<input type="checkbox"/>
Queuing of data between system components or queuing of messages to or from customers of such duration that normal service delivery is affected	<input type="checkbox"/>

For complete Form SCI instructions please refer to [●]

Section 3

<p>Exhibit 1: Rule 1000(b)(4)(ii) Notification of SCI Event Add/Remove/View</p>	<p>The SCI entity shall include:</p> <p>Part 1: All pertinent information known about the SCI event, including: (1) a detailed description of the SCI event; (2) the SCI entity's current assessment of the types and number of market participants potentially affected by the SCI event; (3) the potential impact of the SCI event on the market; and (4) the SCI entity's current assessment of the SCI event, including a discussion of the determination of whether the SCI event is a dissemination SCI event or not.</p> <p>Part 2: To the extent available as of the time of the notification: (1) a description of the steps the SCI entity is taking, or plans to take, with respect to the SCI event; (2) the time the SCI event was resolved or timeframe within which it is expected to be resolved; (3) a description of the SCI entity's rule(s) and/or governing document(s), as applicable, that relate to the SCI event; and (4) an analysis of parties that may have experienced a loss, whether monetary or otherwise, due to the SCI event, the number of such parties, and an estimate of the aggregate amount of such loss.</p>
<p>Exhibit 2: Rule 1000(b)(4)(iii) Update Notification of SCI Event Add/Remove/View</p>	<p>The SCI entity shall provide an update of any information previously provided regarding the SCI event on Exhibit 1, including any information under Part 2 of Exhibit 1 which was not available at the time of submission of Exhibit 1. Subsequent updates shall update any information provided regarding the SCI event until the SCI event is resolved.</p>
<p>Exhibit 3: Information Disseminated Add/Remove/View</p>	<p>The SCI entity shall attach a copy in pdf or html format of any information disseminated to date regarding the SCI event to its members or participants or on the SCI entity's publicly available website.</p>
<p>Exhibit 4: Rule 1000(b)(6) Notification of Planned Material System Changes Add/Remove/View</p>	<p>The SCI entity shall, absent exigent circumstances, notify the Commission in writing at least 30 calendar days before implementation of any planned material systems change, including a description of the planned material system changes as well as the expected dates of commencement and completion of implementation of such changes. If exigent circumstances exist, or if the information previously provided to the Commission regarding any planned material system change has become materially inaccurate, the SCI entity shall notify the Commission, either orally or in writing, with any oral notification to be memorialized within 24 hours after such oral notification by a written notification, as early as reasonably practicable.</p>
<p>Exhibit 5: Rule 1000(b)(8)(i) Report of SCI Review Add/Remove/View</p>	<p>Within 60 calendar days after its submission to senior management of the SCI entity, the SCI entity shall attach the report of the SCI review of the SCI entity's compliance with Regulation SCI, together with any response by senior management.</p>
<p>Exhibit 6: Rule 1000(b)(8)(ii) Semi-Annual Report of Material Systems Changes Add/Remove/View</p>	<p>Within 30 calendar days after the end of June and December of each year, the SCI entity shall attach the report containing a summary description of the progress of any material systems change during the six-month period ending on June 30 or December 31, as the case may be, and the date, or expected date, of completion of implementation of such changes.</p>
<p>Exhibit 7: Rule 1000(b)(9)(iii) Notification of Designations and Standards under Rule 1000(b)(9) Add/Remove/View</p>	<p>The SCI entity shall attach: (1) its standards for designating members or participants it deems necessary, for the maintenance of fair and orderly markets in the event of the activation of its business continuity and disaster recovery plans, to participate in the testing of such plans pursuant to Rule 1000(b)(9)(i); and (2) a list of the designated members or participants, including the name and address of such members or participants.</p>

Section 4

Contact Information

Provide the following information for the persons responsible for addressing the SCI event:

Systems Personnel:

First Name: _____ Last Name: _____

Title: _____

E-Mail: _____

Telephone: _____ Fax: _____

Regulatory Personnel:

First Name: _____ Last Name: _____

Title: _____

E-Mail: _____

Telephone: _____ Fax: _____

Senior Officer:

First Name: _____ Last Name: _____

Title: _____

E-Mail: _____

Telephone: _____ Fax: _____

Additional Contacts (Optional)

Systems Personnel:

First Name: _____ Last Name: _____

Title: _____

E-Mail: _____

Telephone: _____ Fax: _____

Regulatory Personnel:

First Name: _____ Last Name: _____

Title: _____

E-Mail: _____

Telephone: _____ Fax: _____

Section 5

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, { SCI Entity name } has duly caused this notification to be signed on its behalf by the undersigned duly authorized officer:

Date: _____

By (Name) _____

Title (_____)

"Digitally Sign and Lock Form"

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69090 / March 8, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30417 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15233

In the Matter of

William M. Stephens,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTIONS 15(b) AND 21C OF
THE SECURITIES EXCHANGE ACT OF 1934,
AND SECTION 9(b) OF THE INVESTMENT
COMPANY ACT OF 1940, MAKING FINDINGS,
AND IMPOSING REMEDIAL SANCTIONS
AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against William M. Stephens ("Stephens" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

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III.

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

Summary

From February 2008 through March 2011, William M. Stephens operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. While working as an independent consultant for Ranieri Partners LLC, Stephens actively solicited investors on behalf of private funds managed by Ranieri Partners' affiliates and, in return, received transaction-based compensation totaling approximately \$2.4 million. Stephens' solicitation efforts included: (1) sending private placement memoranda, subscription documents, and due diligence materials to potential investors; (2) urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners; (3) providing potential investors with his analysis of Ranieri Partners' funds' strategy and performance track record; and (4) providing potential investors with confidential information relating to the identity of other investors and their capital commitments. By these actions, Stephens engaged in the business of effecting transactions in securities without first being registered as a broker or dealer or associated with a registered broker or dealer. Ranieri Partners and Donald W. Phillips ("Phillips"), its then Senior Managing Partner, provided Stephens with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent Stephens from having substantive contacts with potential investors.

Respondent

1. William M. Stephens, age 60, resides in Hinsdale, Illinois. From 1986 to 1998, Stephens was an asset manager for various public and private pension funds. From 1998 to 2000, Stephens was the Chief Investment Strategist at a San Francisco-based registered investment adviser. In June 2000, the Commission instituted public administrative and cease-and-desist proceedings against Stephens and, in November 2002, the Commission entered an order, based on an offer of settlement by Stephens, finding that Stephens violated certain provisions of the federal securities laws in connection with the investment of pension fund assets. Stephens agreed to the entry of an order requiring him to cease and desist from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. The Commission also barred Stephens from association with any investment adviser, with the right to reapply after two years, and imposed a \$25,000 civil penalty. Stephens never reapplied for permission to become associated with an investment adviser. Since 2002, Stephens has not been registered with the Commission in any capacity, including as a broker or dealer.

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

Other Relevant Entities and Individuals

2. Ranieri Partners is a holding company located in New York, New York. It controls Selene Investment Partners LLC and Selene Investment Partners II LLC, which managed the investments of Selene Residential Mortgage Opportunity Fund L.P. ("Selene I") and Selene Residential Mortgage Opportunity Fund II L.P. ("Selene II") (collectively the "Selene Funds"). On March 26, 2012, Ranieri Residential Investment Advisors, LLC ("RRIA"), another entity controlled by Ranieri Partners, registered with the Commission as an investment adviser and now is the investment adviser to the Selene Funds.

3. Donald W. Phillips, age 63, resides in Barrington, Illinois. Phillips was a Senior Managing Partner of Ranieri Partners before resigning in December 2012. At the time of the conduct at issue, Phillips also was a managing member of a Chicago-based registered investment adviser.

Background

4. In January 2008, Ranieri Partners established the Selene I private investment fund. Selene I's investment strategy was to use investor capital to purchase underperforming or nonperforming residential mortgages, or loan portfolios, at a discount, rehabilitate the mortgages, and then resell them to traditional mortgage companies at a premium. The Private Placement Memorandum ("PPM") for Selene I also permitted the fund to purchase mortgage-backed securities. In 2010, Ranieri Partners formed Selene II. Selene II's investment strategy focused on generating returns from the rehabilitation of distressed residential mortgages.

5. Phillips, a Senior Managing Partner of Ranieri Partners, was in charge of raising capital for the Selene Funds. Phillips was a long-time friend of Stephens. In February 2008, Phillips caused an affiliate of Ranieri Partners to retain Stephens as an independent consultant to find potential investors for Selene I. At the time, Phillips was generally aware of Stephens' prior disciplinary history with the Commission. In 2010, Phillips again caused an affiliate of Ranieri Partners to retain Stephens to find potential investors, this time for Selene II.²

6. Ranieri Partners agreed to pay Stephens a fee equal to 1% of all capital commitments made to the Selene Funds by investors introduced by Stephens.

7. Phillips was responsible for coordinating the activities of Stephens and others engaged by Ranieri Partners to find potential investors for the Selene Funds. According to Phillips, he informed Stephens that Stephens' activities on behalf of Ranieri Partners were limited to contacting potential investors to arrange meetings for the principals of Ranieri Partners and that he specifically informed Stephens that he was not permitted to provide PPMs directly to potential investors. Ranieri Partners controlled the distribution of PPMs for the Selene Funds. According to Phillips, he also informed Stephens that Stephens was not permitted to contact investors directly to discuss his views of the merits and strategies of the Selene Funds.

² In both instances, the terms of Stephens' engagement were reflected in consulting services agreements prepared by outside counsel to Ranieri Partners.

8. Phillips and other Ranieri Partners personnel provided Stephens with materials relating to the Selene Funds. On February 29, 2008, Phillips sent Stephens several copies of a Selene I Executive Summary, which summarized the fund's investment strategy and provided Ranieri Partners' view of the distressed mortgage market and the firm's competitive advantages in the distressed real estate space. On March 1, 2008, Ranieri Partners personnel provided Stephens with a copy of the Selene I PPM and, subsequently, provided Stephens with supplemental PPMs, subscription documents, and presentation materials. Ranieri Partners personnel also provided Stephens with marketing materials for Selene II, including an Executive Summary and PPM, as well as Ranieri Partners' overall business plan.

Stephens Solicited Investors for Selene I

9. Beginning in February 2008, Stephens contacted certain of his acquaintances and former colleagues in the pension fund investment community concerning a possible investment in Selene I.

10. In February 2008, Stephens contacted a former colleague who was the Director of Retirement Investments (hereinafter referred to as "Executive X") for a private corporation (hereinafter referred to as "Company X"). On February 26, 2008, Stephens contacted Executive X to set up a meeting among himself, Executive X, and Phillips. On February 28th, Stephens and Phillips met with Executive X. During the meeting, Phillips described a possible investment in Selene I. After the meeting, Stephens continued to communicate with Executive X directly via email. On March 4th, Stephens provided Executive X with details about Selene I's investment strategy. On April 29th, Stephens emailed Executive X to inform her that he provided due diligence materials regarding Selene I to a consultant that advises Company X on money manager selection and retention. In the same email, Stephens described the Selene I investment as "a rare opportunity to earn above market returns," and encouraged Executive X to consider adjusting Company X's asset allocation plan to take advantage of the Selene I opportunity. Also, Stephens traveled to various cities on four separate occasions in 2008 to meet with Company X's consultant, who was a friend and former consultant to pension funds managed by Stephens. Stephens continued to call upon Company X for an investment in Selene I until at least April 2009, when he again flew to the company's headquarters to meet with Executive X. Despite Stephens' efforts, Company X did not invest in Selene I.

11. In March 2008, Stephens contacted the Chief Investment Officer ("CIO") of an endowment fund of a Midwestern university ("Endowment X") regarding a possible investment in Selene I. Stephens had a close connection to the CIO, who worked for Stephens in the late 1990s when Stephens was the CIO of a large corporate pension fund. Stephens set up a meeting with the CIO to discuss Selene I. At the meeting, Stephens and Phillips met with the CIO and other members of his staff. During the meeting, Phillips made a presentation concerning a possible investment in Selene I. Shortly after the meeting, Stephens sent a copy of the Selene I PPM and other subscription materials to an Endowment X staff member. On April 21st, Stephens sent an email to the same staff member that contained a list of current and prospective investors for Selene I. In the email, Stephens listed the expected dates and amounts of the investors' respective capital commitments and then explained that there was a cap on the amount of investments that would be allowed in Selene I. On April 23rd, Stephens sent another email to the staff attaching

additional due diligence materials on Selene I. On June 30, 2008, Endowment X committed \$65 million in capital to Selene I. Pursuant to his agreement with Ranieri Partners, Stephens was to be paid \$650,000 on the investment.

12. In April 2008, Stephens used a subagent to reach out to the retirement system for a Southern state ("State Retirement System X") concerning a possible investment in Selene I. Stephens' subagent arranged a meeting for Phillips to meet with the CIO of State Retirement System X and his staff. Stephens' subagent accompanied Phillips to the meeting, which took place in April 2008. On June 30, 2008, State Retirement System X invested \$200 million in Selene I. As a result, Ranieri Partners owed Stephens a fee equal to 1% (\$2 million) of the total capital commitment. Pursuant to a side agreement between Stephens and his subagent, 80% of Stephens' fee was to be paid to the subagent.

Stephens Solicited Investors for Selene II

13. Between August 2010 and March 2011, Stephens contacted Executive X about a possible investment by Company X in Selene II. Stephens traveled to Company X's headquarters to discuss Selene II with Executive X and then traveled to meet with Company X's consultant. Stephens also drafted correspondence, for Phillips' signature, that addressed key questions about the potential investment that were raised by Executive X. Stephens continued to contact Executive X until at least March 2, 2011. Once again, despite Stephens' efforts, Company X did not invest in Selene II.

14. In August 2010, Stephens contacted the CIO of Endowment X about a possible investment in Selene II. In an email dated August 4th, Stephens told the CIO and another staff member of Endowment X that the "returns to [Selene I] have been strong and the outlook for [Selene II] looks real positive with Ranieri Partners taking on the role of market leader in this space." In the same email, Stephens told the CIO that Endowment X would pay a lower management fee if it made a commitment before the first closing date for the fund. Stephens also traveled on two occasions to discuss Selene II with the CIO. On October 15th, Endowment X invested \$30 million in Selene II. Pursuant to Stephens' agreement with Ranieri Partners, he was to receive 1% of the funds invested by Endowment X, or approximately \$300,000.

15. In 2009, Stephens' subagent contacted State Retirement System X regarding an investment in Selene II. Stephens and his subagent traveled to meet with the CIO of State Retirement System X on two occasions in 2009. In addition, after State Retirement System X invested in Selene I, its investment office staff stayed in direct contact with Ranieri Partners. After these meetings and contacts, State Retirement System X invested \$150 million in Selene II and an additional \$124 million in a special purpose investment vehicle established by Ranieri Partners specifically for State Retirement System X. Pursuant to a new agreement negotiated between Stephens and Phillips, Ranieri Partners was to pay Stephens a fee equal to 0.3% of State Retirement System X's capital commitments, or approximately \$822,000.

16. In total, investors introduced to Ranieri Partners by Stephens and/or his subagent committed \$569 million to funds managed by Ranieri Partners, earning Stephens \$3.772 million in fees. Ranieri Partners paid Stephens \$2.4 million of the fees he earned. Ranieri Partners also

reimbursed Stephens for travel and entertainment expenses he incurred in connection with raising capital for the Selene Funds. The expenses claimed by Stephens include trips to meet potential investors that Stephens took both with and without Phillips or any other Ranieri Partners personnel. Stephens' expense reports show that he met with representatives of Company X, Endowment X, and State Retirement System X several times after initially introducing them to Ranieri Partners.

17. Stephens was not registered as a broker or dealer or associated with a registered broker or dealer at any time while he was soliciting investors on behalf of Ranieri Partners.

Violations

18. As a result of the conduct described above, Stephens willfully violated Section 15(a) of the Exchange Act, which requires persons engaged in the business of effecting transactions in securities to be registered as a broker or dealer or associated with a registered broker or dealer.

Disgorgement and Civil Penalties

19. Respondent has submitted a sworn Statement of Financial Condition dated January 28, 2013 and other evidence and has asserted his inability to pay disgorgement plus prejudgment interest or a civil penalty.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Stephens shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Stephens 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;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

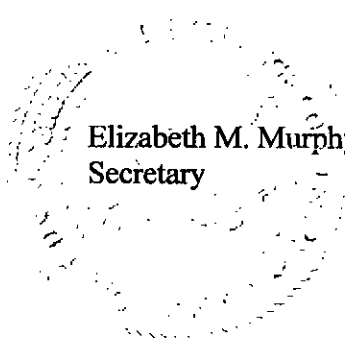
C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered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

D. Respondent shall pay disgorgement of \$2,418,379.20 and prejudgment interest of \$410,248.75, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated January 28, 2013 and other documents submitted to the Commission. Further, based upon Respondent's sworn representations in his Statement of Financial Condition dated January 28, 2013 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement, pre-judgment interest, and a civil penalty. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement, interest, or penalties should not be ordered; (3) contest the amount of disgorgement, interest, or penalties to be ordered; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.


By: Lynn M. Powalski
Deputy Secretary


Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69091 / March 8, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3563 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15234

In the Matter of

**Ranieri Partners LLC and Donald
W. Phillips,**

Respondents.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934 AND
SECTION 203(f) 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 against Donald W. Phillips ("Phillips" or "Respondent Phillips"), pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and that cease-and-desist proceedings be, and hereby are, instituted against Ranieri Partners LLC ("Ranieri Partners" or "Respondent Ranieri Partners") pursuant to Section 21C of the Exchange Act.

II.

In anticipation of the institution of these proceedings, the Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings, and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(f) 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 the Respondents' Offers, the Commission finds¹ that:

Summary

From February 2008 through March 2011, William M. Stephens ("Stephens") operated as an unregistered broker in violation of Section 15(a) of the Exchange Act. While working as an independent consultant for Ranieri Partners, Stephens actively solicited investors on behalf of private funds managed by Ranieri Partners' affiliates and, in return, received transaction-based compensation totaling approximately \$2.4 million. Stephens' solicitation efforts included: (1) sending private placement memoranda, subscription documents, and due diligence materials to potential investors; (2) urging at least one investor to consider adjusting its portfolio allocations to accommodate an investment with Ranieri Partners; (3) providing potential investors with his analysis of Ranieri Partners' funds' strategy and performance track record; and (4) providing potential investors with confidential information relating to the identity of other investors and their capital commitments. By these actions, Stephens engaged in the business of effecting transactions in securities without first being registered as a broker or dealer or associated with a registered broker or dealer. Ranieri Partners and Donald W. Phillips ("Phillips"), its then Senior Managing Partner, provided Stephens with key documents and information related to Ranieri Partners' private equity funds and did not take adequate steps to prevent Stephens from having substantive contacts with potential investors.

Respondents

1. Ranieri Partners is a holding company located in New York, New York. It controls Selene Investment Partners LLC and Selene Investment Partners II LLC, which managed the investments of Selene Residential Mortgage Opportunity Fund L.P. ("Selene I") and Selene Residential Mortgage Opportunity Fund II L.P. ("Selene II") (collectively the "Selene Funds"). On March 26, 2012, Ranieri Residential Investment Advisors, LLC ("RRIA"), another entity controlled by Ranieri Partners, registered with the Commission as an investment adviser and now is the investment adviser to the Selene Funds.

2. Donald W. Phillips, age 63, resides in Barrington, Illinois. Phillips was a Senior Managing Partner of Ranieri Partners before resigning in December 2012. At the time of the conduct at issue, Phillips also was a managing member of a Chicago-based registered investment adviser.

Other Relevant Individuals

3. William M. Stephens, age 60, resides in Hinsdale, Illinois. From 1986 to 1998, Stephens was an asset manager for various public and private pension funds. From 1998 to 2000, Stephens was the Chief Investment Strategist at a San Francisco-based registered investment

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

adviser. In June 2000, the Commission instituted public administrative and cease-and-desist proceedings against Stephens and, in November 2002, the Commission entered an order, based on an offer of settlement by Stephens, finding that Stephens violated certain provisions of the federal securities laws in connection with the investment of pension fund assets. Stephens agreed to the entry of an order requiring him to cease and desist from violating Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, and Sections 206(1) and 206(2) of the Advisers Act. The Commission also barred Stephens from association with any investment adviser, with the right to reapply after two years, and imposed a \$25,000 civil penalty. Stephens never reapplied for permission to become associated with an investment adviser. Since 2002, Stephens has not been registered with the Commission in any capacity, including as a broker or dealer.

Background

4. In January 2008, Ranieri Partners established the Selene I private investment fund. Selene I's investment strategy was to use investor capital to purchase underperforming or nonperforming residential mortgages, or loan portfolios, at a discount, rehabilitate the mortgages, and then resell them to traditional mortgage companies at a premium. The Private Placement Memorandum ("PPM") for Selene I also permitted the fund to purchase mortgage-backed securities. In 2010, Ranieri Partners formed Selene II. Selene II's investment strategy focused on generating returns from the rehabilitation of distressed residential mortgages.

5. Phillips, a Senior Managing Partner of Ranieri Partners, was in charge of raising capital for the Selene Funds. Phillips was a long-time friend of Stephens. In February 2008, Phillips caused an affiliate of Ranieri Partners to retain Stephens as an independent consultant to find potential investors for Selene I. At the time, Phillips was generally aware of Stephens' prior disciplinary history with the Commission. In 2010, Phillips again caused an affiliate of Ranieri Partners to retain Stephens to find potential investors, this time for Selene II.²

6. Ranieri Partners agreed to pay Stephens a fee equal to 1% of all capital commitments made to the Selene Funds by investors introduced by Stephens.

7. Phillips was responsible for coordinating the activities of Stephens and others engaged by Ranieri Partners to find potential investors for the Selene Funds. According to Phillips, he informed Stephens that Stephens' activities on behalf of Ranieri Partners were limited to contacting potential investors to arrange meetings for the principals of Ranieri Partners and that he specifically informed Stephens that he was not permitted to provide PPMs directly to potential investors. Ranieri Partners controlled the distribution of PPMs for the Selene Funds. According to Phillips, he also informed Stephens that Stephens was not permitted to contact investors directly to discuss his views of the merits and strategies of the Selene Funds.

8. Phillips and other Ranieri Partners personnel provided Stephens with materials relating to the Selene Funds. On February 29, 2008, Phillips sent Stephens several copies of a Selene I Executive Summary, which summarized the fund's investment strategy and provided

² In both instances, the terms of Stephens' engagement were reflected in consulting services agreements prepared by outside counsel to Ranieri Partners.

Ranieri Partners' view of the distressed mortgage market and the firm's competitive advantages in the distressed real estate space. On March 1, 2008, Ranieri Partners personnel provided Stephens with a copy of the Selene I PPM and, subsequently, provided Stephens with supplemental PPMs, subscription documents, and presentation materials. Ranieri Partners personnel also provided Stephens with marketing materials for Selene II, including an Executive Summary and PPM, as well as Ranieri Partners' overall business plan.

Stephens Solicited Investors for Selene I

9. Beginning in February 2008, Stephens contacted certain of his acquaintances and former colleagues in the pension fund investment community concerning a possible investment in Selene I.

10. In February 2008, Stephens contacted a former colleague who was the Director of Retirement Investments (hereinafter referred to as "Executive X") for a private corporation (hereinafter referred to as "Company X"). On February 26, 2008, Stephens contacted Executive X to set up a meeting among himself, Executive X, and Phillips. On February 28th, Stephens and Phillips met with Executive X. During the meeting, Phillips described a possible investment in Selene I. After the meeting, Stephens continued to communicate with Executive X directly via email. On March 4th, Stephens provided Executive X with details about Selene I's investment strategy. On April 29th, Stephens emailed Executive X to inform her that he provided due diligence materials regarding Selene I to a consultant that advises Company X on money manager selection and retention. In the same email, Stephens described the Selene I investment as "a rare opportunity to earn above market returns," and encouraged Executive X to consider adjusting Company X's asset allocation plan to take advantage of the Selene I opportunity. Also, Stephens traveled to various cities on four separate occasions in 2008 to meet with Company X's consultant, who was a friend and former consultant to pension funds managed by Stephens. Stephens continued to call upon Company X for an investment in Selene I until at least April 2009, when he again flew to the company's headquarters to meet with Executive X. Despite Stephens' efforts, Company X did not invest in Selene I.

11. In March 2008, Stephens contacted the Chief Investment Officer ("CIO") of an endowment fund of a Midwestern university ("Endowment X") regarding a possible investment in Selene I. Stephens had a close connection to the CIO, who worked for Stephens in the late 1990s when Stephens was the CIO of a large corporate pension fund. Stephens set up a meeting with the CIO to discuss Selene I. At the meeting, Stephens and Phillips met with the CIO and other members of his staff. During the meeting, Phillips made a presentation concerning a possible investment in Selene I. Shortly after the meeting, Stephens sent a copy of the Selene I PPM and other subscription materials to an Endowment X staff member. On April 21st, Stephens sent an email to the same staff member that contained a list of current and prospective investors for Selene I. In the email, Stephens listed the expected dates and amounts of the investors' respective capital commitments and then explained that there was a cap on the amount of investments that would be allowed in Selene I. On April 23rd, Stephens sent another email to the staff attaching additional due diligence materials on Selene I. On June 30, 2008, Endowment X committed \$65 million in capital to Selene I. Pursuant to his agreement with Ranieri Partners, Stephens was to be paid \$650,000 on the investment.

12. In April 2008, Stephens used a subagent to reach out to the retirement system for a Southern state ("State Retirement System X") concerning a possible investment in Selene I. Stephens' subagent arranged a meeting for Phillips to meet with the CIO of State Retirement System X and his staff. Stephens' subagent accompanied Phillips to the meeting, which took place in April 2008. On June 30, 2008, State Retirement System X invested \$200 million in Selene I. As a result, Ranieri Partners owed Stephens a fee equal to 1% (\$2 million) of the total capital commitment. Pursuant to a side agreement between Stephens and his subagent, 80% of Stephens' fee was to be paid to the subagent.

Stephens Solicited Investors for Selene II

13. Between August 2010 and March 2011, Stephens contacted Executive X about a possible investment by Company X in Selene II. Stephens traveled to Company X's headquarters to discuss Selene II with Executive X and then traveled to meet with Company X's consultant. Stephens also drafted correspondence, for Phillips' signature, that addressed key questions about the potential investment that were raised by Executive X. Stephens continued to contact Executive X until at least March 2, 2011. Once again, despite Stephens' efforts, Company X did not invest in Selene II.

14. In August 2010, Stephens contacted the CIO of Endowment X about a possible investment in Selene II. In an email dated August 4th, Stephens told the CIO and another staff member of Endowment X that the "returns to [Selene I] have been strong and the outlook for [Selene II] looks real positive with Ranieri Partners taking on the role of market leader in this space." In the same email, Stephens told the CIO that Endowment X would pay a lower management fee if it made a commitment before the first closing date for the fund. Stephens also traveled on two occasions to discuss Selene II with the CIO. On October 15th, Endowment X invested \$30 million in Selene II. Pursuant to Stephens' agreement with Ranieri Partners, he was to receive 1% of the funds invested by Endowment X, or approximately \$300,000.

15. In 2009, Stephens contacted State Retirement System X regarding an investment in Selene II. Stephens and his subagent traveled to meet with the CIO of State Retirement System X on two occasions in 2009. In addition, after State Retirement System X invested in Selene I, its investment office staff stayed in direct contact with Ranieri Partners. After these meetings and contacts, State Retirement System X invested \$150 million in Selene II and an additional \$124 million in a special purpose investment vehicle established by Ranieri Partners specifically for State Retirement System X. Pursuant to a new agreement negotiated between Stephens and Phillips, Ranieri Partners was to pay Stephens a fee equal to 0.3% of State Retirement System X's capital commitments, or approximately \$822,000.

16. In total, investors introduced to Ranieri Partners by Stephens and/or his subagent committed \$569 million to funds managed by Ranieri Partners, earning Stephens \$3.772 million in fees. Ranieri Partners paid Stephens \$2.4 million of the fees he earned. Ranieri Partners also reimbursed Stephens for travel and entertainment expenses he incurred in connection with raising capital for the Selene Funds. The expenses claimed by Stephens include trips to meet potential investors that Stephens took both with and without Phillips or any other Ranieri Partners personnel.

Stephens' expense reports show that he met with representatives of Company X, Endowment X, and State Retirement System X several times after initially introducing them to Ranieri Partners.

17. Stephens was not registered as a broker or dealer or associated with a registered broker or dealer at any time while he was soliciting investors on behalf of Ranieri Partners.

18. Ranieri Partners failed to adequately oversee Stephens' activities. Although Stephens was not permitted to send documents like PPMs and subscription agreements to potential investors, he was able to obtain such documents from Ranieri Partners, as Ranieri Partners failed to limit Stephens' access to key documents. Stephens, in turn, sent such documents to potential investors. Ranieri Partners also received Stephens' requests for expense reimbursements, which reflected Stephens' extensive contact with potential investors. Yet Ranieri Partners did nothing to monitor or limit Stephens' contact with investors.

19. Since the conduct in question, Ranieri Partners has modified its policies and procedures to provide that it would not retain a third party, including a finder or marketer, that was not a broker or dealer or registered representative of a broker or dealer to market or place any security or investment in any security of any affiliate of Ranieri Partners. Those revised policies and enhanced procedures were implemented in 2011 and were fully in place during 2012. The Commission considered the remedial efforts undertaken by Ranieri Partners in determining to accept Ranieri Partners' Offer.

20. Phillips assisted Stephens' in his solicitation efforts by providing Stephens with key fund documents and information. Phillips also failed to limit Stephens' activities despite knowing that Stephens was supposed to play a limited role in introducing potential investors. Further, Phillips eventually became aware that Stephens was having substantive communications with potential investors, yet he still failed to do anything to curb Stephens' activities. Phillips did little to monitor Stephens' activities other than hold a weekly meeting at which Stephens and others discussed their progress in raising capital for the Selene Funds.

Violations

21. As a result of the conduct described above, Ranieri Partners caused Stephens' violations of Section 15(a) of the Exchange Act, which requires persons engaged in the business of effecting transactions in securities to be registered as a broker or dealer or associated with a registered broker or dealer.

22. As a result of the conduct described above, Phillips willfully aided and abetted and caused Stephens' violations of Section 15(a) of the Exchange Act.

Undertakings

23. Phillips undertakes to provide to the Commission, within 15 days after the end of the nine-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 and in the public interest to impose the sanctions agreed to in the Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act and Section 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Ranieri Partners

1. Respondent Ranieri Partners shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.
2. Respondent Ranieri Partners shall, within 30 days of the entry of this Order, pay a civil money penalty of \$375,000 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 Ranieri Partners 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 Ranieri Partners 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 Ranieri Partners 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 Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

B. Phillips

1. Respondent Phillips shall cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.
2. Respondent Phillips be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer, investment adviser, municipal securities dealer,

municipal adviser, 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.

3. Respondent Phillips shall, within 30 days of the entry of this Order, pay a civil money penalty of \$75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:


- (1) Respondent Phillips 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 Phillips 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 Donald W. Phillips 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 Timothy L. Warren, Senior Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604.

4. Respondent Phillips shall comply with the undertakings enumerated in Section III, paragraph 23, above.

By the Commission.


By: **Lynn M. Powalski**
Deputy Secretary

Elizabeth M. Murphy
Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69092 / March 8, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3564 / March 8, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30418 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15235

In the Matter of

FRY HENSLEY AND
COMPANY, AND NICHOLAS
L. FRY, II

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 15(b) OF THE SECURITIES
EXCHANGE ACT OF 1934, SECTIONS
203(e), 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
AND SECTION 9(b) OF THE
INVESTMENT COMPANY ACT OF 1940.

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) 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 Fry Hensley and Company ("FHC") and Nicholas L. Fry, II ("Fry," or collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This matter concerns an investment adviser's failure to disclose to its clients significant conflicts of interest from which it profited at its clients expense. From at least January 1, 2007 to October 2011, registered investment adviser FHC and its president Fry obtained

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undisclosed compensation in the form of payments from inflated commissions, markups and markdowns ("transaction charges") charged to clients by the broker-dealer that FHC and Fry recommend that its clients use. FHC's agreement with clients provided that they gave Fry discretionary authority to trade in their accounts at their broker-dealer. During the relevant period, Fry typically conducted his equity trading for clients through one of the broker-dealer's principal trading accounts, first instructing the broker-dealer to buy or sell securities with the market and then instructing it how to allocate the trades to his clients. For equity securities, Fry set the amount of the transaction charges clients paid for these trades, and he typically set them much higher than he could have. Fry's wife, who was a registered representative at the broker-dealer, received credit for 50% of the transaction charges paid by FHC's advisory clients, and between January 1, 2007 and October 2011, the broker-dealer credited Fry's wife with more than \$775,669.09 from inflated transaction charges. During this time, FHC was otherwise insolvent, and Fry used hundreds of thousands of dollars from the above inflated transaction charges to support FHC, which would have otherwise gone out of business. In addition, FHC received undisclosed services from the broker-dealer partly in exchange for the inflated commissions. Also during this time, FHC and Fry failed to tell their clients the essential facts about the arrangement described above, and made false and misleading disclosures to them in documents given to clients and filed with the Commission.

2. Specifically, FHC and its clients signed written Portfolio Management Agreements ("PMAs") that specified the compensation the client would pay for FHC's advisory services. However, neither FHC nor Fry informed the clients that Fry also directed their broker-dealer to charge them additional, disguised compensation in the form of inflated transaction charges. In addition, FHC's Forms ADV and firm brochures (Forms ADV Part II) made false and misleading statements to clients about these issues and omitted certain facts that were required to be disclosed. While FHC's disclosure evolved over time, for most of the relevant period, FHC told clients that it and Fry did not have the authority to set client commission rates, while Fry exercised this authority. And FHC misrepresented to clients that it would comply with its duty to obtain best execution for them, when in fact, Fry was not getting best execution at their broker-dealer because he directed it to charge his clients much higher transaction charges than he could. Throughout, FHC and Fry omitted to tell clients that FHC was insolvent, that Fry was benefiting himself, his wife and FHC at the expense of his clients and that Fry was setting their transaction charges much higher than he could in an attempt to prop up his failing advisory business.

B. RESPONDENTS

3. FHC is an Ohio corporation with its principal place of business in Cincinnati, Ohio. FHC is an investment advisory firm that was registered with the Commission as an investment adviser from 1994 until August 2012. In August 2012, FHC withdrew its registration with the Commission. FHC is now registered as an investment adviser with the State of Ohio. According to FHC's August 2012 Form ADV filed with the Commission, FHC had \$32,942,809 in assets under management for 52 client accounts.

4. Fry, age 72, is a resident of Lebanon, Ohio. From at least 2004 to the present, Fry has been FHC's sole owner, president and chief compliance officer. From 1994 through June 2008, Fry was associated with Ross, Sinclair and Associates, LLC ("the Broker-Dealer"), as an

investment company and variable contracts products representative (i.e., NASD/FINRA Series 6 license only).

C. OTHER RELEVANT ENTITY AND PERSON

5. The Broker-Dealer is an Ohio limited liability company with its principal place of business in Cincinnati, Ohio. From 2005 through the present, the Broker-Dealer has been registered with the Commission as a broker-dealer.

6. Jane Fry was Fry's wife. Jane Fry was associated with the Broker-Dealer as a registered representative from about 1990 until her death in October 2011.

D. FACTS

Background

7. From January 1, 2007 to October 2011 ("relevant period"), FHC was an investment advisory firm that Fry operated with just one or two employees. FHC had written contracts with its clients, called PMAs, which specified the advisory fee that the client would pay for FHC's discretionary advisory services. Fry was responsible for these advisory services, which included that Fry would trade securities in the clients' accounts at their broker-dealer.

8. FHC and the Broker-Dealer had a close relationship for many years. Fry and the Broker-Dealer's president were old friends. From approximately 1994 to October 2010, FHC maintained its office within the Broker-Dealer's Cincinnati office. Also, FHC and Fry recommended that their advisory clients maintain their brokerage accounts at the Broker-Dealer, and the vast majority of FHC's clients did so.

9. Fry's wife, Jane Fry, was listed as the Broker-Dealer registered representative assigned to the accounts of FHC's clients. However, Jane Fry was only nominally the representative for FHC's clients and she did not work on their accounts. In fact, a number of FHC's clients were unaware that Jane Fry had any association with the Broker-Dealer or their brokerage accounts. The Broker-Dealer credited Jane Fry with 50% of the transaction charges that it charged to FHC's clients for their equity trades. The Broker-Dealer kept the other 50% of such charges.

10. By no later than 2004, FHC was not collecting sufficient advisory fees to cover its expenses.

11. In early 2004, FHC and Fry changed the way they conducted securities trading on behalf of their clients. Prior to March 2004, FHC and Fry conducted equity trading for clients on an agency basis. In this arrangement, when Fry purchased or sold a particular security for a number of clients, he sent an order to the Broker-Dealer for each client.

12. In March 2004, FHC and Fry switched to trading securities in bulk through at least one principal-trading account at the Broker-Dealer. In this arrangement, Fry first sent one

order to the Broker-Dealer to purchase or sell the total amount of securities with the market in a Broker-Dealer principal trading account. After that trade was completed, and the price that the Broker-Dealer had paid or received for the securities was known, Fry gave the Broker-Dealer the information needed to allocate the securities purchased or sold to FHC's client accounts, specifying which clients would participate and the number of securities each client would purchase or sell. In addition, on equity trades, Fry set the price his clients paid or received, which was different than the price the Broker-Dealer obtained from the market (i.e., Fry set the amount of the markup or a markdown).

13. In early 2005, FHC and the Broker-Dealer entered into a contract that provided that the Broker-Dealer would provide office space and certain office services to FHC. In exchange, FHC paid the Broker-Dealer 50% of the advisory fees it collected from its clients. In addition, the Broker-Dealer took FHC's two employees onto its books as employees. However, Fry set their salaries, and the employees continued to work at Fry's direction on FHC's work. FHC and the Broker-Dealer agreed that the Broker-Dealer would deduct from Jane Fry's share of client transaction charges the salary costs that the Broker-Dealer incurred from the employment of FHC's two employees and for FHC's use of the Broker-Dealer's computer trading system. This agreement was amended in 2009 so that FHC was to pay the Broker-Dealer a fixed fee of \$70,000 per year for office space and services, and FHC continued to pay for its former employees' salaries though an offset against the transaction charges credited to Jane Fry. However, over time, FHC's financial condition grew worse, and it could not pay the full amounts it owed to the Broker-Dealer under the contract and began to accrue a growing debt to the Broker-Dealer.

FHC and Fry Obtained Undisclosed Compensation and Failed to Seek Best Execution

14. From at least January 1, 2007 to October 2011, Fry submitted equity security orders directly to the Broker-Dealer. For these trades, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer. During this time, the Broker-Dealer had a \$50 minimum commission which Fry could have and sometimes did instruct the Broker-Dealer to charge his clients. However, Fry typically set his clients' transaction charges at much higher rates. By failing to seek to obtain the best price or the lowest commission reasonably available for their clients, FHC and Fry breached their obligation to seek best execution for their clients.

15. Between January 1, 2007 and October 2011, Fry caused FHC's advisory clients to pay inflated transaction charges (i.e., more than the minimum) on more than 10,800 occasions (or on approximately 72% of the total equity trade allocations to clients for which Fry set the amount of the transaction charge) without making adequate disclosure to clients that he was doing so. In these instances, FHC's clients paid an average transaction charge of approximately \$195.40 per trade.

16. During this time, FHC and Fry caused FHC's clients to pay more than \$1.58 million in inflated transaction charges, and they secured for themselves and for Jane Fry \$775,669.09 from the undisclosed inflated transaction charges.

17. Each month, the Broker-Dealer credited Jane Fry with 50% of the transaction charges it received from Fry's equity trading for clients. Against these amounts, the Broker-Dealer offset certain amounts owed by FHC to the Broker-Dealer, including the salaries of the two former FHC employees now on the Broker-Dealer's books. The Broker-Dealer also offset a monthly salary advance that it paid to Jane Fry in the amount of \$12,500. In addition, the Broker-Dealer paid to Jane Fry any amount of her 50% share of the transaction charges that exceeded the above offsets. These payments were deposited into a joint bank account that Jane Fry shared with Fry.

