

SECURITIES AND EXCHANGE COMMISSION

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

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

ELISSE B. WALTER, CHAIRMAN

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(41 Documents)

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-69275; File No. 4-660]

**Fixed Income Roundtable**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice of roundtable discussion; request for comment.

**SUMMARY:** The Securities and Exchange Commission will host a one day roundtable to discuss the current market structure and potential ways to improve the transparency, liquidity, efficiency, and other aspects of fixed income markets. The roundtable will focus on the municipal securities, corporate bonds, and asset-backed securities markets.

The roundtable discussion will be held in the multi-purpose room of the Securities and Exchange Commission headquarters at 100 F Street, NE, in Washington, DC on April 16, 2013 beginning at 8:45 a.m. and ending at approximately 4:15 p.m. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-served basis. The roundtable discussion also will be available via webcast on the Commission's website at [www.sec.gov](http://www.sec.gov).

The roundtable will consist of four panels. The participants in the first panel will discuss the current market structure for municipal securities. The participants in the second panel will discuss the current market structure for corporate bonds and asset-backed securities. The participants in the third panel will discuss potential improvements to the market structure for municipal securities. The participants in the fourth panel will discuss potential improvements to the market structure for corporate bonds and asset-backed securities.

**DATES:** The roundtable discussion will take place on April 16, 2013. The Commission will accept comments regarding issues addressed at the roundtable until May 7, 2013.

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

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number 4-660 on the subject line.

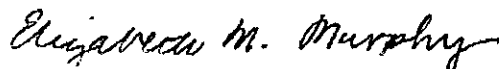
Paper Comments:

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

All submission should refer to File Number 4-660. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Ronesha A. Butler, Special Counsel, at (202) 551-5629, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

By the Commission.



Elizabeth M. Murphy  
Secretary

Dated: April 2, 2013

SECURITIES AND EXCHANGE COMMISSION

SECURITIES AND EXCHANGE ACT OF 1934

Release No. 69279 / April 2, 2013

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934:  
Netflix, Inc., and Reed Hastings

**I. Introduction**

The Division of Enforcement has investigated whether Netflix, Inc. (“Netflix”) and its Chief Executive Officer, Reed Hastings (“Hastings”) violated Regulation FD (17 C.F.R. §243.100 *et seq.*) and Section 13(a) of the Securities Exchange Act of 1934 (“Exchange Act”). The Commission has determined not to pursue an enforcement action in this matter. The investigation concerned Hastings’s use of his personal Facebook page, on July 3, 2012, to announce that Netflix had streamed 1 billion hours of content in the month of June. Neither Hastings nor Netflix had previously used Hastings’s personal Facebook page to announce company metrics, and Netflix had not previously informed shareholders that Hastings’s Facebook page would be used to disclose information about Netflix. The post was not accompanied by a press release, a post on Netflix’s own web site or Facebook page, or a Form 8-K.

The investigation raised questions regarding: 1) the application of Regulation FD to Hastings’s post; and 2) the applicability of the Commission’s August 2008 Guidance on the Use of Company Web Sites<sup>1</sup> to emerging technologies, including social networking sites, such as Facebook.

Regulation FD and Section 13(a) of the Exchange Act prohibit public companies, or persons acting on their behalf, from selectively disclosing material, nonpublic information to certain securities professionals, or shareholders where it is reasonably foreseeable that they will trade on that information, before it is made available to the general public. The Commission’s 2008 Guidance explained that for purposes of complying with Regulation FD, a company makes public disclosure when it distributes information “through a recognized channel of distribution.”