18. In total, from January 1, 2007 to October 2011, the Broker-Dealer credited Jane Fry and FHC with \$775,669.09 in inflated equity transaction charges (i.e., their share of the amount of each client's transaction charges exceeding \$50). During this time, FHC paid the Broker-Dealer for its employees' salaries out of client transaction charges, Fry personally benefited from the deposits into the bank account he shared jointly with Jane Fry, and Fry transferred hundreds of thousands of dollars from that bank account to FHC to pay its other expenses, thus enabling it to stay in business.

False and Misleading Disclosures to Clients in Forms ADV Filed with the Commission

19. During the relevant period, FHC filed a number of Forms ADV with the Commission, and FHC's disclosure about the issues discussed above evolved over time. Fry was the person with ultimate authority over FHC's Form ADV, and he signed each of them as FHC's president, certifying that the statements and information in them were true and correct.

20. From at least 2007 through April 2010, FHC and Fry answered "no" in response to a question on Part 1 of Form ADV, under the heading "Item 8, Investment or Brokerage Discretion," which asked:

"C. Do you or any *related person* have *discretionary authority* to determine the:

* * *

(4) commission rates to be paid to a broker or dealer for a *client's* transactions?"

Fry electronically signed these Forms ADV. During this time, for equity security transactions, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer.

False and Misleading Disclosures in Forms ADV Part II (Firm Brochure)

21. FHC and Fry made similar false and misleading disclosures in its Forms ADV Part II (i.e. its firm brochure) and their disclosure evolved over time. Fry was the person with ultimate authority over FHC's ADV Part II firm brochures. As its disclosure changed, FHC did not provide each new version of their firm brochures to clients, but instead, only advised clients by letter that it was available on request. As a result, a number of clients did not get each new firm brochure.

22. From at least 2007 to May 21, 2010, under the heading "12. Investment or Brokerage Discretion," FHC and Fry checked "no" in response to question 12.A:

"A. Does applicant or any related person have authority to determine, without obtaining specific client consent, the:

* * *

(4) commission rates paid?"

During this time, for equity security transactions, Fry set the amount of transaction charges paid by clients to the Broker-Dealer.

23. In its Form ADV Part II in effect from September 15, 2007 to May 20, 2010, also under heading 12, FHC and Fry checked "yes" in response to question 12B:

"B. Does applicant or a related person suggest brokers to clients?"

Because FHC and Fry checked "yes," the instructions required them to "describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions." FHC and Fry made no disclosure of the factors they considered, and omitted to disclose their financial incentive to direct brokerage to the Broker-Dealer, including that the Broker-Dealer was carrying two of FHC's employees on its books, that the Broker-Dealer was providing FHC with use of its computerized trading system, and that these benefits were being paid for by inflated commissions.

24. In addition, from at least 2007 to May 21, 2010, FHC's firm brochure stated that Fry was a registered representative at the Broker-Dealer, and that he would earn "normal commissions" on client trades made through it. However, the disclosure that Fry would earn "normal" commissions is misleading, because, FHC and Fry omitted to state that Fry was setting the clients' transaction charges, and at much higher rates than he could have charged. And FHC and Fry still did not disclose to clients that Jane Fry, FHC and Fry were benefiting from 50% of the inflated charges.

25. FHC and Fry prepared a new Form ADV Part II that was in effect from May 21, 2010 to March 30, 2011. In this Brochure, FHC and Fry changed their answer to Question 12A, "Investment or Brokerage Discretion," now answering "yes," indicating that they now had authority to determine the commission rates paid by its clients, disclosing for the first time that they were determining the client transaction charges. But they still did not disclose to clients Fry set client transaction charge much higher than he could have.

26. Also in this version of their brochure, FHC and Fry stated: "Although the commission and/or transaction fees paid by Registrant's clients shall comply with the Registrants duty to obtain best execution, a client may pay a commission that is higher than another qualified broker-dealer might charge to effect the same transaction where the Registrant determines, in good faith, that the commission/transaction fee is reasonable in relation to the value of the brokerage and

research services received.” This statement was also false and misleading, as FHC and Fry were not obtaining best execution at the Broker-Dealer, but instead, were setting client transaction charges at much higher rates than they could have.

27. In this version, FHC and Fry also answered “yes” to Item 12B: “Does applicant or a related person suggest brokers to clients?” Because FHC and Fry checked “yes,” the instructions required them to “describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions.” In explaining, FHC and Fry for the first time included a discussion of the conflict of interest that arose from Jane Fry’s position with the Broker-Dealer and that the Broker-Dealer provided FHC with services that were paid for “through commission sharing” In addition, in a different part of Schedule F, FHC and Fry stated that “the brokerage commissions or transaction fees charged by the designed broker-dealer/custodian are exclusive of, and in addition to, Registrants investment management fee.” However, FHC and Fry still did not disclose that Fry was setting client transaction charges at much higher rates than he could have.

28. FHC prepared a new Form ADV Part 2 dated March 31, 2011. The instructions for Item 12, as now amended, required FHC and Fry to disclose the factors they considered in selecting or recommending brokers and in determining the reasonableness of the broker’s compensation, and required them to disclose, among other things, the research, products or services they received from the Broker-Dealer. Under “Item 12 – Brokerage Practices,” FHC and Fry now stated that “we do not solicit or accept soft dollar benefits from any brokerage firm, including [the Broker-Dealer].” In another part of this brochure, under the heading “Additional Fee and Expenses,” FHC and Fry stated that “we recommend [the Broker-Dealer] based on the full range and quality of its services, including the value of the research provided, execution capability, financial responsibility, and responsiveness to our clients, and not merely comparative trading costs.” FHC and Fry also stated that they were authorized to determine the commission rates paid by their clients at the Broker-Dealer, and that Fry’s wife would earn commissions on securities trades. However, FHC and Fry failed to disclose that they were directing the Broker-Dealer to charge their clients more than necessary in order to benefit Fry, his wife, and to compensate the Broker-Dealer for providing certain services to FHC.

False and Misleading Disclosures to Clients in FHC’s Portfolio Management Agreements

29. FHC and its clients signed PMAs that spelled out the agreement between FHC and the client. During the relevant period, the PMAs stated that “this management agreement represents our entire understanding with regard to the matters specified here and any changes must be in writing.” The PMA specified the advisory services that FHC would provide and the compensation the clients would pay (typically as a percentage of assets in their account). The PMA also noted, in a section titled “Other Fees,” that: “Our management fee is payment for management of your account by Fry Hensley & Company. Any transfer fees, transaction fees, redemption fees, sales loads, wiring fees, etc. charged against your account by any third parties are separate from our management fee and will be deducted from the account by the Custodian.” But while stating that their Broker-Dealer would charge transaction fees to their accounts, FHC failed to tell clients that Fry (and not the Broker-Dealer) was setting the amount of these charges, and at much higher rates than he could.

Failure to Disclose FHC's Financial Condition

30. Throughout the relevant period, FHC failed to disclose to its clients that its financial condition was so seriously impaired that it was reasonably likely to impair its ability to provide services to its clients. FHC also did not disclose that it stayed in business only because Fry charged clients additional advisory compensation in the form of inflated transaction charges, and because Fry transferred hundreds of thousands of dollars of those client funds to FHC. Without this infusion of client funds, FHC would not have been able to stay in business.

D. VIOLATIONS

31. As a result of the conduct described above, FHC willfully violated Sections 206(1), 206(2), 206(4), Rule 206(4)-4 thereunder, and Section 207 of the Advisers Act.

32. As a result of the conduct described above, Fry willfully violated Sections 206(1), 206(2), and Section 207 of the Advisers Act. In addition, as a result of the conduct described above, Fry willfully aided and abetted and caused FHC's violations of Sections 206(1), 206(2), 206(4), Rule 206(4)-4, and Section 207 of the Advisers Act.

III.

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

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

B. What, if any, remedial action is appropriate in the public against Respondent FHC pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act:

C. What, if any, remedial action is appropriate in the public interest against Respondent Fry 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:

D. What, if any, remedial action is appropriate in the public interest against Respondent Fry pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act.

E. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

D. Whether, pursuant to 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of, and any future violations of Sections

206(1), 206(2), and Section 207 of the Advisers Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 203 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 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 provision 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. 69094 / March 8, 2013

Admin. Proc. File Nos. 3-14872, 3-15116

In the Matter of

BDO CHINA DAHUA CPA CO., LTD.,
ERNST & YOUNG HUA MING LLP,
KPMG HUAZHEN (SPECIAL GENERAL
PARTNERSHIP),
DELOITTE TOUCHE TOHMATSU CERTIFIED
PUBLIC ACCOUNTANTS LTD., and
PRICEWATERHOUSECOOPERS ZHONG
TIAN CPAs LIMITED

ORDER GRANTING EXTENSION

I.

The Chief Administrative Law Judge, Brenda P. Murray, has moved, pursuant to Commission Rule of Practice 360(a)(3),¹ for an extension of time to issue the initial decision in the proceeding instituted on May 9, 2012 against Deloitte Touche Tohmatsu Certified Public Accountants Ltd. ("D&T Shanghai"). For the reasons set forth below, we have determined to grant the law judge's motion.

On May 9, 2012, we issued an Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice and Notice of Hearing against D&T Shanghai, a public accounting firm registered with the Public Company Accounting Oversight Board.² The OIP alleges that D&T Shanghai willfully failed to provide audit workpapers in response to a Commission request, despite its legal obligations as a registered accounting firm to do so under § 106 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7216.³

¹ 17 C.F.R. § 201.360(a)(3).

² *Deloitte Touche Tohmatsu Certified Public Accountants, Ltd.*, Exchange Act Release No. 66948, 2012 SEC LEXIS 1457 (May 9, 2012). We subsequently issued a Second Corrected OIP, which corrected typographical errors in certain dates in the original OIP. That OIP is available at <http://www.sec.gov/litigation/admin/2012/34-66948.pdf>.

³ 2012 SEC LEXIS 1457, at *1-2.

On December 3, 2012, we issued an additional Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice and Notice of Hearing against D&T Shanghai and four other respondents.⁴ The OIP in this second proceeding alleges that the respondents willfully refused to provide the Commission with audit workpapers and other materials prepared in connection with audit work or interim reviews in contravention of their legal obligations under Sarbanes-Oxley § 106 as foreign public accounting firms.⁵ The first proceeding, in which D&T Shanghai was the sole respondent, was subsequently consolidated with this second proceeding.

II.

The OIP in the first proceeding directs the presiding law judge to issue an initial decision no later than 300 days from the date of service of the OIP. On February 6, 2013, Chief Judge Murray filed a motion stating that the initial decision with respect to the first proceeding is due on March 11, 2013 and requesting an extension pursuant to Commission Rule of Practice 360(a)(3).⁶ Chief Judge Murray calculated the due date by reference to a May 14, 2012 service date for the OIP.⁷

We adopted Rules of Practice 360(a)(2) and 360(a)(3) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for administrative hearings.⁸ The rules further provide for extensions under certain circumstances, if supported by a motion from the Chief Administrative Law Judge and we determine that "additional time is necessary or appropriate in the public interest."⁹

In the motion, Chief Judge Murray states that it is not possible to issue an initial decision in the first proceeding by March 11, 2013 because "the proceeding was postponed for approximately five months pending the Commission's negotiations with the China Securities Regulatory Commission and has since been consolidated with [the second proceeding], which was instituted approximately seven months" after the first proceeding. Chief Judge Murray seeks a seven month extension to issue a decision in the first proceeding.¹⁰ Under the circumstances, it is appropriate in the public interest to grant the Chief Administrative Law Judge's request and to extend the initial decision deadline.

⁴ *BDO China Dahua CPA Co., Ltd.*, Exchange Act Release No. 68335, 2012 SEC LEXIS 3704 (Dec. 3, 2012).

⁵ *Id.* at *3-4.

⁶ 17 C.F.R. § 201.360(a)(3).

⁷ In the motion, Chief Judge Murray states that, while D&T Shanghai admitted that service of the OIP in the first proceeding had been effected on May 14, 2012 by delivery to its registered agent for service of process, D&T Shanghai now contests the propriety of service. We need not address D&T Shanghai's contention in this order and do not do so.

⁸ *See Adopting Release*, Securities Act Release No. 8240, 2003 SEC LEXIS 1404, at *2-3 (June 11, 2003).

⁹ 17 C.F.R. § 201.360(a)(3).

¹⁰ Motion Requesting Extension of Time to File Initial Decision, Administrative Proceedings Rulings Release No. 747 (Feb. 5, 2013).

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in the first proceeding is extended to October 11, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9388 / March 8, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 69096 / March 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14863

In the Matter of

UBS FINANCIAL SERVICES INC.
OF PUERTO RICO

Respondent.

ORDER EXTENDING THE TIME BY WHICH UBS PR SHALL SUBMIT TO THE COMMISSION THE FINDINGS OF THE INDEPENDENT CONSULTANT MAKING RECOMMENDATIONS FOR ANY CHANGES IN OR IMPROVEMENTS TO UBS PR'S POLICIES, PROCEDURES, AND PRACTICES, AND A PROCEDURE FOR IMPLEMENTING SUCH RECOMMENDED CHANGES

I.

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 ("Order") against Respondent UBS Financial Services Inc. of Puerto Rico ("UBS PR") (Securities Act Rel. No. 9318 (May 1, 2012)).

On July 27, 2012, the Commission issued an Order Extending the Time by Which UBS PR Shall Submit to the Commission the Findings of the Independent Consultant Making Recommendations for any Changes in or Improvements to UBS PR's Policies, Procedures, and

Practices, and a Procedure for Implementing Such Recommended Changes, which authorized a 120-day extension of time by which UBS PR shall submit to the Commission the findings of the independent consultant making recommendations for any changes in or improvements to UBS PR's policies, procedures, and practices, and a procedure for implementing such recommended changes (Securities Act Rel. No. 9343 (July, 27, 2012)) ("the July 27 Order"). In the July 27 Order, the Commission authorized, upon good cause being shown, the staff of the Commission to grant UBS PR such additional time as the staff deems necessary, not to exceed 90 additional days, for the independent consultant to complete its review or for UBS PR to submit to the Commission the independent consultant's report and recommendations. Good cause was shown and the staff authorized a 90-day extension.

Additional time is necessary for the independent consultant to complete its review and submit its report to UBS PR. UBS PR has consented to submit the findings of the independent consultant to the Commission within 90 days from March 7, 2013.

II.

Accordingly, IT IS ORDERED that: The time for UBS PR to submit to the Commission the findings of the independent consultant making recommendations for any changes in or improvements to UBS PR's policies, procedures, and practices, and a procedure for implementing such recommended changes of the independent third-party consultant, is extended until June 5, 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. 69099 / March 11, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15239

In the Matter of

Gazoo Energy Group,
Coach Industries Group,
Pacificap Entertainment,

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 Gazoo Energy Group, Coach Industries Group, and Pacificap Entertainment.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. **Gazoo Energy Group** (CIK No. 0001210536) is a California corporation located in San Clemente, California with a class of securities registered with the Commission pursuant to Exchange Act 12(g). Gazoo Energy Group has not filed any periodic reports since it filed its October 31, 2010 Form 10-K on March 30, 2011. As of November 27, 2012 the common stock of Gazoo Energy Group (symbol "GAZU") was quoted on OTC Link operated by Pink OTC Markets, Inc. ("OTC Link").

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2. **Coach Industries Group** (CIK No. 0000791115) is a Missouri corporation located in Kansas City, Missouri with a class of securities registered with the Commission pursuant to Exchange Act 12(g). Coach Industries Group has not filed any periodic reports since it filed its September 30, 2006 Form 10-Q on November 14, 2006. Coach Industries Group's securities are not currently publicly quoted or traded.

3. **Pacificap Entertainment** (CIK No. 0001129284) is a California corporation located in Beverly Hills, California with a class of securities registered with the Commission pursuant to Exchange Act 12(g). Pacificap Entertainment has not filed any periodic reports since it filed its June 30, 2008 Form 10-Q on January 9, 2009. As of November 27, 2012, the common stock of Pacificap Entertainment (symbol "PFEH") was quoted on OTC Link.

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, with the exception of Gazoo Energy, 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.

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 are true and, in connection therewith, to afford 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 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 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 answer, 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 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's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)]. In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69100 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15240

In the Matter of

CHRISTOPHER A. SEELEY,

Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Seeley, 37 years old, is a resident of Herriman, Utah. Seeley does not hold any securities licenses.

2. From approximately May 2006 through September 2009, Seeley was an owner, officer, and director of AVF, Inc., d/b/a Alden View Funding, a Utah corporation, and from at least July 2007 through July 2010, Seeley was also the co-owner, president, and chief financial officer of AV Funding, LLC d/b/a Alden View Funding, a Utah limited liability company. From approximately May 2006 through January 2009, Seeley sold promissory notes through AVF, Inc. and AV Funding, LLC and during this time, made use of the mails or means or instrumentalities of

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interstate commerce to effect transactions in or to induce or attempt to induce the purchase or sale of securities without being registered in accordance with Section 15(b) of the Exchange Act.

B. ENTRY OF THE INJUNCTION

3. On February 13, 2013, a final judgment was entered against Respondent, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Christopher A. Seeley and Justin G. Dickson, Civil Action Number 2:11-cv-00907-CW, in the United States District Court for the District of Utah.

4. The Commission's complaint alleged that, from at least July 2006 through January 2009, Seeley offered and sold securities of AVF, Inc. and AV Funding, LLC and, in connection with the offer and sale of such securities, Seeley made material misrepresentations and omissions to investors regarding, among other things, the track record of AVF, Inc.'s and AV Funding, LLC's borrowers in repaying loans, the total amount of funds loaned, the collateral obtained in connection with borrower loans, and AVF, Inc.'s and AV Funding, LLC's due diligence in making loans to borrowers. The complaint also alleged that Seeley acted as an unregistered broker and offered and sold unregistered securities.

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary


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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9389 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15237

In the Matter of

STATE OF ILLINOIS,

Respondent.

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

I.

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

II.

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

III.

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

Summary

1. In connection with multiple bond offerings raising over \$2.2 billion from approximately 2005 through early 2009, the State of Illinois misled bond investors about the

adequacy of its statutory plan to fund its pension obligations and the risks created by the State's underfunding of its pension systems.¹

2. The State omitted to disclose in preliminary and final official statements material information regarding the structural underfunding of its pension systems and the resulting risks to the State's financial condition. Enacted in 1994, the Illinois Pension Funding Act (the "Statutory Funding Plan") established a pension contribution schedule that was not sufficient to cover both (1) the cost of benefits accrued in the current year and (2) a payment to amortize the plans' unfunded actuarial liability. This methodology structurally underfunded the State's pension obligations and backloaded the majority of pension contributions far into the future. The resulting systematic underfunding imposed significant stress on the pension systems and on the State's ability to meet its competing obligations.

3. During this same time period, the State also misled investors about the effect of changes to the Statutory Funding Plan, including substantially reduced pension contributions in 2006 and 2007 ("Pension Holidays"). Although the State's preliminary and final official statements disclosed the fact of the Pension Holidays and other legislative amendments to the plan, Illinois did not disclose the effect of those changes on the contribution schedule or on the State's ability to meet its pension obligations.

Respondent

4. Illinois possesses all powers, functions, rights, privileges, and immunities authorized by the United States Constitution, the Illinois Constitution, and the State's laws, including the power to issue debt.

Pension Funding in Illinois

5. The pension systems of Illinois currently are among the lowest-funded plans in the nation. As of 2011, the systems collectively were underfunded by \$83 billion, and system assets covered only 43 percent of system liabilities. The State's current funding deficit was created in significant part by the State's historical failure to fund its pension systems in a manner to avoid the growth of the unfunded liability.

6. The State of Illinois provides funding for five retirement systems that pay pension benefits upon retirement, death, or disability to public employees and their beneficiaries. The five systems are the Teachers' Retirement System of the State of Illinois, the State Universities Retirement System of Illinois, the State Employees' Retirement System of Illinois, the Judges' Retirement System of Illinois, and the General Assembly Retirement System, State of Illinois. Generally speaking, the systems are all defined-benefit plans that require contributions by employees and employers, with a significant portion funded by the State.

¹ These bonds are general obligation bonds, which are backed by the full faith and credit of the State.

7. Until 1981, the State funded pensions by covering the out-of-pocket costs associated with benefits as they came due. Employee contributions and investment income funded a reserve for future benefits. This approach had no relation to actuarial calculations of liability and was abandoned in 1982 during a period of fiscal stress. Without a remedial plan in place, state contributions were held relatively constant from 1982 to 1995. As a result of level contributions and rising costs, by 1995 the pension systems were significantly underfunded. In the aggregate, system assets covered only 50 percent of actuarial accrued liabilities, which had grown to approximately \$20 billion.

8. In an effort to address this imbalance, the Illinois General Assembly enacted the Statutory Funding Plan in 1994. Effective in 1995, this Statutory Funding Plan established a fifty-year schedule intended to achieve a 90 percent funded ratio for each system by 2045.² The Statutory Funding Plan called for the State to meet this target by contributing a level percentage of payroll each year sufficient to reach this goal. Under the level percentage of payroll method, amortization payments are calculated so that they are a constant percentage of the projected payroll of active plan members over a given number of years. Each year, actuaries for each pension system would use demographic and other data and various assumptions to calculate actuarial value of assets, actuarial accrued liability, and the State's contributions based on the statutory requirements and objectives. Rather than requiring the immediate funding of plan contributions calculated in this manner, the legislature phased in the State's contribution over a fifteen-year "ramp" period. During the ramp period, the Statutory Funding Plan required that the percentage of payroll increase each year such that, by 2010, the State would be contributing the level percentage of payroll required under the plan for 2011 to 2045. At the conclusion of the ramp period in 2010, the Statutory Funding Plan required the State to contribute a level percentage of state payroll in order to achieve the 2045 target.

9. Rather than controlling the State's growing pension burden, the Statutory Funding Plan's contribution schedule increased the unfunded liability, underfunded the State's pension obligations, and deferred pension funding. This resulting underfunding of the pension systems ("Structural Underfunding") enabled the State to shift the burden associated with its pension costs to the future and, as a result, created significant financial stress and risks for the State.

a. For the majority of the years under the Statutory Funding Plan, the State's annual required contributions were insufficient to prevent the growth of its unfunded liability. Specifically, the statutory contributions were not sufficient to cover both (1) the cost of pension benefits earned by public employees by virtue of their service in the current year ("the normal cost") and (2) a payment to amortize the accumulated amount of pension liabilities that have been deemed earned but are not funded (the unfunded actuarial accrued liability, or "UAAL") for an identified group of plan participants. The normal cost and amortization payment collectively are referred to as the actuarially required contribution ("ARC"). The State's pension contributions were calculated in accordance with State law, not in accordance with the ARC, and therefore the

² The funded ratio, which is one measure of the financial health of a pension plan, is the actuarial value of assets expressed as a percentage of the actuarial accrued liability. A 100 percent funded ratio means that existing assets cover the present value of future benefits to be paid by the systems.

Statutory Funding Plan deferred funding of the State's pension obligations and compounded its pension burden.

b. The 90 percent funding target allowed the State to amortize the UAAL in a manner that would not eliminate it entirely. By failing to amortize the UAAL completely, the State was able to lower its contributions. However, by assuring that some portion of the UAAL would remain outstanding, it also increased the economic cost of the pensions and delayed the cash outlays necessary to fulfill its pension obligations.

c. The State's plan also spread costs over fifty years, in contrast to the thirty-year amortization period adopted by the pension plans of most other states. The longer amortization period extended the amount of time required to pay down the UAAL, reducing the State's annual statutory contributions while increasing the real cost of the pensions over time.

d. The State's phased contributions during the fifteen-year ramp period accelerated the growth of the UAAL during this time period and amplified the burden and risk associated with the State's plan.

e. In contrast to the ARC, which typically is calculated using the closed group approach, contributions under the Statutory Funding Plan are calculated using an open group method, which spreads the cost of providing benefits over existing and new entrants. The Illinois approach requires actuaries to estimate pension benefits for employees to be hired far into the future, particularly given the State's use of a 2045 target date.

f. The State's use of the projected unit credit ("PUC") actuarial cost method compounded the risk of the Statutory Funding Plan. The PUC method, used by Illinois and a minority of states, allocates a higher portion of retirement costs closer to retirement, while the entry age normal ("EAN") method, used by a substantial majority of public sector plans, averages those same costs evenly over the pensioner's period of employment. Compared to an EAN approach, the PUC method results in less funding for active employees, accumulates assets more slowly, produces more volatile measures of contribution rates, and results in rising rather than level contribution rates.

10. From 1996 to 2010, the State's unfunded liability increased by \$57 billion. The State's insufficient contributions under the Statutory Funding Plan were the primary driver of this increase, outweighing other causal factors, such as market performance and changes in benefits. This Structural Underfunding created significant financial risks for the State:

a. Although the most significant effects of this Structural Underfunding materialize in the future, the pension shortfall already has imposed a severe strain on the finances of the Illinois government, and pension costs are affecting the State's ability to manage other significant obligations. In April 2012, the State acknowledged that the pension shortfall is "one of the most difficult problems that Illinois government has faced for more than three decades," and "[u]nsustainable pension costs are squeezing core programs in education, public safety, and human services, in addition to limiting [the State's] ability to pay [its] bills."

b. The State understood that the Structural Underfunding put the plan at serious risk and that the State likely would not be able to afford the level of contributions required to reach

90 percent funding. As explained by one of the system's actuaries in 2009, "[t]he perpetual underfunding puts the plan at serious risk for ultimate exhaustion of the trust, leaving the responsibility for the payment of benefits elsewhere." He observed further that "[t]he plan is in significant funding peril unless the contributions recommended under the actuarially required contribution can be made." Similarly, a pension consultant retained by the Governor's Office of Management and Budget ("GOMB") wrote in August 2009 that "the Illinois pension system is now so underfunded that the State likely [would] never be able to afford the level of contributions required to ever reach 90 percent funding." Other documents generated by GOMB reflected serious concerns about the financial strain produced by the State's unfunded pension obligations. This information was not disclosed to bond investors in bond offering documents.

c. The Structural Underfunding of the pension systems and the State's increasing inability to afford contributions created the significant risk that the State would be unable to satisfy its competing obligations. This underfunding also compromised the creditworthiness of the State and increased the State's financing costs.

Underfunding of the State's Pension Obligations

11. In its bond offering documents from 1995 to 2010, the State disclosed that Illinois funded its pension obligations through the Statutory Funding Plan, which according to the State provided for funding "necessary" or "sufficient" to achieve 90 percent funding of liabilities in 2045. Specifically, official statements disclosed that the Statutory Funding Plan "created a 50-year funding schedule of the Retirement Systems which requires the State to contribute each year, starting with Fiscal Year 2011, the level percentage of payroll sufficient to cause the assets of the Retirement Systems to equal 90 percent of the total accrued liabilities by the end of Fiscal Year 2045. In Fiscal Years 1997 through 2010, contributions as a percentage of payroll are increased each year such that by Fiscal Year 2010, the contribution rate is at the same level as required for years 2011 through 2045."

12. The State also disclosed statistics regarding the systems' assets and liabilities and other information. Among other things, the State provided, for an historical five-year period, the actuarial assets and liabilities for each of the pension systems, as prescribed by state law; the UAAL, which is one measure of the funded status of pension plans; the funded ratio, which is the actuarial value of assets as a percentage of the actuarial accrued liability; and summary financial statements for each of the pension systems. The State's official statements also reviewed recent legislation affecting pension funding and demographic data for participants in the pension systems.

13. The State did not disclose that contributions required by the Statutory Funding Plan significantly underfunded the State's pension obligations and deferred pension funding into the future.

a. The State did not disclose in its official statements its failure to contribute to the full amount of the ARC and the consequences of not funding the full amount of the ARC.³

³ The State's comprehensive annual financial reports ("CAFRs"), which the official statements incorporated by reference, compared the calculation of the contribution under the

b. The State also did not disclose that multiple aspects of the Statutory Funding Plan deferred pension contributions and increased the burden associated with the pension plans. For instance, the State did not explain the implications of its decision to spread costs over fifty years, the fifteen-year ramp period, and 90 percent funding target.

c. The State did not inform investors that other aspects of the State's funding method, such as the State's use of the PUC method, delayed contributions and increased the unfunded liability.

d. In its official statements, the State cited a number of factors that, in the past, contributed to the increase in unfunded pension liability, such as statutory benefit enhancements and market performance, but did not disclose that the State's insufficient contributions were the primary driver of the increase.

e. The State disclosed that its UAAL could increase in the future by virtue of a variety of factors, such as a decrease in the performance of investments and changes in legislation, actuarial assumptions, inflation, benefits, or the State's contribution rate. However, the State misleadingly omitted to disclose the primary driver of the increase—the insufficient contributions mandated by the Statutory Funding Plan.

14. The State also failed to disclose the risks created by the Structural Underfunding.

a. The State failed to disclose the effect of its unfunded pension systems on the State's ability to manage other obligations. The State also did not inform investors that rising pension costs could continue to affect its ability to satisfy its commitments in the future. In contrast, the State included multiple metrics to assist potential investors' evaluation of the burden associated with the State's bond offerings and obligations.

b. Although the State understood that the Structural Underfunding could risk the eventual exhaustion of the pension systems' funds and that the State likely would not be able to afford the level of contributions required by the Statutory Funding Plan, it did not disclose that the State's inability to make its contributions increased the investment risk to bondholders. The State did not identify or discuss how this underfunding compromised the State's creditworthiness or increased its financing costs.

Failure to Adhere to the Statutory Funding Plan

15. As described above, the Statutory Funding Plan set contribution requirements at a level that failed to control the growth of the unfunded liability until the latter years of the plan. Nevertheless, the State did not meet the requirements of the plan as enacted in 1995. Beginning in 2005, the State amended the Statutory Funding Plan, lowering these already deficient contributions, or borrowed to cover its payments. This modification to the original Statutory

Statutory Funding Plan to a contribution calculated in accordance with generally accepted accounting principles. However, the CAFR disclosures did not describe the risks and implications of the Statutory Funding Plan and deviations from that plan.

Funding Plan created further risk to the pension systems and the financial condition of the State. The State misled investors about the effect of these changes on the State's financial condition and, in particular, the impact of the Pension Holidays instituted in 2006 and 2007.

16. On June 1, 2005, the State legislatively enacted Pension Holidays, lowering the contribution in 2006 and 2007 by 56 and 45 percent, respectively. The Pension Holidays had the dual effect of increasing the UAAL and further delaying payment of the deferred portion of the contribution to a future fiscal year.

17. Contrary to the State's CAFRs, which stated that the Pension Holidays would be offset by increased contributions from 2008 to 2010, the 2005 amendment to the Statutory Funding Plan did not require increased contributions in 2008 through 2010 to offset the reduced contributions in 2006 and 2007. Instead, the statute required contributions from 2008 to 2010 to be "increased in equal annual increments from the required State contribution for State fiscal year 2007." In other words, the Illinois legislature mandated a resumption of the ramp period from the reduced 2006 and 2007 levels, not an increase in the 2008, 2009, and 2010 contribution levels to offset those reduced contributions.

18. Although the State disclosed the basic fact of these reduced contributions, the State did not disclose that each of these deviations exacerbated the Structural Underfunding, deferred contributions further into the future, impaired the ability of the State to meet its pension obligations, and negatively impacted the State's creditworthiness.

19. Due to the State's failure to adhere to the original Statutory Funding Plan prior to the conclusion of the ramp period, the State should have known that it likely would have significant difficulty making the required contributions in the future. In addition, the State should have known that its disclosures regarding the Structural Underfunding and the related risks were inadequate.

Significance to Potential Investors

20. The funding of pension obligations is a significant aspect of the State's budget and financial status. Reasonable investors would have considered information regarding the State's Structural Underfunding of its pensions, the risks created by that underfunding, and the financial condition of the pension plans to be important factors in the investment decision-making process. Reasonable investors would have viewed such information as significantly altering the total mix of information available regarding the State's financial condition and the State's future financial prospects. Such information allows investors to weigh and price the risk associated with the State's debt obligations.

21. Concern about the State's pension financing was a significant factor prompting downgrades of the State's credit rating from 2010 to 2012. For example, on June 4, 2010, Moody's lowered the State's general obligation bond rating based on the State's increased reliance on non-recurring measures. A significant factor cited by Moody's was the fiscal pressure caused by the State's pension funding burden, and, for the first time, Moody's provided additional detail regarding the State's funding challenges and difficulty complying with its pension law in recent years.

22. Certain events ultimately revealed the State's Structural Underfunding of pensions and the risks associated with the underfunding. For example, on January 21, 2011, the State included enhanced pension disclosures released in a preliminary official statement for a general obligation offering on February 11, 2011. Following this event and others, the risk premium associated with Illinois bonds rose, causing the spread between the yield on Illinois bonds relative to other AAA-rated municipal bonds to widen.

Institutional Failures

23. The State's misleading disclosures resulted from, among other things, various institutional failures. The State failed to adopt or implement sufficient controls, policies, or procedures designed to ensure that material information was assembled and communicated to individuals responsible for disclosure determinations, to train personnel involved in the disclosure process adequately, or to retain disclosure counsel. As a result, the State lacked proper mechanisms to identify and incorporate into its official statements relevant information held by the pension systems and other bodies within the State.

24. GOMB, which managed the issuance of debt for the State, coordinated the drafting, review, and revision of the bond disclosure documents, including the section regarding pension funding. GOMB's procedures were inadequate for ensuring that material information concerning State Pension Funds or the State's financing of State Pension Funds was disclosed and accurate in bond offering documents. The State failed to implement sufficient policies and procedures, to conduct adequate training, or to consult securities disclosure counsel to ensure adequate disclosure. Relying on prior "carryover" disclosures and "page-turn" reviews during group conference calls, the State and its advisors did not scrutinize the institutionalized description of the Plan adequately and made little affirmative effort to collect potentially pertinent information from knowledgeable sources—in particular, actuaries for the pension systems and the State's Commission on Government Forecasting and Accountability ("COGFA").

25. Within GOMB, the team responsible for managing the disclosure process purported to rely on its consultants, underwriters, underwriter's counsel, and bond counsel to identify and evaluate the need for additional disclosures. Those parties, however, relied on the State to do the same. The result was a process in which no one person fully accepted responsibility for identifying and analyzing potential pension disclosures.

Remedial Measures

26. The State has taken significant steps to correct these process deficiencies and enhance its pension disclosures. Among other things, the State issued enhanced disclosures; retained disclosure counsel; instituted written policies and procedures, disclosure controls, and training programs; and designated a disclosure committee.

a. In the State's April 2009 bond offering documents, the State provided a hyperlink to a February 2009 COGFA monthly briefing in which COGFA provided certain negative information regarding, among other things, the decline in the State's pension system assets.

b. In June 2009, the State commissioned a Pension Modernization Task Force to evaluate the benefit structure, costs, and funding of the State's pension systems. The task force

met from June to November 2009 and issued a report in November 2009. The report contained detailed information about the history of pension investments, benefits, and funding and reflected the views of various experts. In its official statement for the January 2010 offering, the State included a hyperlink to the task force report in the pension section.

c. In late 2009, the State made a series of personnel changes in the GOMB, including in its most senior positions. These new officers worked to formalize the disclosure and underwriting process.

d. In March 2010, COGFA produced a report on the funded status of the pension systems as of June 30, 2009. The report contained certain historical and projected information regarding the State's funding of its pensions.

e. Promptly following the Commission's settled action against the State of New Jersey in August 2010,⁴ the State began to implement a series of remedial measures. The State retained disclosure counsel, significantly enhanced disclosures in the pension section of its bond offering documents, developed training materials, and added formal disclosure controls regarding pension disclosures. The State also designated a disclosure committee responsible for collecting information from relevant sources, evaluating the State's disclosure obligations, and approving bond offering disclosures. Prior to dissemination of official statements, the committee ensures that the disclosures are reviewed by the pension systems, COGFA, the Office of the Comptroller, the Office of the Treasurer, and the Office of the Illinois Attorney General.

f. These steps culminated with significant corrective disclosures in connection with an offering in February 2011, the State's first offering since the Commission's settled action against the State of New Jersey. In particular, the State disclosed contrasts between contributions determined under the Illinois Statutory Funding Plan and the costs implied by standard actuarial methods and assumptions and Government Accounting Standards Board ("GASB") Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The State also discussed the effect of such deviations on the State's ability to meet its pension obligations and included the projected funded status of the pension systems. Finally, the State disclosed the effect of amendments to its Statutory Funding Plan on its ability to fund its pension obligations and the State's financial condition. The State's disclosures also included an extensive discussion of the background of the pension systems, history of contributions to the pension systems, the financial condition of the plans, projections of funded status, substantive references to additional sources of information, and a discussion of disclosure policies and procedures.

Legal Discussion

27. Issuers of municipal securities are responsible for the accuracy of their disclosure documents. Proper disclosure allows investors to understand and evaluate the financial health of the municipality in which they invest. The Commission has repeatedly emphasized that disclosure

⁴ *In re* State of New Jersey, Securities Act Release No. 33-9135 (Aug. 18, 2010).

in municipal debt offerings may be rendered materially misleading due to the omission of other material facts.

28. The antifraud provisions of Section 17(a) of the Securities Act prohibit fraudulent or deceptive practices in the offer or sale of securities by the issuers of municipal securities. Section 17(a) of the Securities Act prohibits obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading. A fact is material if there is a substantial likelihood that a reasonable investor would have viewed the information as "having significantly altered the 'total mix' of information available." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). To the extent the omitted information relates to contingent future events, materiality depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of circumstances." *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988). Negligence is sufficient to prove violations of Section 17(a)(2) or (3) of the Securities Act. *Aaron v. SEC*, 446 U.S. 680, 696-97 (1980).

Violations

29. As a result of the negligent conduct described above, the State violated Sections 17(a)(2) and 17(a)(3) of the Securities Act. Specifically, in numerous bond offerings from approximately 2005 through March 2009, the State misled bond investors by omitting to disclose information about the adequacy of its statutory plan to fund its pension obligations and the risks created by the State's Structural Underfunding of its pension obligations. During this same time period, the State also misled bond investors about the effect of changes to that plan, including the Pension Holidays in 2006 and 2007.

30. The State was aware of the Structural Underfunding and the potential effects of the underfunding. However, due largely to institutional failures, the State misled investors by omitting to disclose material information, rendering certain statements misleading, in bond offering documents regarding the State's ability to fund its pension obligations or the impact of the State's pension obligations on the State's financial condition.

Remedial Acts

31. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by the State, as described in Paragraph 26, and cooperation afforded the Commission staff during the investigation.

IV.

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

Accordingly, it is hereby ORDERED that, pursuant to Section 8A of the Securities Act, the State of Illinois shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act.

By the Commission.

Elizabeth M. Murphy
Secretary

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



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9390 / March 11, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3566 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15238

In the Matter of

OPPENHEIMER ASSET
MANAGEMENT INC. and
OPPENHEIMER
ALTERNATIVE
INVESTMENT
MANAGEMENT, LLC,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933 AND SECTIONS
203(e) AND 203(k) OF THE INVESTMENT
ADVISERS ACT OF 1940, MAKING
FINDINGS, AND IMPOSING REMEDIAL
SANCTIONS AND A CEASE-AND-DESIST
ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Oppenheimer Asset Management Inc. and Oppenheimer Alternative Investment Management, LLC ("Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

SUMMARY

1. This matter concerns registered investment advisers Oppenheimer Asset Management Inc.'s ("OAM") and Oppenheimer Alternative Investment Management, LLC's ("OAIM") misrepresentations and omissions to investors and prospective investors about the asset value of a fund of private equity funds vehicle they managed, Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"). OAM's and OAIM's written policies and procedures did not contain provisions reasonably designed to prevent violations of the Advisers Act and the rules adopted thereunder. While the policies and procedures required the compliance department to review and approve marketing materials, those procedures did not require a review of portfolio manager valuations and were not reasonably designed to ensure that valuations were determined in a manner consistent with written representations to investors.

2. From October 2009 through 2010, Respondents disseminated marketing materials to prospective investors and quarterly reports to existing investors that contained material misrepresentations and omissions concerning Respondents' valuation policies and OGR's performance. Respondents stated in the marketing materials and quarterly reports to investors that OGR's asset values were "based on the underlying managers' estimated values" when that was not the case with respect to one of the assets in OGR's investment portfolio. Beginning in October 2009, while OGR was being marketed to new investors, OGR's portfolio manager ("Portfolio Manager") changed the value of OGR's largest holding, Cartesian Investors-A, LLC ("Cartesian"), using a different valuation method than that used by Cartesian's underlying manager. The Portfolio Manager did not inform, and caused Respondents not to inform, investors either of this change or of the fact that the new valuation method resulted in a significant increase in the value of Cartesian over that provided by Cartesian's underlying manager.

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

3. Additionally, former employees overseeing OAIM's investments misrepresented and caused Respondents to misrepresent to potential investors that: (i) the increase in Cartesian's value was due to an increase in Cartesian's performance when, in fact, the increase was attributable to the Portfolio Manager's new valuation method; (ii) a third party valuation firm used by Cartesian's underlying manager wrote up the value of Cartesian when that was not true; and (iii) OGR's underlying funds were audited by independent, third party auditors when, in fact, Cartesian was unaudited. Former employees overseeing OAIM's investments and the Respondents marketed OGR using the marked-up value of the Cartesian investment from October 2009 through June 2010 and succeeded in raising approximately \$61 million in new investments in OGR during that period.

4. These misrepresentations and omissions were made possible, in part, by Respondents' failure to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules adopted thereunder.

5. By virtue of this conduct, Respondents willfully² violated Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.

RESPONDENTS

6. OAM is located in New York City and is registered with the Commission as an investment adviser. OAM is a subsidiary of E.A. Viner International Co., which is a subsidiary of Oppenheimer Holdings, Inc., a publicly held company listed on the New York Stock Exchange.

7. OAIM is located in New York City and is registered with the Commission as an investment adviser. OAIM is wholly owned by OAM, and OAM is the sole member of OAIM. OAIM is the general partner of and, through employees of OAM, provides investment advisory services to several funds, including OGR and other private equity funds. Accordingly, OAM can be deemed to have served as the investment adviser to OGR.

BACKGROUND

8. In 2007, Respondents formed OGR, a private equity fund of funds vehicle that began admitting limited partners in April 2008. As of September 30, 2009, OGR made commitments to four investment vehicles, including Cartesian, a vehicle managed by Cartesian Capital Group, LLC ("Cartesian Capital"). Cartesian was formed by Cartesian Capital in June 2008 for the purpose of purchasing shares of S.C. Fondul Proprietatea S.A ("Fondul"), and Fondul is Cartesian's only holding. Fondul, in turn, is a holding company set up by the

² A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Romanian government to compensate citizens whose property was seized by the communist regime. Upon adjudication of a citizen's claim for restitution and an assessment of the value of the seized property, the Romanian government issued an equivalent value of shares of Fondul at 1 RON per share (also referred to as the "par value" of the Fondul shares).

9. From at least October 2009 through June 2010, the Portfolio Manager and his group marketed OGR to investors, primarily institutions such as pensions, foundations and endowments, as well as high net worth individuals and families. The Portfolio Manager found prospective investors through Oppenheimer's network of financial advisors and through independent consulting firms ("consultants") that provided investment advice to institutional investor clients.

10. Respondents and the Portfolio Manager distributed pitch books to consultants and investors that summarized the performance of OGR's investments as of a particular quarter. Respondents and the Portfolio Manager also responded to consultants' questionnaires and other requests for information, and their communications and documents contained representations concerning OGR's valuation policies and performance.

11. Investors in OGR received quarterly reports that contained summaries of the performance of OGR's investments as of a particular quarter. The performance summaries also contained representations concerning OGR's valuation policies and performance.

MISREPRESENTATIONS AND OMISSIONS

12. By October 2009, OGR had raised approximately \$70 million in capital commitments — approximately one-third of the goal of \$200 million — and the Portfolio Manager had succeeded in securing an extension of the fund's closing date.

13. As of Thursday, October 22, 2009, Respondents' compliance department had approved an OGR pitch book that was to be used to market OGR. Pursuant to Respondents' practice, compliance assigned to the pitch book a compliance code, which is an alphanumeric code that is unique to each compliance-approved document.

14. The pitch book that was approved by compliance on October 22, 2009 stated that OGR's asset values were "based on the underlying managers' estimated values." The asset values of the underlying funds — including Cartesian — were in fact based upon the values provided by the underlying managers, as had been OGR's valuation practice since inception. However, the approval process did not contain a provision to ensure that the valuations were based on the values provided by such managers.

15. On or about October 22, 2009, the Portfolio Manager declined to value Cartesian using the methodology adopted by Cartesian Capital, the manager of Cartesian, and instead valued OGR's investment in Cartesian himself. Rather than relying on Cartesian's valuation methodology, the Portfolio Manager valued OGR's investment in Cartesian at "par value" — that is, the price at which the Romanian government issued shares to claimants. Use

of the par value of Fondul to value OGR's investment in Cartesian resulted in a material increase in the value of OGR's Cartesian investment and, because it was OGR's largest holding, in OGR's performance.

16. Immediately after Respondents' compliance department approved the OGR pitch book on October 22, the Portfolio Manager instructed members of his team to incorporate the higher par value of Fondul in any document that included performance numbers for Cartesian. Over the weekend of October 23-25, 2009, the Portfolio Manager, with the assistance of members of his team, revised OGR marketing materials (including the pitch book) to reflect his higher par value valuation. After revising these documents, no one resubmitted the pitch book to Respondents' compliance department for review, as required by Respondents' policies. Moreover, the Portfolio Manager and his team left the same compliance code that was affixed to the October 22 presentation on the revised presentation, thus creating the appearance that the revised presentation had been approved by Respondents' compliance department.

17. By no longer using Cartesian Capital's valuation, the presentation's performance table footnote, which stated that the asset values were based on the underlying managers' values, was no longer accurate.

18. The Portfolio Manager never subsequently informed compliance that he had changed the valuation of one of OGR's investments so as to deviate from the policy stated in the footnote to the performance table, which stated that the values were based on values provided by the underlying managers. Because Respondents did not verify that the asset values were in fact based on values provided by the underlying managers, the misleading footnote continued to appear in later versions of the pitch book that compliance did approve.

19. The Portfolio Manager incorporated the new valuation into performance summary tables in pitch books and quarterly reports that were used to market OGR to prospective investors from October 26, 2009 through June 2010.

20. The performance summary tables in the pitch books and quarterly reports used with prospective investors contained explanatory footnotes stating that OGR's asset values were "based on the underlying managers' estimated values" as of a particular quarter. For the October 2009 through December 2010 period during which the Portfolio Manager valued OGR's Cartesian investment using his par value rather than adopting Cartesian Capital's value, these statements about valuation policy were false and misleading.

21. The Portfolio Manager's use of par value rather than Cartesian Capital's value resulted in a material increase in both the value and internal rate of return ("IRR")³ of

³ Internal Rate of Return is a metric commonly used to compare the profitability of various investments. The IRR of an investment is the discount rate at which the net present value of costs (negative cash flows) of the investment equals the net present value of the benefits (positive cash flows) of the investment. The market value of each investment at the end of each quarter is also

OGR's Cartesian investment. As Cartesian was OGR's largest holding, the change in Cartesian's IRR had a significant impact on the IRR of OGR. For example, for the quarter ended June 30, 2009, the Portfolio Manager's mark-up of the Cartesian investment changed OGR's IRR from approximately 3.8% to 38.3%.

22. During their marketing efforts, the Portfolio Manager and others in his group touted the performance of Cartesian and OGR to prospective investors, pointing to OGR's high IRR. No one told investors and prospective investors that the reported increase in OGR's performance was a result of the Portfolio Manager's change in valuation method and that, if OGR had used Cartesian Capital's value, as OGR had done in the past and as was stated in the quarterly statements and pitch books, the performance numbers would have been materially lower.

23. The former employees overseeing OAIM's investments made additional misrepresentations in connection with the marketing of OGR. They represented that: (i) the increase in Cartesian's value was due to an increase in performance when, in fact, the increase was attributable to the Portfolio Manager's new valuation method; (ii) a third party valuation firm used by Cartesian's underlying manager wrote up the value of Cartesian when that was not true; and (iii) OGR's underlying funds were audited by independent, third party auditors when, in fact, Cartesian was unaudited.

DEFICIENT POLICIES AND PROCEDURES

24. Respondents' written policies and procedures were not reasonably designed to ensure that valuations provided to prospective and existing investors were presented in a manner consistent with written representations to investors and prospective investors. As a result, the Cartesian valuation stated in quarterly reports and pitch books was not in fact that of the underlying manager, as was represented in the documents.

VIOLATIONS

25. As a result of the conduct described above, Respondents willfully violated Section 17(a)(2) of the Securities Act, which prohibits any person in the offer or sale of securities from obtaining money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

26. As a result of the conduct described above, Respondents willfully violated Section 17(a)(3) of the Securities Act, which prohibits any person in the offer or sale of securities from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

included in the IRR computation. IRR is expressed as a percentage and essentially measures the rate of growth of an investment.

27. As a result of the conduct described above, Respondents willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibits any fraudulent, deceptive, or manipulative act, practice, or course of business by an investment adviser to any investor or prospective investor in a pooled investment vehicle.

28. As a result of the conduct described above, Respondents willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires, among other things, that registered investment advisers adopt and implement written policies and procedures reasonably designed to prevent violation, by the investment adviser and its supervised persons, of the Advisers Act and its rules.

UNDERTAKINGS

Respondents have undertaken to the following:

29. Respondent-Administered Distribution

a) Respondents undertake to distribute, within 60 days of the date of this Order, a total of \$2,269,098 consisting of \$1,868,463 from this proceeding and \$400,635 from a related Commonwealth of Massachusetts proceeding ("Disgorgement Fund") to OGR investors who invested in OGR during the time period October 2009 through June 2010 ("Marketed Investors"). The Disgorgement Fund represents the management fees collected by OAM from the Marketed Investors from October 2009 through September 2012, and an amount for reasonable interest. The records provided by Respondents and reviewed by Commission staff of the management fees paid by each of the investors shall be the basis of the distribution allocation.

b) Respondents undertake to administer the distribution of the Disgorgement Fund. Respondents undertake to:

- i. deposit the amount representing the Disgorgement Fund into an escrow account acceptable to the Commission staff within 20 days of the date of the Order, and shall provide the staff with evidence of such deposit in a form acceptable to the staff;
- ii. distribute on a pro rata basis to Marketed Investors the Disgorgement Fund described in paragraph 29(a) within 60 days of the date of the Order; and

c) Any amounts remaining after distribution, and any amounts Respondents are unable, due to factors beyond their control, to pay to investors, shall be paid to the United States Treasury or, in the case of amounts payable to Massachusetts investors as a result of the related action by the Commonwealth of Massachusetts, shall be paid to the Commonwealth of Massachusetts, by and through Martha Coakley, Attorney General. Payment must be made in one of the following ways:

- i. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- ii. 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
- iii. 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 Oppenheimer Asset Management, Inc. and Oppenheimer Alternative Investment Management, LLC 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 Bruce Karpati, Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281, or such other address as the Commission staff may provide.

d) Respondents agree to be responsible for all tax compliance responsibilities associated with distribution of the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid out of the Disgorgement Fund.

e) Within 90 days after the date of the entry of the Order, Respondents shall submit to the Commission staff a final accounting and certification of the disposition of the Disgorgement Fund not unacceptable to the staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (i) the amount paid to each payee; (ii) the date of each payment; (iii) the check number or other identifier of money transferred; (iv) the date and amount of any returned payment; (v) a description of any effort to locate a prospective payee whose payment was returned; or to whom payment was not made due to factors beyond Respondents' control; (vi) any amounts to be paid to the United States Treasury pursuant to paragraph 29(c) above; and (vii) an affirmation that the amount paid to the investors represents a fair calculation of the Disgorgement Fund. Respondents shall submit proof and

supporting documentation of such payments in a form acceptable to Commission staff. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request.

f) After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any remaining amount to the United States Treasury.

g) The Commission staff may extend any of the procedural dates set forth in this subsection 29 for good cause shown. Deadlines for dates relating shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

30. Independent Consultant.

a) Within 90 days of the date of this Order, Respondents shall retain an independent consultant ("IC") not unacceptable to the staff of the Commission to:

- i. Conduct a review of the adequacy of Respondents' valuation policies and procedures pertaining to:
 1. Respondents' valuation process and oversight, controls and compliance relating thereto;
 2. Respondents' written communications with current or prospective investors concerning valuation;
 3. Respondents' use of independent parties such as auditors and valuation experts; and
 4. Respondents' oversight, control and compliance with respect to marketing materials concerning OAIM funds prepared by entities with which it has a sub-advisory relationship.
- ii. recommend any additional policies and procedures which, on the basis of its review, the IC believes are necessary to ensure that Respondents' valuation policies and procedures described in items (a)(i)(1)-(4) above, are adequate (the "Recommendations");
- iii. submit to Respondents and the staff of the Commission, within 30 days of the completion of its review, and in any event no later than 180 days after being retained by Respondents, a report

describing the scope and results of the IC's review ("Report"), and the Recommendations, if any, made by the IC to Respondents;

- iv. conduct a follow-up review commencing no earlier than 120 days after completion of the Report to determine if the Recommendations (either in their original form or modified pursuant to paragraph 30(b) below) were properly implemented by Respondents and are operating to ensure Respondents' compliance with applicable provisions of the federal securities laws;
- v. submit to Respondents and the staff of the Commission, within 30 days of the completion of the follow-up review, and in any event no later than 360 days after being retained by Respondents, a follow-up IC report ("Follow-up Report") describing the results of the IC's follow-up review.

b) Respondents shall adopt all Recommendations of the IC within 60 days of the Report; provided, however, that within 45 days of the completion of the review described in paragraph 30 above, Respondents shall in writing advise the IC and the staff of the Commission of any Recommendations that it considers to be unnecessary, inappropriate, or unduly burdensome. With respect to any Recommendation that Respondents considers unnecessary, inappropriate, or unduly burdensome, Respondents need not adopt that Recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose. As to any Recommendation on which Respondents and the IC do not agree, such parties shall attempt in good faith to reach an agreement within 30 days after Respondents serve the advice described above. In the event that Respondents and the IC are unable to agree on an alternative proposal, Respondents will abide by the determinations of the IC.

c) Within ninety (90) days of Respondents' adoption of all of the Recommendations as determined pursuant to the procedures set forth herein, Respondents shall certify in writing to the IC and the Commission staff that Respondents have adopted and implemented all of the IC's Recommendations. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, Suite 400, New York, New York, 10281, or such other address as the Commission staff may provide.

d) Respondents shall cooperate fully with the IC and shall provide the IC with access to such of their files, books, records, and personnel as are reasonably requested by the IC for review.

e) To ensure the independence of the IC, Respondents: (1) shall not have the authority to terminate the IC or substitute another independent compliance consultant for the initial IC, without the prior written approval of the Commission staff; and (2) shall compensate the IC and persons engaged to assist the IC for services rendered pursuant to this Order at their reasonable and customary rates.

f) Respondents shall require the IC to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the IC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the IC will require that any firm with which the IC is affiliated or of which the IC is a member, and any person engaged to assist the IC in the performance of the IC's duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondents, or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

g) Respondents shall not be in, and shall not have an attorney-client relationship with the IC and shall not seek to invoke the attorney-client privilege or any other doctrine or privilege to prevent the IC from transmitting any information, reports, or documents to the staff of the Commission.

31. Recordkeeping. Respondents shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of Respondents' compliance with the undertakings set forth in this Order.

32. Notice to Advisory Clients. Within ten (10) days of the entry of this Order, Respondents shall prominently post on their principal website a hyperlink to the entire Order. Respondents shall maintain the hyperlink on the website for a period of twelve (12) months from the entry of this Order. Within thirty (30) days of the entry of this Order, Respondents shall provide a copy of the Order to each of OAIM's existing advisory clients as of the entry of this Order via mail, e-mail, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff.

33. Deadlines. The Commission staff shall have the authority, in its discretion, to extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

34. Certifications of Compliance by Respondents. As set forth in paragraph 30(c), Respondents shall certify, in writing, compliance with its 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 Respondents agree to

provide such evidence. The certification and supporting material shall be sent to Panayiota K. Bougiamas, Assistant Regional Director, Asset Management Unit, New York Regional Office, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281, 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.

35. Cooperation: Respondents shall 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, Respondents shall: (i) produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Commission staff subject to any restrictions under the law of any foreign jurisdiction; (ii) use their best efforts to cause their officers, employees, and directors to be interviewed by the Commission staff at such time as the staff reasonably may direct; and (iii) use their best efforts to cause their officers, employees, and directors to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission staff.

36. Respondents will pay a penalty of \$132,421 to the Commonwealth of Massachusetts in a related action by the Commonwealth of Massachusetts, by and through Martha Coakley, Attorney General.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents OAM and OAIM shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder.

B. Respondents OAM and OAIM are censured.

C. Respondents shall pay a total of \$2,269,098, representing \$2,128,232 in disgorgement and \$140,866 in prejudgment interest. Payment of \$376,700 in disgorgement and \$23,935 in prejudgment interest shall be deemed satisfied by that portion of Respondents' payments made pursuant to a related action by the Commonwealth of Massachusetts, by and through Martha Coakley, Attorney General.

D. Respondents are liable, jointly and severally, for a civil money penalty in the amount of \$617,579. Respondents shall satisfy this obligation within 60 days of the entry of this Order. The penalty shall be paid to the Securities and Exchange Commission for remittance to the

United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment to the Securities and Exchange Commission must be made in one of the following ways:

- 1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- 2) 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
- 3) 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 Oppenheimer Asset Management, Inc. and Oppenheimer Alternative Investment Management, LLC 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 Bruce Karpati, Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281, or such other address as the Commission staff may provide.

E. Respondents acknowledge that the Commission is not imposing a civil penalty in excess of \$617,579 based upon their cooperation in this investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondents knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondents, petition the Commission to reopen this matter and seek an order directing that the Respondents pay an additional civil penalty. Respondents may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

F. Respondents shall comply with the undertakings enumerated in paragraphs 29-34 above.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Lynn M. Powalski
Deputy Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9391 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15238

In the Matter of	:	ORDER UNDER SECTION 27A(b) OF
	:	THE SECURITIES ACT OF 1933 AND
	:	SECTION 21E(b) OF THE SECURITIES
OPPENHEIMER ASSET	:	EXCHANGE ACT OF 1934, GRANTING
MANAGEMENT INC. and	:	WAIVERS OF THE DISQUALIFICATION
OPPENHEIMER	:	PROVISIONS OF SECTION 27A(b)(1)(A)(ii)
ALTERNATIVE	:	OF THE SECURITIES ACT OF 1933 AND
INVESTMENT	:	SECTION 21E(b)(1)(A)(ii) OF THE
MANAGEMENT, LLC,	:	SECURITIES EXCHANGE ACT OF 1934
	:	AS TO OPPENHEIMER ASSET
Respondents.	:	MANAGEMENT INC. AND
	:	OPPENHEIMER ALTERNATIVE
	:	INVESTMENT MANAGEMENT, LLC

I.

Oppenheimer Asset Management Inc. ("OAM") and Oppenheimer Alternative Investment Management, LLC ("OAIM") (collectively, "Respondents"), have submitted a letter, dated January 31, 2013, requesting a waiver of Section 27A(b)(1)(A)(ii) disqualification from the safe harbor provision of Section 27A(c) of the Securities Act of 1933, as amended ("Securities Act"), and the Section 21E(b)(1)(A)(ii) disqualification from the safe harbor provision of Section 21E(c) of the Securities Exchange Act of 1934, as amended ("Exchange Act") arising from Respondents' settlement of an administrative proceeding commenced by the Commission.

On March 11, 2013, pursuant to Respondents' Offer of Settlement, the Commission issued an Order Instituting Proceedings Pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 203(e) and (k) of the Investment Advisers Act of 1940 ("Advisers Act"), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against Respondents ("Order"). Under the Order, the Commission found that Respondents disseminated marketing materials to prospective investors and quarterly reports to existing investors that contained material misrepresentations and omissions concerning Respondents' valuation policies and the performance of Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"), a fund of private equity funds vehicle. The Commission found that Respondents stated in the marketing materials and quarterly reports to investors that OGR's asset values were "based on the underlying managers' estimated values" when that was not the case with respect to one of the assets in OGR's investment portfolio. The Commission also found that Respondents'

written policies and procedures were not reasonably designed to ensure that valuations provided to prospective and existing investors were presented in a manner consistent with written representations to investors and prospective investors. In the Order, the Commission ordered Respondents to (i) cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder, (ii) censured Respondents, (iii) required Respondents to pay a civil money penalty in the amount of \$617,579, (iv) required Respondents to pay a total of \$2,269,098 in disgorgement and pre-judgment interest to certain OGR investors, and (v) required that Respondents comply with certain undertakings, including retaining, at their own expense, the services of an independent consultant to conduct a review of Respondents' valuation policies and procedures.

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

Based upon the representations set forth in Respondents' request, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the issuance of the Commission's Order instituting proceedings 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 provision of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Oppenheimer Asset Management Inc. and Oppenheimer Alternative Investment Management, LLC and their present and future affiliates resulting from entry of the Order is granted.

By the Commission.

Elizabeth M. Murphy
Secretary


By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9392 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15238

In the Matter of

OPPENHEIMER ASSET
MANAGEMENT INC. and
OPPENHEIMER
ALTERNATIVE
INVESTMENT
MANAGEMENT, LLC,

Respondents.

ORDER UNDER RULE 602(e) OF THE
SECURITIES ACT OF 1933 GRANTING
A WAIVER OF THE RULE 602(c)(3)
DISQUALIFICATION PROVISION

I.

Oppenheimer Asset Management Inc. ("OAM") and Oppenheimer Alternative Investment Management, LLC ("OAIM") (collectively, "Respondents"), have submitted a letter, dated January 25, 2013, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from Respondents' settlement of an administrative proceeding commenced by the Commission.

On March 11, 2013, pursuant to Respondents' Offer of Settlement, the Commission issued an Order Instituting Proceedings Pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 203(e) and (k) of the Investment Advisers Act of 1940 ("Advisers Act"), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order against Respondents. Under the Order, the Commission found that Respondents disseminated marketing materials to prospective investors and quarterly reports to existing investors that contained material misrepresentations and omissions concerning Respondents' valuation policies and the performance of Oppenheimer Global Resource Private Equity Fund I, L.P. ("OGR"), a fund of private equity funds vehicle. The Commission found that Respondents stated in the marketing materials and quarterly reports to investors that OGR's asset values were "based on the underlying managers' estimated values" when that was not the case with respect to one of the assets in OGR's investment portfolio. The Commission also found that Respondents'

written policies and procedures were not reasonably designed to ensure that valuations provided to prospective and existing investors were presented in a manner consistent with written representations to investors and prospective investors. In the Order, the Commission (i) ordered Respondents to cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) and 17(a)(3) of the Securities Act and Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder, (ii) censured Respondents, (iii) required Respondents to pay a civil money penalty in the amount of \$617,579, (iv) required Respondents to pay a total of \$2,269,098 in disgorgement and pre-judgment interest to certain OGR investors, and (v) required that Respondents comply with certain undertakings, including retaining, at their own expense, the services of an independent consultant to conduct a review of Respondents' valuation policies and procedures.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if, among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to Section 203 (e) of the Investment Advisers Act of 1940. 17 C.F.R. § 230.602(c)(3). Rule 602(e) of the Securities Act of 1933 ("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).

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

Accordingly, **IT IS ORDERED**, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provision of Rule 603(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

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. 69111 / March 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15241

In the Matter of

KEVIN J. WILCOX,

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 against Kevin J. Wilcox ("Respondent" or "Wilcox") pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

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.

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III.

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

1. Wilcox was an employee of JCN, Inc., a corporation organized under the laws of Utah, from approximately May 2008 through July 2010, and served as Vice President of JCN, Inc. from approximately August 2009 through July 2010. Wilcox also served as Vice President of ProStar Capital, LLC from approximately July 2008 through July 2010. Wilcox is not and has never been registered with the Commission in any capacity.

2. On February 19, 2013, a final judgment was entered by consent against Wilcox, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933, Exchange Act Sections 10(b) and 15(a) and Exchange Act Rule 10b-5, and aiding and abetting violations of Exchange Act Sections 10(b) and 15(a) and Exchange Act Rule 10b-5, in the civil action entitled SEC v. Wilcox et al., Civil Action No. 2:11-cv-01219-DN, in the United States District Court for the District of Utah.

3. The Commission's Complaint alleged that Wilcox made materially false and misleading statements to investors in connection with a Ponzi scheme orchestrated by Joseph Nelson ("Nelson"). From approximately August 2005 through July 2010, Nelson operated a Ponzi scheme through JCN, Inc., JCN Capital, LLC, JCN International, LLC, and ProStar Capital, LLC. The Complaint alleged that Wilcox participated in and aided and abetted the scheme, and that Wilcox made materially false and misleading statements to investors including, among other things, that: (i) Nelson and his companies were engaged in the business of purchasing and selling merchant credit card portfolios; (ii) Nelson and his companies owned merchant credit card portfolios; (iii) Nelson and his companies earned monthly residual fees generated by the merchant credit card portfolios they owned; (iv) investor funds would be used to purchase additional portfolios; and (v) as part owners of the merchant credit card portfolios, investors would earn a portion of the monthly residual fees generated by the portfolios. The Complaint also alleged that Wilcox acted as an unregistered broker dealer and sold unregistered securities.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Wilcox be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a

broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Elizabeth M. Murphy
Secretary



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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 69116 / March 12, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15242

In the Matter of

**Adzone Research, Inc.,
Arctcraft III, Inc.,
Atlantic Security, Inc.,
Branded Media Corp.,
Capital Group One, Inc.,
Cyberworld Technologies, Inc., and
Cyfit Wellness Solutions, Inc.,**

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Adzone Research, Inc., Arctcraft III, Inc., Atlantic Security, Inc., Branded Media Corp., Capital Group One, Inc., Cyberworld Technologies, Inc., and Cyfit Wellness Solutions, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Adzone Research, Inc. (CIK No. 1102013) is a void Delaware corporation located in Calverton, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Adzone Research is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of over \$1.1

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million for the prior six months. As of March 4, 2013, the company's stock (symbol "ADZR") was traded on the over-the-counter markets.

2. Arcraft III, Inc. (CIK No. 1294611) is a void Delaware corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Arcraft III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended February 28, 2006, which reported a net loss of over \$1,000 for the prior nine months.

3. Atlantic Security, Inc. (CIK No. 1102743) is a dissolved Florida corporation located in Oxfordshire, England with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Atlantic Security is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended March 31, 2005, which reported a net loss of over \$420,000 for the prior year.

4. Branded Media Corp. (CIK No. 80751) is a revoked Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Branded Media is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10/A registration statement on September 21, 2006, which reported a net loss of over \$14 million for the nine-month period ended June 30, 2006. As of March 4, 2013, the company's stock (symbol "BMCP") was traded on the over-the-counter markets.

5. Capital Group One, Inc. (CIK No. 1107772) is a dissolved Florida corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Capital Group One is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended February 28, 2007, which reported a net loss of \$150 for the prior year.

6. Cyberworld Technologies, Inc. (CIK No. 1080135) 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). Cyberworld Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on April 12, 2001, which reported a net loss of over \$16,000 for the nine-month period ended November 30, 2000.

7. Cyfit Wellness Solutions, Inc. (CIK No. 1092642) is a permanently revoked Nevada corporation located in Hauppauge, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cyfit Wellness Solutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of over \$2.1 million for the prior nine months.

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

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

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 30424 / March 13, 2013

In the Matter of)

UBS AG)
c/o UBS Investment Bank)
677 Washington Boulevard)
Stamford, CT 06901)

UBS IB Co-Investment 2001 GP Limited)
c/o UBS Investment Bank)
677 Washington Boulevard)
Stamford, CT 06901)

UBS Financial Services Inc.)
1200 Harbor Boulevard)
Weehawken, NJ 07086)

UBS Alternative and Quantitative Investments LLC)
677 Washington Boulevard)
Stamford, CT 06901)

UBS Willow Management, L.L.C.)
UBS Eucalyptus Management, L.L.C.)
UBS Juniper Management, L.L.C.)
299 Park Ave., 29th Floor)
New York, NY 10171)

UBS Global Asset Management (Americas) Inc.)
One North Wacker Drive)
Chicago, IL 60606)

UBS Global Asset Management (US) Inc.)
1285 Avenue of the Americas, 12th Floor)
New York, NY 10019)

UBS Securities Japan Co., Ltd.)
 c/o UBS Investment Bank)
 677 Washington Boulevard)
 Stamford, CT 06901)
)
 (812-14105))
)

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

UBS AG, UBS IB Co-Investment 2001 GP Limited, UBS Financial Services Inc., UBS Alternative and Quantitative Investments LLC, UBS Willow Management, L.L.C., UBS Eucalyptus Management, L.L.C., UBS Juniper Management, L.L.C., UBS Global Asset Management (Americas) Inc., UBS Global Asset Management (US) Inc., and UBS Securities Japan Co., Ltd. (the "Settling Firm") (collectively, "Applicants") filed an application on December 19, 2012, and amended the application on January 31, 2013, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting Applicants and any other company of which the Settling Firm is or hereafter becomes an affiliated person (together with Applicants, "Covered Persons") from section 9(a) of the Act with respect to a guilty plea entered on December 19, 2012, by the Settling Firm in the United States District Court for the District of Connecticut.

On December 19, 2012, the Commission issued a temporary conditional order exempting Applicants from section 9(a) of the Act with respect to the above-referenced guilty plea from December 19, 2012 until the Commission took final action on an application for a permanent order or, if earlier, February 15, 2013 (Investment Company Act Release No. 30311). On February 15, 2013, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 30383) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

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

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations contained in the application filed by UBS AG et al. (File No. 812-14105), as amended, that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of a guilty plea, described in the application, entered by the United States District Court for the District of Connecticut on December 19, 2012.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69137 / March 14, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15244

In the Matter of

CACHE D. DECKER,

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 against Cache D. Decker ("Respondent" or "Cache Decker") pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

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.

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III.

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

1. Cache Decker was employed by Zufelt Inc. ("ZI"), a corporation organized under the laws of Utah, from approximately June 2005 through June 2006. Zufelt designated Cache Decker as a Project Manager and the Vice President of Investor Relations for the Eastern Regional Office of ZI. Cache Decker is not and has never been registered with the Commission in any capacity.

2. On March 6, 2013, a final judgment was entered by consent against Cache Decker, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a)(2) and (a)(3) of the Securities Act of 1933, Exchange Act Section 15(a), and aiding and abetting violations of Exchange Act Section 15(a), in the civil action entitled SEC v. Zufelt et al., Civil Action No. 2:10-cv-00574, in the United States District Court for the District of Utah.

3. The Commission's complaint alleged that Cache Decker solicited investors through materially false and misleading statements in connection with two distinct but related Ponzi schemes orchestrated by Anthony Zufelt ("Zufelt"). From June 2005 through June 2006, Zufelt operated a Ponzi scheme through ZI, and ran a second fraudulent scheme through Silver Leaf Investments, Inc. ("SLI") between July 2006 and December 2006. The complaint alleged that, in connection with these schemes, Cache Decker made materially false and misleading statements to investors about, among other things, the profitability of ZI and SLI, the ability of ZI and SLI to repay investors, the use of investor funds, and the security of the investments. The complaint also alleged that Cache Decker acted as an unregistered broker dealer and sold unregistered ZI and SLI securities.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Cache Decker be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

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


By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69150 / March 15, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14950

In the Matter of

Centaur Management Co. LLC

Respondent.

ORDER APPOINTING FUND
ADMINISTRATOR AND APPROVING
FUND ADMINISTRATOR BOND

On July 17, 2012, the Commission issued an 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") against Centaur Management Co. LLC ("Centaur"). Advisers Act Rel. No. 3432 (July 17, 2012). The Order found that Centaur willfully violated Section 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder when it directed its client, Argent Classic Convertible Arbitrage Fund L.P. ("Argent Classic"), to provide it with approximately \$15 million in interest free loans, and failed to adequately disclose the loan practice to Argent Classic's investors. The Commission simultaneously accepted Centaur's offer of settlement, whereby Centaur agreed to pay disgorgement of \$172,438, prejudgment interest of \$41,884, and a civil money penalty of \$150,000 for a total payment of \$364,322 ("Fair Fund"). The Order created a Fair Fund for a distribution to harmed investors pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended.

The Division of Enforcement ("Division") now seeks approval of the appointment of Gilardi and Company LLC ("Gilardi") as the fund administrator and the approval of a fund administrator bond in the amount of \$364,322. Division staff formed a committee to

recommend an appointment of a fund administrator and solicited proposals from candidates. The committee reviewed and evaluated the candidates' proposals and determined that Gilardi'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 Gilardi is appointed as the fund administrator, and Gilardi shall obtain a bond in the manner prescribed in Rule 1105(c) in the approved amount of \$364,322.

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. 69165 / March 18, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15247

In the Matter of

BRUCE H. HAGLUND, ESQ.

Respondent.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE PROCEEDINGS AND
IMPOSING TEMPORARY SUSPENSION
PURSUANT TO RULE 102(e)(3)(i) 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 Bruce H. Haglund ("Respondent" or "Haglund") pursuant to Rule 102(e)(3)(i)(A)¹ of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(3)(i)(A)].

II.

The Commission finds that:

1. On February 24, 2011, the Commission filed a complaint against Haglund and others in the United States District Court for the Central District of California, that alleged, among other things, that since at least April 2008, Francis E. Wilde ("Wilde"), through Matrix Holdings LLC ("Matrix"), orchestrated two fraudulent investment schemes. By falsely promising outsized returns, Wilde and Matrix raised more than \$11 million from investors through "prime bank" or "high-yield" investment programs. At Wilde's direction, Haglund served as escrow attorney for a trust account used in one of the schemes, referred to as the Bank Guarantee Program. Between October 2009 and March 2010, Haglund accepted payments of over \$6.3 million from at least 24

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

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

investors into the trust account set up by him for this "program." Per Wilde's request, Haglund wired each investor's money out of the trust account soon after it arrived. While investors believed their money would remain in escrow until a bank guarantee was issued or obtained, most lost their entire investment. Haglund received \$472,500 from investor funds as "legal fees." Haglund knew that amounts representing a substantial portion of the investments flowing into the trust account were being used improperly. First, Haglund was aware that the \$472,500 he received purportedly as "legal fees," bore no rational relationship to the value of services he was rendering (ministerial acts of setting up an account and wiring funds from it). Second, he wired almost all of the remaining investor funds to Wilde, other scheme promoters, and "consultants" and "advisors." Third, Haglund admitted in his sworn testimony that he knowingly wired funds to old investors using new investor money in March 2010, a practice he conceded was typically called, in his words, "[a] Ponzi scheme." And, Haglund made these transfers even after having received a subpoena from the Commission in connection with the investigation that led to this enforcement action.

2. In the complaint, the Commission charged Haglund with aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, by his participation in this fraudulent investment scheme. The lawsuit sought a permanent injunction, disgorgement of unlawful proceeds plus pre-judgment, a financial penalty, and an order prohibiting Haglund from acting as an officer or director of any public company. *Securities and Exchange Commission v. Francis E. Wilde, et al.*, Civil Action Number SA CV11-00315 (DOC) (AJWx).

3. On December 18, 2012, the District Court entered a final judgment against Haglund, which permanently enjoins him from violating, "directly or indirectly," 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 Haglund, 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 Haglund be temporarily suspended from appearing or practicing before the Commission.

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

IT IS FURTHER ORDERED that Haglund 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 Haglund 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



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9393 / March 18, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 69167 / March 18, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3568 / March 18, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15248

In the Matter of

**Banco Comercial
Português, S.A.**

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS
PURSUANT TO SECTION 8A OF THE
SECURITIES ACT OF 1933, SECTIONS 15(b)
AND 21C OF THE SECURITIES EXCHANGE
ACT OF 1934, AND SECTIONS 203(e) AND
203(k) OF THE INVESTMENT ADVISERS
ACT OF 1940, MAKING FINDINGS, AND
IMPOSING REMEDIAL SANCTIONS AND A
CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Banco Comercial Português, S.A. ("BCP" or "Respondent").

II.

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

1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

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

Summary

1. Since at least 2006, BCP, a commercial bank headquartered in Portugal, maintained accounts for U.S. resident customers, primarily Portuguese immigrants or citizens residing in the U.S., that held products deemed to be securities under U.S. law (“securities”). Although BCP has never been registered with the Commission as a broker, dealer or investment adviser, BCP, in violation of the broker-dealer and investment adviser registration provisions, bought and sold securities for U.S. resident customers and provided some of those customers with investment advice. Such transactions in the BCP accounts were not registered and did not qualify for any exemption from registration. By offering and selling securities in the U.S. without registration and without an exemption from registration, and by acting as a broker-dealer and investment adviser to U.S. residents without registering with the Commission, BCP willfully² violated Sections 5(a) and 5(c) of the Securities Act, Section 15(a) of the Exchange Act, and Section 203(a) of the Advisers Act.

Respondent

2. BCP is a Portuguese bank, headquartered in Oporto, Portugal. BCP and its subsidiaries have more than 1,700 branches located throughout the world and over 5 million customers. BCP has never been registered with the Commission as a broker, dealer or investment adviser. BCP shares trade on the NYSE Euronext-Lisbon Exchange.

Facts

3. BCP’s Private Bank is a commercial unit within BCP that is in charge of the banking relationship with private banking customers. During the relevant period, the general benchmark (although capable of adjustments/exceptions for particular cases) amount of assets required for one to become a Private Bank customer was €500,000.

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

² A willful violation of the securities laws means merely “that the person charged with the duty knows what he is doing.” *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor “also be aware that he is violating one of the Rules or Acts.” *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

4. During the relevant period, BCP provided brokerage and/or advisory services to customers residing in the U.S., including seventy-one BCP Private Bank customers.

5. The BCP Private Bank accounts in question were opened in Portugal and serviced by BCP private bankers based in Portugal. The private bankers serviced these accounts in several ways: telephone, facsimile, mail, e-mail and in-person visits, in both Portugal and the U.S. Some of these communications related to securities transactions in the customers' BCP accounts.

6. None of the private bankers was registered as an investment adviser representative or a representative of a broker-dealer, or associated with a Commission-registered investment adviser or broker-dealer. These individuals were not residents of the U.S. and did not hold any U.S. securities licenses.

7. BCP offered and sold a variety of securities to the U.S. resident Private Bank customers, including:

- (a) *Valores Mobiliários*, which include stock shares, bonds and investment funds;
- (b) Unit-Linked *Planos Poupança Reforma*, which are tax advantaged retirement products linked to the performance of a specified index or basket of securities; and
- (c) Structured Products.

8. Some of these securities were held in *Gestao Discrecional de Carteiras* ("GDCs"). GDCs are actively managed portfolios over which BCP had discretionary authority to purchase securities, based on the investment profile agreed upon between BCP and the GDC account holder.

9. There were no registration statements filed or in effect for the securities BCP bought and sold for U.S. resident customers.

10. BCP is a large and sophisticated financial institution and it knew or should have known of its need to comply with the federal securities laws when providing brokerage and advisory services to U.S. residents.

11. BCP charged U.S. resident customers various commissions and fees on their accounts (including management fees on GDC accounts) and for securities transactions. The commissions and fees charged depended on the type of account (i.e., brokerage or advisory), security, and transaction. From 2006 through 2010, Respondent derived gross income totaling approximately €1,097,403 in connection with securities transactions by U.S. resident Private Bank customers.

Violations

12. As a result of the conduct described above, BCP willfully violated Sections 5(a) and 5(c) of the Securities Act, which make it unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

13. As a result of the conduct described above, BCP willfully violated Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security, unless such broker or dealer is registered or associated with a registered broker or dealer.

14. As a result of the conduct described above, BCP willfully violated Section 203(a) of the Advisers Act, which makes it unlawful for any investment adviser, unless registered, to make use of the mails or any means or instrumentality of interstate commerce in connection with its business as an investment adviser.