In its investigation, the SEC staff learned (and some public commentary further suggested) that there is uncertainty concerning how Regulation FD and the Commission’s 2008 Guidance apply to disclosures made through social media channels. Since the issuance of the 2008 Guidance, the use of social media has proliferated and the Commission is aware that public companies are increasingly using social media to communicate with shareholders and the market generally. The ways in which companies may use these social media channels, however, are not fundamentally different from the ways in which the web sites, blogs, and RSS feeds addressed by the 2008 Guidance are

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<sup>1</sup> Commission Guidance on the Use of Company Web Sites, Release No. 34-58288 (Aug. 7, 2008) (“2008 Guidance”).

used. Accordingly, the Commission deems it appropriate and in the public interest to issue this Report of Investigation ("Report") pursuant to Section 21(a) of the Exchange Act to provide guidance to issuers regarding how Regulation FD and the 2008 Guidance apply to disclosures made through social media channels.<sup>2</sup>

## II. Background of Regulation FD and the 2008 Commission Guidance on the Use of Company Web Sites

Regulation FD provides that when an issuer, or a person acting on its behalf, discloses material, nonpublic information to securities market professionals or shareholders where it is reasonably foreseeable that they will trade on the basis of the information, it must distribute that information in a manner reasonably designed to achieve effective broad and non-exclusionary distribution to the public.<sup>3</sup> When the disclosure of material, nonpublic information is intentional, distribution of the same information to the public must be made simultaneously. When the disclosure of material, nonpublic information is inadvertent, distribution of the same information to the public must be made promptly afterwards. Regulation FD was adopted out of concern that issuers were selectively "disclosing important nonpublic information, such as advance warning of earnings results, to securities analysts or selected institutional investors before making full disclosure of the same information to the general public."<sup>4</sup> In our previous statements on Regulation FD, we have recognized that the "regulation does not require use of a particular method, or establish a 'one size fits all' standard for disclosure."<sup>5</sup> We did, however, "caution issuers that a deviation from their usual practices for making public disclosure may affect our judgment as to whether the method they have chosen in a particular case was reasonable."<sup>6</sup> We have since encouraged "honest, carefully considered attempts to comply with Regulation FD."<sup>7</sup>

In August 2008, in response to the changing electronic landscape of issuer disclosure and the wide-spread use of web sites to disseminate information electronically

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<sup>2</sup> Section 21(a) of the Exchange Act authorizes the Commission to investigate violations of the federal securities laws, and, in its discretion, "to publish information concerning any such violations." This Report does not constitute an adjudication of any fact or issue addressed herein. The facts discussed in Section III, *infra*, are matters of public record or based on documentary records.

<sup>3</sup> 17 C.F.R. § 243.100. Final Rule: Selective Disclosure and Insider Trading, Exchange Act, Release No. 34-43154, 65 Fed. Reg. 51,716 (Aug. 15, 2000) (the "Adopting Release"). Regulation FD applies generally to selective disclosures made to persons outside the issuer who are (1) a broker or dealer or persons associated with a broker or dealer, (2) an investment advisor or persons associated with an investment advisor, (3) an investment company or persons affiliated with an investment company, or (4) a holder of the issuer's securities under circumstances in which it is reasonably foreseeable that the person will trade in the issuer's securities on the basis of the information. 17 CFR § 243.100(b)(1).

<sup>4</sup> *Id.*, at 51,716.

<sup>5</sup> *Id.*, at 51,724.

<sup>6</sup> *Id.*

<sup>7</sup> Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: Motorola, Inc., Release No. 34-46898 (Nov. 25, 2002).

to investors and the market, the Commission issued its 2008 Guidance.<sup>8</sup> As the 2008 Guidance explained, the Commission has “long recognized the vital role of the Internet and electronic communications in modernizing the disclosure system under the federal securities laws and in promoting transparency, liquidity and efficiency in our trading markets.”<sup>9</sup> Additionally, the guidance detailed the many steps we have taken over the years to encourage the dissemination of information electronically, “as we believe that widespread access to company information is a key component of our integrated disclosure scheme, the efficient functioning of the markets, and investor protection.”<sup>10</sup>

The Commission has not explicitly addressed the application of Regulation FD and the 2008 Guidance to disclosures made through social media channels. The 2008 Guidance was directed primarily at the use of issuer web sites as a method of disseminating information in compliance with Regulation FD. Yet the guidance also contemplated other “push” technology forms of communication such as email alerts and RSS feeds, along with “interactive” communication tools such as blogs.<sup>11</sup> In light of the rapid “development and proliferation of company web sites since 2000” and with the expectation of “continued technological advances,” the 2008 Guidance was designed to be flexible and adaptive.<sup>12</sup> Accordingly, the guidance provided issuers with a factor-based framework for analysis, rather than static rules applicable only to web sites.

As explained in the 2008 Guidance, “whether a company’s web site is a recognized channel of distribution will depend on the steps that the company has taken to alert the market to its web site and its disclosure practices, as well as the use by investors and the market of the company’s web site.”<sup>13</sup> The guidance offered a non-exhaustive list of factors to be considered in evaluating whether a corporate web site constitutes a recognized channel of distribution.<sup>14</sup> The central focus of this inquiry is whether the company has made investors, the market, and the media aware of the channels of distribution it expects to use, so these parties know where to look for disclosures of material information about the company or what they need to do to be in a position to receive this information.

### III. Facts

Netflix is an on-line entertainment service that provides movies and television programming to subscribers by streaming content through the internet and by distributing DVDs through the mail. Over the last two years, Netflix has stated that it is increasingly focused on expanding its internet streaming business.

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<sup>8</sup> 2008 Guidance, at 10.

<sup>9</sup> *Id.*, at 6.

<sup>10</sup> *Id.*, at 7.

<sup>11</sup> *Id.*, at 9 n.20, 21, & n.51.

<sup>12</sup> *Id.*, at 5.

<sup>13</sup> *Id.*, at 18-19.

<sup>14</sup> *Id.*, at 20-22.

On January 4, 2012, Netflix announced by press release that it had streamed two billion hours of content in the fourth quarter of 2011. Netflix also featured the two billion hours streaming metric in the opening paragraph of the January 25, 2012, letter to shareholders signed by Hastings that accompanied Netflix's quarterly financial results included in its earnings release, a copy of which was also furnished on EDGAR on a Current Report on Form 8-K. During Netflix's 2011 year-end and fourth quarter earnings conference call on January 25, 2012, Hastings was asked why this streaming metric was relevant (since Netflix's revenues are derived through fixed subscriber fees, not based on the number of hours of programming viewed). Hastings explained that streaming was "a measure of an engagement and scale in terms of the adoption of our service and use of our service. . . . It [two billion hours streaming in a quarter] is a great milestone for us to have hit. And like I said, shows widespread adoption and usage of the service." He also stated that although he did not anticipate that Netflix would regularly report the number of hours of streamed content, Netflix would update the metric "on a milestone basis."

In an early June posting on Netflix's official blog, Netflix made a brief reference to people "enjoying nearly a billion hours per month of movies and TV shows from Netflix." The blog was technical in nature, announcing a new content delivery network available to Internet Service Providers, and there was no further detail given about the streaming metric. Beyond that, Netflix did not make any milestone announcements regarding streaming hours between January 25, 2012 and the beginning of July 2012.

On July 3, 2012, just before 11:00 a.m. Eastern time, Hastings posted the following message on his personal Facebook page:

Congrats to Ted Sarados, and his amazing content licensing team. Netflix monthly viewing exceeded 1 billion hours for the first time ever in June. When House of Cards and Arrested Development debut, we'll blow these records away. Keep going, Ted, we need even more!

This announcement represented a nearly 50% increase in streaming hours from Netflix's January 25, 2012 announcement that it had streamed 2 billion hours over the preceding three-month quarter.

Prior to his post, Hastings did not receive input from Netflix's chief financial officer, the legal department, or investor relations department. Netflix did not file with or furnish to the Commission a Current Report on Form 8-K, issue a press release through its standard distribution channels, or otherwise announce the streaming milestone. Also on July 3, 2012, and after the Facebook post, Netflix issued a press release announcing the date of its second quarter 2012 earnings release but did not mention Hastings's Facebook post. Netflix's stock continued a rise that began when the market opened on July 3, increasing from \$70.45 at the time of Hastings's Facebook post to \$81.72 at the close of the following trading day.