BCP's Remedial Efforts

15. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and the cooperation afforded the Commission staff.

Undertakings

16. Respondent agrees to comply with the following undertakings:

- (a) By no later than ninety (90) days from the entry of this Order (the "Termination Date"), Respondent will terminate all business of providing broker-dealer and investment advisory services to any U.S. person, as that term is used in Exchange Act Rule 15a-6 [17 C.F.R. §240.15a-6], which require registration under Section 15(a) of the Exchange Act or Section 203(a) of the Advisers Act, unless those services are conducted by a BCP entity that is appropriately registered with the Commission as a broker or dealer or investment adviser or qualifies for an exception or exemption from registration (a "Registered/Exempted Entity");

- (b) By no later than sixty (60) days from the entry of this Order, for each U.S. person resident in the U.S. with an account with Respondent holding securities that is not an account with a Registered/Exempted Entity (each, a "U.S. Customer"), Respondent will send a letter, in a form not unacceptable to the Commission staff, (i) informing the U.S. Customer that Respondent is terminating the business described in paragraph 16(a) of this Order and (ii) providing the U.S. Customer with instructions regarding the termination of the business described in paragraph 16(a) of this Order;
- (c) In effecting the termination described in paragraph 16(a) of this Order, Respondent will engage in only those activities that are necessary to accomplish the objectives of the termination, including, but not limited to, liquidating transactions, communications with U.S. persons who are located in the U.S., or using U.S. jurisdictional means in a manner that is limited solely to the termination of the account relationship, provided, however, that (i) Respondent will not accept any securities from U.S. Customers, except: (1) in connection with the repurchase of securities issued by Respondent or its subsidiaries in connection with the termination of the business described in paragraph 16(a) of this Order, or (2) as payment in kind of outstanding indebtedness to Respondent; (ii) Respondent will not enter into any new positions in securities on behalf of a U.S. Customer, except a position that results from a dividend reinvestment occurring pursuant to a pre-existing contractual arrangement; and (iii) Respondent may not seek or receive any transaction-based or other compensation in connection with any securities transactions or investment advisory activities undertaken in connection with the termination of the business described in paragraph 16(a) of this Order.

16.1 Notwithstanding paragraph 16 herein, for the following special categories of accounts and products (except to the extent that broker-dealer or investment advisory services for such accounts and products are conducted by a Registered/Exempted Entity), Respondent agrees to comply with the undertakings set forth in this paragraph 16.1.

- (a) With respect to any account with Respondent holding securities that, based on the account documentation on file with Respondent, is last known to have been held by a U.S. person and for which Respondent is unable to establish and/or maintain contact with the account holder(s) prior to the Termination Date (unless it is subsequently determined that the account holder is not or is no longer a U.S. person):
 - (i) At such point as contact with the account holder(s) is re-established, Respondent shall promptly proceed, in accordance with the undertakings set forth in paragraphs 16.2(a) and (b), to

terminate the business of providing such account holder broker-dealer or investment advisory services which require registration under Section 15(a) of the Exchange Act or Section 203(a) of the Advisers Act unless those services are conducted by a Registered/Exempted Entity; and

- (ii) Respondent may not seek or receive any transaction-based or other compensation in connection with any securities transactions or investment advisory activities undertaken in connection with such account.
- (b) With respect to any account with Respondent holding securities that is held by a U.S. person and for which Respondent has determined that such account holder may be treated as having received a notice of termination pursuant to paragraph 16(b), but for which Respondent has been unable to obtain transfer or closing instructions:
- (i) Respondent will continue to comply with the undertakings in paragraph 16(e), except to the extent that Respondent is unable to maintain contact with the account holder(s), in which case such account will be treated in accordance with the undertakings set forth in paragraph 16.1(a)(i)-(ii).
- (c) With respect to any account with Respondent holding securities that is held by a U.S. person and that contains an interest in any private equity product, real estate investment fund, or other illiquid product(s) (i.e., a product subject to transfer and/or termination restrictions) unless those services are conducted by a Registered/Exempted Entity:
- (i) For any such account that, prior to the Termination Date, is known by Respondent to be held by a U.S. person:
 - (aa) Respondent shall not provide any securities services in connection with such account, except to the extent required to service the relevant illiquid product(s) (e.g., conduct capital calls);
 - (bb) Respondent may not seek or receive any transaction-based or other compensation in connection with any securities transactions or investment advisory activities undertaken in connection with such account or the portion of any management, administrative or other fee paid by the investment fund that would be allocable to such interests held

by a U.S. person (except to the extent such fee is to be paid to a third party unaffiliated with Respondent); and

(cc) Upon maturity of the relevant private equity, real estate fund or other illiquid product(s), or as soon as any applicable transfer and/or termination restrictions are no longer in force, Respondent shall promptly provide notice to the U.S. person account holder that it must cease the business of providing such account holder broker-dealer or investment advisory services which require registration under Section 15(a) of the Exchange Act or Section 203(a) of the Advisers Act unless those services are conducted by a Registered/Exempted Entity.

(ii) For any such account other than as described in paragraph 16.1(c)(i):

(aa) Respondent shall provide securities services in connection with such account only in accordance with Section 15(a) of the Exchange Act and Section 203(a) of the Advisers Act or such securities services required to service the relevant illiquid investments (e.g., conduct capital calls).

16.2. With respect to any account with Respondent holding securities which is held by an individual account holder who, after the Termination Date, becomes (or is determined to be) a U.S. person, other than accounts or services described in paragraph 16.1(c) herein: Upon Respondent obtaining knowledge that such account holder is or has become a U.S. person (e.g., by the account holder submitting new documentation indicating a relevant change in U.S. residency), Respondent agrees, in accordance with the following undertakings, to no longer provide such account holder with broker-dealer or investment advisory services which require registration under Section 15(a) of the Exchange Act or Section 203(a) of the Advisers Act unless those activities are necessary to accomplish the objectives of the termination (as described in paragraph 16(c)) or those services are conducted by a Registered/Exempted Entity:

- (a) Within 45 days, Respondent will inform the account holder that Respondent will no longer be able to provide such services unless those services are conducted by a Registered/Exempted Entity; and
- (b) Respondent will use U.S. jurisdictional means for communication about such services (other than those conducted by a Registered/Exempted Entity) in a manner that is limited to facilitating the termination of such services or the transfer of the account to a Registered/Exempted Entity.

17. Respondent will certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Gerald A. Gross, Assistant Director, 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's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent BCP cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act, Section 15(a) of the Exchange Act, and Section 203(a) of the Advisers Act.

B. Respondent BCP is censured.

C. Respondent BCP shall, within 7 days of the entry of this Order, pay disgorgement of \$1,352,220, prejudgment interest of \$289,838, 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 31 USC § 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;³
- (2) 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
- (3) 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:

³ The minimum threshold for transmission of payment electronically is \$1,000,000. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

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 BCP as the 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, New York, NY 10281.

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

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. 3570 / March 19, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15250

In the Matter of

BERTON M. HOCHFELD,

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 Berton M. Hochfeld ("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.

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III.

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

1. Hochfeld, age 66, is a resident of Stamford, Connecticut. Hochfeld is the sole shareholder and manager of Hochfeld Capital Management, L.L.C. ("HCM"), which is the general partner of the Heppelwhite Fund, LP ("Heppelwhite"), a hedge fund. Hochfeld also is the Managing Director of the Hochfeld Independent Research Group, Inc., an equity research company. In 2005, the Commission filed a settled fraud case against Hochfeld and HCM. See SEC v. Berton M. Hochfeld and Hochfeld Capital Management, LLC, Case No. 05-CIV-9921 (S.D.N.Y. 2005). A final judgment, which the court entered on January 5, 2006, included a fraud injunction against Hochfeld and HCM and ordered disgorgement and a civil penalty. In a follow-on administrative proceeding pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act, the Commission entered an Order barring Hochfeld from associating with any broker, dealer, or investment adviser, with a right to reapply after four years. See In the Matter of Berton M. Hochfeld, File No. 3-12154 (January 20, 2006). Hochfeld has not applied for reinstatement.

2. On November 21, 2012, a judgment was entered by consent against Hochfeld, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 203, 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. Berton M. Hochfeld, et al., Civil Action Number 12-CV-8202, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that between April 2011 and October 2012, Hochfeld misappropriated from Heppelwhite approximately \$1.3 million, which he used, in part, to make payments on a collection of valuable antiques he purchased. The complaint also alleged that Hochfeld materially misstated the value of each investor's assets in Heppelwhite in periodic statements that were sent to each investor, and also failed to inform investors and potential investors that Hochfeld remained subject to a January 2006 Commission Order barring him from association with any broker, dealer or investment adviser.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Hochfeld be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

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

By the Commission.

Elizabeth M. Murphy
Secretary


By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
not participating

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934

Release No. 69177 / March 19, 2013

Admin. Proc. File No. 3-14844

In the Matter of the Application of

ERIC J. WEISS
c/o Wesley J. Paul, Esq.
Paul Law Group, LLP
902 Broadway, 6th Floor
New York, New York 10010

For Review of Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DENIAL OF
MEMBERSHIP CONTINUANCE APPLICATION

Registered securities association denied member firm's application to retain its membership if it employed an individual who was statutorily disqualified because of his consent to an order barring him by a state banking authority. *Held*, the review proceeding is *dismissed*.

APPEARANCES:

Wesley J. Paul, of the Paul Law Group, LLP, for *Eric J. Weiss*.

Alan Lawhead and *Andrew J. Love*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: April 11, 2012

Last brief received: August 31, 2012

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I.

Eric J. Weiss was a general securities representative and general securities principal associated with American Capital Partners, LLC ("ACP"), a FINRA member firm. While associated with ACP, Weiss consented to a seven-year bar by the Connecticut Department of Banking from transacting business in or from Connecticut as a broker-dealer, agent, investment adviser, investment adviser agent, or agent of issuer.¹ As a result of that consent order, Weiss became statutorily disqualified,² losing his ability to associate with ACP, or any other FINRA member firm, without FINRA's consent.³

On July 28, 2009, ACP sought such consent, filing an MC-400 Membership Continuance Application with FINRA's Department of Registration and Disclosure in which it asked that Weiss be permitted to continue his employment with the firm as a general securities representative.⁴ After holding a hearing, FINRA denied ACP's application, finding that allowing Weiss to continue to associate with the firm was "not in the public interest, and would create an unreasonable risk of harm to the market or investors."⁵ This appeal by Weiss followed.⁶

¹ *Eric John Weiss*, No. CO-09-7664-S, 2009 CT Banking Comr. LEXIS 131 (Conn. Dep't of Banking June 9, 2009).

² Exchange Act § 3(a)(39)(F) provides that "[a] person is subject to a 'statutory disqualification' with respect to membership or participation in, or association with a member of, a self-regulatory organization if such person . . . has committed . . . any act, or is subject to an order or finding, enumerated in subparagraph (D), (E), (H) or (G) of paragraph (4) of section 15(b) of this title . . ." 15 U.S.C. § 78c(a)(39)(F). Section 15(b)(4)(H), in turn, involves persons who are "subject to any final order of a State securities commission (or any agency or officer performing like functions) [or] State Authority that supervises or examines banks . . . that—(i) bars such person from association with an entity regulated by such commission, authority, agency, or officer, or from engaging in the business of securities, insurance, banking, savings association activities, or credit union activities; or (ii) constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct." 15 U.S.C. § 78o(b)(4)(H).

³ FINRA's By-Laws state that no person shall be associated with a member, continue to be associated with a member, or transfer association to another member if such person is or becomes subject to disqualification. FINRA By-Laws, Art. III, § 3.

⁴ FINRA's By-Laws allow a member firm to request relief from ineligibility to associate with a disqualified person on behalf of the prospective associated person. *See* FINRA By-Laws, Art. III, § 3(d).

⁵ NAC Decision, dated Mar. 16, 2012, at 12.

⁶ Under the Exchange Act, "any person aggrieved" by FINRA's denial of a membership application may file an application for Commission review. *See* 15 U.S.C. § 78s(d); *see also* 17 C.F.R. § 201.420 (providing that any person aggrieved by a FINRA denial of membership may file an application for review); *cf., e.g., Leslie A. Arouh*, Securities Exchange Act Release No. 62898, 2010 SEC LEXIS 2977, at *1 (Sept. 13, 2010) (considering appeal by an associated person of FINRA's denial of a firm's membership continuation application).

II.

A. Weiss became statutorily disqualified after consenting to a seven-year bar issued by a state banking authority.

Weiss entered the securities industry in 1992 and was associated with nine other firms as a registered representative before joining ACP in May 2005. Sometime after joining ACP, Weiss opened an account for Rita Tuohy, whose brother (an existing client of Weiss's) had referred her to Weiss. In opening Tuohy's account, Weiss used the New Jersey business address of Tuohy's brother. Weiss testified, however, that approximately three months after Tuohy opened her account, he learned that she lived in Connecticut, not New Jersey. Connecticut law generally prohibits individuals from transacting certain securities-related business in the state unless registered as an agent.⁷ Weiss, however, did not register in Connecticut until after learning that Tuohy lived there.⁸

Approximately fifteen months after opening Tuohy's account, Weiss discussed a prospective investment with her involving a company called InPhonic, Inc. Weiss testified that, at the time of his discussion with Tuohy, he did not know if she had any other assets or accounts and did not know the amount or components of Tuohy's liquid net worth. Weiss knew, however, that Tuohy "didn't have a lot" and was "not rich."⁹ Despite this, he advised Tuohy that she should invest the entire amount in her account (approximately \$9,000) in InPhonic's stock. Weiss testified that he based his recommendation on research reports that the company was about to receive a "significant cash injection at the time from Goldman Sachs."¹⁰

In his reply brief, Weiss contends, for the first time, that he based his recommendation to invest in InPhonic on a research report produced by ACP.¹¹ Weiss contends that he did not testify about the ACP research report during the hearing, below, because ACP's president, Edward Cahill, "demanded that I not say where I got the recommendation."¹² He alleges that Cahill "personally threatened me with my job by stating that ACP would withdraw their [*sic*] MC-400 application and I 'would be out of the industry' if I told the NAC committee that I received the recommendation from an ACP report."¹³ The record is not clear, however, about why ACP would want Weiss not to discuss the ACP report, nor does Weiss provide any evidence for his allegations other than his own declaration. Whatever the basis for Weiss's recommendation, Tuohy agreed to invest the entire amount in her account in InPhonic's stock, which Weiss acknowledges represented an "increased risk" to Tuohy compared to her previous

⁷ See CONN. GEN. STAT. § 36b-6(a) (prohibiting an individual from transacting certain business in the state as an agent of a broker-dealer unless the individual is registered in Connecticut).

⁸ Transcript of NAC Hearing ("Tr.") at 26.

⁹ *Id.* at 29, 34.

¹⁰ *Id.* at 24.

¹¹ As explained in notes 75-76, *infra*, and accompanying text, that report does not establish that his recommendation to Tuohy was suitable.

¹² Eric J. Weiss Decl., dated Aug. 21, 2012, ¶ 11.

¹³ *Id.*

investments.¹⁴ InPhonic soon filed for bankruptcy, which caused Tuohy to lose almost all of her investment.

On June 9, 2009, Weiss entered into a consent order with the Connecticut Department of Banking. In that order, Connecticut alleged that Weiss had (i) conducted business in an unregistered capacity; (ii) engaged in a dishonest or unethical practice by falsely reporting on firm records that the securities transactions he effected for a Connecticut customer, while he was unregistered, were associated with a New Jersey address; and (iii) made unsuitable recommendations to a Connecticut customer. While neither admitting nor denying Connecticut's allegations, Weiss consented to Connecticut's revoking his registration as an agent in the state and barring him for seven years from transacting business in or from Connecticut as a broker-dealer, agent, investment adviser, investment adviser agent, or agent of issuer. Weiss further consented, among other things, to being precluded from supervising any broker-dealer agents with respect to securities business transacted in or from Connecticut. The consent order provided that Weiss could reapply for registration after five years.

B. ACP filed a membership continuation application.

On July 28, 2009, ACP filed an MC-400 Membership Continuance Application with FINRA's Department of Registration and Disclosure in which the firm asked that it be allowed to continue as a FINRA member if Weiss remained associated with it as a general securities representative. In its application, the firm stated that it "does not deem it necessary to place Mr. Weiss under heightened supervision. The State of Connecticut disclosure is the only item on Mr. Weiss's CRD within the past 4 years."¹⁵ ACP's general counsel explained at the hearing that Weiss's statutory disqualification had not triggered heightened supervision under the firm's protocols because ACP's procedures triggered such supervision only under "certain thresholds, none of which were met."¹⁶ ACP's president added that "we looked at the allegations," but the "conclusion of the compliance staff was that [heightened supervision] wasn't necessary at that time."¹⁷ Approximately two years after filing the application, however, ACP placed Weiss under heightened supervision after FINRA's Department of Member Regulation told it such supervision was "critical."¹⁸

¹⁴ Appellant's Br. in Sup. of Pet. for Review at 2.

¹⁵ Certified Record ("R.") at 140.

¹⁶ Tr. at 18. The example ACP's counsel gave of what would trigger heightened scrutiny was when a representative had acquired three or more written complaints.

¹⁷ *Id.* at 19.

¹⁸ *Id.* at 50.

C. FINRA denied ACP's membership continuance application.

On October 6, 2011, a two-person subcommittee of FINRA's Statutory Disqualification Committee held a hearing to consider ACP's application.¹⁹ At the panel's request, the firm submitted a revised plan of heightened supervision for Weiss after the hearing. In it, the firm appointed Guy Gorham, an operations manager, as Weiss's primary on-site supervisor, and Eric Drewes as Weiss's backup supervisor. According to the plan, Gorham's supervisory duties required him to "review and initial all of Mr. Weiss' trade and check blotters weekly" and to review "[e]very document associated with Mr. Weiss' transactions" no later than the next business day.²⁰ Though Gorham would be compensated for his additional responsibilities, such compensation would not be based on Weiss's production. The plan also stipulated that Weiss would not act in a supervisory capacity, would allow his Series 24 supervisory registration to lapse,²¹ and would not maintain any discretionary accounts.²²

On March 16, 2012, the NAC denied ACP's membership continuance application. The NAC found that allowing Weiss to continue to associate with ACP was "not in the public interest, and would create an unreasonable risk of harm to the market or investors."²³ In particular, it expressed concern that the Connecticut order was recent and serious; and ACP's supervision, both generally and in terms of the proposed plan of heightened supervision, was "troubling."²⁴ The NAC also found that Weiss had eleven customer complaints filed against him before becoming associated with ACP:

- May 2005—a customer alleged that Weiss used his margin account without authorization. This customer claimed \$7,035 in damages.²⁵

¹⁹ See FINRA Rule 9524(a)(1) (stating that, when an applicant requests a hearing, "the National Adjudicatory Council or the Review Subcommittee shall appoint a Hearing Panel composed of two or more members, who . . . shall conduct a hearing and recommend a decision on the request for relief").

²⁰ R. at 490.

²¹ A Series 24 supervisory license authorizes a general securities principal to "supervise all areas of the member's investment banking and securities business, such as underwriting, trading and market making, advertising, or overall compliance with financial responsibilities." *Qualifications FAQ - Examinations, FINRA-Compliance-Registration*, available at <http://www.finra.org/Industry/Compliance/Registration/QualificationsExams/RegisteredReps/Qualifications/p011087> (last visited Mar. 14, 2013).

²² NAC Decision at 1 n.1. Neither the panel's nor the full Statutory Disqualification Committee's recommendations is part of the record. See FINRA Manual, available at http://finra.complinet.com/en/display/display.html?rbid=2403&element_id=4598 (last visited Mar. 14, 2013) (By-Laws of FINRA Regulation, Inc., Art. V, § 5.1 (Authority)); FINRA website, available at <http://www.finra.org/Industry/Enforcement/SanctionGuidelines/p016371> (last visited Mar. 14, 2013) (March 2006 Revisions to the NASD Sanction Guidelines—FAQ).

²³ NAC Decision at 12.

²⁴ *Id.* The NAC's decision notes, for example, that ACP's proposed back-up supervisor (Eric Drewes) had been the subject of five customer complaints and a state regulatory action, including allegations of failures to supervise, between 1994 and 2008. Weiss does not dispute this.

²⁵ According to the CRD, this matter was still pending as of March 14, 2013. Report, Eric John Weiss, CRD No. 224852, at *22–23 (generated Mar. 14, 2013), available at <http://www.finra.org/brokercheck>.

- June 2004—a customer alleged a breach of contract and trust claim, asserting \$49,294 in damages. Weiss's firm at the time settled the claim for \$12,500, to which Weiss personally contributed \$7,800.
- December 1999—a customer alleged that Weiss recommended unsuitable securities, claiming \$250,000 in damages. Weiss personally paid the customer \$5,000 to settle the matter.
- September 1999—a customer alleged that Weiss breached his fiduciary duties, breached a contract, made misrepresentations, and failed to disclose material facts. The customer claimed \$214,610 in damages. Weiss personally paid the customer \$2,500 to settle the matter.
- March 1998—two customers alleged that Weiss recommended unsuitable securities, made misrepresentations, and churned their account, claiming \$96,000 in damages. Weiss personally paid the customers \$7,000 to settle the matter.
- October 1997—two customers alleged that Weiss made misrepresentations, claiming \$79,000 in damages. They withdrew their complaint in December 1997.
- August 1997—a customer alleged that Weiss recommended unsuitable securities, breached his fiduciary duties, engaged in fraud, and made misrepresentations, claiming \$45,000 in damages. Weiss personally paid the customer \$1,000 to settle the matter.
- July 1997—a customer alleged that Weiss failed to supervise, recommended unsuitable securities, and breached his fiduciary duties, claiming \$96,000 in damages. Weiss personally paid the customer \$6,666 to settle the matter.
- July 1997—a customer alleged that Weiss failed to supervise and recommended unsuitable investments, claiming \$40,000 in damages. The customer withdrew the complaint in March 1998, after which Weiss personally paid \$1,500 to the customer's attorney to cover the fees.
- April 1997—a customer alleged that Weiss made misrepresentations and omissions, engaged in unauthorized trading, and churned the customer's account, claiming \$160,000 in damages. Weiss personally paid the customer \$9,000 to settle the matter.
- March 1996—a customer alleged that Weiss made misrepresentations, recommended unsuitable securities, failed to execute a trade, and failed to supervise, claiming \$5,740 in damages. Weiss's firm at the time paid \$2,000 to settle the matter. Weiss did not personally contribute to the settlement.

The NAC found that these complaints "raise serious concerns regarding Weiss' dealings with customers and compliance with securities laws and regulations."²⁶

The NAC observed that, "[w]ere we otherwise inclined to approve this Application, which we are not, we would have given the Firm an opportunity to submit a . . . revised plan that cures [the deficiencies in ACP's proposed supervisory plan]."²⁷ The NAC concluded here, however, that Weiss's disqualifying misconduct and the numerous customer complaints "alone warrant denial of this Application."²⁸ This appeal by Weiss followed.

III.

Section 19(f) of the Exchange Act sets forth the criteria that govern our review of FINRA's denial of ACP's application.²⁹ We must dismiss Weiss's appeal if we find that (i) the specific grounds on which FINRA based its action exist in fact, (ii) the denial was in accordance with FINRA rules, and (iii) those rules were applied in a manner consistent with the purposes of the Exchange Act.³⁰ For the reasons below, we find that FINRA's denial met this criteria, and we accordingly dismiss Weiss's appeal.³¹

A. The grounds for FINRA's decision exist in fact.

We first find, and Weiss does not dispute, that the grounds on which FINRA based its decision exist in fact. The record establishes that Weiss consented to a seven-year bar by the Connecticut Department of Banking and that the Connecticut order is a statutorily disqualifying event. Although Weiss claims, for the first time on appeal, that he was "manipulated and coerced by ACP, into accepting the Connecticut Order,"³² we have long "held that principles of collateral estoppel dictate that a respondent must not be permitted to retry the merits of a proceeding that results in conviction or an injunction."³³ Moreover, Weiss admits to the relevant events that led

²⁶ NAC Decision at 11.

²⁷ *Id.*

²⁸ *Id.* at 12.

²⁹ 15 U.S.C. § 78s(f).

³⁰ *Id.*; accord *Arouh*, 2010 SEC LEXIS 2977, at *25 (stating standard of review under Exchange Act § 19(f)); *Wm. J. Haberman*, Exchange Act Release No. 40673, 53 SEC 1024, 1998 SEC LEXIS 2466, at *6 (Nov. 12, 1998) (same), *aff'd per curiam*, 205 F.3d 1345 (8th Cir. 2000) (table).

³¹ Exchange Act § 19(f) also requires us to set aside FINRA's action if we find that the action imposed an undue burden on competition. 15 U.S.C. § 78s(f). Weiss does not claim, and the record does not support a finding, that FINRA's actions imposed such a burden.

³² Appellant's Reply Brief at 4.

³³ *BFG Sec., Inc.*, Exchange Act Release No. 44627, 55 SEC 276, 2001 SEC LEXIS 1521, at *5 n.5 (July 31, 2001) (dismissing petition for review of denial of membership application by FINRA's predecessor, NASD); see also *Gershon Tannenbaum*, Exchange Act Release No. 31080, 50 SEC 1138, 1992 SEC LEXIS 1998, at *6 (Aug. 24, 1992) (stating that "[i]t is always true in a case of this sort that a respondent cannot mount a collateral attack on findings that have previously been made against him"); *Boleslaw Wolny*, Exchange Act Release No. 40013, 53 SEC

to that order. For instance, Weiss testified that he recommended that Tuohy invest her entire account in a single company's stock, while admitting that he knew she did not have many assets. Weiss also concedes that he transacted business in an unregistered capacity and incorrectly reported that transactions he effected were associated with a non-Connecticut address (although Weiss claims that, once he learned that the customer resided in Connecticut, he immediately registered in the state).

The record also establishes that, from May 1992 through May 2005, eleven customer complaints were filed against Weiss, many of which involved the same allegation of making unsuitable recommendations as Connecticut alleged in the consent order.³⁴ We also find that, as ACP's general counsel conceded at the hearing, the firm did not implement a heightened supervisory plan for Weiss until approximately two years after his disqualifying event, and even then only after FINRA staff told ACP that implementing such a plan was critical. We further find that, among other deficiencies, ACP's supervisory plan proposed a backup supervisor who had been subject to various customer complaints alleging failures to supervise, the most recent of which was in 2008.

B. FINRA's denial of ACP's membership continuation application was in accordance with FINRA's rules.

We next turn to whether FINRA denied ACP's membership application in accordance with FINRA's rules. We find that it did so by, among other things, convening a hearing panel,³⁵ conducting an eligibility hearing at which FINRA afforded Weiss an opportunity to be heard and to submit evidence, and allowing ACP to submit a revised supervisory plan after the hearing.³⁶

Weiss does not dispute that FINRA conducted the application process in accordance with its rules. Weiss instead claims that FINRA's determination was prejudiced by his sponsoring firm, ACP, which Weiss contends was subject to "ongoing FINRA reviews and possible sanctions and could arguably [have] been motivated to lay blame on Mr. Weiss in an attempt to deflect additional potential[] liability."³⁷ Weiss claims that, because of ACP's supposed motivation to blame him, the firm did not advise him about submitting evidence at the NAC

(...continued)

590, 1998 SEC LEXIS 996, at *5 (May 20, 1998) (holding that FINRA correctly adhered to its long-standing policy of prohibiting collateral attacks on underlying disqualifying events); *Jan Biesiadecki*, Exchange Act Release No. 39113, 53 SEC 182, 1997 SEC LEXIS 1975, at *8 (Sept. 22, 1997) (same).

³⁴ See *infra* notes 63–68 and accompanying text (discussing relevance and admissibility of Weiss's past customer complaints).

³⁵ See *supra* note 19 and accompanying text (citing FINRA rule regarding appointment of hearing panel).

³⁶ See FINRA By-Laws, Art. III, § 3(d) (stating that FINRA "may conduct such inquiry or investigation into the relevant facts and circumstances as it, in its discretion, considers necessary to its determination" of whether to approve a member's application for relief from ineligibility from membership); see also generally FINRA Rules 9520 to 9525 (setting forth parameters of eligibility proceedings).

³⁷ Appellant's Br. in Sup. of Pet. for Review at 14.

hearing "that would have mitigated the charges against him."³⁸ This, Weiss claims, ultimately "stripped [him] of his due process rights."³⁹

We find no evidence that ACP prevented Weiss from submitting evidence or otherwise deprived him of a fair hearing.⁴⁰ ACP initiated the MC-400 application process and supported its application throughout the subsequent FINRA proceedings by, among other things, submitting multiple plans of heightened supervision and having three ACP personnel appear and testify at the hearing, including the firm's president. Although ACP's supervisory plan had deficiencies (not the least of which was the firm's failure to implement such a plan for two years after learning of Weiss's statutory disqualification), we find no evidence supporting Weiss's vague and speculative allegations that ACP somehow prevented Weiss from presenting evidence on his own behalf.

Furthermore, if ACP had actually wanted to distance itself from Weiss, or otherwise deflect blame, it presumably could have avoided the unnecessary time, expense, and attention of the application process by simply withdrawing its application. And as Weiss himself concedes, he "is not proposing that he had ineffective counsel or that he be provided with the right to separate counsel in connection with an MC-400 application."⁴¹ Weiss's dissatisfaction with his sponsoring firm is not germane to the relevant inquiry for our review: whether *FINRA* reviewed and denied ACP's continuation application fairly and in accordance with its rules, which we find it did.

³⁸ *Id.* at 6.

³⁹ *Id.* at 7.

⁴⁰ Furthermore, SROs such as FINRA are not state actors and thus not subject to the Constitution's due process requirements. *See, e.g., Timothy P. Pedregon*, Exchange Act Release No. 61791, 2010 SEC LEXIS 1164, at *19 n.19 (Mar. 26, 2010) ("It is well established that the requirements of constitutional due process do not apply to FINRA because FINRA is not a state actor."); *see also D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc.*, 279 F.3d 155, 162 (2d Cir. 2002) (stating that it is a well-settled principle that FINRA's predecessor, NASD, is not a governmental actor); *Mark H. Love*, Exchange Act Release No. 49248, 57 SEC 315, 2004 SEC LEXIS 318, at *12 n.13 (Feb. 13, 2004) ("We have held that NASD proceedings are not state actions and thus not subject to constitutional requirements."); *William J. Gallagher*, Exchange Act Release No. 47501, 56 SEC 163, 2003 SEC LEXIS 599, at *9 n.10 (Mar. 14, 2003) ("[W]e note that many courts and this Commission have determined that self-regulatory organizations . . . are not subject to . . . constitutional limitations applicable to government agencies."); *but see* 15 U.S.C. § 78o-3(b)(8) (stating that SROs are required to "provide a fair procedure for . . . the denial of membership to any person seeking membership").

⁴¹ Reply Brief at 8; *see also Citadel Sec. Corp.*, Exchange Act Release No. 49666, 57 SEC 502, 2004 SEC LEXIS 949, at *11 (May 7, 2004) (stating that "[t]here is no constitutional or statutory right to representation of counsel in administrative proceedings" (quoting *Love*, 2004 SEC LEXIS 318, at *18)).

C. FINRA applied its rules in a manner consistent with the Exchange Act.

We last turn to whether FINRA applied its rules in a manner consistent with the Exchange Act when it denied ACP's application. Under the Exchange Act, FINRA may deny a firm's application for association with a statutorily disqualified person if FINRA determines that such association would be inconsistent with the public interest and the protection of investors.⁴² To be consistent with the Exchange Act, "FINRA must 'independently [evaluate the] application, based upon the totality of the circumstances, and . . . explain the bases for its conclusion.'"⁴³ In doing so, FINRA "may demand a high level of integrity from securities professionals" in order to protect investors.⁴⁴ We have also recognized that FINRA has discretion in determining whether persons subject to statutory disqualification should be permitted to associate with a member firm.⁴⁵ Moreover, in a FINRA proceeding such as this, "the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."⁴⁶ Here, we find that FINRA acted in a manner consistent with the Exchange Act by weighing the facts and circumstances surrounding the Connecticut order, Weiss's history of customer complaints, and ACP's proposed supervisory plan to conclude that ACP had not met its burden of showing that it would be in the public interest for Weiss to continue associating with the firm.

FINRA was properly concerned, for example, with the suitability violation that led to the Connecticut order. Registered representatives are obligated to make "a customer-specific determination of suitability and to tailor [their] recommendations to the customer's financial profile and investment objectives."⁴⁷ Weiss exhibited a remarkable lack of care about this obligation by recommending that Tuohy invest the entire amount in her account in a single

⁴² 15 U.S.C. § 78o-3(g)(2) (providing that FINRA "may . . . deny membership to any registered broker or dealer, and bar from becoming associated with a member any person, who is subject to a statutory disqualification"); see also *Frank Kufrovich*, Exchange Act Release No. 45437, 76 SEC 2180, 2002 SEC LEXIS 357, at *11-12 (Feb. 13, 2002) (describing the steps that NASD must take when denying an application to be consistent with the purposes of the Exchange Act).

⁴³ *Arouh*, 2010 SEC LEXIS 2977, at *46 (quoting *Pedregon*, 2010 SEC LEXIS 1164, at *20).

⁴⁴ *Kufrovich*, 2002 SEC LEXIS 357, at *17.

⁴⁵ See, e.g., *Arouh*, 2010 SEC LEXIS 2977, at *48-49 (stating that the Commission has "afforded FINRA discretion in determining whether persons subject to statutory disqualification should be permitted to associate with a member firm"); *Am. Inv. Servs., Inc.*, Exchange Act Release No. 43991, 54 SEC 1265, 2001 SEC LEXIS 306, at *12 (Feb. 21, 2001) ("NASD is afforded discretion in considering the circumstances under which a person subject to a statutory disqualification may associate with a member."); *Halpert & Co., Inc.*, Exchange Act Release No. 28615, 50 SEC 420, 1990 SEC LEXIS 3564, at *6 (Nov. 14, 1990) ("Particularly in matters involving a firm's employment of persons subject to a statutory disqualification, it is appropriate to recognize the NASD's evaluation of appropriate business standards for its members."); see also FINRA By-Laws Art. III, § 3(d) ("The Board may, in its discretion, approve the continuance in membership, and may also approve the association or continuance of association of any person, if the Board determines that such approval is consistent with the public interest and the protection of investors.").

⁴⁶ *Timothy H. Emerson Jr.*, Exchange Act Release No. 60328, 2009 SEC LEXIS 2417, at *11 (July 17, 2009) (quoting *Tannenbaum*, 1992 SEC LEXIS 1998, at *4-5).

⁴⁷ *F.J. Kaufman & Co. of Va.*, Exchange Act Release No. 27535, 50 SEC 164, 1989 SEC LEXIS 2376, at *9 (Dec. 13, 1989) (finding that a broker had made unsuitable recommendations).

company's stock despite knowing little about her net assets other than that she "didn't have a lot."⁴⁸ Such admissions plainly supported FINRA's conclusion that Weiss "fails to appreciate the suitability issues presented by [the Tuohy] transaction and is a risk to the investing public."⁴⁹

FINRA also expressed a reasonable concern with Weiss's failure to register as an agent in Connecticut and report his transactions on firm records accurately. Registration requirements, we have noted, provide "an important safeguard in protecting public investors and, consequently, strict adherence . . . is essential."⁵⁰ Similarly, reporting requirements allow SROs and state regulatory agencies "to monitor and determine the fitness of securities professionals."⁵¹ By failing to properly register in Connecticut and report the transactions he effected for Tuohy on firm records accurately, Weiss undermined these important investor protection provisions.

FINRA also properly considered the time between Weiss's disqualifying event and ACP's application. Weiss entered into the consent order approximately three-and-one-half years ago. FINRA reasonably concluded that was too recent for him to have demonstrated a sufficiently long-term change in behavior to show he would comply with the securities regulations going forward.⁵² For these reasons, we agree with FINRA that the conduct underlying Weiss's

⁴⁸ Tr. at 29. *Cf. Luis Miguel Cespedes*, Exchange Act Release No. 59404, 2009 SEC LEXIS 368, at *22 (Feb. 13, 2009) (noting that modest investments, which represented "all or substantially all" of a customer's liquid net worth, left "little margin for error or loss"), *petition for review denied*, 462 F. App'x 2012 (D.C. Cir. 2012); *James B. Chase*, Exchange Act Release No. 47476, 56 SEC 149, 2003 SEC LEXIS 566, at *16 (Mar. 10, 2003) (finding broker's recommendation to be unsuitable where broker recommended that the customer invest entire account in a single security even though customer was "young with a lifetime of earning potential"); *Stephen Thorlief Rangen*, Exchange Act Release No. 38486, 52 SEC 1304, 1997 SEC LEXIS 762, at *10 (Apr. 8, 1997) (finding recommendations to be unsuitable, in part, because, "by concentrating so much of [the customers'] equity in particular securities, [the broker] increased the risk of loss for these individuals beyond what is consistent with the objective of safe, non-speculative investing").

⁴⁹ NAC Decision at 11; *see also id.* at 10 (citing *Dep't of Mkt. Reg. v. Kresge*, Complaint No. CMS030182, 2008 FINRA Discip. LEXIS 46, at *15 n.12 (NAC Oct. 9, 2008) (stating that "it is axiomatic that fraud and unsuitable recommendations rank among the most serious kinds of securities law violations").

⁵⁰ *Kevin D. Kunz*, Exchange Act Release No. 45290, 55 SEC 551, 2002 SEC LEXIS 104, at *36 (Jan. 16, 2002); *accord Michael F. Flannigan*, Exchange Act Release No. 47142, 56 SEC 817, 2003 SEC LEXIS 40, at *13-14 (Jan. 8, 2003) (observing that registration requirements provide "an important safeguard in protecting public investors and strict adherence to that requirement is essential").

⁵¹ *Rosario R. Ruggiero*, Exchange Act Release No. 37070, 52 SEC 725, 1996 SEC LEXIS 990, at *8-9 (Apr. 5, 1996) (stating that reporting requirements are "used by all the self-regulatory organizations, including the NASD, state regulators, and broker-dealers to monitor and determine the fitness of securities professionals"); *see also Stephen J. Horning*, Exchange Act Release No. 56886, 2007 SEC LEXIS 2796, at *52 (Dec. 3, 2007) (noting that "[t]he books and records that broker-dealers are required to maintain are 'a keystone of the surveillance of brokers and dealers by [Commission] staff and by the securities industry's self-regulatory bodies'" (quoting *Edward Mawod & Co.*, Exchange Act Release No. 13512, 46 SEC 865, 1977 SEC LEXIS 1811, at *16 n.39 (May 6, 1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979))), *aff'd*, 570 F.3d 337 (D.C. Cir. 2009).

⁵² *See, e.g., Haberman*, 1998 SEC LEXIS 2466, at *14 (finding representative's association with member firm to be "not in the public interest" where representative's felony conviction was "only six years ago"); *Louis A. Frangos*, Exchange Act Release No. 26009, 49 SEC 865, 1988 SEC LEXIS 1687, at *6 (Aug. 18, 1988) (describing an approximately five-year-old felony conviction as "recent").

disqualifying event, and his admissions about that conduct, weighed against allowing Weiss to associate with a member firm.⁵³

Weiss does not dispute the events underlying his disqualification. To the contrary, he acknowledges that his "statutorily disqualifying event was serious and was securities related."⁵⁴ Instead, Weiss contends that these events "were mostly based on justifiable human error and not malicious intent."⁵⁵ He argues that, in comparison to his disqualifying event, the disqualifying events in other FINRA denials of continuing membership involved "felonies, fraud or some other type of heinous act."⁵⁶ The type of disqualifying event, however, is not the determining factor. Congress, not FINRA or the Commission, decided that certain orders by state securities commissions trigger statutory disqualification.⁵⁷ The relevant inquiry is instead whether, under "the totality of the circumstances," a person's continued association with a member firm is inconsistent with the public interest and the protection of investors.⁵⁸ FINRA performed this analysis by not only examining the circumstances underlying Weiss's disqualification, but also examining Weiss's professional history and ACP's application.⁵⁹

For example, FINRA expressed "serious concern" with the eleven customer complaints filed against Weiss, many of which FINRA correctly noted "involved serious allegations such as unauthorized trading, misrepresentations, failures to disclose material facts, and churning customer accounts."⁶⁰ Although Weiss argues that the majority of the customer complaints related to one of his previous firms shutting down (while he was listed as an officer on that firm's Form BD),⁶¹ four of the most recent complaints had nothing to do with that previous firm. And, as FINRA noted, "several of the complaints alleged that Weiss made unsuitable

⁵³ Cf., e.g., *Citadel Sec. Corp.*, 2004 SEC LEXIS 949, at *12-15 (finding that NASD properly considered the seriousness and recency of the disqualifying permanent injunction, which involved a failure to supervise, when denying a firm's membership continuation application).

⁵⁴ Appellant's Br. in Sup. of Pet. for Review at 9.

⁵⁵ *Id.* at 10.

⁵⁶ *Id.* at 9 (citing *Pedregon*, 2010 SEC LEXIS 1164, at *1 (sustaining denial of application where disqualifying event was felony conviction for online solicitation of a minor); *Emerson*, 2009 SEC LEXIS 2417, at *2 (sustaining denial of application where disqualifying event was a felony DUI conviction); *Jan Biesiadecki*, Exchange Act Release No. 39113, 53 SEC 1102, 1997 SEC LEXIS 1975, at *1 (Sept. 22, 1997) (sustaining denial of application where disqualifying event was felony conviction for mail fraud, wire fraud, racketeering, and conspiracy to commit racketeering)).

⁵⁷ See *supra* note 2.

⁵⁸ *Pedregon*, 2010 SEC LEXIS 1164, at *20 (quoting *Kufrovich*, 2002 SEC LEXIS 357, at *16).

⁵⁹ See, e.g., *Emerson*, 2009 SEC LEXIS 2417, at *14 (finding FINRA's denial of application consistent with Exchange Act where it "appropriately weigh[ed] all the facts and circumstances surrounding [the statutorily disqualifying event] and [the] proposed supervisory plan"). We are also concerned by Weiss's continued insistence that he "did absolutely nothing wrong." Appellant's Br. in Sup. of Pet. for Review at 4. Such a refusal to recognize the wrongfulness of his conduct provides little assurance that Weiss will not repeat his misconduct in the future.

⁶⁰ NAC Decision at 11.

⁶¹ Form BD is the application form entities use to apply to the Commission for registration as a broker-dealer.

recommendations similar to the Connecticut Order."⁶² While some of these complaints may not be recent, such history still "reflects poorly on [an applicant's] judgment and trustworthiness."⁶³ And taken together, Weiss's history of complaints suggests a continuous and troubling pattern of poor behavior towards customers.⁶⁴

Weiss argues that it was improper and prejudicial for FINRA to cite the more than \$40,000 he paid to settle some of the customer complaints. In doing so, he relies on the prohibitions in Federal Rule of Evidence 408 (related to settling claims). Those rules, however, are inapplicable here because, as we have noted, SRO proceedings "are informal and are not bound by the rules of evidence used in courts of law."⁶⁵ Moreover, courts have consistently allowed agencies to consider settled actions for purposes such as showing that a respondent was aware of a regulatory requirement.⁶⁶ Here, Weiss paid to settle multiple customer complaints that alleged he had made unsuitable recommendations. Those settlements, at the very least, should have alerted Weiss about the risks of making unsuitable recommendations. Weiss, however, admits that he nevertheless recommended that a customer invest the entire amount in her account in a single company's stock despite knowing little about her net assets other than that she "didn't have a lot."⁶⁷ Such conduct, as FINRA reasonably concluded, raises "serious concerns regarding Weiss's dealings with customers and compliance with securities laws and regulations."⁶⁸

⁶² NAC Decision at 11.

⁶³ *Kufrovich*, 2002 SEC LEXIS 357, at *20 (concluding that prior misconduct, even if not recent, still reflects poorly on a statutorily disqualified person).

⁶⁴ *See, e.g., Emerson*, 2009 SEC LEXIS 2417, at *17-18 (holding that FINRA reasonably concluded that two customer complaints alleging unsuitable recommendations filed against a disqualified individual and settled by his firm, as well as discharges from prior firms, reflected poorly on his judgment and trustworthiness); *Robert J. Prager*, Exchange Act Release No. 51974, 2005 SEC LEXIS 1558, at *59 n.73 (July 6, 2005) (rejecting respondents' argument that certain settled disciplinary actions were too stale to be considered for sanctions purposes because, as NASD had noted, that history established "a disturbing pattern of disregard for regulatory compliance matters"); *cf. Michael D. Smith*, CFTC Docket No. 93-9, 1997 CFTC LEXIS 48, at *22 (Mar. 11, 1997) (stating that evidence of prior wrongdoing is "relevant in assessing the threat a respondent will pose to market integrity in that it further indicates a pattern of respondent's failure to comply with significant regulatory requirements").

⁶⁵ *Robert E. Gibbs*, Exchange Act Release No. 32401, 51 SEC 482, 1993 SEC LEXIS 1290, at *6 (June 2, 1993) (rejecting applicant's contention "that he was prejudiced by the admission of 'certain settlements' of customer complaints"), *aff'd*, 25 F.3d 1056 (10th Cir. 1994) (table); *see also* FINRA Rule 9145(a) ("The formal rules of evidence shall not apply in a proceeding brought under the Rule 9000 Series.").

⁶⁶ *See, e.g., United States v. Gilbert*, 668 F.2d 94, 97 (2d Cir. 1981) (allowing an earlier consent decree between defendant and the SEC to be introduced to show defendant's awareness of SEC requirements); *cf. FED. R. CIV. P. 408* (prohibiting admission of compromise offers and negotiations "to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or a contradiction," but expressly allowing the admission of such evidence "for another purpose"); *Tate v. U.S. Postal Service*, No. 2012-3066, 2012 U.S. App. LEXIS 20904, at *8-9 (Fed. Cir. Oct. 9, 2012) (stating that it was proper for the Postal Service to consider Tate's history of settled disciplinary actions for purposes of establishing that Tate had notice of his obligations and the likelihood of discipline for such violations); *Emerson*, 2009 SEC LEXIS 2417, at *17 (denying membership continuation application where disqualified individual's personal history included, in part, two customer complaints alleging unsuitable recommendations).

⁶⁷ Tr. at 29.

⁶⁸ NAC Decision at 11; *see supra* notes 47-49 and accompanying text (discussing risk to the investing public of making unsuitable recommendations).

Weiss also challenges the relevance of the customer complaints by arguing that, after "[e]xamining the overall context, it becomes clear that [he] has been an extraordinary representative with a high degree of integrity."⁶⁹ In support, Weiss attached thirty-seven letters from former and current customers to his opening brief. None of these letters, however, was introduced during the FINRA proceeding, nor is there any evidence that Weiss attempted to do so until now. Weiss instead claims only that his "counsel at the time did not advise [him] in submission of these letters."⁷⁰

Under our Rule of Practice 452, a party who wishes to introduce additional evidence must file a motion for leave to do so.⁷¹ That rule requires that "[s]uch [a] motion shall show with particularity that such additional evidence is material and that there were reasonable grounds for failing to adduce such evidence previously."⁷² Weiss meets none of these standards. He did not file a motion seeking permission to introduce the new evidence; he has not explained with any particularity why he did not introduce the evidence previously; and none of the thirty-seven customer letters deals with the relevant issues here. All Weiss's letters show is that thirty-seven customers were happy with his services. None of the letters addresses the specific circumstances surrounding the disqualifying event or the eleven customer complaints—circumstances that FINRA reasonably concluded raised serious concerns about Weiss's dealings with customers and compliance with securities laws and regulations.⁷³ We therefore decline to admit this evidence.⁷⁴

In his reply brief, Weiss attached additional new evidence without seeking permission to do so. This evidence consisted of (i) a research report concerning InPhonic prepared by ACP (which Weiss now claims for the first time on appeal that he relied upon when recommending the stock to Tuohy) and (ii) an alleged e-mail from Tuohy in which she writes, in part, that she holds "no bad feelings" toward Weiss and that her complaint "appears to have been more with ACP" rather than Weiss. Neither of these attachments is relevant to these proceedings.

⁶⁹ Appellant's Br. in Sup. of Pet. for Review at 5.

⁷⁰ *Id.* at 6.

⁷¹ 17 C.F.R. § 201.452.

⁷² *Id.*; see also 17 C.F.R. § 201.460(c) (providing that documents not admitted at hearing "shall not be considered a part of the record before the Commission").

⁷³ Cf. *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 SEC LEXIS 3936, at *27 (Nov. 4, 2009) ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct."), *petition for review denied*, 416 F. App'x 95 (2d Cir. 2011).

⁷⁴ See *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at *58 (Nov. 9, 2012) (declining to admit evidence where applicant had not sought permission to do so, where applicant had not explained failure to introduce exhibits earlier, and where attachments did not address issues relevant to the case), *appeal filed*, No. 13-31 (2d Cir. Jan. 8, 2013); *John Edward Mullins*, Exchange Act Release No. 66373, 2012 SEC LEXIS 464, at *56 n.60 (Feb. 10, 2012) (declining to admit exhibits attached to an applicant's brief that were "not material to [the applicant's] case" and that addressed issues not under review); *CMG Inst'l Trading, LLC*, Exchange Act Release No. 59325, 2009 SEC LEXIS 215, at *18 & n.20 (Jan. 30, 2009) (determining not to admit into the record documents proffered when applicants did not file a motion under Rule 452).

First, we fail to see how Weiss's supposed reliance on ACP's research report made his recommendation to Tuohy any more suitable. If anything, the ACP report reinforces the unsuitability of recommending that Tuohy invest the amount of her entire account in InPhonic's stock. Although the ACP report labeled the company's stock as a "buy" because of new management and other changes to the company, the report also warned that the company had suffered eight consecutive years of operating losses, was experiencing "plummeting sales," and was in transition and undergoing "deep restructuring."⁷⁵ Even more troubling is Weiss's apparent willingness to mislead the FINRA hearing panel about whether ACP was the source of the research report. That ACP allegedly pressured him into misleading the hearing panel does not lessen our concern.⁷⁶

Second, Tuohy's supposed e-mail that she held "no bad feelings" towards Weiss is similarly irrelevant, as FINRA's "power to enforce its rules is independent of a customer's decision not to complain."⁷⁷ Weiss also fails to provide a reason for why these documents were not introduced earlier, and we find no basis for that failure. We accordingly decline to admit this evidence.⁷⁸

FINRA also considered ACP's proposed supervisory plan. In assessing a supervisory plan, "we require . . . stringent supervision for a person subject to a statutory disqualification."⁷⁹ ACP clearly failed in this responsibility. Most troubling is the firm's conscious decision not to place Weiss on heightened supervision for approximately two years after learning that Weiss had been statutorily disqualified. Although ACP eventually placed Weiss under supervision, it did so only after FINRA expressed the importance of doing so.⁸⁰ Even after ACP instituted a plan, and revised it twice, it still contained inconsistencies about how often Weiss's primary supervisor would review Weiss's daily transactions⁸¹ and proposed a backup supervisor who had been

⁷⁵ Gregory F. Grose, CFA, *Actionable Update, InPhonic, Inc.*, Am. Capital Partners, LLC, Sept. 24, 2007, at 1, 3 (attached to Appellant's Reply Brief).

⁷⁶ Cf. *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at *69 (Feb. 1, 2010) (stating that a registered representative "cannot shift the blame for her violations to others or claim that others' misconduct somehow excuses her own misdeeds"), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011).

⁷⁷ *Maximo Justo Guevara*, Exchange Act Release No. 42793, 54 SEC 655, 2000 SEC LEXIS 986, at *18 (May 18, 2000) (rejecting petitioner's argument that none of his customers had complained about him); *petition for review denied*, 47 F. App'x 198 (3d Cir. 2002).

⁷⁸ On August 31, 2012, FINRA moved for leave to file a surreply. FINRA represented that a surreply was "necessary, and should be accepted by the Commission, because of new evidence and arguments based upon such new evidence raised by Weiss for the first time in his reply brief." FINRA's Motion for Leave to File Surreply and Surreply in Opposition to Eric J. Weiss's Application for Review at 1. Because we have denied Weiss's attempts to introduce the new evidence, FINRA's surreply is not necessary and FINRA's motion is accordingly denied.

⁷⁹ *Haberman*, 1998 SEC LEXIS 2466, at *16.

⁸⁰ Cf. *Andrew P. Gonchar*, Exchange Act Release No. 60506, 2009 SEC LEXIS 2797, at *54 (Aug. 14, 2009) (stating that registered representatives are expected to follow SRO rules and that, because of this, compliance with those rules is not a mitigating factor), *petition for review denied*, 409 F. App'x 396 (2d Cir. 2010).

⁸¹ As the NAC noted, ACP's plan stated in one section that Weiss's supervisor would review "[e]very document related to Weiss's transactions' no later than the next business day," while stating in another section that Weiss's supervisor would review Weiss's trade and check blotters "weekly." NAC Decision at 11 (quoting supervisory plan).

subject to various customer complaints and regulatory action, including alleged failures to supervise.

ACP's inaction and indifference to the supervision of a statutorily disqualified person represents a striking failure to appreciate its obligations to the markets and investors. It also raises serious concerns about whether ACP would comply with its supervisory plan going forward.⁸² Such "inattention to the requirements of heightened supervision," we have previously noted, "is not acceptable in statutory disqualification matters."⁸³

Weiss himself recognizes that ACP's proposed plan is deficient, but argues that "it does not seem fair or equitable to deny [his] application simply because ACP failed to correctly set forth an adequate heightened supervisory plan."⁸⁴ A stringent supervisory plan, however, is an essential condition of employing a statutorily disqualified person.⁸⁵ Moreover, regardless of whether ACP could implement a more stringent plan, Weiss now states on appeal that he "is no longer willing to be sponsored by ACP."⁸⁶ He instead asks the Commission to restore him "to the same position as he was prior to the NAC hearing but with another broker deal[er] that is willing to sponsor [his] application for association."⁸⁷

Weiss asks for a remedy that we cannot (and need not) provide. Section 19(f) "leaves no discretion to the SEC with respect to the appropriate remedy."⁸⁸ We "must either dismiss the proceeding or set aside the denial and order admission."⁸⁹ Therefore, the only decision before us in this case is whether to dismiss Weiss's appeal or to set aside FINRA's denial of ACP's application. For all the reasons above, we have determined to dismiss Weiss's appeal. But our conclusion does not limit Weiss's ability to pursue association with another firm, under a different supervisory arrangement. FINRA did not expel Weiss from the securities industry, nor did FINRA impose a penalty or remedial sanction.⁹⁰ FINRA merely denied Weiss "relief from a

⁸² See, e.g., *Pedregon*, 2010 SEC LEXIS 1164, at *27 (expressing concern about whether firm would provide the required heightened level of supervision where, among other things, the firm proposed an unqualified backup supervisor).

⁸³ *Emerson*, 2009 SEC LEXIS 2417, at *20-21 (expressing concern with whether firm would comply with supervisor plan given the firm's failure to comply with its other internal supervisory rules).

⁸⁴ Appellant's Br. in Sup. of Pet. for Review at 13.

⁸⁵ See *supra* note 79 and accompanying text.

⁸⁶ Reply at 11.

⁸⁷ *Id.*

⁸⁸ *Feins v. AMEX, Inc.*, 81 F.3d 1215, 1220 (2d Cir. 1996).

⁸⁹ *Id.*

⁹⁰ See *Dennis Milewitz*, Exchange Act Release No. 40254, 53 SEC 701, 1998 SEC LEXIS 1524, at *13 (July 23, 1998) ("NASD's consideration of the applicant's disciplinary history prior to the statutory disqualification, including misconduct for which sanctions were imposed previously, does not amount to a further penalty for that prior misconduct."); *Halpert & Co., Inc.*, 1990 SEC LEXIS 3564, at *5 (noting that NASD's denial of membership was not "imposing a penalty on applicants in this matter or even a remedial sanction").

previously existing disqualification."⁹¹ Weiss remains free to restart the association process with a different firm at any time. If he does so, any new firm would then need to submit its own, separate membership continuation application for FINRA to consider in accordance with its rules.

For these reasons, we dismiss this review proceeding. An appropriate order will issue.⁹²

By the Commission (Chairman WALTER and Commissioners AGUILAR and PAREDES); Commissioner GALLAGHER not participating.

Elizabeth M. Murphy
Secretary


By: Jill M. Peterson
Assistant Secretary

⁹¹ *Milewitz*, 1998 SEC LEXIS 1524, at *12; *see also Halpert & Co., Inc.*, 1990 SEC LEXIS 3564, at *5 (stating that the denial of an application is a denial only of the "request *at this time* for relief from [his] previously incurred disqualification" (emphasis added)).

⁹² We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69177 / March 19, 2013

Admin. Proc. File No. 3-14844

In the Matter of the Application of

ERIC J. WEISS
c/o Wesley J. Paul, Esq.
Paul Law Group, LLP
902 Broadway, 6th Floor
New York, New York 10010

For Review of Action Taken by

FINRA

ORDER DISMISSING REVIEW PROCEEDINGS

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

ORDERED that the application for review filed by Eric J. Weiss is hereby dismissed.

By the Commission.

Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9394 / March 19, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 69171 / March 19, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3569 / March 19, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30428 / March 19, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15249

In the Matter of

CRAIG BERKMAN, d/b/a
VENTURES TRUST LLC,
JOHN B. KERN,
FACE OFF ACQUISITIONS, LLC,
FACE OFF MANAGEMENT, LLC,
a/k/a FACE OFF ACQUISITIONS
MANAGEMENT, LLC,
VENTURES TRUST II LLC,
VENTURES TRUST III LLC,
VENTURES TRUST IV LLC,
VENTURES TRUST V LLC,
VENTURES TRUST VI LLC,
VENTURES TRUST ASSET FUND
LLC, VENTURES TRUST
MANAGEMENT LLC, VENTURES
TRUST ASSET MANAGEMENT,
LLC, a/k/a VENTURES TRUST II
ASSET MANAGEMENT, LLC,
ASSENSUS CAPITAL, LLC AND
ASSENSUS CAPITAL
MANAGEMENT, LLC,

Respondents.

ORDER INSTITUTING
ADMINISTRATIVE AND CEASE-AND-
DESIST PROCEEDINGS PURSUANT TO
SECTION 8A OF THE SECURITIES ACT
OF 1933, SECTION 21C OF THE
SECURITIES EXCHANGE ACT OF 1934,
SECTIONS 203(f) AND 203(k) OF THE
INVESTMENT ADVISERS ACT OF 1940,
SECTION 9(b) OF THE INVESTMENT
COMPANY 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 and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(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 Craig Berkman, d/b/a Ventures Trust LLC ("Berkman"), John B. Kern ("Kern"), Face Off Acquisitions, LLC ("Face Off Acquisitions"), Face Off Management, LLC, a/k/a Face Off Acquisitions Management, LLC ("Face Off Management"), Ventures Trust II LLC ("Ventures II"), Ventures Trust III LLC ("Ventures III"), Ventures Trust IV LLC ("Ventures IV"), Ventures Trust V LLC ("Ventures V"), Ventures Trust VI LLC ("Ventures VI"), Ventures Trust Asset Fund LLC ("Ventures Asset Fund"), Ventures Trust Management LLC, Ventures Trust Asset Management, LLC a/k/a Ventures Trust II Asset Management, LLC (Ventures Trust Management LLC and Ventures Trust Asset Management, LLC are collectively referred to hereinafter as "Ventures Trust Management"), Assensus Capital, LLC ("Assensus Capital"), Assensus Capital Management, LLC ("Assensus Management") (all collectively referred to hereinafter as "Respondents").

II.

After an investigation, the Division of Enforcement (the "Division") alleges that:

A. SUMMARY

1. From approximately October 2010 through September 2012, Berkman fraudulently raised at least \$13.2 million from approximately 120 investors by selling membership interests in limited liability companies ("LLCs") that Berkman controlled, including Face Off Acquisitions, Assensus Capital and several LLCs with the words "Ventures Trust" in their names.

2. Berkman made material misrepresentations he knew were false to investors in three different sets of offerings. In one set of offerings, Berkman told investors in Ventures II, III, IV, V, and VI (collectively, the "Ventures LLCs") that their funds would be used to acquire highly coveted, pre-initial public offering ("pre-IPO") shares of Facebook, Inc., LinkedIn, Inc., Groupon, Inc., and Zynga Inc. In another offering, Berkman told investors in Face Off Acquisitions that their money would be used either to purchase pre-IPO shares of Facebook or to acquire a company that held pre-IPO Facebook shares. In a third offering, Berkman told investors in Assensus Capital that he would use their money to fund various new, large-scale, technology ventures.

3. Instead of using the investor funds to acquire pre-IPO shares or fund technology ventures, Berkman misappropriated most of the offering proceeds. Berkman used most of the money to make payments to investors in his earlier investment schemes and to some of the victims of this fraud in Ponzi-scheme fashion, including approximately \$5.43 million to satisfy a prior judgment against him and another \$4.8 million to investors who had invested either in this pre-IPO scheme or in other schemes. Berkman also used approximately \$1.6 million to fund his own personal expenses, including large cash withdrawals and dining and travel expenses.

4. Of the \$13.2 million raised, Berkman used \$600,000 to purchase a small interest in an unrelated fund that had acquired pre-IPO Facebook stock. That purchase did not provide any of

the Ventures LLCs, or any other company affiliated with Berkman, with ownership of Facebook shares. Berkman and/or one of his associates nevertheless used a forged letter about that investment to falsely represent to investors that Ventures II owned nearly half a million shares of Facebook stock. Upon discovering the forgery, the fund informed Berkman that it was immediately terminating and liquidating the Ventures II interest, leaving Ventures II without even an indirect interest in Facebook shares.

5. To aid and abet the fraud, Kern, a lawyer and general counsel to the Ventures LLCs and Face Off Acquisitions, made certain material misstatements to investors that he knew or recklessly disregarded were false and misleading.

B. RESPONDENTS

6. **Berkman**, age 71, resides in Odessa, Florida. At all relevant times, Berkman controlled each of the Respondent entities. Berkman served as Oregon's state Republican Party chairman from 1989 to 1993 and ran unsuccessfully for the Republican nomination for Governor of Oregon in 1994.

7. **Kern**, age 49, resides in Charleston, South Carolina. Kern is an attorney licensed to practice law in South Carolina and has an office in the Republic of San Marino. Kern is or was Ventures II's general counsel and Face Off Acquisitions' general counsel. Kern represented Ventures II in the staff's investigation.

8. **Face Off Acquisitions** is a Delaware LLC formed on May 24, 2011. Face Off Acquisitions purports to be a private equity firm with offices in Tampa, Florida and New York, New York and "an expected capitalization of \$100,000,000" for a "Special Opportunity Facebook Stock Purchase Fund."

9. **Face Off Management** is a Delaware LLC formed on May 24, 2011. It purports to serve as Face Off Acquisitions' Managing Member and to be "responsible for sourcing, selection, structuring and oversight of the Facebook investment."

10. **Ventures II** is a Delaware LLC formed on June 15, 2010. Ventures II purports to have offices in Tampa, Florida, Los Angeles, California, and New York, New York. Ventures II purports to be a private equity firm with a "unique opportunity to purchase discounted shares of Facebook." The majority of the investor funds at issue were deposited into Ventures II bank accounts and comingled with investor funds initially deposited into accounts held in the names of the other Ventures LLCs.

11. **Ventures Trust Asset Management** is a Delaware LLC formed on March 7, 2007. It purports to serve as the managing member for the Ventures LLCs and to be "responsible for the sourcing, structuring and oversight of the portfolio investments." Berkman owns or owned 100% of the membership interests of Ventures Trust Asset Management.

12. **Ventures Trust Management** is a Delaware LLC formed on August 8, 2011. It purports to serve as the Managing Member for the Ventures LLCs.

13. **Ventures III** is a Delaware LLC formed on December 28, 2010. Ventures III purports to have offices in Los Angeles, California. It purports to be a private equity firm with a "unique opportunity to purchase discounted shares" and whose "first investment will be made in LinkedIn." Ventures Trust Management purports to be Ventures III's Managing Member.

Ventures III holds a bank account through which Berkman funneled investor funds. Berkman is listed as a signatory on the bank account.

14. **Ventures IV** is a Delaware LLC formed on January 27, 2011. Ventures IV purports to have offices in Los Angeles, California. Ventures IV purports to be a private equity firm with a "unique opportunity to purchase discounted shares," whose "first investment will be made in Groupon." Ventures Trust Management purports to be Ventures IV's Managing Member. Ventures IV holds a bank account through which Berkman funneled investor funds and whose title is "Ventures Trust IV Groupon." Berkman is listed as a signatory on the bank account.

15. **Ventures V** is a Delaware LLC formed on January 27, 2011. It also holds a bank account through which Berkman funneled investor funds. Berkman is listed as a member and signatory on the bank account.

16. **Ventures VI** is a Delaware LLC formed on January 27, 2011. It similarly holds a bank account through which Berkman funneled investor funds. Berkman is the managing director of Ventures VI. Berkman is listed as a signatory to Ventures VI's bank account, entitled "Ventures Trust VI Zynga."

17. **Ventures Trust Asset Fund** is a Washington LLC formed on January 11, 2007. Berkman is its manager. A portion of the misappropriated investor funds at issue were transferred to Ventures Trust Asset Fund.

18. **Assensus Capital** is a Delaware LLC formed on July 14, 2011. Assensus Capital purports to have offices in Tampa, Florida and New York, New York. It purports to be a private equity firm focused on "funding affiliated, groundbreaking companies in surgical technology fields and in the forefront of a new generation of nuclear power plant design."

19. **Assensus Management** is a Delaware LLC formed on July 14, 2011. It purports to serve as Assensus Capital's Managing Member and to be "responsible for the sourcing, structuring and oversight of the portfolio investments."

C. OTHER RELEVANT PERSON AND ENTITIES

20. **The Manager**, age 49, resides in Encinitas, California. At all relevant times, the Manager managed and provided "day-to-day leadership" for the respective managing members of Face Off Acquisitions, Ventures Trust, and Assensus Capital.

21. **Actual Facebook Funds** are two single-purpose, pooled investment vehicles associated with a registered broker-dealer in New York City. The two Actual Facebook Funds both held pre-IPO Facebook stock during the relevant period.

22. **The Law Firm** is a large law firm that served as corporate counsel to the Actual Facebook Funds.

23. **Actual Facebook Fund 2** is a Delaware LLC (unrelated to the Actual Facebook Funds) formed to acquire pre-IPO securities of Facebook. Actual Facebook Fund 2 held only pre-IPO Facebook stock during the relevant period.

24. **The Broker-Dealer** is a registered broker-dealer in New York City. The Broker-Dealer has not acquired or tried to acquire pre-IPO Facebook securities or interests in pre-IPO Facebook securities or operated single-purpose funds holding Facebook securities.

D. **FACTS**

Berkman's Prior Securities Violations and Bankruptcy

25. In 2001, the Oregon Division of Finance and Securities issued a cease-and-desist order against Berkman for offering and selling convertible promissory notes without a brokerage license to Oregon residents between 1983 and 1997. Berkman received a \$50,000 fine.

26. In June 2008, an Oregon jury found Berkman liable in a private action for breach of fiduciary duty, conversion of investor funds, and misrepresentation to investors, among other things, arising from Berkman's involvement with a series of purported venture capital funds known as Synectic Ventures (collectively "Synectic"). Berkman's improper use of Synectic funds included more than \$5 million in purported "personal loans" and the misuse of investor funds to cover personal expenses and execute personal stock purchases. The court entered a \$28 million judgment against Berkman ("2008 Oregon Judgment").

27. In March 2009, Synectic filed an involuntary Chapter 7 bankruptcy petition against Berkman in the Middle District of Florida alleging that he owed more than \$15.4 million in unpaid debts arising from the 2008 Oregon Judgment. On August 11, 2010, the court entered three judgments against Berkman totaling nearly \$15 million, plus 9% interest and costs, deemed non-dischargeable in bankruptcy.

28. The parties to the bankruptcy proceeding then reached a settlement in which Berkman was required to pay \$4.75 million in seven installments, beginning on November 30, 2010. After making the first four payments, totaling \$1.5 million, Berkman failed to make the fifth payment, due on March 17, 2011. He defaulted on several subsequent revised payment schedules, which also included 5% annual interest. The Chapter 7 Trustee recommenced adversary proceedings, leading to a further revised settlement agreement with a final payment date of May 11, 2012. On May 9, 2012, Berkman paid the remaining balance of more than \$3.2 million and the pending adversary proceedings against him were dismissed with prejudice.

29. As detailed below, Berkman used a substantial part of the proceeds of his pre-IPO offering fraud (and none of his own money) to pay the Florida bankruptcy claims.

The Ventures Fraud

30. From approximately October 2010 through February 2012, Berkman and the Manager made numerous misrepresentations to Ventures LLC investors when offering and selling membership interests in the various Ventures LLCs, both orally and in writing, including in the formal offering documents.

31. Berkman and the Manager falsely told investors that each of the Ventures LLCs would use their funds to acquire highly coveted, pre-IPO shares in one or more social media companies that were planning IPOs at the time, including Facebook, LinkedIn, Groupon or Zynga. For example, Berkman and the Manager falsely told certain investors that Ventures II was going to purchase pre-IPO Facebook shares and falsely told other investors that Ventures II had already purchased such shares.

32. At a hotel meeting with a group of California investors in approximately 2010, Berkman and the Manager told investors that Berkman had access to Facebook employees who

wanted to sell their shares of Facebook prior to Facebook's IPO and had formed an LLC to purchase shares from Facebook employees.

33. In an e-mail to an investor in November 2011, the Manager similarly misrepresented that "[w]e have been notified that we can purchase up to 5 million of Facebook common at 30.00 per share."

34. Berkman orally told a prospective investor in approximately January 2012 that he could immediately purchase \$2 million worth of pre-IPO Facebook shares at \$25 per share because another Ventures II investor needed to sell his position to satisfy an \$18 million tax liability. Berkman also falsely claimed in an email to the same prospective investor the next month that Ventures II "currently ha[s] \$2 million [of Facebook shares] at \$25 per share [and] I may be able to secure another \$1.8 million at \$25 per share as long as I have your firm commitment to purchase it."

35. The Manager told another investor in approximately February 2012 that Facebook shares were reserved for Ventures II and that Ventures II had over \$1 million worth of pre-IPO Facebook shares available to sell at \$25 per share through a partnership with another fund. That month, the Manager e-mailed the same investor and copied Berkman: "We have been notified that we can purchase up to \$3.0 million of Facebook common stock. Priced at \$25.00 per share."

36. Berkman and the Manager sent prospective investors offering documents that similarly contained a host of materially false statements.

37. Berkman and the Manager provided investors with at least three different versions of a private placement memorandum ("Memorandum") for Ventures II and other formal offering materials, all of which contained false statements about acquiring Facebook shares. For example, Berkman provided a February 2012 Ventures II Memorandum to at least one potential investor, and the Manager provided Memoranda dated November 2010 and September 2011 to other investors. These Memoranda all represent that "investment proceeds will be used to purchase Facebook shares" and that "Facebook shares will be purchased" at various prices per share.

38. Berkman and the Manager also provided investors with the Ventures II operating agreement, which states that "the purpose of the Company is to acquire Facebook stock." Both Berkman and the Manager signed Ventures LLC membership certificates falsely stating that the investor is a "registered holder of one unit invested in Facebook." The Manager provided these certificates to investors.

39. Berkman signed letters to Ventures II investors acknowledging receipt of their investment proceeds and falsely stating, among other things, that the "investment was used to purchase . . . shares of Facebook stock at a cost basis of [a certain amount] per share." In addition, Berkman signed Ventures II "Quarterly Reports" and a "Letter of Ownership," which the Manager provided to investors, falsely stating that their Ventures II investment purchased a specific number of shares of pre-IPO Facebook shares at a specific price. The Manager further provided investors with a Ventures II "Facebook Opportunity Fund Overview," which falsely stated that their "investment is solely allocated to the purchase of Facebook stock."

40. Berkman also lied to Ventures II investors about the annual interest rate they would receive. The Ventures II Memoranda and other documents represented that members "will receive a 5% annual simple interest return on the investment until 100% of their principal and accumulated interest has been returned." Berkman signed a quarterly report falsely stating that the value of the

investment had increased, apparently due to the 5% annual interest. Berkman had the Manager give the quarterly report to Ventures II investors.

41. Berkman knew all of these statements were false, because he knew that none of the Ventures LLCs owned pre-IPO Facebook, LinkedIn, Groupon or Zynga shares and because he was personally misappropriating the investors' funds.

42. To further solicit certain investors, the Manager used a forged letter.

43. In late 2010, Ventures II used \$600,000 of investor funds to acquire an interest in the Actual Facebook Funds. This acquisition did not entitle Ventures II to the ownership of Facebook shares owned by the Actual Facebook Funds, but it did entitle Ventures II to an approximately 3.19% interest in the Actual Facebook Funds. At most, Ventures II's \$600,000 interest in the Actual Facebook Funds represented an indirect interest equivalent to approximately 22,253 shares of Facebook.

44. In September 2011, Kern asked the Law Firm, counsel to the Actual Facebook Funds, for a letter on the firm's letterhead describing Ventures II's interest in the Actual Facebook Funds and Facebook. In response, an associate at the Law Firm sent a letter with his signature to a purported Ventures II office in Manhattan at an address Kern provided. The letter, dated October 19, 2011, was addressed to Berkman and the Manager. The letter accurately stated that Ventures II held a 3.1899% interest in the Actual Facebook Funds and that the Actual Facebook Funds held an unspecified amount of Facebook shares. The letter did not state that Ventures II actually owned any Facebook shares.

45. Berkman, the Manager, Kern and/or someone working with them later altered the letter. The altered version was dated February 22, 2012. It was printed on the Law Firm's letterhead and had a forged version of the Law Firm associate's signature on it. The letter falsely represented that the Actual Facebook Funds "ha[ve] allocated 497,625 shares of Facebook, Inc. in Ventures Trust II LLC[s] capital account."

46. In or prior to February 2012, a prospective investor, who happened to be a securities attorney, asked the Manager for some assurance that Ventures II had acquired the pre-IPO Facebook shares that the Manager had claimed it acquired. In approximately February 2012, the Manager showed the forged letter to the investor, who then invested \$108,000 in Ventures II. The Manager refused to let the investor retain a copy of the letter.

47. On February 27, 2012, the Manager sent an email to another prospective investor with a copy of the forged letter attached.

48. On March 1, 2012, the Law Firm wrote a letter addressed to Berkman and the Manager. The letter enclosed a copy of the forged letter and stated that the forged letter "constitutes a fraudulent misrepresentation of your participation and interest in" the Actual Facebook Funds, "since your investment represents only 22,253 shares of Facebook, Inc. stock." The letter continued: "[The forged letter] was not drafted, executed or distributed by this law firm, is an unlawful and unauthorized use of this law firm's name and letterhead and contains a forged signature of an attorney at this law firm." The letter further informed Berkman and the Manager that "[y]our misconduct is consistent with a general pattern of deceit" and therefore that Ventures II's interest in the Actual Facebook Funds "is hereby terminated effective as of the dates of your initial investments."

49. On March 9, 2012, Kern, "as counsel to Ventures [II]," wrote back to the Law

Firm. Kern's letter claimed that Ventures II "is the victim of some other party's fabrication of the letter" and "we do not know the source of that letter." Kern's letter took issue with the termination of "important legal and economic rights of Ventures [II]" and threatened to file an NASD complaint.

50. On approximately March 12, 2012, a partner at the Law Firm informed Kern by telephone that Ventures II's \$600,000 interest in the Actual Facebook Funds had been rescinded and that the proceeds would be held in a segregated account to satisfy potential future claims. In other words, Ventures II no longer held even an indirect interest in Facebook shares.

51. Despite Kern's threats of legal action, neither Kern nor anyone else associated with Ventures II took legal action against the Actual Facebook Funds. The Actual Facebook Funds transferred Ventures II's interest to another investor and placed the cash proceeds in a segregated account.

52. In total, Berkman and the Manager raised more than \$9.9 million from all the Ventures LLC investors. Of that amount, approximately \$6.56 million was deposited in various Ventures II bank accounts, purportedly to be used to acquire pre-IPO Facebook shares; approximately \$1.68 million was deposited in a Ventures III account, purportedly to be used to acquire pre-IPO LinkedIn shares; approximately \$624,000 was deposited in a Ventures IV account, purportedly to be used to acquire pre-IPO Groupon shares; and approximately \$1.07 million was deposited in a Ventures VI account, purportedly to be used to acquire pre-IPO Zynga shares.

53. Besides the \$600,000 that was used to purchase the later-terminated interest in the Actual Facebook Funds, none of the Ventures LLCs' investor funds were ever used to purchase pre-IPO shares of Facebook, LinkedIn, Groupon, Zynga, or any other company, as Berkman knew.

The Face Off Acquisition Fraud

54. From approximately 2011 through July 2012, while he was conducting the Ventures fraud, Berkman fraudulently raised approximately \$2.6 million by selling membership interests in Face Off Acquisitions.

55. Actual Facebook Fund 2 owned a significant amount of pre-IPO Facebook shares.

56. Berkman told prospective investors over the telephone and in face-to-face meetings that Face Off Acquisitions would use its investor funds to acquire Actual Facebook Fund 2 or would otherwise acquire pre-IPO Facebook shares.

57. Berkman's effort to acquire Actual Facebook Fund 2 was perfunctory, at best. Berkman approached Actual Facebook Fund 2 about a proposal to purchase it, and Actual Facebook Fund 2's manager told Berkman in approximately April 2011 that it would cost at least \$28 million. Because Berkman and his entities never had the money, a deal was never likely or imminent.

58. Yet Berkman and Kern falsely portrayed the Actual Facebook Fund 2 deal as imminent to prospective investors.

59. In a letter dated April 14, 2012, Kern sent Berkman a letter that described the status of negotiations between Face Off Acquisitions and Actual Facebook Fund 2 and falsely implied that Face Off Acquisitions' purchase of Actual Facebook Fund 2 was likely and imminent. Kern captioned his letter "Memorandum of Understanding for Investors in Face Off Acquisitions, LLC

to acquire [Actual Facebook Fund 2] (1,012,500 shares of Facebook)." Kern's letter stated:

- "I am writing to confirm that yesterday afternoon I spoke with . . . legal counsel for [Actual Facebook Fund 2]. . . and the Company's Managing Director . . . about the prospect for a timely acquisition of the Company by Face Off Acquisitions;"
- "The purpose of this letter is to provide direction for completing [Face Off Acquisitions'] purchase of [Actual Facebook Fund 2]."
- "[Counsel for [Actual Facebook Fund 2] confirms that under the right set of circumstances, [Actual Facebook Fund 2] is willing to enter into a transaction in the coming few days with Face Off Acquisitions."
- "[T]he sole assets of [Actual Facebook Fund 2] are 1,012,500 shares of Class B Common shares of Facebook, Inc."
- "With proof of funds, a summary Term Sheet will be prepared and we will immediately set upon organizing a 'Securities Transaction Agreement' for the purchase and sale of the ownership interests of [Actual Facebook Fund 2]. Because the Facebook IPO is expected to be effective in early May[,] the [Actual Facebook Fund 2] purchase must occur on or before April 24, 2012."

60. Berkman knew the letter was misleading. The seemingly urgent negotiations were a charade, because Berkman knew Face Off Acquisitions could not possibly pay \$28 million (or any amount even close to \$28 million) to purchase Actual Facebook Fund 2.

61. In approximately April 2012, Berkman provided at least one prospective investor with Kern's letter.

62. Berkman also provided at least one other Face Off Acquisitions investor with an Actual Facebook Fund 2 Memorandum and Actual Facebook Fund 2's due diligence materials to lend the purported acquisition the appearance of legitimacy.

63. In an email on May 15, 2012, Berkman told yet another Face Off Acquisitions investor that Berkman was "[i]n NY for the closing. We have agreed on a \$35.00 per [s]hare price. Will check in with you when the deal is done." In fact, as Berkman knew, there was no closing, no agreement on a share price, and no money to close any such deal.

64. Berkman also provided prospective investors with Face Off Acquisitions Memoranda and other formal offering materials that contained false statements regarding the use of investor funds to purchase pre-IPO Facebook shares or to purchase Actual Facebook Fund 2.