The announcement of the streaming milestone reached the securities market incrementally. The post was picked up by a technology-focused blog about an hour later and by a handful of news outlets within two hours. Approximately an hour after the post, Netflix sent it to several reporters, but did not disseminate it to the broader mailing list normally used for corporate press releases. After the markets closed early at 1:00 p.m., several articles in the mainstream financial press picked up the story. Research analysts also wrote about the streaming milestone, describing the metric as a positive measure of customer engagement, indicative of a reduction in the rate Netflix is losing customers, or “churn,” and possibly suggesting that quarterly subscriber numbers would be at the high end of guidance.<sup>15</sup>

Facebook members can subscribe to Hastings’s Facebook page, which had over 200,000 subscribers at the time of the post, including equity research analysts associated with registered broker-dealers, shareholders, reporters, and bloggers. Neither Hastings nor Netflix had previously used Hastings’s Facebook page to announce company metrics. Nor had they taken any steps to make the investing public aware that Hastings’s personal Facebook page might be used as a medium for communicating information about Netflix. Instead, Netflix has consistently directed the public to its own Facebook page, Twitter feed, and blog and to its own web site for information about Netflix. In early December 2012, Hastings stated for the public record that “we [Netflix] don’t currently use Facebook and other social media to get material information to investors; we usually get that information out in our extensive investor letters, press releases and SEC filings.”

#### **IV. Discussion**

A fundamental question raised during the staff’s investigation was the application of Regulation FD and the 2008 Guidance to issuer disclosures through rapidly changing forms of communication, including social media channels. We do not wish to inhibit the content, form, or forum of any such disclosure, and we are mindful of placing additional compliance burdens on issuers. In fact, we encourage companies to seek out new forms of communication to better connect with shareholders. We also remind issuers that the analysis of whether Regulation FD was violated is always a facts-and-circumstances analysis based on the specific context presented.

We take this opportunity to clarify and amplify two points. First, issuer communications through social media channels require careful Regulation FD analysis comparable to communications through more traditional channels. Second, the principles outlined in the 2008 Guidance — and specifically the concept that the investing public should be alerted to the channels of distribution a company will use to disseminate material information — apply with equal force to corporate disclosures made through social media channels.

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<sup>15</sup> On July 24, 2012, after the close of market, Netflix announced its second quarter earnings, including quarterly subscriber numbers on the low end of guidance. The stock dropped from the previous day’s close of \$80.39 to \$60.28 per share on July 25, 2012.



## A. Disclosures Triggering Regulation FD

Regulation FD applies when an issuer discloses material, non-public information to certain enumerated persons, including shareholders and securities professionals.<sup>16</sup> It prohibits selective disclosure “[w]henver an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer *to any person* described in paragraph (b)(1) of this section.”<sup>17</sup> Although the Regulation FD Adopting Release highlights the Commission’s special concerns about selective disclosure of information to favored analysts or investors, the identification of the enumerated persons within Regulation FD is inclusive, and the prohibition does not turn on an intent or motive of favoritism. Nor does the rule suggest that disclosure of material, non-public information to a broader group that includes both enumerated and non-enumerated persons but that still falls short of a public disclosure negates the applicability of Regulation FD. On the contrary, the rule makes clear that public disclosure of material, nonpublic information must be made in a manner that conforms with Regulation FD whenever such information is disclosed to any group that includes one or more enumerated persons.