65. Berkman sent at least one investor an April 2012 Face Off Acquisitions Memorandum stating that "Face Off Acquisitions is focused on generating above average financial returns by purchasing up to 1,012,500 pre IPO Facebook common shares, and significant preferred shareholder interest in five proprietary medical technology, capacitor, and water treatment companies."

66. Berkman sent at least one other investor a May 2012 Face Off Acquisitions Memorandum stating that "investment proceeds will be used solely to acquire up to 1,012,500 pre IPO Facebook shares at a \$35.00 per share cost basis," and described the "use of proceeds [as] one hundred percent invested in pre Facebook IPO stock."

67. In addition to the Memoranda, Berkman provided investors with other documents that contained similar misrepresentations, including:

- A Face Off Acquisitions operating agreement, which claimed that Face Off Acquisitions “has been formed to acquire, hold and/or dispose of all the issued and outstanding limited liability interests in [Actual Facebook Fund 2];”
- A Face Off Acquisitions memorandum dated April 11, 2012, which thanks the investor for his “willingness to review the Face Off Acquisitions investment opportunity to acquire 1,012,500 series B common pre IPO Facebook shares;” and
- A letter dated May 8, 2012, in which Berkman acknowledges receipt of a \$250,000 investment and tells the investor that it was “for the purpose of purchasing seven thousand one hundred forty two Facebook Series B common Rule 144 shares at a cost basis of \$35.00 per share.”

68. Berkman knew that each of these statements in the offering documents was false and misleading, because he intended to and did misappropriate all the funds invested in Face Off Acquisitions.

The Assensus Capital Fraud

69. After Facebook’s IPO on May 18, 2012, Berkman shifted gears and began focusing on another phony investment vehicle called Assensus Capital. Berkman made similar misrepresentations to prospective investors in Assensus Capital: The investors’ money would be invested in some new cutting edge venture, when Berkman was in fact misappropriating the offering proceeds.

70. Berkman sent one investor a June 2012 Assensus Capital Memorandum that stated: “Investment proceeds will be used to acquire significant equity interest in unique enterprises that serve large and growing markets, with superior profit margins [through] investing in state-of-the-art medical devise, infrastructure (water), distressed debt, and advanced nanotechnology materials companies.”

71. Berkman also wrote memoranda to prospective Assensus Capital investors that named specific companies in which Assensus Capital would invest and extended an investment “guaranty” purportedly backed up by cash or shares from one of its “portfolio” companies, including Facebook.

72. One such memorandum to a prospective investor, dated August 27, 2012, stated: “Upon making [an] Assensus Capital LLC investment, you will receive a 5% simple interest from the date of your investment, which will be returned together with your principal investment [in cash] or the equivalent in Facebook shares.” That investor later invested approximately \$150,000.

73. Afterwards, Berkman tried to solicit another investment from the same investor by again offering a “guaranty” linked to Facebook stock, this time making the following representations about the nature and basis for the guaranty:

- “Assensus Capital LLC and Face Off Acquisitions LLC will obtain the removal of all Facebook share legends upon the expiration of the Facebook November lock-up period in order to allow all or a portion of the shares to be sold as soon as allowed after the expiration date;”

- “Assensus Capital is willing to provide this guaranty for two specific reasons: (1) a high degree of confidence that [EVI] will be acquired within the next 6-12 months; and (2) the value of my carried interest in previous investment activities relating to the acquisition of Facebook shares, that is represented by share certificates for 165,713,000 common shares that I am holding as part of my compensation;” and
- “If you decide to exercise the investment guaranty, you can elect to receive the amount of your prospective investment together with the accumulated five percent annual simple interest or, a partial or complete distribution of 6,500 [Facebook] shares in addition to the 51,666 Facebook shares that are in your capital account as the result of your initial \$150,000 [investment] with a cost basis of \$7.74 per share.”

74. As Berkman knew, each of these representations was false. He intended to and did misappropriate all of the funds invested in Assensus Capital and knew neither he nor Assensus Capital had Facebook shares with which to guaranty investments.

75. Despite Berkman’s assurances, the investor declined to invest additional funds.

76. In total, Berkman raised approximately \$718,000 from Assensus Capital investors.

The Misappropriation of Investor Funds

77. None of the statements made by Berkman and the Manager about the use of the funds invested in the Venture LLCs, Face Off Acquisitions, or Assensus Capital were true. Other than the \$600,000 investment in the Actual Facebook Funds, none of the offering proceeds were used to make any investments at all, much less the purchase of pre-IPO shares in Facebook, LinkedIn, Groupon or Zynga.

78. In light of Berkman’s checkered past, the Manager falsely told investors that any withdrawals from the Ventures LLCs’ bank accounts would require both his and Berkman’s signature and consent and that Berkman would not have sole access to the bank accounts. Yet Berkman and the Manager each made countless withdrawals from the Ventures LLCs’ bank accounts without the other’s signature.

79. Berkman personally transferred approximately \$5.1 million of investor funds to his personal bank account. Berkman used most of that \$5.1 million, plus a \$925,000 direct transfer from a Ventures LLC account, to pay his judgment creditors in the bankruptcy proceeding.

80. Berkman used the remaining money that he had transferred to his personal account (approximately \$600,000) and another approximately \$1 million taken directly from the Ventures LLC accounts to make large cash withdrawals, pay legal fees, fund his own travel and other personal expenses and make numerous other payments unrelated to the purported business of the Ventures LLCs, Face Off Acquisitions or Assensus Capital. For example, Berkman spent approximately \$300,000 on dining, travel, retail and healthcare expenses and withdrew at least another \$165,000 in cash or cash equivalents.

81. In addition, Kern received approximately \$293,000 from the Ventures LLC accounts.

82. The Manager received approximately \$502,000 from accounts into which investor funds were deposited.

83. The majority of the rest of the offering proceeds, approximately \$4.8 million, was used to make payments to earlier investors in the pre-IPO scheme or, in some cases, to investors in Berkman's prior investment schemes. For example, in 2010 and 2011, Berkman transferred \$400,000 from a Ventures LLC account to two individuals to whom Berkman owed money from investments they had made in unrelated Berkman ventures in approximately 2004.

Misrepresentations To Conceal The Scheme

84. As the end of the lock up period for pre-IPO Facebook stock approached and investors began making requests for their distributions, the fraud began to unravel. In response, Berkman, Kern, and the Manager knowingly or recklessly made, or caused to be made, misrepresentations to investors to keep them from learning of the fraud and demanding the return of their funds.

85. For example, in August 2012, Kern wrote and signed a "Memorandum to Investors About Ventures Trust II LLC Efforts to Secure and Protect Interests with Our Trading Counterparties." Kern's memorandum stated that he was writing "to advise [investors] on the status of our efforts to address concerns that have been raised about the integrity of the funds."

86. Kern's memorandum represented that "Ventures Trust II has utilized two separate counterparties in securing the investments in privately held Facebook stock," and that "we are in the process of attempting to secure the transfer of these shares to our own trading account in order to avoid any complications arising out of the counterparty's trading practices."

87. Kern's memorandum represented that with respect to the first counterparty, "which involves approximately 20% of the investment capital of Ventures Trust II in Facebook stock," the counterparty "and its counsel have repeatedly affirmed that it has the requisite shares and reconfirmed to us that we have the securities interests to which we subscribed." The memorandum then suggested that the counterparty may have "more-or-less fabricated" the price of the shares, creating a "collateral issue," but assured investors that Ventures II would "address this in due course on behalf of our investors," if necessary.

88. Kern's memorandum further represented that the second counterparty "holds approximately 80% of our investments in Facebook."

89. The memorandum also stated that Ventures II "is subject to non-disclosure agreements with [both] counterparties which prevent us from disclosing the identity of these New York based groups at this time" and that Ventures II "is not a Ponzi scheme and absolutely and affirmatively rejects this assertion as false and malicious."

90. As Kern knew or at least recklessly disregarded, his statements were false. The Actual Facebook Funds were the first counterparty described in Kern's memorandum. As set forth above, Kern had learned five months earlier that the Actual Facebook Funds had terminated and liquidated Ventures II's interest in the Actual Facebook Funds based on the forged letter and that Ventures II therefore held no Facebook shares based on its transaction with the Actual Facebook Funds. Kern therefore knew that his representations about the first counterparty were false. The Broker-Dealer was the second counterparty described in Kern's memorandum. The Broker-Dealer never received an investment from, or engaged in any transactions with, Ventures II or any other entity associated with Berkman. Had Kern contacted the Broker-Dealer or conducted even the most cursory inquiry, he would have known for certain that this representation was false. In fact,

contrary to Kern's representation, no non-disclosure agreement existed between the Broker-Dealer and Ventures II (or any of the other Respondent entities).

91. For the same reasons, the Manager knew or recklessly disregarded that these statements were false.

92. For the same reasons and because he had misappropriated virtually all of the Ventures II investors' funds, Berkman knew these statements were false.

93. Nevertheless, in August 2012, the Manager emailed Kern's memorandum to certain investors, with a copy to Berkman. Berkman thereafter told investors that he had decided to liquidate the fund investments and that the funds would soon start making distributions. As Berkman knew, such statements were false and, as recently as in or around March 2013, Berkman gave investors a series of false excuses for why the distributions were still being delayed.

E. VIOLATIONS

94. As a result of the conduct described in paragraphs 1 through 93 above, Berkman, Face Off Acquisitions, Face Off Management, Ventures II, Ventures III, Ventures IV, Ventures V, Ventures VI, Ventures Trust Asset Fund, Ventures Trust Management, Ventures Trust Asset Management, Assensus Capital, and Assensus Management committed or caused violations of, and Berkman willfully violated, Sections 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

95. As a result of the conduct described in paragraphs 1 through 93 above, Berkman, Face Off Management, Ventures Trust Management, Ventures Trust Asset Management and Assensus Management committed or caused violations of, and Berkman willfully violated, Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which prohibit certain fraudulent conduct by an investment adviser.

96. Berkman willfully aided and abetted (a) the violations committed by Ventures II, Ventures III, Ventures IV, Ventures V, Ventures VI, Ventures Trust Asset Fund, Ventures Trust Management, Ventures Trust Asset Management, Face Off Acquisitions, Face Off Management, Assensus Capital, and Assensus Management of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and (b) the violations committed by Ventures Trust Management, Ventures Trust Asset Management, Face Off Management, Assensus Management, and the Manager of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which prohibit certain fraudulent conduct by an investment adviser.

97. Kern was a cause of, and willfully aided and abetted, violations committed by Berkman, Ventures Trust Management, and the Manager of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which prohibit certain fraudulent conduct by an investment adviser.

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 203(f) of the Advisers Act including, but not limited to, disgorgement pursuant to Section 203(j) and civil penalties pursuant to Section 203(i) of the Advisers Act;

C. What, if any, remedial action is appropriate and in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act, including, but not limited to, disgorgement pursuant to Section 9(e) and civil penalties pursuant to Section 9(d) of the Investment Company Act; and

D. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Kern should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1), (2) and (4) of the Advisers Act and Rule 206(4)-8; whether the other Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), (2) and (4) of the Advisers Act, and Rule 206(4)-8; and whether Respondents should be ordered to pay disgorgement, plus prejudgment interest thereon, pursuant to Section 8A(e) of the Securities Act, Section 21C(e) of the Exchange Act, and/or Section 203(j) of the Advisers Act, and civil penalties pursuant to Section 21B(a)(2) of the Exchange Act and/or Section 203(i)(B) 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 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



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 69191 / March 20, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15253

In the Matter of

Lunar Growth Corp.,

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 Lunar Growth Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Lunar Growth Corp. (CIK No. 1381806) is a Cayman Islands corporation located in Wuhan, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Lunar Growth 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 \$4,300 for the prior nine months.

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, have repeatedly failed to meet its obligations to file timely periodic reports, and failed to heed delinquency letters sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations or,

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through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

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

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

IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any 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


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. 69185 / March 20, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15251

In the Matter of

AMERICAS ENERGY COMPANY-AECO,

Respondent.

ORDER INSTITUTING PROCEEDINGS,
MAKING FINDINGS, AND REVOKING
REGISTRATION OF SECURITIES
PURSUANT TO SECTION 12(j) OF THE
SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Americas Energy Company-AECO ("Americas" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, Respondent consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

A. Americas Energy Company-AECO, a Nevada corporation based in Knoxville, Tennessee, previously claimed to be in the coal mining and exploration business. The common stock of Americas has been registered under Section 12(g) of the Exchange Act since December 6,

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2004. Americas' common stock previously was quoted on the Over-the-Counter Bulletin Board and currently is quoted on OTC Link operated by OTC Markets Group, Inc., under the ticker symbol AENYQ.

B. On December 7, 2011, Americas filed a petition in the United States Bankruptcy Court for the Eastern District of Tennessee, Northern Division (Knoxville) (the "Bankruptcy Court") for relief under Chapter 11 of Title 11, United States Code (11 U.S.C. §§ 101, *et seq.*), in the case of Americas Energy Company, as debtor (case number 3:11-bk-35466). Americas currently is in Chapter 11 proceedings before the Bankruptcy Court. On December 22, 2011, the Bankruptcy Court issued an order approving the United States Trustee's appointment of Thomas H. Dickenson as the Trustee for the debtor in bankruptcy (the "Bankruptcy Trustee").

C. Americas has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission, in that Americas has not filed an Annual Report on Form 10-K since July 18, 2011, or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ended September 30, 2011.

IV.

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

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

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

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

By the Commission.



Elizabeth M. Murphy
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 69189 / March 20, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15252

In the Matter of

**Allonline.com, Inc.,
Bonded Motors, Inc.,
Cass M L Production Corp.,
Cyber Grind, Inc.,
Cyni Investments, Inc.,
Czech Connection, Inc., and
Dynatec 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 Allonline.com, Inc., Bonded Motors, Inc., Cass M L Production Corp., Cyber Grind, Inc., Cyni Investments, Inc., Czech Connection, Inc., and Dynatec International, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Allonline.com, Inc. (CIK No. 1140004) is a permanently revoked Nevada corporation located in Newport Beach, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Allonline.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of over \$6,000 for the prior nine months.

2. Bonded Motors, Inc. (CIK No. 1006376) is a California corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bonded Motors 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 over \$2.6 million for the prior nine months.

3. Cass M L Production Corp. (CIK No. 878745) is an Alberta corporation located in Calgary, Alberta, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cass M L Production is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the year ended December 31, 1994, which reported a net loss of over \$3 million for the prior year.

4. Cyber Grind, Inc. (CIK No. 1111162) is a revoked Nevada corporation located in Beverly Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cyber Grind is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2004.

5. Cygni Investments, Inc. (CIK No. 1117046) 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). Cygni Investments is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2008, which reported a net loss of over \$3,800 for the prior six months.

6. Czech Connection, Inc. (CIK No. 1078364) is a permanently revoked Nevada corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Czech Connection 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, 2000, which reported a net loss of \$100 for the prior six months.

7. Dynatec International, Inc. (CIK No. 752208) is an expired Utah corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dynatec International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2001, which reported a net loss of over \$978,000 for the prior six months. On November 14, 2001, Dynatec International filed a Chapter 11 petition in the United States Bankruptcy Court for the District of Utah, and the case was terminated on April 27, 2011.

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



*Commissioner Gallagher
not participating*

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9396 / March 22, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 69208 / March 22, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3571 / March 22, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30435 / March 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15255

In the Matter of

JOHN THOMAS CAPITAL MANAGEMENT
GROUP LLC, d/b/a PATRIOT28 LLC,

GEORGE R. JARKESY JR.,

JOHN THOMAS FINANCIAL, INC., and

ANASTASIOS "TOMMY" BELESIS,

Respondents.

: ORDER INSTITUTING
: ADMINISTRATIVE AND CEASE-
: AND-DESIST PROCEEDINGS
: PURSUANT TO SECTION 8A OF
: THE SECURITIES ACT OF 1933,
: SECTIONS 15(b)(4), 15(b)(6) AND 21C
: OF THE SECURITIES EXCHANGE
: ACT OF 1934, SECTIONS 203(e), 203(f),
: AND 203(k) OF THE INVESTMENT
: ADVISERS ACT OF 1940 AND
: SECTION 9(b) OF THE
: INVESTMENT COMPANY 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 and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(4), 15(b)(6) 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 John Thomas Capital Management Group LLC, d/b/a Patriot28 LLC ("JTCM"), George R. Jarkesy Jr. ("Jarkesy"), John Thomas Financial, Inc. ("JTF") and Anastasios "Tommy" Belesis ("Belesis") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This case concerns fraudulent conduct by Jarquesy, the manager of two hedge funds formerly known as the John Thomas Bridge and Opportunity Fund LP I ("Fund I") and John Thomas Bridge and Opportunity Fund LP II ("Fund II," collectively the "Funds"), and the Funds' adviser, formerly known as JTCM. As alleged herein, Jarquesy also elevated the interests of Respondents JTF and Belesis over those of the Funds by steering millions of dollars in bloated fees to the broker-dealer.

2. Jarquesy and JTCM launched Fund I in 2007 and Fund II in 2009. Since September 2011, the Funds have been known as Patriot Bridge and Opportunity Fund LP I and LP II and the adviser has been known as Patriot28 LLC.¹

3. The Funds invest in three asset classes: bridge loans to start-up companies; equity investments principally in microcap companies; and life settlement policies. The Funds' assets under management peaked at approximately \$30 million at the end of 2011.

4. Among other things, Jarquesy and JTCM:

- a. recorded arbitrary valuations without any reasonable basis for certain of the Funds' largest holdings, thus causing the Funds' performance figures to be false and misleading and their own compensation to be falsely inflated;
- b. marketed the Funds on the basis of false representations about, among other things, the identities of their auditor and prime broker; and
- c. breached their fiduciary duty of full and fair disclosure to the Funds by failing to disclose their repeated favoring of the pecuniary interests of Belesis, the chief executive officer of JTF, and JTF, which served as the Funds' placement agent.

5. While they shared the same brand name, JTCM (the adviser) purported to be wholly independent of JTF (the placement agent).

6. Notwithstanding representations that he was "responsible for all of the investment decisions" of the Funds, Jarquesy capitulated to Belesis' aggressive demands regarding certain investment decisions. JTCM's purported independence from JTF was a

¹ This Order Instituting Proceedings will refer to the Funds and the adviser by the names they used at their inception.

sham designed to enrich Belesis at the expense of the Funds, and to insulate him from future accusations of wrongdoing.

7. In addition to capitulating to Belesis' demands regarding certain Fund activities, Jarquesy and JTCM abandoned their fiduciary duty to the Funds by negotiating arrangements whereby borrowing companies would divert large fees to JTF and Belesis using proceeds received from the Funds. For example, in connection with certain bridge loans made by Fund I, Belesis (acting through JTF) received hundreds of thousands of dollars in "fees" for providing little or no services.

8. Jarquesy and JTCM placed the interests of Belesis and JTF above the interests of the Funds, thereby violating the fiduciary duty that they owed to the Funds. For example, after being berated by Belesis for not delivering enough fees, Jarquesy promised him in an email in late 2009, "*We will never retreat we will never surrender and we will always try to get you as much [fees] as possible, Everytime [sic] without exception!*"

B. RESPONDENTS

9. Respondent JTCM is an unregistered investment adviser that serves as the general partner of two hedge funds, John Thomas Bridge and Opportunity Fund LP I and John Thomas Bridge and Opportunity Fund LP II. It is based in Houston, Texas.

10. Respondent Jarquesy, age 38, of Tomball, Texas, is the manager of JTCM. In that capacity, Jarquesy purportedly controls all operations and activities of JTCM and the Funds. Jarquesy is a frequent media commentator, a radio talk show host, and the founder of the National Eagles and Angels Association, an organization designed to introduce investors to start-up companies in need of financing.

11. Respondent Belesis, age 38, of New York, New York, is the founder and chief executive officer of JTF, which is based in New York. Until late 2011, JTF was the primary placement agent for the Funds, and was one of several broker-dealers that executed equity trade orders for the Funds. Belesis and Jarquesy became acquainted in 2003.

12. Respondent JTF is a broker-dealer registered with the Commission and a member of the Financial Industry Regulatory Authority ("FINRA"). Approximately 125 registered representatives are associated with the firm. JTF is wholly owned by ATB Holding Company LLC, which is controlled by Belesis. JTF offers brokerage and investment services, investment banking services and private wealth management.

C. FRAUD ON THE FUNDS

Background

13. Jarquesy created JTCM as an unregistered investment adviser in 2007 to serve as the adviser to Fund I. The venture grew from Jarquesy's prior successes with bridge loan financings.

14. In 2009, Jarquesy and JTCM formed a twin fund: Fund II. With the termination of Fund I scheduled for 2012, Fund II was formed in order to hold certain longer-term investments, including life settlement policies that had not matured. Initially, Fund II was structured to solicit foreign investors but when none bought shares, JTCM opened Fund II to domestic investors.

15. Jarquesy and JTCM purport to invest the Funds in three asset classes: (i) equity investments, including shares of stock, options and warrants, mostly in speculative microcap companies that are either not traded publicly or thinly-traded over the counter; (ii) bridge loans to public and non-public growth-stage companies; and (iii) life settlement policies. Although only Fund I is invested in life settlement policies, Fund II is invested in Fund I.

16. The Funds' limited partnership agreements ("LPAs") with shareholders provide that publicly traded securities will be valued at market price, dealer-supplied prices or by pricing models, but that Jarquesy may exercise his discretion in adjusting the values of both public and non-public holdings. The LPAs also provide that Jarquesy, as manager, has the discretion to value the Funds' non-publicly traded holdings as he "may reasonably determine." The Annual Financial Statements JTCM provided to investors, which included the independent auditors' report, stated that JTCM "records its investments at fair value" and had adopted Financial Accounting Standard 157 for purposes of valuation of the Funds' holdings, although JTCM has no records of its pricing analysis to support its valuation.

17. Jarquesy, as the manager of JTCM, was solely responsible for ensuring that the values assigned to the Funds' investments were consistent with representations in the LPAs.

18. The Funds' former administrator calculated the Funds' monthly net asset value based on valuation data provided by JTCM and Jarquesy. The administrator explicitly defined itself as a "scorekeeper" that did not independently analyze or verify the valuation data it was provided.

19. The Funds' former independent auditor expressly limited the scope of its valuation work to verifying that the Funds had correctly recorded the price of publicly traded securities; the auditor did not verify the valuation Jarquesy and JTCM assigned to non-publicly traded holdings. In practice, Jarquesy often invoked his discretion in order to misprice certain of the Funds' holdings.

20. Each Fund has a lock-up period. Fund I's lock-up period was five years and was scheduled to expire in September 2012, when the Fund was to terminate. At that time, Jarquesy and JTCM were expected to distribute its assets in cash and/or in kind, although distribution was incomplete by the end of December 2012. Fund II's lock-up period is four years and Fund II is scheduled to terminate no later than 2019. With Jarquesy's consent and

at his discretion, and provided they pay a penalty fee, investors can redeem their shares before the respective lock-up periods expire.

21. JTF had several roles relating to the Funds, although JTF and JTCM purported to be wholly independent. JTF served as the primary placement agent for solicitation of investments in the Funds; it served as the investment bank for some of the companies that received bridge loans from the Funds; and it acted as the broker for many of the Funds' equity trades. To date, JTF has received millions of dollars in fees related to the Funds.

22. At the end of 2011, Jarquesy valued Fund I at approximately \$18 million to \$20 million and Fund II at approximately \$10 million. The Funds' auditor reported Fund I's "total return since inception" was twenty-four percent. Together the Funds have approximately 120 investors.

23. Under the applicable LPAs, Jarquesy earns an incentive fee only after investors earn a nine percent return. After that, he earns a twenty percent incentive fee on any profits above the first nine percent. In addition, he earns a two percent management fee to cover operational costs of the Funds, including his own expenses, such as travel. To date, JTCM has received at least \$1.3 million in management fees, and Jarquesy has received at least \$260,000 as an incentive fee with more than \$500,000 additionally accrued for his incentive but not yet paid.

Jarquesy's Baseless Valuation of Fund Holdings

24. Investors in the Funds received monthly statements indicating the value of their shares and gains or losses compared with previous time periods. Investors' monthly statements did not identify the Funds' holdings or the values of each of the Funds' positions, however the value of each investor's shares was derived from a portion of the Funds' overall values.

25. Jarquesy and JTCM misrepresented the value of shareholders' investments in the Funds, which were based on an arbitrary and *ad hoc* methodology that differed from disclosures in the LPAs. As alleged more fully herein, Jarquesy's and JTCM's misrepresentations included incorrect valuations of the Funds' equity positions in certain companies, incorrect valuations of the Funds' short-term notes provided to other companies, and misvaluing of at least two of the Funds' life settlement policies.

26. JTCM's internal monthly holdings reports identified the Funds' holdings and the values of each position. The holdings reports served as the basis for valuing investors' Fund shares, which JTCM reported to investors on monthly statements. In addition, JTCM used the internal holdings reports to establish the Funds' performance, which was shared with existing and prospective shareholders. Finally, the net asset values of the Funds were the basis for calculating Jarquesy's management and incentive fees, which were deducted from the Funds.

27. For certain of the Funds' holdings, Jarquesy arbitrarily inflated valuations, causing his management and incentive fees, and the valuation of investors' shares, to be materially overstated. Specific examples are provided below.

Company A: An Invented and Inconsistent Valuation

28. Company A was formed in April 2010 when Company C, a company in which the Funds had invested, merged with a third company.

29. JTF and Belesis had a long-standing relationship with Company C. JTF had raised substantial amounts of capital for the company through numerous private placements.

30. Jarquesy and JTCM first invested the Funds in Company C in 2009, when Fund I extended a bridge loan to the company. That loan was repaid, and another one was made at the end of the year. From that point on, neither of the Funds' loans to Company C was repaid; instead, the Funds received allotments of penalty shares of Company C and then Company A after the merger. In 2010, the Funds' positions in Company A had grown disproportionately to their other holdings so that nearly a third of each Fund's assets were invested in Company A.

31. By late 2010, the Company A position grew to a paper value of more than \$8 million in Fund I, and more than \$2 million in Fund II, or nearly a third of each Fund's values.

32. In various versions of JTCM's internal monthly holdings statements for the same time period, Jarquesy's valuations of Company A's equity position were inconsistent, such as with two versions of the January 2009 holdings statement that valued the Company A position at seventy-five cents and \$750,000.

33. On JTCM's internal monthly holdings statements, Jarquesy recorded large swings in Company A's share value – ranging from more than three dollars per share in August 2010 to ten cents in December 2010 – that did not pertain to any underlying change in Company A's prospects or financial condition, and that he could not otherwise explain.

34. In addition, Jarquesy's valuation of Company A's shares was inconsistent across versions of the monthly holdings statements for the same period. On some versions of the same month's statement, Jarquesy listed Company A as either ten cents or one dollar per share. For at least one month, Jarquesy listed Company A's per-share value for Fund I differently than he listed it for Fund II.

35. The conflicting and inconsistent valuation of Company A was exacerbated in May 2011 by a typographical error made by JTCM's controller, who accidentally entered the value at two cents per share when it should have been sixty cents. After the error, Jarquesy retained an outside consultant to confirm his valuation.

36. The outside consultant, however, disregarded actual data and based its valuation on the assumption that Company A – a deeply troubled company that had never earned a single dollar – would generate \$61 million in revenue in 2011.

37. In June 2011, shortly after receiving the consultant's report, Jarquesy wrote off the Funds' investment in Company A.

38. Jarquesy's valuations of Company A shares were arbitrary and inconsistent with Jarquesy's obligation to use his discretion to make reasonable valuation determinations as disclosed in the LPAs, and resulted in the recording of unreasonable and unsupported valuations on JTCM's monthly holdings reports. The phony valuations on the monthly holdings lists served as the basis for valuing shareholders' individual positions in the Funds, which were reported to them on monthly statements. Performance results for the Funds, and management and incentive fees for the adviser and manager, also were derived from the baseless and unreasonable values Jarquesy recorded on the monthly holdings lists.

Company B: Jarquesy Hired Promoters to Boost the Share Price

39. In 1996, Jarquesy personally invested in a publicly traded shell company (the "shell") that, after a later merger, would become Company B. Jarquesy was chairman of the board of directors of the shell; in 2007, when he formed JTCM and the Funds, he stepped down as chairman but remained a director.

40. Jarquesy and JTCM invested approximately \$200,000 of the Funds' money in the shell in late 2009, and the Funds became the shell company's controlling shareholders. The shell merged with a small, private oil and gas company in the summer of 2010 to form Company B, a microcap oil and gas exploration company. The Funds owned approximately twenty-five percent of Company B's unrestricted stock after the merger, which Jarquesy valued by reference to its publicly quoted share price. At the time, public trading of Company B's shares in the over the counter market had only recently commenced and was extremely thin.

41. Between November and December 2010, Company B's share price jumped from \$1 to \$4. Accordingly, Jarquesy revalued the position on JTCM's monthly holdings reports, causing a material improvement in the Funds' performance. The beneficial spike in Company B's stock price did not, however, correlate to any disclosed corporate event.

42. About a year later, in late 2011, Jarquesy testified under oath that the sudden increase in Company B's stock price may have been due to a bank extending a loan to the company, thereby indicating to the marketplace that Company B had upside as a company. No such bank loan was extended to Company B between November and December 2010, when its share price jumped.

43. Jarquesy was in fact directly responsible for orchestrating the increase in Company B's share price at the end of 2010 through a promotion campaign he financed using money in Fund I's bank account. In December 2010, he authorized at least three

wire transfers totaling \$35,000 from Fund I's bank account to a promotional firm he selected to tout Company B and its stock.

44. Jarquesy's transfers from Fund I to the promoter coincided with the jump in Company B's share price. As a result, Jarquesy was able to record unreasonable and unsustainable valuations for the Funds' Company B shares at the same time he was writing down the value of the Company A holding, thus stabilizing the Funds' year-end performance.

45. Jarquesy also manipulated the value of Company B's shares in JTCM's records in other ways. For example, at a time when the market – and Jarquesy – valued Company B shares at \$1 each, he sold 300,000 shares from Fund I to Fund II at twenty-two cents per share. Then, after the shares had been transferred to Fund II, he re-valued them in Fund II at \$1 per share.

46. Jarquesy also recorded values for Company B's warrants held by the Funds that were inconsistent with the valuation methods disclosed in the LPAs. Between August and December 2010, his values for the warrants ranged from twelve cents to \$6.92. While a warrant's value often correlates with the value of the stock, which for Company B increased from \$1 to \$4 during that time period, it rarely rises higher than the value of the stock, particularly in the case of a speculative penny stock. Jarquesy's work papers for his valuation of Company B warrants reflect that he calculated the value based on an inaccurate share price, which therefore generated warrant values inconsistent with the methods disclosed in the LPAs.

47. Furthermore, Jarquesy's accounting for the Funds' holdings of shares of Company B are at odds with Company B's filings with the Commission. Company B reported a reverse stock split effective in September 2010, but the Funds' holdings reports for August 2010 prematurely reflected the reverse split and thereby enabled Jarquesy to record a premature benefit from the reverse split.

Company D: Jarquesy Also Hired Promoters to Boost Share Price

48. Company D is a publicly traded microcap company in which Jarquesy invested both personally and on behalf of the Funds. Until February 2012, Jarquesy was a director of Company D.

49. Jarquesy, as a director of Company D, voted to hire three different promotional firms in early 2011 to promote the company. Jarquesy paid the promoters directly from Fund I's bank account and with cash that Fund II loaned to Company D that was earmarked for paying promoters. In addition, the promoters were compensated with Company D shares.

50. As with his use of Fund money to finance the Company B promotional campaign, Jarquesy's direct and indirect financing of Company D's promotion with Fund

assets was designed to boost the value of the Funds' large equity positions in Company D and maintain the Funds' overall performance.

51. The promotional campaigns that Jarquesy financed with Fund money had the effect of enhancing Jarquesy's own remuneration. If the promotional campaigns were successful in raising the share prices for publicly traded holdings of the Funds, such as Company D and Company B, then the Funds' valuation would increase – along with Jarquesy's compensation, which was based on the Funds' value and performance.

52. Jarquesy also used cash from the Funds to make several short-term bridge loans to Company D. Throughout 2010, Jarquesy valued \$1.3 million of these loans at par in Fund I's portfolio. In reality, Company D – as disclosed in its 2010 Form 10-K filed with the Commission – had defaulted on those loans as of December 31, 2009. As a result, Fund I's valuation falsely reflected a par value for the loans when at best, the position would have been worth the value of whatever penalty shares the Fund expected to receive in exchange for repayment of the loans.

Life Settlement Policies: Inconsistent Values in Fund Documents

53. Jarquesy and JTCM purchased twelve life settlement policies in Fund I. When the first policy paid off on the death benefit in the spring of 2011, the proceeds were distributed to investors. The Funds acquired the life settlement policies, and assumed responsibility for payment of their premiums, to obtain the payouts that would occur upon the death of the individuals covered by the policies.

54. Jarquesy claimed – and told at least one Fund investor – that JTCM retained one of his former business associates to value the life settlement policies using a Milliman model, an industry standard valuation tool used to calculate the net present value of policies. The associate purportedly inputted life expectancies provided by third-party agencies, which he then used to generate the value of the policies. However, the Funds' former auditors' work papers indicate that it was Jarquesy, not his associate, who valued the life settlement policies using the Milliman model. Thus, investors received different information about who was responsible for the valuation of the assets meant to hedge the Funds' risky, speculative investments, undermining the reliability of what was represented to be the conservative side of the Funds.

55. Between February and March 2010, JTCM's internal documents showed that the values of two of the life settlement policies more than doubled, one rising from \$900,000 to nearly \$2.6 million and the other increasing from \$526,000 to \$1.4 million. In calculation tables JTCM purportedly used to value the policies, however, no such increase was indicated. The internal documents, which are inconsistent with the calculation tables, were the basis of monthly statements that were sent to investors.

56. Jarquesy has explained that the two life settlement policies were revalued based on a suggestion from the Funds' former auditor. However, the auditor's suggestions would have changed the values by approximately three percent, while Jarquesy's baseless

changes resulted in increasing the two policies by 167 percent and 184 percent, respectively, thereby increasing the Funds' overall asset value by nearly twelve percent. Management fees payable to JTCM and Jarquesy, and Jarquesy's incentive fees, were correspondingly increased as a percentage of the overall asset value of the Funds.

JTCM's Sales Materials Contain Misrepresentations

57. Jarquesy controlled all aspects of the creation of JTCM's marketing materials. JTCM's and Jarquesy's marketing materials for the Funds contained material misrepresentations about the Funds' performance, allocation of assets, and service providers – including prime broker and auditor – that Jarquesy included to create an appearance of legitimacy.

58. Jarquesy materially exaggerated aspects of JTCM's operations in sales and marketing materials, including that:

- a. JTCM engaged in "detailed legal and technical due diligence" before investing Fund assets when, in fact, such diligence consisted merely of cursory analysis conducted by Jarquesy, for example, his seeking free advice from academic or industry experts and investors in the Funds;
- b. JTCM employed many expert consultants when, in fact, Jarquesy had yet to hire his only in-house analyst at the time the literature was prepared;
- c. as manager, Jarquesy had more than 10 years of experience, "both years as a professional as well as years in the firm;"
- d. estimated annual returns of Fund I would be thirty percent; and
- e. no investment would exceed five percent of either Fund's value when, in fact, at least one investment (Company A and its predecessor company, Company C) exceeded a third of the value of each Fund in 2010.

The Funds' Auditor was not KPMG

59. Investor updates and other marketing materials created by Jarquesy and JTCM between 2008 and 2010 identified KPMG LLP, among others, as the auditor of Fund I. Other marketing materials also identified KPMG as auditor for both Fund I and Fund II. Belesis and JTF marketed Fund I and Fund II to potential investors with the understanding that KPMG was the auditor of both Funds.

60. KPMG never audited Fund I.

61. KPMG also never audited Fund II. In 2009, Fund II was created as a vehicle for foreign investors and JTCM and Jarquesy retained KPMG's Cayman Island office for audit work. When no foreigners invested in Fund II, the Fund was opened to American investors and KPMG resigned without having done any substantive audit work.

62. One set of JTCM marketing materials for Fund I dated June 1, 2007, identified Malone & Bailey, P.C., now known as MaloneBailey LLP, as the auditor. MaloneBailey never audited either of JTCM's Funds.

63. Contrary to much of Jarquesy's and JTCM's marketing materials, neither KPMG nor MaloneBailey ever audited the Funds. The actual auditor of the Funds was a small Houston-based firm that resigned from the engagement in 2011.

The Funds' Prime Broker was not Deutsche Bank

64. Jarquesy's and JTCM's marketing materials for the Funds identified Deutsche Bank, among others, as the Funds' prime broker. Deutsche Bank, however, never had a prime brokerage agreement with JTCM, and requested that the designation "prime broker" be removed from the private placement memorandum ("PPM") for Fund II, which had an inactive retail account at Deutsche Bank for six months in 2009.

65. After Deutsche Bank requested that the false designation of "prime broker" be removed from Fund II's PPM, JTCM and Jarquesy continued to falsely identify it as the Funds' prime broker in other marketing materials.

The Undisclosed Role of Belesis and JTF in Fund Operations

66. JTCM – acting through Jarquesy, its manager – represented that it was solely responsible for managing the Funds. The only disclosed connection between JTF and JTCM was JTF's role as placement agent and potential broker-dealer for the Funds' securities transactions. There was no disclosure – or even suggestion – that JTF or Belesis would become involved in JTCM's and the Funds' investment activities.

67. To underscore the independence of JTCM and JTF, JTCM's website included a disclaimer indicating that other than using JTF as a placement agent, JTCM had no business relationship with JTF.

68. Belesis was aware of the disclaimer distancing JTCM from JTF because he used it as a model in an unrelated business venture.

69. In reality, Belesis frequently sought to intervene in the Funds' business decisions. As leverage, Belesis conveyed to Jarquesy – often in a profane and belligerent manner – that the millions of dollars invested into the Funds by JTF customers required Jarquesy to follow Belesis' instructions.

70. In light of his improper meddling in the Funds' business, Belesis separately indicated to registered representatives at JTF that the independence of JTCM and JTF on paper would be a helpful fact in the event anything improper happened with respect to the Funds.

71. For example, Belesis – sometimes, but not always, in collaboration with Jarkey – periodically guided how the Funds' money would be invested in Company A. Company A's chief executive officer requested that Belesis allocate Fund money to pay operating costs, including rent, payroll and payments to Company A's service providers. The Funds' bank records show debits to pay certain Company A expenses.

72. In some cases, Belesis' decisions regarding Company A, one of the Funds' largest holdings, overrode the decisions of Company A's corporate officers, who implored him to handle company affairs differently. As one example, Company A officers were displeased with Belesis' choice of chief financial officer for the company, who they thought required too high a salary.

73. As another example, Company A's officer complained that Belesis prematurely completed a stock purchase agreement that they had wanted to revise. However, Company A's officers had no choice but to accept Belesis' decisions about their company because of Belesis' influence over when, how and if money would flow to Company A from the Funds, the company's main source of capital.

74. Belesis also supplanted Jarkey as the decision maker for JTCM in connection with certain of the Funds' investments in Company B. Indeed, Belesis' role was clear when the Funds extended a bridge loan to Company B and the proceeds were delayed in arriving at the company. The company president and chief executive officer addressed Belesis – not Jarkey, the supposed exclusive manager of the Funds – about the delay, and Belesis reassured him, *"You will have it, smoke a nice cigar."*

75. Numerous emails reflect Jarkey's subservience to Belesis and efforts to please him by offering him benefits from the Funds' investment activities, including cash, fees and securities.

The Undisclosed Business Relationship between JTCM and JTF

76. In addition to the undisclosed influence Belesis exerted over the Funds' operations, JTCM and Jarkey, despite publicly professing their independence from JTF, were in fact actively seeking to generate revenue for JTF and Belesis. For example, in March 2009, a JTCM employee wrote to Belesis:

George [Jarkey] and I have worked hard over the past month creating a backlog of potential clients for JTF and JTCM.... We now have two or three that could be JTF clients in a matter of weeks with tens of thousands of dollars in monthly fees not to mention [another business transaction] already in the bag....

The failure of your staff to execute payment on our contract has put a stop to our progress. . . . I still have high hopes for the potential of this liaison between JTF, JTCM . . . and myself. Based upon your email below I estimate that you feel same. George, I know is optimistic of the potential that this relationship holds....

77. In March 2009, the director of a company that JTCM and Jarquesy had steered to JTF asked to meet with Belesis before paying for JTF's services. In response, Belesis erupted at Jarquesy: "*GEORGE WHAT KIND OF BULL[...JT IS THIS*".

78. Jarquesy's reply indicates his allegiance to Belesis: "*I just told him to send the stock and money, sign the document or get lost,*" he wrote. "*I think this will get done today. Nobody gets access to Tommy [Belesis] until they make us money!!!!!"*

Jarquesy and JTCM Diverted the Funds' Money to Enrich Belesis and JTF

79. In breach of his fiduciary duty to the Funds, Jarquesy, through his role at JTCM, actively negotiated fees on behalf of JTF and Belesis in connection with the Funds' activities, to the detriment of the Funds.

80. Jarquesy used his role as manager of the Funds to enrich Belesis and JTF, and kept an appreciative Belesis apprised of his efforts. For example, Jarquesy giddily wrote to Belesis in March 2010: "*[W]e are all going to make so much f[...]ing money this year, the clients of John Thomas are going to have a banner year.... Write yourself a check and get ready to cash it \$45 million.*" Belesis replied, "*Sounds great buddy, look forward to it.... Lol [laughing out loud],*" to which Jarquesy responded, "*Your [sic] going to not stop laughing when you are liquidating everyones [sic] stock.*"

81. On another occasion, after Belesis complained that Jarquesy was not securing sufficient fees for JTF in February 2009, Jarquesy responded that "*we will always try to get you as much as possible, Everytime [sic] without exception!"*

82. Overall, Jarquesy's allegiance to Belesis and JTF cost the Funds significant sums of money, directly or indirectly, for placement fees, loans to small companies that then used the money to pay fees to JTF, and for unearned bridge loan fees JTF received for doing no work.

Fund Money Was Routed to JTF for Unearned Bridge Loan Fees

83. The Funds extended short-term bridge loans to small, usually private companies. In exchange for the loans, the Funds received interest on the amount of the loan and what Jarquesy called an "equity kicker" of stock, options or warrants in the company.

84. JTF and Belesis occasionally introduced Jarquesy and JTCM to candidates for bridge loans. For its involvement, JTF earned a fee of approximately thirteen percent of

each bridge loan the Funds made. Jarquesy and JTCM made no effort to negotiate a lower fee for JTF.

85. The Funds typically extended bridge loans to struggling, cash-poor ventures. Every dollar provided in the loan was essential to the borrowers' future prospects and, therefore, the Funds' investment in the borrowing companies and chances of ultimately being repaid. Jarquesy, however, often abandoned his fiduciary duties to the Funds and affirmatively negotiated arrangements whereby the borrowers would divert large fees to JTF using proceeds received from the Funds.

86. Jarquesy abandoned his fiduciary duties to the Funds and negotiated arrangements whereby the borrowing companies – in which the Funds were invested and from which the Funds sought repayment – would divert large fees to JTF using proceeds received from the Funds. Thus, Jarquesy, in his capacity as manager of the Funds, when negotiating bridge loans between the Funds and the borrowing companies, placed the interests of Belesis and JTF above the interests of JTCM's clients, the Funds, and assumed responsibility for negotiating on behalf of Belesis and JTF. As examples:

- a. In March 2009, Jarquesy offered Belesis increasingly favorable fees on a bridge loan the Funds were extending to Company A, and also offered him commissions and warrants without Belesis requesting such benefits.
- b. In February 2010, Jarquesy drafted a \$130,000 commission for JTF in a term sheet for a \$1 million bridge loan to a company that expressly informed him that it did not want to commit to long-term financing with JTF.
- c. In May 2009, Jarquesy structured a transaction between the Funds and Company D specifically so that JTF and Belesis could be "the hero," as Jarquesy wrote in an email, and earn commissions and fees.

87. Belesis and JTF were willing recipients of the Funds' generosity provided by Jarquesy and JTCM, but it was Jarquesy who was responsible for negotiating their fees from the Funds' bridge loans.

88. So beholden was Jarquesy to Belesis and JTF that in some instances, Jarquesy negotiated and procured a fee for them even though they had not referred the borrower to the Funds for financing and had done, at most, minimal work relating to the loan. For example:

- a. Jarquesy was a director of Company D and introduced the company to the Funds for a bridge loan and to JTF for long-term financing. When the Funds extended a bridge loan in October 2008, JTF received a full fee for having done merely negligible work relating to the loan.

- b. Jarquesy was a director of Company B and brought the company to JTF for investment banking work in the summer of 2010. When the Funds extended a bridge loan to Company B, JTF received a fee on the loan despite having done only minor work on the loan or the referral.

89. Between 2008 and 2010, JTF was paid a total of \$488,750 in fees from four bridge loans, including at least two for which it did nearly inconsequential work. JTF's fees came from the borrowing company, which paid the fees upon receipt of the bridge loan money from the Funds, thereby immediately diminishing the loans the Funds made by the amount of the fees Jarquesy arranged for JTF.

90. In addition to the bridge loan fees, Jarquesy and JTCM paid JTF more than \$741,000 in brokerage commissions from the Funds' securities trades, and nearly \$2.5 million in placement fees for selling shares of the Funds.

D. VIOLATIONS

1. As a result of the conduct described above, JTCM and Jarquesy willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

2. As a result of the conduct described above, JTCM and Jarquesy willfully aided, abetted and caused the Funds' violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

3. As a result of the conduct described above, JTCM and Jarquesy willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 thereunder, which prohibits making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances in which they were made, not misleading to any investor or prospective investor in a pooled investment vehicle or otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in a pooled investment vehicle.

4. As a result of the conduct described above, JTF and Belesis willfully aided, abetted and caused JTCM's and Jarquesy's violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 thereunder, which prohibits making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in light of the circumstances in which they were made, not misleading to any investor or prospective

investor in a pooled investment vehicle or otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in a pooled investment vehicle.

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 Sections 15(b)(4) and 15(b)(6) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;
- C. What, if any, remedial action is appropriate in the public interest against Respondents JTCM and Jarkesy pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement pursuant to Section 203(j), civil penalties pursuant to Section 203(i) and censure pursuant to Section 203(e) of the Advisers Act;
- D. What, if any, remedial action is appropriate in the public interest against Respondents JTCM, Jarkesy, JTF and Belesis pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement pursuant to Section 9(e) and civil penalties pursuant to Section 9(d) of the Investment Company Act; and
- E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondent Jarkesy should be prohibited 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 if the conduct of that Respondent demonstrates unfitness to serve as an officer or director of any such issuer, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 203(j) of the Advisers Act, and Section 9(e) of the Investment Company 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

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

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69214 / March 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15256

In the Matter of

EDWARD L. MOSKOP,

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 Edward L. Moskop ("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.

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III.

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

1. Respondent was the president and sole owner of Financial Services Moskop & Associates, Inc. ("Financial Services"), an Illinois corporation that offered and purported to sell various financial products to the public. Until 1990, Respondent was a registered representative associated with broker-dealers registered with the Commission. However, in 1990, the National Association of Securities Dealers (n/k/a the Financial Industry Regulatory Authority) ("FINRA") barred Respondent from association in any capacity with any member of FINRA. Respondent, 64 years old, is a resident of Belleville, Illinois.

2. On July 21, 2011, a final judgment was entered by consent against Moskop, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Edward L. Moskop and Financial Services Moskop & Associates, Inc., Civil Action Number 1:10-CV-07462, in the United States District Court for the Northern District of Illinois, Eastern Division.

3. The Commission's complaint alleged that from at least 1989 to November 2010, Respondent, in connection with the sale of securities, misused investor funds, falsely stated to investors their funds were invested, sent out false account statements indicating that investors' funds were fully invested and earning returns, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Moskop 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


By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69216; File No. SR-NASDAQ-2012-090)

March 22, 2013

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Order Granting Approval of a Proposed Rule Change to Amend Rule 4626—Limitation of Liability

I. Introduction

On July 23, 2012, The NASDAQ Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Exchange Rule 4626—Limitation of Liability (“accommodation proposal”).

The proposed rule change was published for comment in the Federal Register on August 1, 2012.³ The Commission received 11 comment letters on the accommodation proposal⁴ and a

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 67507 (July 26, 2012), 77 FR 45706 (August 1, 2012) (“Notice”).

⁴ See letters to Elizabeth M. Murphy, Secretary, Commission, from Sis DeMarco, Chief Compliance Officer, Triad Securities Corp., dated August 20, 2012 (“Triad Letter”); Eugene P. Torpey, Chief Compliance Officer, Vandham Securities Corp., dated August 21, 2012 (“Vandham Letter”); John C. Nagel, Managing Director and General Counsel, Citadel LLC, dated August 21, 2012 (“Citadel Letter”); Benjamin Bram, Watermill Institutional Trading LLC, dated August 22, 2012 (“Bram Letter”); Daniel Keegan, Managing Director, Citigroup Global Markets Inc., dated August 22, 2012 (“Citi Letter”); Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated August 22, 2012 (“SIFMA Letter I”); Mark Shelton, Group Managing Director and General Counsel, UBS Securities LLC, dated August 22, 2012 (“UBS Letter I”); Andrew J. Entwistle and Vincent R. Cappucci, Entwistle & Cappucci LLP, dated August 22, 2012 (“Entwistle Letter”); Douglas G. Thompson, Michael G. McLellan, and Robert O. Wilson, Finkelstein Thompson LLP, Christopher Lovell, Victor E. Stewart, and Fred T. Isquith, Lovell Stewart Halebian Jacobson LLP, Jacob H. Zamansky and Edward H. Glenn, Zamansky & Associates LLC, dated August 22, 2012 (“Thompson Letter I”); James J. Angel, Associate Professor of Finance, Georgetown University, McDonough School of

response letter from Nasdaq.⁵ On September 12, 2012, the Commission extended the time period for Commission action to October 30, 2012.⁶ On October 26, 2012, the Commission instituted proceedings to determine whether to approve or disapprove the accommodation proposal.⁷ The Commission then received six additional comment letters on the proposal⁸ and a second response letter from Nasdaq.⁹ On January 23, 2013, the Commission extended the time period for Commission action to March 29, 2013.¹⁰ This order approves the proposed rule change.

Business, dated August 23, 2012 (“Angel Letter”); and Leonard J. Amoruso, General Counsel, Knight Capital Group, Inc., dated August 29, 2012 (“Knight Letter”).

⁵ See letter to Elizabeth M. Murphy, Secretary, Commission, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated September 17, 2012 (“Nasdaq Letter I”).

⁶ See Securities Exchange Act Release No. 67842 (September 12, 2012), 77 FR 57171 (September 17, 2012).

⁷ See Securities Exchange Act Release No. 68115 (October 26, 2012), 77 FR 66197 (November 2, 2012).

⁸ See letters to Elizabeth M. Murphy, Secretary, Commission, from John Robinson, dated November 13, 2012 (“Robinson Letter”); Theodore R. Lazo, Managing Director and Associate General Counsel, Securities Industry and Financial Markets Association, dated November 20, 2012 (“SIFMA Letter II”); Jeremy Abelson, MJA Capital, dated November 21, 2012 (“Abelson Letter”); Douglas G. Thompson, Michael G. McLellan, and Robert O. Wilson, Finkelstein Thompson LLP, Christopher Lovell, Victor E. Stewart, and Fred T. Isquith, Lovell Stewart Halebian Jacobson LLP, Jacob H. Zamansky and Edward H. Glenn, Zamansky & Associates LLC, dated November 23, 2012 (“Thompson Letter II”); Tim Mann, dated November 23, 2012 (“Mann Letter”); and Mark Shelton, Group Managing Director and General Counsel, UBS Securities LLC, dated November 23, 2012 (“UBS Letter II”).

⁹ See letter to Elizabeth M. Murphy, Secretary, Commission, from Joan C. Conley, Senior Vice President and Corporate Secretary, Nasdaq, dated December 7, 2012 (“Nasdaq Letter II”).

¹⁰ See Securities Exchange Act Release No. 68707 (January 23, 2013), 78 FR 6154 (January 29, 2013).

II. Description of Proposal

Pursuant to existing Nasdaq Rule 4626(a), Nasdaq and its affiliates are not liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use.¹¹ However, existing Nasdaq Rule 4626(b) allows Nasdaq to compensate users of the Nasdaq Market Center for losses directly resulting from the systems' actual failure to correctly process an order, Quote/Order, message, or other data, provided the Nasdaq Market Center has acknowledged receipt of the order, Quote/Order, message, or data. Nasdaq's payment for all claims made by all market participants related to the use of the Nasdaq Market Center during a single calendar month shall not exceed the larger of \$500,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy.¹²

Nasdaq proposes to add subsection (3) to Nasdaq Rule 4626(b) to establish a voluntary accommodation program for certain claims arising from the initial public offering ("IPO") of

¹¹ According to Nasdaq Rule 4626(a), any losses, damages, or other claims, related to a failure of the Nasdaq Market Center to deliver, display, transmit, execute, compare, submit for clearance and settlement, adjust, retain priority for, or otherwise correctly process an order, Quote/Order, message, or other data entered into, or created by, the Nasdaq Market Center is absorbed by the member, or the member sponsoring the customer, that entered the order, Quote/Order, message, or other data into the Nasdaq Market Center.

¹² See Nasdaq Rule 4626(b)(1). Under Nasdaq Rule 4626(b)(2), with respect to the aggregate of all claims made by all market participants during a single calendar month related to a systems malfunction or error of the Nasdaq Market Center concerning locked/crossed market, trade through protection, market maker quoting, order protection, or firm quote compliance functions of the market participant, to the extent such functions are electronically enforced by the Nasdaq trading system and where Nasdaq determines in its sole discretion that such systems malfunction or error was caused exclusively by Nasdaq and no outside factors contributed to the systems malfunction or error, Nasdaq's payment during a single calendar month will not exceed the larger of \$3,000,000 or the amount of the recovery obtained by Nasdaq under any applicable insurance policy. See Nasdaq Rule 4626(b)(2). The Facebook initial public offering does not implicate the types of systems errors or malfunctions described in Nasdaq Rule 4626(b)(2).

Facebook, Inc. ("Facebook") on May 18, 2012 (collectively "Facebook IPO").¹³ Specifically, Nasdaq proposes to compensate market participants for certain claims related to system difficulties in the Nasdaq Halt and Imbalance Cross process ("Cross")¹⁴ in connection with the Facebook IPO in an amount not to exceed \$62 million.¹⁵ Further, as proposed by Nasdaq, claims for compensation must arise solely from realized or unrealized direct trading losses from four specific categories of Cross orders: (i) sell Cross orders that were submitted between 11:11 a.m. ET and 11:30 a.m. ET on May 18, 2012, that were priced at \$42.00 or less, and that did not execute; (ii) sell Cross orders that were submitted between 11:11 a.m. ET and 11:30 a.m. ET on May 18, 2012, that were priced at \$42.00 or less, and that executed at a price below \$42.00; (iii) buy Cross orders priced at exactly \$42.00 and that were executed in the Cross, but not immediately confirmed; and (iv) buy Cross orders priced above \$42.00 and that were executed in the Cross, but not immediately confirmed, but only to the extent entered with respect to a customer¹⁶ that was permitted by the member to cancel its order prior to 1:50 p.m. and for which a request to cancel the order was submitted to Nasdaq by the member, also prior to 1:50 p.m.¹⁷

¹³ In addition to adding proposed subsection (b)(3) to Nasdaq Rule 4626, Nasdaq proposes to make certain technical amendments to existing subsections of that rule. See, e.g., proposed Nasdaq Rule 4626(b)(4) and (b)(6).

¹⁴ See Nasdaq Rule 4753. The Commission recently proposed Regulation Systems Compliance and Integrity ("Regulation SCI") because of a highlighted "need to consider an updated and formalized regulatory framework for ensuring that the U.S. securities trading markets develop and maintain systems with adequate capacity, integrity, resiliency, availability, and security, and reinforce the requirement that [automated] systems operate in compliance with the [Act]." See Securities Exchange Act Release No. 69077 (March 8, 2013) (File No. S7-01-13) (proposing release for Regulation SCI).

¹⁵ See proposed Nasdaq Rule 4626(b)(3); Notice, supra note 3, at 47507.

¹⁶ As proposed, unless Nasdaq Rule 4626 states otherwise, the term "customer" includes any unaffiliated entity upon whose behalf an order is entered, including any unaffiliated broker or dealer. See proposed Nasdaq Rule 4626(b)(3)(A).

¹⁷ See proposed Nasdaq Rule 4626(b)(3)(A); Notice, supra note 3, at 45710-11. In addition, proposed Nasdaq Rule 4626(b)(3)(C) states that alleged losses arising in any form or that

According to proposed Nasdaq Rule 4626(b)(3)(B), the measure of loss for the Cross orders described in (i), (iii), and (iv) above would be the lesser of: (a) the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and the actual execution price received; or (b) the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and a benchmark price of \$40.527.¹⁸ With respect to Cross orders described in (iv) above, the amount of loss would be reduced by 30 percent.¹⁹ Further, according to proposed Rule 4626(b)(3)(B), the measure of loss for the Cross orders described in (ii) above would be the differential between the expected execution price of the orders in the Cross process that established an opening print of \$42.00 and the actual execution price received.²⁰

With respect to the process for submitting claims pursuant to proposed Nasdaq Rule 4626(b)(3), all claims must be submitted in writing no later than seven days after this accommodation proposal is approved by the Commission.²¹ As proposed, the Financial Industry

in any way resulted from any other causes would not be considered losses eligible for the proposed accommodations. Proposed Nasdaq Rule 4626(b)(3)(C) sets forth a non-exhaustive list of examples of such losses.

¹⁸ \$40.527 constitutes the volume-weighted average price (“VWAP”) of Facebook stock on May 18, 2012, between 1:50 p.m. ET and 2:35 p.m. ET. See proposed Nasdaq Rule 4626(b)(3)(B). See also Notice, supra note 3, at 45710-11 (describing Nasdaq’s rationale for establishing the \$40.527 benchmark).

¹⁹ See proposed Nasdaq Rule 4626(b)(3)(B); see also Notice, supra note 3, at 45710 (describing Nasdaq’s rationale for lowering the amount of eligible losses for the fourth category of Cross orders).

²⁰ Each member’s direct trading losses calculated in accordance with proposed Nasdaq Rule 4626(b)(3)(A) and (B) are referred to as the “member’s share.” See proposed Nasdaq Rule 4626(b)(3)(B).

²¹ See proposed Nasdaq Rule 4626(b)(3)(D). According to Nasdaq, notice of approval would be publicly posted on the Nasdaq Trader website at www.nasdaqtrader.com and provided directly to all member firms via an Equity Trader Alert. See Notice, supra note 3, at 45712.

Regulatory Authority, Inc. ("FINRA") would process and evaluate all the claims submitted, using the standards set forth in Nasdaq Rule 4626.²² FINRA would then provide to the Nasdaq Board of Directors and the Board of Directors of The NASDAQ OMX Group, Inc. an analysis of the total value of eligible claims submitted under proposed Nasdaq Rule 4626(b)(3), and Nasdaq would thereafter file with the Commission a proposed rule change setting forth the amount of eligible claims and the amount it proposes to pay to its members.²³ All payments would be made in cash and would not be made until the proposed rule change setting forth the amount of eligible claims becomes final and effective.²⁴

Furthermore, as proposed, in order to receive payment under Nasdaq Rule 4626(b)(3), not later than seven days after the effective date of the proposed rule change setting forth the amount of eligible claims, the member must submit to Nasdaq an attestation detailing the amount of customer compensation²⁵ and covered proprietary losses.²⁶ Failure to provide the required

²² See proposed Nasdaq Rule 4626(b)(3)(D). FINRA may request such supplemental information as it deems necessary to assist its evaluation of claims. See id. According to Nasdaq, FINRA's role would be limited to measuring data against the benchmarks established under Nasdaq Rule 4626(b)(3) to ascertain the eligibility and value of each member's claims. See Notice, supra note 3, at 45712. Further, Nasdaq represented that FINRA staff assessing the claims would not be involved in providing regulatory services to any Nasdaq market, and they would not have purchased Facebook stock during Nasdaq's IPO opening process or currently own Facebook stock. See id.

²³ See proposed Nasdaq Rule 4626(b)(3)(E). According to Nasdaq, the report that FINRA prepares for Nasdaq on its analysis of the eligibility of claims also would be provided to the public members of FINRA's Audit Committee. See Notice, supra note 3, at 45712.

²⁴ See proposed Nasdaq Rule 4626(b)(3)(E).

²⁵ According to proposed Nasdaq Rule 4626(b)(3)(F)(i), "customer compensation" means the amount of compensation, accommodation, or other economic benefit provided or to be provided by the member to its customers (other than customers that were brokers or dealers trading for their own account) in respect of trading in Facebook on May 18, 2012.

²⁶ According to proposed Nasdaq Rule 4626(b)(3)(F)(ii), "covered proprietary losses" means the extent to which the losses reflected in the member's share were incurred by the member trading for its own account or for the account of a customer that was a broker or dealer trading for its own account.

attestation within the specified time period would void the member's eligibility to receive compensation under proposed Nasdaq Rule 4626(b)(3).²⁷ In addition, under proposed Nasdaq Rule 4626(b)(3)(H), all payments to members under the accommodation proposal would be contingent upon the execution and delivery to Nasdaq of a release by the member of all claims by it or its affiliates against Nasdaq or its affiliates for losses that arise out of, are associated with, or relate in any way to the Facebook IPO Cross or any actions or omissions related in any way to that Cross.²⁸ The failure to provide this release within 14 days after the effective date of the proposed rule change setting forth the amount of eligible claims would void the member's eligibility to receive compensation pursuant to proposed Nasdaq Rule 4626(b)(3).²⁹

With respect to the priority of payment under proposed Nasdaq Rule 4626(b)(3), payments would be made in two tranches.³⁰ First, if the member has provided customer compensation, the member would receive an amount equal to the lesser of the member's share³¹ or the amount of customer compensation.³² Second, the member would receive an amount with respect to covered proprietary losses, however, the sum of payments to a member would not exceed the member's share.³³ According to proposed Nasdaq Rule 4626(b)(3)(G), if the amount calculated under the first tranche (i.e., customer compensation) exceeds \$62 million,

²⁷ See proposed Nasdaq Rule 4626(b)(3)(F). In addition, each member must maintain books and records that detail the nature and amount of customer compensation and covered proprietary losses. See *id.* According to Nasdaq, it, through FINRA, would expect to examine the accuracy of a member's attestation at a later date. See Notice, *supra* note 3, at 45712.

²⁸ See proposed Nasdaq Rule 4626(b)(3)(H); Notice, *supra* note 3, at 45713 (explaining the purpose of the release requirement).

²⁹ See proposed Nasdaq Rule 4626(b)(3)(H).

³⁰ See proposed Nasdaq Rule 4626(b)(3)(G).

³¹ See *supra* note 20.

³² See proposed Nasdaq Rule 4626(b)(3)(G).

³³ See *id.*

accommodation would be prorated among members eligible to receive accommodation under the first tranche. If the first tranche is paid in full and the amount calculated under the second tranche exceeds the funds remaining from the \$62 million accommodation pool, such funds would be prorated among members eligible to receive accommodation under the second tranche.³⁴ Further, if a member's eligibility to receive funds is voided under proposed Nasdaq Rule 4626(b)(3), and the funds payable to other members must be prorated, the funds available to pay other members would be increased accordingly.³⁵

III. Summary of Comments and Nasdaq's Responses

As previously noted, the Commission received a total of seventeen comment letters on the accommodation proposal and two response letters from Nasdaq.³⁶ Fourteen commenters raised concerns with respect to the accommodation proposal,³⁷ two commenters expressed their support for the accommodation proposal,³⁸ and one commenter addressed the issue of exchange liability more broadly.³⁹

Commenters raised concerns in the following areas, each of which is discussed in greater detail below: (1) the requirement that market participants release all other potentially valid claims as a condition to participation in the accommodation program; (2) Nasdaq's calculation

³⁴ See id.

³⁵ See id.

³⁶ See supra notes 4-5, and 8-9.

³⁷ See Triad Letter; Vandham Letter; Bram Letter; Citi Letter; SIFMA Letter I; UBS Letter I; Entwistle Letter; and Thompson Letter I, supra note 4. See also, Robinson Letter; SIFMA Letter II; Abelson Letter; Thompson Letter II; Mann Letter; and UBS Letter II, supra note 8.

³⁸ See Citadel Letter and Knight Letter, supra note 4.

³⁹ See Angel Letter, supra note 4. The Angel Letter does not opine on the proposal, but rather comments more generally on what the appropriate parameters of liability should be for national securities exchanges.

and use of a benchmark price of \$40.527; (3) the categories of claim-eligible trading losses; (4) the amount of the accommodation pool; (5) regulatory immunity from private suits and limitations on liability; (6) the applicability of Nasdaq Rule 4626; (7) the impact of approval of the accommodation proposal on pending litigation; and (8) two procedural issues.

A. Release of All Claims Relating to the Facebook IPO Cross

Several commenters expressed concerns that payment to eligible claimants is conditioned upon the member firm executing a release of claims by the firm or its affiliates against Nasdaq for losses associated with the Facebook IPO on May 18, 2012.⁴⁰ Specifically, one commenter indicated that requiring execution of the release as a precondition to participation in the accommodation proposal creates a “fundamentally unfair dilemma” for members.⁴¹ According to the commenter, Nasdaq members must choose to execute a release of claims and participate in the accommodation program, which may not make the member whole, or pursue “cost-and resource-intensive alternative avenues of recovery.”⁴² This commenter believes that members should be able to both participate in the accommodation program and be able to pursue other avenues of recourse. According to this commenter, any recovery under the accommodation program should be “setoff against future claims,” but should not preclude future claims against Nasdaq, especially for claims for losses that are not eligible for compensation under the accommodation program.⁴³ This commenter further stated that any release requirement should be limited to the categories of claim-eligible trading losses—allowing other avenues of recourse

⁴⁰ See UBS Letter I, supra note 4, at 3-4; Vandham Letter, supra note 4, at 3; Knight Letter, supra note 4, at 2; and UBS Letter II, supra note 8 at 3-4.

⁴¹ See UBS Letter I, supra note 4, at 3.

⁴² See id.

⁴³ See UBS Letter II, supra note 8, at 3.

for losses that are not eligible to receive compensation under the accommodation program.⁴⁴

Another commenter noted that releases of claims are typically the product of commercial, arms-length negotiation and not part of a rule imposed by a regulatory authority.⁴⁵ Finally, one commenter suggested that Nasdaq members be given the option to “opt in” to the accommodation program on an order by order basis or a firm by firm basis.⁴⁶

In response, Nasdaq asserted that the release requirement is fair, reasonable, and furthers the objectives of Section 6(b)(5) of the Act⁴⁷ because it is “aimed at avoiding unnecessary litigation and ensuring equal treatment of all members receiving funds under the [accommodation] [p]roposal.”⁴⁸ Moreover, Nasdaq noted that participation in the accommodation program and execution of the release are entirely voluntary.⁴⁹ Accordingly, members that wish to forgo participation in the accommodation program and pursue claims against Nasdaq instead remain free to do so.⁵⁰ Nasdaq also noted that the use of a release is routine in the context of a payment in settlement of a disputed claim, including those brought against regulated entities.⁵¹ Finally, Nasdaq argued that allowing members to participate in the

⁴⁴ See id.

⁴⁵ See Knight Letter, supra note 4, at 2.

⁴⁶ See Vandham Letter, supra note 4, at 3.

⁴⁷ 15 U.S.C. 78f(b)(5).

⁴⁸ See Nasdaq Letter I, supra note 5, at 5. One commenter observed that the release requirement may actually “deter those who suffered the greatest harm from participating in the Program” which may result in Nasdaq exhausting the \$62 million accommodation pool without significantly reducing Nasdaq’s litigation exposure. See UBS Letter II, supra note 8, at note 5.

⁴⁹ See Nasdaq Letter I, supra note 5, at 5; and Nasdaq Letter II, supra note 9, at 4.

⁵⁰ See id.

⁵¹ See id.

accommodation program without releasing Nasdaq from other claims related to the Facebook IPO Cross would, in effect, “subsidize the costs of future litigation against itself.”⁵²

B. Nasdaq’s Uniform Benchmark Price

Several commenters expressed concern with Nasdaq’s calculation and use of the uniform benchmark price of \$40.527 to determine the amount of compensation owed to a member under the accommodation proposal.⁵³ Generally, these commenters stated that, contrary to Nasdaq’s assertion, a “reasonably diligent member” would not have mitigated losses during the first forty-five minutes after execution reports were delivered to firms.⁵⁴ More specifically, two commenters stated that the uniform benchmark price should be based on a VWAP of Facebook stock on Monday, May 21, 2012.⁵⁵

In response, Nasdaq reasserted that the use of the VWAP of Facebook stock during the 45 minute window after 1:50 p.m. is appropriate as the benchmark price because 45 minutes provided members enough time to identify and mitigate any unexpected losses or unanticipated

⁵² See Nasdaq Letter I, supra note 5, at 5. Nasdaq stated that it “is not prepared to make the accommodation it proposes to members that are unwilling to accept that accommodation in full satisfaction of any claims they might otherwise assert against Nasdaq.” See Nasdaq Letter II, supra note 9, at 4.

⁵³ See Triad Letter, supra note 4, at 1-3; Vandham Letter, supra note 4, at 2; Bram Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 and 10. According to Nasdaq, the forty-five minutes after execution reports were delivered “would have been ample time for a reasonably diligent member to have identified any unexpected customer losses or unanticipated customer positions, and taken steps to mitigate or liquidate them.” See Notice, supra note 3, at footnote 24.

⁵⁴ See Triad Letter, supra note 4, at 1-3; Vandham Letter, supra note 4, at 2; Bram Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 and 10.

⁵⁵ See Triad Letter, supra note 4, at 1; and Citi Letter, supra note 4, at 2 (stating that the benchmark price should be the VWAP of Facebook stock between the opening price on Monday, May 21, 2012 and the price at noon on that same day).

positions.⁵⁶ Nasdaq argued that an objective benchmark, rather than a subjective benchmark premised on an evaluation of each individual member's circumstances and trading decisions, is necessary to avoid inconsistent and potentially discriminatory distributions under the accommodation proposal.⁵⁷ Additionally, because Nasdaq is not prepared to increase the size of the \$62 million accommodation pool, Nasdaq believes that "a change in the benchmark price would actually reduce the funds available to claimants that acted quickly to mitigate their losses, for the benefit of those that did not."⁵⁸

C. Nasdaq's Categories of Claim-Eligible Trading Losses

Several commenters stated that the types of orders eligible to receive compensation under the accommodation proposal are too narrowly defined.⁵⁹ Two commenters believe that Nasdaq should provide compensation for losses resulting from "downstream operational, technological and customer issues."⁶⁰ One commenter stated that Nasdaq's system failures, specifically the failure to deliver execution reports for more than two hours after trading began, "caused direct

⁵⁶ See Nasdaq Letter I, supra note 5, at 3. Specifically, Nasdaq noted that: (i) all orders and cancellations, including those entered between 11:11 a.m. and 11:30 a.m., were "executed, cancelled, or released into the market" by 1:50 p.m.; (ii) confirmations of all trades and cancellations had been disseminated to members by 1:50 p.m.; and (iii) Nasdaq began reporting a firm bid and ask to the tape and all data feeds were operating normally by 1:50 p.m. See id. at 3-4. Nasdaq also stated that it issued a "System Status message" informing members that all systems were operating normally at 1:57 p.m. See id. at 4.

⁵⁷ See Nasdaq Letter II, supra note 9, at 4.

⁵⁸ See id.

⁵⁹ See UBS Letter I, supra note 4, at 2-3; Citi Letter, supra note 4, at 7-10; Vandham Letter, supra note 4, at 3; and UBS Letter II, supra note 8, at 3.

⁶⁰ See UBS Letter I, supra note 4, at 3. See also UBS Letter II, supra note 8, at 3; and Citi Letter, supra note 4, at 7-10 (noting that "[i]n some cases, investors submitted multiple redundant orders based on the belief that the orders were not going through" and "[i]n other cases, investors submitted cancellations before receiving order confirmations, but were stuck with the stock.").

and severe damage” to the commenter and other market participants and led to direct trading losses.⁶¹ Another commenter argued that customer orders entered before 11:11 a.m. on May 18, 2012, that were “cancel/replaced” between 11:11 a.m. and 11:30:09 a.m. should be treated differently from other orders entered during such time and should be entitled to full compensation.⁶²

Another commenter observed that the accommodation proposal provides no direct compensation to “ordinary retail investors” and does not guarantee that retail investors would receive any compensation for losses.⁶³ Because Nasdaq’s proposal contemplates paying retail customers through Nasdaq member broker-dealers, the commenter expressed concern that there is no guarantee that compensation will ultimately be passed back to the retail investor, especially in instances where the member’s “customer” is another broker-dealer.⁶⁴

Nasdaq responded by stating that the question before the Commission is only whether the proposal is consistent with the requirements of the Act.⁶⁵ Nasdaq asserted that commenters have not argued that the proposal “discriminates unfairly” among members or that it is otherwise inconsistent with the requirements of the Act.⁶⁶ Nasdaq stated its belief that none of the

⁶¹ See UBS Letter I, supra note 4, at 3; UBS Letter II, supra note 8, at 3 (urging the Commission to condition approval of the accommodation proposal on expansion of the categories of losses eligible for compensation).

⁶² See Vandham Letter, supra note 4, at 3. The commenter believes that Nasdaq’s failure to properly account for cancel/replaced orders resulted in Nasdaq “taking the profits generated from certain clients to distribute amongst a larger group.” See id.

⁶³ See Thompson Letter I, supra note 4, at 3-4; and Thompson Letter II, supra note 8, at note 1.

⁶⁴ See Thompson Letter I, supra note 4, at 11. See also Thompson Letter II, supra note 8, at note 1.

⁶⁵ See Nasdaq Letter I, supra note 5, at 2.

⁶⁶ See id. But see Robinson Letter, supra note 8, at 1; Abelson Letter, supra note 8, at 2; and Mann Letter, supra note 8, at 1 (all generally stating each commenter’s belief that

comments provide a basis for the Commission to determine that a modification to the methodology and criteria it proposed “is necessary to remedy any inconsistency with the Exchange Act.”⁶⁷ With respect to retail investors, Nasdaq stated that its accommodation proposal would benefit retail investors with eligible claims even though Nasdaq has no direct relationship with them.⁶⁸ Nasdaq noted that the accommodation proposal requires each member to submit an attestation detailing the amount of compensation provided or to be provided by the member to its customers.⁶⁹ Moreover, Nasdaq pointed out that accommodation payments are to be made in two tranches with the first tranche going toward retail customer claims.⁷⁰

D. \$62 Million Accommodation Pool is Insufficient

Several commenters argued that the proposed \$62 million accommodation pool is an insufficient amount to compensate market participants harmed by Nasdaq’s systems issues.⁷¹

One commenter expressed concern that the second tranche of payments, which would provide compensation for covered proprietary losses⁷² (the majority of this commenter’s losses), may not

anything less than full compensation for his losses is inconsistent with the “just and equitable principles of trade” and is therefore inconsistent with the requirements of the Act); see also Triad Letter, supra note 4, at 2; Vandham Letter, supra note 4, at 1, 3; UBS Letter I, supra note 4, at 2-3; Thompson Letter I, supra note 4, at 3-4 (generally arguing for greater compensation to market participants for their losses).

⁶⁷ See Nasdaq Letter I, supra note 5, at 4.

⁶⁸ See id. at 8.

⁶⁹ See id.

⁷⁰ See id.

⁷¹ See UBS Letter I, supra note 4, at 2 (estimating that its losses are “in excess of \$350 million” and describing Nasdaq’s proposal to pay \$62 million in the aggregate as “woefully inadequate”); Thompson Letter I, supra note 4, at 4 and 20; Thompson Letter II, supra note 8, at note 1; and UBS Letter II, supra note 8, at 2-4.

⁷² See supra notes 26, 30-34 and accompanying text.

be reimbursed at all as claims for customer losses disbursed in the first tranche will likely exhaust the entire accommodation pool.⁷³

Nasdaq responded that commenters' objections to the amount of compensation are "unpersuasive" because the Commission has already determined that rules, such as existing Nasdaq Rule 4626, limiting exchange liability are consistent with the Act.⁷⁴ Furthermore, according to Nasdaq, if the accommodation proposal is disapproved, the current (much lower) limitation on liability of \$500,000 would apply.⁷⁵ Nasdaq emphasized that members who believe the amount of compensation offered is insufficient or otherwise dislike the accommodation proposal may elect not to participate.⁷⁶ Nasdaq stated that it is not prepared to increase the size of the \$62 million dollar accommodation pool.⁷⁷ According to Nasdaq, the purpose of the accommodation proposal is "to modify an existing rule that limits Nasdaq's liability to \$500,000 in order to make additional funds available to compensate members and their customers for the categories of loss defined in the [accommodation] [p]roposal"⁷⁸ Nasdaq stated that "[t]he purpose of the [accommodation] [p]roposal is not to pay all claims of losses alleged with respect to the trading of Facebook stock, nor even all claims of losses alleged to have been incurred on May 18, 2012."⁷⁹ As to one commenter's concern that the accommodation pool will be exhausted before any payments are made in the second tranche for covered proprietary losses,

⁷³ See UBS Letter II, supra note 8, at 2-4.

⁷⁴ See Nasdaq Letter I, supra note 5, at 2.

⁷⁵ See id.

⁷⁶ See id. at 2-3; and Nasdaq Letter II, supra note 9, at 4.

⁷⁷ See Nasdaq Letter II, supra note 9, at 4.

⁷⁸ See Nasdaq Letter I, supra note 5, at 4.

⁷⁹ See id. Nasdaq expanded on this point in its second response letter, emphasizing that the proposal is designed to compensate members for "only those losses directly attributable to the systems issues experienced by Nasdaq" and not "to address specific members' individual problems." See Nasdaq Letter II, supra note 9, at 3.

Nasdaq stated that it believes that the \$62 million “will be sufficient fully to compensate valid claims under the terms” of the accommodation proposal.⁸⁰ Moreover, Nasdaq argued, that it believes “the proposed prioritization of payment in favor of members who have or will pass compensation on to their customers is consistent with the Act.”⁸¹

E. Regulatory Immunity from Private Suits and Limitations on Liability

A number of commenters asserted that Nasdaq is not entitled to immunity from liability because it was acting in its “for profit” capacity in its handling of the Facebook IPO, rather than acting in its “regulatory capacity” as a self-regulatory organization.⁸² However, several commenters stated their belief that the broader issues of regulatory immunity and limitations on exchange liability should be considered separately from Nasdaq’s accommodation proposal.⁸³

Nasdaq responded that the Commission’s task with regard to the accommodation proposal is only to determine whether the proposed rule change is consistent with the Act, and the Commission does not need to address the issue of regulatory immunity to do so.⁸⁴

F. Applicability of Nasdaq Rule 4626

According to one commenter, market participants’ losses “resulted not from the type of ordinary system failures contemplated by Rule 4626 . . . , but rather from a known design flaw that resulted in a similar technology issue dating back to Fall 2011, as well as Nasdaq’s high-

⁸⁰ See Nasdaq Letter II, supra note 9, at 4.

⁸¹ See id.

⁸² See Citi Letter, supra note 4, at 2-4 and 12-15; SIFMA Letter I, supra note 4, at 2-4; Thompson Letter I, supra note 4, at 8-10; Thompson Letter II, supra note 8, at note 1; and UBS Letter II, supra note 8, at 4-5.

⁸³ See Citadel Letter, supra note 4, at 2; Knight Letter, supra note 4, at 2; Thompson Letter II, supra note 8, at note 2; UBS Letter II, supra note 8, at 4-5; SIFMA Letter II, supra note 8, at 3.