Accordingly, we emphasize for issuers that all disclosures to groups that include an enumerated person should be analyzed for compliance with Regulation FD. Specifically, if an issuer makes a disclosure to an enumerated person, including to a broader group of recipients through a social media channel, the issuer must consider whether that disclosure implicates Regulation FD.<sup>18</sup> This would include determining whether the disclosure includes material, nonpublic information.<sup>19</sup> Further, if the issuer were to elect not to file a Form 8-K, the issuer would need to consider whether the information was being disseminated in a manner “reasonably designed to provide broad, non-exclusionary distribution of the information to the public.”<sup>20</sup>

## B. Broad, Non-Exclusionary Distribution of Information to the Public

Our 2008 Guidance was directed primarily at the use of corporate web sites for the disclosure of material, non-public information. Like web sites, corporate social media pages are created, populated, and updated by the issuer. The 2008 Guidance, furthermore, specifically identified “push” technologies, such as email alerts and RSS feeds and “interactive” communication tools, such as blogs, which could enable the automatic electronic dissemination of information to subscribers.<sup>21</sup> Today’s evolving social media channels are an extension of these concepts, whereby information can be

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<sup>16</sup> See *supra* n.3.

<sup>17</sup> 17 CFR § 243.100(a) (emphasis added).

<sup>18</sup> We reiterate that nothing in Regulation FD is intended to interfere with “legitimate, ordinary-course business communications” or communications with the press. Adopting Release, 65 Fed. Reg. at 51,718.

<sup>19</sup> 17 CFR § 243.100(a).

<sup>20</sup> 17 CFR § 243.100(e)(1)-(2).

<sup>21</sup> See *supra* n.10.

disseminated to those with access. Thus, the 2008 Guidance continues to provide a relevant framework for applying Regulation FD to evolving social media channels of distribution.

Specifically, in light of the direct and immediate communication from issuers to investors that is now possible through social media channels, such as Facebook and Twitter, we expect issuers to examine rigorously the factors indicating whether a particular channel is a “recognized channel of distribution” for communicating with their investors.<sup>22</sup> We emphasize for issuers that the steps taken to alert the market about which forms of communication a company intends to use for the dissemination of material, non-public information, including the social media channels that may be used and the types of information that may be disclosed through these channels, are critical to the fair and efficient disclosure of information. Without such notice, the investing public would be forced to keep pace with a changing and expanding universe of potential disclosure channels, a virtually impossible task.

Providing appropriate notice to investors of the specific channels a company will use for the dissemination of material, nonpublic information is a sensible and expedient solution. It is not expected that this step would limit the channels of communication a company could use after appropriate notice or the opportunity for a company and investors to benefit from technological innovation and changes in communications practices. The 2008 Guidance encourages issuers to consider including in periodic reports and press releases the corporate web site address and disclosures that the company routinely posts important information on that web site. Similarly, disclosures on corporate web sites identifying the specific social media channels a company intends to use for the dissemination of material non-public information would give investors and the markets the opportunity to take the steps necessary to be in a position to receive important disclosures — e.g., subscribing, joining, registering, or reviewing that particular channel. These are some, but certainly not all, of the methods a company could use, with minimal burden, to enable evolving social media channels of corporate disclosure to be used as recognized channels of distribution in compliance with Regulation FD and the 2008 Guidance.

Although every case must be evaluated on its own facts, disclosure of material, nonpublic information on the personal social media site of an individual corporate officer, without advance notice to investors that the site may be used for this purpose, is unlikely to qualify as a method “reasonably designed to provide broad, non-exclusionary distribution of the information to the public” within the meaning of Regulation FD.<sup>23</sup> This is true even if the individual in question has a large number of subscribers, friends, or other social media contacts, such that the information is likely to reach a broader audience over time. Personal social media sites of individuals employed by a public company would not ordinarily be assumed to be channels through which the company would disclose material corporate information. Without adequate notice that such a site

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<sup>22</sup> 2008 Guidance, at 20-22.

<sup>23</sup> 17 CFR § 243.101(e)(2).

may be used for this purpose, investors would not have an opportunity to access this information or, in some cases, would not know of that opportunity, at the same time as other investors.