⁸⁴ See Nasdaq Letter I, supra note 5, at 6-7.

risk, profit-oriented behavior prior to and during the IPO . . .⁸⁵ This commenter argued that it is improper to use Rule 4626 to create an accommodation fund in connection with the Facebook IPO because the losses suffered in connection with the IPO do not fall within the parameters of Rule 4626.⁸⁶

Nasdaq emphasized in response that Rule 4626 is a pre-existing Commission approved rule and that the rule squarely applies to Nasdaq's systems issues related to the Facebook IPO.⁸⁷

G. Impact on Pending Litigation

Two commenters expressed concern that Commission approval of the accommodation proposal might negatively impact other adjudications of disputes with Nasdaq regarding the Facebook IPO.⁸⁸ The commenters expressed concern that courts or other adjudicative bodies might interpret Commission approval of the accommodation proposal as defining or approving the classes of eligible claimants as restricted only to market participants who submitted one of the four enumerated Cross order types.⁸⁹ Nasdaq did not specifically respond to commenters' concerns on this issue.

H. Procedural Concerns

⁸⁵ See Citi Letter, supra note 4, at 4, and 15-16.

⁸⁶ See id.

⁸⁷ See Nasdaq Letter I, supra note 5, at 5-6.

⁸⁸ See Thompson Letter I, supra note 4, at 4-8; and Entwistle Letter, supra note 4, at 2. See also Thompson Letter II, supra note 8, at 2-3.

⁸⁹ See Thompson Letter I, supra note 4, at 4-8; and Entwistle Letter, supra note 4, at 2. One commenter also expressed concern about the potential impact of Commission approval on pending litigation with respect to: (i) Nasdaq's claim of immunity; (ii) the causes and effects of Nasdaq's system issues; (iii) the validity of Nasdaq's uniform benchmark price as an estimate of Facebook's stock price in the absence of any Nasdaq systems issues; (iv) the types and categories of losses that should or should not be recognized as compensable; and (v) various other factual and legal assumptions the commenter believes Nasdaq's accommodation proposal contains. See Thompson Letter II, supra note 8, at 2.

Several commenters raised procedural concerns regarding the implementation of the accommodation proposal.⁹⁰ Two commenters noted that Nasdaq should waive the one-year time limit to bring actions against Nasdaq in Sections 18(H) and 19 of its Service Agreement given the amount of time it could take to implement the compensation process set forth in the proposed rule change.⁹¹ Four commenters stated that Nasdaq member firms should not be required to release Nasdaq from liability before member firms receive notice of a final payment amount pursuant to the accommodation proposal.⁹²

Nasdaq responded that commenters' requests to extend the one-year time limit for members to bring claims against Nasdaq improperly ask the Commission to interfere with existing contractual relationships that have no bearing on whether Nasdaq Rule 4626 should be amended.⁹³ As for concerns that claimants might have to release their claims against Nasdaq prior to receiving compensation under the accommodation proposal, Nasdaq represents that the release will become effective upon payment.⁹⁴

⁹⁰ See Citi Letter, supra note 4, at 16; SIFMA Letter I, supra note 4, at 5; Knight Letter, supra note 4, at 2; and SIFMA Letter II supra note 8, at 3.

⁹¹ Section 18(H) provides "that any claim, dispute, controversy, or other matter in question arising out of the agreement must be made no later than one year after it has arisen. Section 19 of the agreement provides that any claim, dispute, controversy, or other matter in question arising out of the agreement is expressly waived if it is not brought within that period." See SIFMA Letter I, supra note 4, at 5; see also Citi Letter, supra note 4, at 16; and SIFMA Letter II, supra note 8, at 3.

⁹² See SIFMA Letter I, supra note 4, at 5-6; Citi Letter, supra note 4, at 16; Knight Letter, supra note 4, at 2; and UBS Letter II, supra note 8, at 4. See also SIFMA Letter II supra note 8, at 2.

⁹³ See Nasdaq Letter I, supra note 5, footnote 11. Nasdaq believes that members who voluntarily choose to proceed with their claims outside of the accommodation proposal "should do so under the terms and conditions they have agreed to, and not seek to use the Commission's notice and comment process to renegotiate their prior contractual commitments." See id.

⁹⁴ See id. at footnote 9. Nasdaq also stated that it intends to implement the accommodation proposal such that a member would be aware of the results of its claim prior to being

IV. Discussion and Commission Findings

As described above, commenters have raised a number of concerns about the proposed rule change, many contending that it is not a fair or equitable approach to compensating market participants harmed by Nasdaq's system issues. Nasdaq has explained, however, that it did not design the proposed rule change to compensate all claims of loss suffered by market participants relating to Nasdaq's system difficulties with the Cross.⁹⁵ Rather, Nasdaq, in the accommodation proposal, is proposing to change a Nasdaq rule that in its current form strictly limits the amount of compensation that may be paid to users of the Nasdaq Market Center. In considering whether to approve the proposed rule change, the Commission takes into account the existing circumstances and the manner in which the current Nasdaq rules would operate if the Commission disapproved the proposed rule change.⁹⁶

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹⁷ Specifically, the Commission finds that the proposed rule change is consistent with Section

required to execute a release. See id. See also, SIFMA Letter II, supra note 8, at 2 (stating that this commenter appreciated Nasdaq's clarification on this issue).

⁹⁵ See supra notes 78 to 79 and accompanying text. Several commenters observed that the accommodation proposal will indeed not result in full compensation for their losses. See, e.g., supra notes 71-73 and accompanying text. Commenters also noted that some market participants have brought legal actions alleging claims against Nasdaq based on system difficulties encountered during the Facebook IPO. See Thompson Letter I, supra note 4, at 3; and Entwistle Letter, supra note 4, at 1. The Commission notes that approval of this proposed rule change has no bearing on claims made in any pending litigation against Nasdaq related to systems difficulties encountered during the Facebook IPO.

⁹⁶ While commenters have suggested various modifications to the accommodation proposal that would, in their view, make it better, the Commission's authority is only to approve or disapprove the change as proposed by Nasdaq. See generally Section 19(b) of the Act.

⁹⁷ In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

6(b)(5) of the Act,⁹⁸ which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Existing Nasdaq rules state that Nasdaq and its affiliates are not liable for any losses, damages, or other claims arising out of the Nasdaq Market Center or its use.⁹⁹ However, as noted above,¹⁰⁰ Nasdaq Rule 4626(b) currently allows Nasdaq to compensate users of the Nasdaq Market Center for certain types of losses directly resulting from its systems' actual failures.

Under current Nasdaq Rule 4626(b)(1), payment for all such claims made by all market participants during a single calendar month cannot exceed the larger of \$500,000 or the amount of recovery obtained by Nasdaq under any applicable insurance policy.¹⁰¹ While the accommodation proposal is not designed to, and would not, compensate all claims of loss suffered by market participants relating to Nasdaq's system difficulties with the Cross,¹⁰² the Commission notes that the accommodation proposal would create a means of providing significantly more compensation for eligible claims, outside of litigation, than would otherwise be available under existing Nasdaq Rule 4626(b). Accordingly, approval of the proposed rule

⁹⁸ 15 U.S.C. 78f(b)(5).

⁹⁹ See Nasdaq Rule 4626(a).

¹⁰⁰ See supra notes 11-12 and accompanying text.

¹⁰¹ See Nasdaq Rule 4626(b)(1).

¹⁰² See supra note 79 and accompanying text.

change will make more funds available to compensate investors and Nasdaq members under Nasdaq's rules, which the Commission believes is in the public interest.¹⁰³

The Commission believes that the proposal sets forth objective and transparent processes to determine eligible claims and how such claims would be paid to Nasdaq members that elect to participate in the accommodation plan. Specifically, Nasdaq proposes to provide additional compensation beyond that available under existing Rule 4626(b)(1) for claims of realized or unrealized direct trading losses arising from four specific categories of Cross orders.¹⁰⁴ Also, as noted above, proposed Nasdaq Rule 4626(b)(3)(B) would set forth the methods for calculating the amount of losses for each of the four categories of Cross orders.¹⁰⁵ In addition, proposed Nasdaq Rule 4626(b)(3)(D) specifies the time period for a member to submit its claim and provides that FINRA would process and evaluate the claims.¹⁰⁶ Proposed Nasdaq Rule 4626(b)(3)(E) sets forth details regarding FINRA's review process, the timing of payments by Nasdaq, and the manner of payment (i.e., in cash).¹⁰⁷

As discussed in more detail above, several commenters objected to limiting compensation under the accommodation proposal to the four categories of Cross orders.¹⁰⁸ Further, several commenters questioned the adequacy of the amount of compensation that would be provided to Nasdaq members under the accommodation proposal as well as the calculation and use of the

¹⁰³ Several commenters questioned the adequacy of the amount of compensation that would be provided to Nasdaq members under the accommodation proposal as well as the calculation and use of the benchmark price in determining the amount of loss repayable under the accommodation proposal. See supra notes 53-55, 71 and accompanying text.

¹⁰⁴ See proposed Nasdaq Rule 4626(b)(3)(A).

¹⁰⁵ See supra notes 18-20 and accompanying text.

¹⁰⁶ See supra notes 21-23 and accompanying text.

¹⁰⁷ See supra notes 23-24 and accompanying text.

¹⁰⁸ See supra notes 59-64 and accompanying text.

benchmark price in determining the amount of loss repayable under the accommodation proposal.¹⁰⁹ In determining that approval of the accommodation proposal is consistent with the Act, the Commission is not reaching any conclusion on the overall adequacy of the amount of the compensation pool, the benchmark price used, or other limitations on eligibility.

In order to receive compensation under proposed Nasdaq Rule 4626(b)(3), a member must timely submit to Nasdaq an attestation detailing the amount of customer compensation and covered proprietary losses.¹¹⁰ The proposal would further require the member to maintain books and records that detail the nature and amount of customer compensation and covered proprietary losses.¹¹¹ The Commission believes that the proposed attestation and recordkeeping requirements should help incentivize Nasdaq members to accurately determine the amount of customer compensation and covered proprietary losses and submit claims accordingly.

Moreover, payments made pursuant to proposed Nasdaq Rule 4626(b)(3) would be made in two tranches - a member would first receive an amount equal to the lesser of the member's share or the amount of customer compensation,¹¹² and then receive an amount with respect to covered proprietary losses.¹¹³ The Commission believes that, because the accommodation proposal would accommodate members for customer losses before accommodating members for proprietary losses, the accommodation proposal should encourage members to compensate their customers for customer losses related to the Facebook IPO.

¹⁰⁹ See supra notes 53-55, 71 and accompanying text.

¹¹⁰ See proposed Nasdaq Rule 4626(b)(3)(F).

¹¹¹ See id.

¹¹² See supra note 25 (defining "customer compensation").

¹¹³ See proposed Nasdaq Rule 4626(b)(3)(G). See also supra notes 26 (defining "covered proprietary losses") and 30-35 and accompanying text (explaining how funds are to be allocated).

Lastly, in order to receive payments under proposed Nasdaq Rule 4626(b)(3), within 14 days after the effective date of a separate proposed rule change setting forth the amount of eligible claims, a member must execute and deliver to Nasdaq a release of all claims by the member or its affiliates against Nasdaq or its affiliates for losses that arise out of, are associated with, or relate in any way to the Facebook IPO Cross or to any actions or omissions related in any way to that Cross.¹¹⁴ As discussed above, several commenters opposed the proposed waiver of claims.¹¹⁵ However, although a member must execute a release of claims in order to receive any payment under proposed Nasdaq Rule 4626(b)(3), participation in the accommodation program is voluntary, which means a member is free to elect not to submit a claim for compensation under the accommodation program and choose instead to pursue other remedies.¹¹⁶

For the reasons discussed in this section, the Commission finds that Nasdaq's proposal to amend its existing Rule 4626 to increase the amount of compensation Nasdaq is authorized to provide from \$500,000 to \$62 million for certain types of claims arising in connection with the Facebook IPO on May 18, 2012, is consistent with the Section 6(b)(5) of the Act. In reaching its conclusion, the Commission is relying on the representations made by Nasdaq in its accommodation proposal, but is not making any determinations regarding the accuracy of the facts as represented by Nasdaq, and notes that certain commenters have contested Nasdaq's representation of the facts. In addition, the Commission is not expressing any view with respect to any issue other than whether the proposed rule change is consistent with Section 19(b) of the

¹¹⁴ See proposed Nasdaq Rule 4626(b)(3)(H).

¹¹⁵ See supra notes 40-46 and accompanying text.

¹¹⁶ The Commission notes that Nasdaq intends to implement the accommodation proposal such that a member would be aware of the results of its claim prior to being required to execute a release and that Nasdaq represents that the release will become effective upon payment. See supra note 94 and accompanying text.

Act. For example, as discussed above, several commenters questioned whether Nasdaq should be entitled to immunity from liability based on its actions with respect to the Facebook IPO.¹¹⁷ Other commenters argued that the question of whether regulatory immunity applies should be considered separately from this proposed rule change.¹¹⁸ Whether regulatory immunity should apply to Nasdaq in connection with its actions related to the Facebook IPO is outside the scope of the proposed rule change and the Commission's consideration of such proposed rule change. Similarly, as discussed in more detail above, several commenters expressed concern that approval of the proposed rule change could potentially impact pending litigation with Nasdaq regarding the Facebook IPO.¹¹⁹ The Commission emphasizes that this approval order addresses only whether the proposed change to Nasdaq's existing accommodation rule is consistent with Section 19(b) of the Act. The Commission also notes that, given the amount of time it could take to implement the compensation process set forth in the proposed rule change, several commenters urged Nasdaq to waive the one-year time limit set forth in Nasdaq's service agreement within which members must bring actions against Nasdaq.¹²⁰ Because Nasdaq's service agreement is not before the Commission as a part of this proposed rule change, the Commission expresses no view with respect to whether Nasdaq should provide an exception under the service agreement. Finally, in issuing this order, the Commission is expressing no view as to whether Nasdaq or any other person may have violated the federal securities laws or any other laws, any rule or regulation thereunder, or the rules of Nasdaq or any other self-regulatory organization, in connection with the Facebook IPO.

¹¹⁷ See supra note 82 and accompanying text.

¹¹⁸ See supra note 83 and accompanying text.

¹¹⁹ See supra notes 88-89 and accompanying text.

¹²⁰ See supra note 91 and accompanying text.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹²¹ that the proposed rule change (SR-NASDAQ-2012-090) be, and hereby is, approved.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

¹²¹ 15 U.S.C. 78s(b)(2).

*Chairman Walter
not participating*

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 69228 / March 20, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15254

In the Matter of

WILLIAM G. REEVES, ESQ.,

Respondent.

CORRECTED
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 William G. Reeves ("Respondent" or "Reeves") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e)

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

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

of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Reeves, age 61, is an attorney licensed to practice in the State of Florida.
2. On February 5, 2013, the Commission filed a complaint against Reeves in SEC v. William G. Reeves. (S.D. Fl., Civil Action No. 2:13-cv-14048-KMM). On February 27, 2013, the court entered an order permanently enjoining Reeves, by consent, from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act") and providing permanent injunctive relief under Sections 17(a)(2) and 17(a)(3) of the Securities Act.
3. The Commission's complaint alleged, among other things, that Reeves participated in an offering fraud conducted by We the People, Inc. of the United States ("WTP"), while serving as WTP's vice president and regulatory counsel. The Commission alleged that WTP sold its products without filing any registration statement and without a valid exemption from registration. Moreover, the Commission alleged, among other things, that WTP's marketing materials and offering documents misrepresented several important features of WTP's product, including its value and the safety and security of the investment.

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, as follows:

- A. Reeves is suspended from appearing or practicing before the Commission as an attorney for 5 years from the date of the Order.
- B. After 5 years from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.
- C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.
- D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:
 1. that Respondent has complied with the Order;

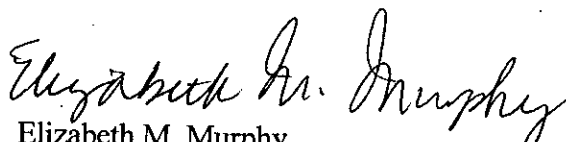
2. that Respondent:
 - a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and
 - b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;
3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and
4. that Respondent, since the entry of the Order:
 - a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;
 - b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;
 - c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and
 - d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his

affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.


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. 69224 / March 25, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15257

In the Matter of

SUSAN SKAER, Esq.,

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 Susan Skaer ("Respondent" or "Skaer") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.¹

II.

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

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

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name . . . [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.

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. Skaer, age 49, is a California resident living in Emerald Hills, California. Skaer is a member of the California state bar. Skaer served as General Counsel of Mercury Interactive Corporation ("Mercury") from November 2000 to November 2005, and as Secretary of the company from May 2001 to November 2005. From October 1996 to November 2000, Skaer was a partner with the law firm GCA Law Partners LLP (formerly General Counsel Associates LLP). During her tenure with GCA Law Partners LLP, Skaer served at various times as outside counsel to Mercury. Skaer holds a bachelor's degree from the University of North Carolina and a law degree from the University of Virginia.

2. Mercury was acquired by Hewlett-Packard Company ("HP") by an agreement consummated on November 8, 2006, and is now Mercury Interactive, LLC, a non-trading subsidiary of HP. Prior to the consummation of the merger, Mercury was a corporation headquartered in Mountain View, California, and organized under the laws of Delaware. Mercury made software used to test and optimize information technology systems and software applications. At the time of the conduct described in this Order, the company's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and listed on the NASDAQ under the symbol MERQ.

3. On May 31, 2007, the Commission filed a complaint against Skaer in Securities and Exchange Commission v. Mercury Interactive, et al., Civil Action Number C 07-2822 (WHA/JSC), in the United States District Court for the Northern District of California. On March 19, 2013, the court entered an order permanently enjoining Skaer by consent from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Sections 13(b)(5) and 14(a) of the Exchange Act, and Exchange Act Rules 13b2-1, 13b2-2, and 14a-9, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13. The final judgment also ordered her to pay disgorgement of \$423,136, prejudgment interest in the amount of \$204,901, and a \$225,000 civil penalty.

4. The Commission's complaint alleged, among other things, that beginning in 1999, Skaer prepared or directed the preparation of documentation of in-the-money stock option grants to Mercury employees and executives, the grant dates for which were chosen with the benefit of hindsight. According to the complaint, the granting of such in the money stock options caused Mercury, between 1999 and 2005, (i) to file materially false and misleading financial statements that materially understated its compensation expenses and materially overstated its quarterly and annual net income and earnings per share, and (ii) to make disclosures in its periodic filings and proxy statements that falsely portrayed Mercury's options as having been granted at exercise prices equal to the fair market value of Mercury's common stock on the date of the grant.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

Skaer 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. 69242 / March 26, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14403

In the Matter of

WUNDERLICH SECURITIES, INC.,
TRACY L. WISWALL, and
GARY K. WUNDERLICH, JR.,

Respondents.

**ORDER DIRECTING TRANSFER
OF REMAINING FUNDS TO THE
UNITED STATES TREASURY**

On May 27, 2011, the Securities and Exchange Commission ("Commission") instituted settled administrative and cease-and-desist proceedings against Wunderlich Securities, Inc. ("WSI"), Tracy L. Wiswall ("Wiswall"), and Gary K. Wunderlich, Jr. ("Wunderlich") finding that: (1) WSI willfully violated Sections 204A, 206(2), 206(3) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rules 204A-1 and 206(4)-7 thereunder, (2) Wiswall willfully aided and abetted and caused WSI's violations of Sections 204A and 206(4) of the Advisers Act and Rules 204A-1 and 206(4)-7 thereunder and caused WSI's violations of Section 206(3) of the Advisers Act, and (3) Wunderlich willfully aided and abetted and caused WSI's violations of Sections 204A and 206(4) of the Advisers Act and Rules 204A-1 and 206(4)-7 thereunder ("Order"). Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and Cease-And-Desist Orders, Exchange Act Rel. No. 64558 (May 27, 2011).

Section IV.E. of the Order required, among other things: (1) that WSI deposit \$369,336.15 in disgorgement ("Disgorgement Fund") in an escrow account for distribution to affected current and former advisory clients; (2) that WSI be responsible for administering the Disgorgement Fund, including all tax compliance responsibilities associated with the Disgorgement Fund and any costs of professional services associated with the Disgorgement Fund; (3) that, if the total amount otherwise payable to a client was less than the *de minimus* amount of \$25.00, WSI was to instead pay such amount to the Commission for transmittal to the United States Treasury as provided in the Order; (4) that WSI submit to the Commission's staff for its approval a final accounting and certification of the disposition of the Disgorgement Fund; and (5) that the Commission's staff submit the final accounting to the Commission for approval and request Commission approval to send any remaining amount to the United States Treasury.

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After consultations with the Commission's staff, WSI completed its distributions and submitted a certification and final accounting to the Commission's staff as required by the Order. The final accounting certified that WSI disbursed \$348,894.67 of the total Disgorgement Fund (*i.e.*, almost 95%), leaving a remaining balance of \$20,441.48. Of that amount, \$655.23 was attributable to the \$25.00 *de minimus* amount contemplated by the Order and \$19,786.25 was attributable to checks sent to current or former advisory clients that were returned undelivered or mailed but not cashed. WSI subsequently sent the remaining \$20,441.48 to the Commission for transmittal to the United States Treasury, and the Commission is in possession of that amount. The final accounting, which was 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 Order, is now approved.

Accordingly, IT IS ORDERED that the remaining balance of \$20,441.48 shall be transferred to the United States Treasury.

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. 69252 / March 28, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15258

In the Matter of

DAVID M. DECKER, JR.

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 against David M. Decker, Jr. ("Respondent" or "David Decker") pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

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.

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III.

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

1. David Decker was the Vice President of Sales for Zufelt, Inc. ("ZI"), a corporation organized under the laws of Utah, from approximately June 2005 through June 2006. David Decker was also the Vice President of Development for Silver Leaf Investments, Inc. ("SLI"), a corporation organized under the laws of Utah, from approximately July 2006 through December 2006. David Decker is not and has never been registered with the Commission in any capacity.

2. On March 6, 2013, a final judgment was entered by consent against David Decker, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a)(2) and (a)(3) of the Securities Act of 1933, Exchange Act Section 15(a), and aiding and abetting violations of Exchange Act Section 15(a), in the civil action entitled SEC v. Zufelt et al., Civil Action No. 2:10-cv-00574, in the United States District Court for the District of Utah.

3. The Commission's complaint alleged that David Decker solicited investors through materially false and misleading statements in connection with two distinct but related Ponzi schemes orchestrated by Anthony Zufelt ("Zufelt"). From June 2005 through June 2006, Zufelt operated a Ponzi scheme through ZI, and ran a second fraudulent scheme through SLI between July 2006 and December 2006. The complaint alleged that, in connection with these schemes, David Decker made materially false and misleading statements to investors about, among other things, the profitability of ZI and SLI, the ability of ZI and SLI to repay investors, the use of investor funds, and the security of the investments. The complaint also alleged that David Decker acted as an unregistered broker-dealer and sold unregistered ZI and SLI securities.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent David Decker be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

with the right to apply for reentry after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

*Commissioner Gallagher
not participating*

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69256; File No. SR-NYSEArca-2012-28)

March 28, 2013

Self-Regulatory Organizations; NYSE Arca, Inc.; Response to Comments Submitted After the Issuance on December 14, 2012, of a Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of a Proposed Rule Change as Modified by Amendment No. 1 to List and Trade Shares of the JPM XF Physical Copper Trust Pursuant to NYSE Arca Equities Rule 8.201

I. Introduction

On April 2, 2012, NYSE Arca, Inc. ("Exchange" or "NYSE Arca") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade shares ("Shares") of the JPM XF Physical Copper Trust ("Trust") pursuant to NYSE Arca Equities Rule 8.201. The proposed rule change was published for comment in the Federal Register on April 20, 2012.³

On December 14, 2012, the Commission approved the proposed rule change,⁴ finding that it was consistent with the requirements of the Act. In its Approval Order, the Commission invited interested persons to submit written data, views, and arguments concerning the Approval

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 66816 (April 16, 2012), 77 FR 23772 ("Notice").

⁴ See Securities Exchange Act Release No. 68440, 77 FR 75468 (December 20, 2012) ("Approval Order"). Prior to approving the proposed rule change, the Commission: (1) extended the time period for Commission action to July 19, 2012, see Securities Exchange Act Release No. 67075 (May 30, 2012), 77 FR 33258 (June 5, 2012); (2) instituted proceedings to determine whether to approve or disapprove the proposed rule change, see Securities Exchange Act Release No. 67470 (July 19, 2012), 77 FR 43620 (July 25, 2012); and (3) issued a notice of designation of longer period for Commission action on proceedings to determine whether to approve or disapprove the proposed rule change, see Securities Exchange Act Release No. 67965 (October 2, 2012), 77 FR 61457 (October 9, 2012).

Order, including whether Amendment No. 1 to the proposed rule change is consistent with the Act.⁵

In response to the solicitation of comments, the Commission received two comment letters.⁶ Both letters opposed the approval of the proposed rule change, and one commenter specifically requested that the Commission reconsider and reverse its decision, and disapprove the proposed rule change.⁷ This Response addresses those comments.

II. Response to Comments

One commenter (referred to herein as “the commenter”) repeated many concerns that had been previously raised, considered by the Commission, and expressly addressed in the Approval

⁵ See Approval Order, supra note 4, 77 FR at 75487.

⁶ See letter from Robert B. Bernstein, Partner, Eaton & Van Winkle LLP (“EVW”), to Elizabeth M. Murphy, Secretary, Commission, dated January 9, 2013 (“EVW January 9 Letter”); and e-mail from Janet Klein, dated January 7, 2013 (“Klein E-mail”). Comment letters are available at <http://www.sec.gov/comments/sr-nysearca-2012-28/nysearca201228.shtml>. Ms. Klein asserted that approval of the proposed rule change would: (1) be “contrary to rational oversight of wise practice,” without explaining the basis for her judgment; (2) not contribute to the economy; and (3) promote “speculative swings of a commodity price not related to supply/demand,” again without explaining the basis for her conclusion. See Klein E-mail, supra. The Commission discussed the likelihood of any impact of the proposed rule change on the price of copper in the Approval Order. See Approval Order, supra note 4, 77 FR at 75477–82.

⁷ See EVW January 9 Letter, supra note 6. This commenter submitted seven comment letters opposing the proposed rule change prior to the Commission’s issuance of the Approval Order. See letters from Vandenberg & Feliu, LLP (“V&F”), received May 9, 2012 (“V&F May 9 Letter”); Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated July 13, 2012; Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated August 24, 2012 (“V&F August 24 Letter”); Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated September 10, 2012 (“V&F September 10 Letter”); Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated October 23, 2012; Robert B. Bernstein, V&F, to Elizabeth M. Murphy, Secretary, Commission, dated November 16, 2012; and Robert B. Bernstein, EVW, to Elizabeth M. Murphy, Secretary, Commission, dated December 7, 2012 (“EVW December 7 Letter”).

Order. This commenter, however, expanded upon and clarified some of his prior arguments.⁸

Accordingly, the Commission responds below to certain comments made by the commenter after the Commission approved the proposed rule change.⁹

A. Direct Participation in Trading on the London Metal Exchange ("LME")

The commenter asserts that the Approval Order contained an incorrect statement of fact regarding who may trade directly on the LME. The commenter asserts that the Commission was incorrect in stating that "[o]nly eligible organizations or members are able to participate directly in trading on the LME," and asserts that only "open outcry" trading on the LME is limited to eligible organizations or members, and that most trading on the LME takes place in inter-office trading that is open to anyone who has a telephone and a computer screen.¹⁰ The commenter further states that the Commission relied on this conclusion in reaching its decision.¹¹

The Commission believes that the description in the Approval Order regarding trading on the LME is correct.¹² The Commission understands that trading on the LME can occur in a number of ways, all of which must occur through a member.¹³ Trading can occur in the LME's

⁸ See supra note 7.

⁹ The other comment is addressed supra at note 6.

¹⁰ See EVW January 9 Letter, supra note 6, at 4-5 (quoting Approval Order, supra note 4, 77 FR at 75469).

¹¹ See EVW January 9 Letter, supra note 6, at 5.

¹² The Approval Order expressly states that this description comes from the description of the copper market that the Exchange included in its filing. See Approval Order, supra note 4, 77 FR at 75469. In the notice of the proposed rule change, the Exchange stated: "The LME is a principal-to-principal market where only eligible organizations or 'members' are able to participate directly in trading." Notice, supra note 3, 77 FR at 23776. The commenter did not raise any concerns about the Exchange's description of the LME in any of the comment letters he previously submitted.

¹³ See Approval Order, supra note 4, 77 FR at 75469.

open-outcry trading floor (the “Ring”), but such trading is limited to ring-dealing members.¹⁴ Electronic trading can occur through LMEselect; although clients can access LMEselect, such access is available only via member systems or member-sponsored Independent Software Vendor (“ISV”) platforms.¹⁵ Similarly, the LME’s inter-office telephone market, which operates 24 hours a day, facilitates trading between LME members.¹⁶ However, even assuming that direct trading on the LME were not limited to eligible organizations or members, such an assumption was not a basis for the Commission’s findings.¹⁷

B. The Impact of Queues

In a comment submitted prior to issuance of the Approval Order, the commenter discussed the existing unloading queues for metals, including copper, at LME warehouses.¹⁸ The commenter asserted that queues to unload copper from LME warehouses appear to be lengthening because owners of LME warehouses are “paying producers with surplus metal huge financial incentives to deposit their metal in LME warehouses, at which point such product may be sold, reportedly in some cases to owners of other LME warehouses, which is what is

¹⁴ See LME, Trading, Venues and Systems, The Ring, <http://lme.com/trading/venues-and-systems/ring/>.

¹⁵ See LME, Trading, Venues and Systems, Electronic, <http://lme.com/trading/venues-and-systems/electronic/>. In the case of member systems, client traffic must pass through a member order-routing bridge and/or a pre-trade risk engine fully controlled by the sponsoring member’s compliance team. Client traffic can also pass through an ISV pre-trade risk engine endorsed and controlled by the sponsoring member’s compliance team.

¹⁶ See LME, Trading, Venues and Systems, Telephone, <http://lme.com/trading/venues-and-systems/telephone/>.

¹⁷ See Approval Order, *supra* note 4, 77 FR at 75474–75 (discussing the availability of the Trust’s copper); and *id.* at 75486–87 (discussing the Commission’s findings).

¹⁸ See EVW December 7 Letter, *supra* note 7.

reportedly creating and perpetuating the ever-growing queue.”¹⁹ According to the commenter, the development of these queues “creates a scarcity of free units of metal that not only forces up premiums above LME cash prices in local geographic markets” but may ultimately prevent end-users of copper from obtaining access to needed copper in a timely fashion.²⁰

In the Approval Order, the Commission addressed this comment. In concluding that the Trust’s copper will remain available to consumers and other participants in the physical copper market, the Commission assumed, based on the record, that copper would be transferred to a redeeming authorized participant’s book-entry account within three business days, and that a redeeming authorized participant taking delivery of copper from an LME warehouse would then have to wait in the queues just like other owners withdrawing metal from that warehouse.²¹ The Commission stated its belief that waiting up to an extra three business days beyond the time required to take copper off of LME warrant is not a significant enough delay to consider the copper delivered from the Trust unavailable for immediate delivery, and noted that the commenter, who acknowledged that taking copper off of LME warrant takes time, considers copper on LME warrant to be available for immediate delivery.²² In addition, the Commission pointed out that the Trust’s copper may be held in both LME-approved warehouses and non-LME-approved warehouses, and there was nothing in the record concerning the existence of

¹⁹ See id. at 2.

²⁰ See id.

²¹ See Approval Order, supra note 4, 77 FR at 75474 n.83.

²² See id.

unloading queues in non-LME warehouses.²³ Further, the Commission stated that the LME appears to be attempting to address the problem of unloading queues.²⁴

In the post-Approval Order comment letter, the commenter expands upon his prior comment about queues by asserting that “the placement of additional copper in LME warehouses may lead to substantially longer queues that will make it even more difficult for all consumer [sic] and other market participants to obtain physical copper that otherwise used to be available for immediate delivery.”²⁵ The commenter also argues in his post-Approval Order letter that the longer queues that he predicts will occur, combined with the “huge costs of storage” that will be borne by anyone choosing to take physical delivery of copper, “may itself discourage the exercise of redemption rights.”²⁶

Several factors would impact how much copper will be deposited into each approved warehouse during the creation process, and how quickly. Authorized participants will determine where to deliver copper in exchange for Shares, choosing from among the eight permitted warehouse locations, which include LME and non-LME warehouses.²⁷ Authorized participants

²³ See id.

²⁴ See id.

²⁵ EVW January 9 Letter, supra note 6, at 13. According to the commenter, queue formation is a function of the demand to unload all metals stored in LME warehouses. See EVW December 7 Letter, supra note 7. Accordingly, even if Shares were created and redeemed in a manner that could exacerbate the existing queues, that activity could be offset entirely by fewer requests to take physical delivery of other metals stored in the warehouses.

²⁶ See EVW January 9 Letter, supra note 6, at 13.

²⁷ “The Trust will store its copper in both LME-approved warehouses and non-LME-approved warehouses Initially, the permitted warehouse locations will be in the Netherlands (Rotterdam), Singapore (Singapore), South Korea (Busan and Gwangyang), China (Shanghai), and the United States (Baltimore, Chicago, and New Orleans).” Approval Order, supra note 4, 77 FR at 75471.

may determine to deliver copper to non-LME warehouses in exchange for Shares. As noted in the Approval Order, there is nothing in the record concerning the existence of unloading queues in non-LME warehouses.²⁸ Further, it is unknown how many Shares would be created (*i.e.*, how much copper would be deposited at permitted warehouse locations), and how quickly they would be created (*i.e.*, how quickly the copper would be deposited at the permitted warehouse locations).²⁹ Thus, based on the record, the Commission cannot conclude that the placement of additional copper in LME warehouses due to the creation of Shares would lead to longer queues.

With respect to redemptions, it is unknown how often Share redemptions will occur and whether they will be followed by physical delivery.³⁰ Redeeming authorized participants (or their customers) will determine whether to retain the warehouse receipt or request physical delivery of copper. Some authorized participants who redeem Shares may choose to hold the warehouse receipt rather than withdraw the copper from the warehouse.³¹ Thus, based on the

²⁸ See *id.* at 75474 n.83.

²⁹ See *id.* at 75476-77. The commenter states that queues would be exacerbated only to the extent that additional copper is deposited into LME warehouses. See EVW January 9 Letter, *supra* note 6, at 13. In a prior comment letter, the commenter stated that authorized participants would likely create Shares by taking copper off warrant at an LME warehouse and using that copper to create Shares without ever removing it from the LME warehouse (referred to as "white lining"). See V&F September 10 Letter, *supra* note 7, at 2. Even assuming that the commenter is correct that authorized participants will elect to create Shares through white lining, then no additional copper would be added to an LME warehouse's inventory. If the commenter is now asserting that copper will be delivered from another source, this supports the Commission's belief that it is more plausible that copper that is not on LME warrant would be used to create Shares. See Approval Order, *supra* note 4, 77 FR at 75476.

³⁰ Additionally, when physical delivery is demanded after the redemption of Shares, for the reasons discussed above in the discussion of creations, it is unclear how often withdrawals would be from LME warehouses.

³¹ As discussed in the Approval Order, copper received in exchange for redeemed Shares could be: (1) sold in the over-the-counter ("OTC") market for cash; (2) swapped in the OTC market for copper in a different location or for a different brand; (3) placed on LME

record, the Commission cannot conclude that redemptions of Shares would lead to longer queues.

According to the commenter, anyone choosing to take physical delivery of copper following redemption will have to bear “huge storage costs.”³² The holders of Shares, however, also will pay storage costs indirectly through the Trust.³³ The commenter does not explain how storage costs, together with the longer queues that the commenter asserts would occur, would discourage redemption, because those who purchase Shares would have to pay storage costs, whether the Shares are redeemed or held.

For the reasons discussed above, and based on the record, the Commission cannot conclude that storage costs, together with “longer” queues that the commenter asserts would occur, would discourage the exercise of redemption rights.

C. Availability of Particular Copper Brands

In comments submitted prior to approval of the proposed rule change, the commenter expressed concern regarding the ability of end users to acquire copper of a preferred brand or in a preferred location.³⁴ The commenter asserted that end users would not acquire Shares and redeem them for physical copper because the copper they would receive in exchange for the

warrant and traded on the LME; or (4) removed from the warehouse and consumed. See Approval Order, supra note 4, 77 FR at 75474. The commenter does not assert that the existence of queues would discourage authorized participants from redeeming Shares with the intent to sell or trade the copper, rather than take physical delivery.

³² See EVW January 9 Letter, supra note 6, at 13.

³³ The Trust’s expenses will include both the Sponsor’s fee, including storage costs, and other expenses. Registration statement for the Trust, amended on July 12, 2011 (No. 333-170085), at 57 (“Registration Statement”).

³⁴ See V&F September 10 Letter, supra note 7.

Shares might be in a location far from, or might be of brands that are not acceptable to, their plants.³⁵

The Commission addressed these comments in the Approval Order, stating that, regardless of the preferences of these consumers, authorized participants may redeem Shares for copper and the record does not contain any evidence that these or any other consumers of copper could not use the Shares to obtain copper through an authorized participant.³⁶ Further, the Commission stated that the record supports that the same logistical issues exist and are regularly addressed by end-users of copper holding LME warrants,³⁷ and that nothing in the record indicates that copper merchants will not be able to perform the same function in connection with copper delivered in connection with Share redemptions.³⁸

In the post-Approval Order letter, the commenter augments his prior argument by asserting that the purchase and sale of physical copper held by the Trust will not operate in the same way as the trading of copper on LME warrants because copper held by the Trust will not be for sale until after Shares are redeemed. The commenter further argues that the only "copper that can conceivably be traded by merchants for desired brands is copper on warrant in LME warehouses."³⁹ Accordingly, the commenter concludes that if, as he predicts, only copper on LME warrant is used to create Shares (and is thereby taken off warrant and unavailable for sale),

³⁵ See Approval Order, supra note 4, at 75474 (citations omitted).

³⁶ See id.

³⁷ See id.

³⁸ See id.

³⁹ See EVW January 9 Letter, supra note 6, at 17.

“there is a much greater likelihood of there not being copper of the desired brands in the desired locations available for copper merchants to trade.”⁴⁰

In the Approval Order, the Commission stated that, while the sources of copper used to create Shares are uncertain,⁴¹ it believes it is more plausible that a sufficient portion of the estimated 1.4 million metric tons of liquid copper inventories not on LME warrant would be available to authorized participants to use to create Shares.⁴² Further, as mentioned above, authorized participants will choose the location of copper used to create Shares,⁴³ which makes it difficult to predict the location(s) from which the Trust’s copper will come. Moreover, there is no data in the record concerning the availability of particular brands of copper, much less the availability of particular brands in particular locations.⁴⁴ The commenter does not provide in his post-Approval Order letter any new evidence to suggest that this scenario of brand scarcity in particular locations is likely to occur as a result of Share creation. Therefore, the Commission

⁴⁰ See id.

⁴¹ See Approval Order, supra note 4, 77 FR at 75475.

⁴² See id. at 75475–76.

⁴³ This may be informed by the locational premia in the various authorized warehouse locations, but “premia in different locations have fluctuated historically relative to one another and will continue to change over time...” and “a region with the highest locational premia at a given time may have the lowest locational premia at a later date.” Id. at 75475.

⁴⁴ The commenter, however, did provide projections that production will increase through 2016 in amounts that also exceed – and in most years greatly exceed – the amount of copper that the commenter predicts the Trust will hold. See V&F August 24 Letter, supra note 7, at 2 (providing data indicating that global refined copper is projected to increase by 519,000 metric tons in 2012; 1,603,000 metric tons in 2013; 1,195,000 metric tons in 2014; 1,091,000 metric tons in 2015, and 375,000 metric tons in 2016). While this data does not support the proposition that particular brands of copper will be more widely available at particular locations in the future, it also does not support the commenter’s contention that particular brands of copper will be more scarce at particular locations in the future.

does not believe that the record supports the commenter's argument that, as a result of the Trust, it is much more likely that brand-sensitive end-users of copper will not be able to obtain their desired brands of copper at their desired locations.

* * * * *

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