## **V. Conclusion**

There has been a rapid proliferation of social media channels for corporate communication since the issuance of the Commission's 2008 Guidance. An increasing number of public companies are using social media to communicate with their shareholders and the investing public. We appreciate the value and prevalence of social media channels in contemporary market communications, and the Commission supports companies seeking new ways to communicate and engage with shareholders and the market. This Report is not aimed at inhibiting corporate communication through evolving social media channels. To the contrary, we seek to remind issuers that disclosures to persons enumerated in Regulation FD, even if made through evolving social media channels, must still be analyzed for compliance with Regulation FD. Moreover, we emphasize that the Commission's 2008 Guidance, though largely focused on the use of web sites, is equally applicable to current and evolving social media channels of corporate communication. The 2008 Guidance explained that issuers must take steps sufficient to alert investors and the market to the channels it will use for the dissemination of material, nonpublic information. We believe that adherence to this guidance will help, with minimal burden, to assure compliance with Regulation FD and the fair and efficient operation of the market.

By the Commission.

**UNITED STATES OF AMERICA  
BEFORE THE  
SECURITIES AND EXCHANGE COMMISSION**

**Securities Act of 1933  
Release No. 9398 / April 2, 2013**

**Securities Exchange Act of 1934  
Release No. 69265 / April 2, 2013**

**ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR  
2013 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002**

The Sarbanes-Oxley Act of 2002 (the "Act") provides that the Securities and Exchange Commission (the "Commission") may recognize, as generally accepted for purposes of the securities laws, any accounting principles established by a standard setting body that meets certain criteria. Consequently, Section 109 of the Act provides that all of the budget of such a standard setting body shall be payable from an annual accounting support fee assessed and collected against each issuer, as may be necessary or appropriate to pay for the budget and provide for the expenses of the standard setting body, and to provide for an independent, stable source of funding, subject to review by the Commission. Under Section 109(f) of the Act, the amount of fees collected for a fiscal year shall not exceed the "recoverable budget expenses" of the standard setting body. Section 109(h) amends Section 13(b)(2) of the Securities Exchange Act of 1934 to require issuers to pay the allocable share of a reasonable annual accounting support fee or fees, determined in accordance with Section 109 of the Act.

On April 25, 2003, the Commission issued a policy statement concluding that the Financial Accounting Standards Board ("FASB") and its parent organization, the Financial Accounting Foundation ("FAF"), satisfied the criteria for an accounting

standard-setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.<sup>1</sup> As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2013. In connection with its review, the Commission also reviewed the budget for the FAF and the FASB for calendar year 2013.

Section 109 of the Act also provides that the standard setting body can have additional sources of revenue for its activities, such as earnings from sales of publications, provided that each additional source of revenue shall not jeopardize, in the judgment of the Commission, the actual or perceived independence of the standard setter. In this regard, the Commission also considered the interrelation of the operating budgets of the FAF, the FASB, and the Governmental Accounting Standards Board ("GASB"), the FASB's sister organization, which sets accounting standards used by state and local government entities. The Commission has been advised by the FAF that neither the FAF, the FASB, nor the GASB accept contributions from the accounting profession.

The Commission understands that the Office of Management and Budget ("OMB") has determined that the FASB is included in sequestration anticipated by the the Budget Control Act of 2011 ("BCA").<sup>2</sup> So long as sequestration is applicable, we anticipate that the FAF will work with the Commission and Commission staff as appropriate regarding its implementation of sequestration. In that event, the Commission also requests the FAF to provide the Commission with information regarding the FAF's

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<sup>1</sup> Financial Reporting Release No. 70.

<sup>2</sup> See "OMB Report Pursuant to the Sequestration Transparency Act of 2012" (P.L. 112-155), page 222 of 224 at: [http://www.whitehouse.gov/sites/default/files/omb/assets/legislative\\_reports/stareport.pdf](http://www.whitehouse.gov/sites/default/files/omb/assets/legislative_reports/stareport.pdf).

plans for implementation of sequestration, including how it will impact 2013 spending for each of the FAF's program areas and cost categories.

After its review, the Commission determined that the 2013 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

IT IS ORDERED, pursuant to Section 109 of the Act, that the FASB may act in accordance with this determination of the Commission.

By the Commission.

A handwritten signature in cursive script that reads "Elizabeth M. Murphy".

Elizabeth M. Murphy  
Secretary

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69277 / April 2, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3450 / April 2, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-14201

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In the Matter of  
Eric J. Bur, CPA

: ORDER GRANTING APPLICATION FOR  
: REINSTATEMENT TO APPEAR AND PRACTICE  
: BEFORE THE COMMISSION AS AN ACCOUNTANT  
: RESPONSIBLE FOR THE PREPARATION OR  
: REVIEW OF FINANCIAL STATEMENTS REQUIRED  
: TO BE FILED WITH THE COMMISSION

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On January 20, 2011, Eric J. Bur, CPA ("Bur") was suspended from appearing or practicing before the Commission as an accountant as a result of settled public administrative proceedings instituted by the Commission against Bur pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.<sup>1</sup> Bur consented to the entry of the order without admitting or denying the findings therein but for the Commission's finding that a final judgment and permanent injunction and other relief had been previously entered against him. This order is issued in response to Bur's application for reinstatement to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

The Commission's Complaint alleged, among other things, that from at least 2002 to 2007, while Bur was employed as the Chief Financial Officer of NIC Inc. ("NIC"), the company's Chief Executive Officer received more than \$1.18 million in undisclosed perquisites. Bur had responsibility, along with NIC's Chief Accounting Officer, for NIC's internal controls, books and records, and executive compensation disclosures in public filings. Bur was informed that the CEO was not submitting documentation supporting a business purpose for his expenses as required by NIC's policies and a subordinate raised his concerns to Bur that some of the CEO's expenses were not business related. However, Bur permitted NIC to pay the CEO's expenses, which caused NIC's books, records and accounts to falsely characterize the CEO's perquisites as business expenses. In addition, the Complaint alleged that Bur was aware of the Commission's rules requiring the

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<sup>1</sup> See Accounting and Auditing Enforcement Release No. 3233 dated January 20, 2011. Bur was permitted, pursuant to the order, to apply for reinstatement after one year upon making certain showings.

disclosure of perquisites in proxy statements and annual reports, yet he reviewed, signed, and/or certified NIC's filings with the Commission for 2002 through 2006, which failed to disclose the CEO's perquisites and contained false statements concerning the CEO's compensation. As a result, Bur violated Rules 13a-14 and 13b2-1 under the Securities Exchange Act of 1934 ("Exchange Act"), and aided and abetted violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 14a-3, and 14a-9 thereunder.

In his capacity as a preparer or reviewer, or as a person responsible for the preparation or review, of financial statements of a public company to be filed with the Commission, Bur attests that he will undertake to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, while practicing before the Commission in this capacity. Bur is not, at this time, seeking to appear or practice before the Commission as an independent accountant. If he should wish to resume appearing and practicing before the Commission as an independent accountant, he will be required to submit an application to the Commission showing that he has complied and will comply with the terms of the original suspension order in this regard. Therefore, Bur's suspension from practice before the Commission as an independent accountant continues in effect until the Commission determines that a sufficient showing has been made in this regard in accordance with the terms of the original suspension order.

Rule 102(e)(5) of the Commission's Rules of Practice governs applications for reinstatement, and provides that the Commission may reinstate the privilege to appear and practice before the Commission "for good cause shown."<sup>2</sup> This "good cause" determination is necessarily highly fact specific.

On the basis of information supplied, representations made, and undertakings agreed to by Bur, it appears that he has complied with the terms of the January 20, 2011 order suspending him from appearing or practicing before the Commission as an accountant, that no information has come to the attention of the Commission relating to his character, integrity, professional conduct or qualifications to practice before the Commission that would be a basis for adverse action against him pursuant to Rule 102(e) of the Commission's Rules of Practice, and that Bur, by undertaking to have his work reviewed by the independent audit committee of any company for which he works, or in some other manner acceptable to the Commission, in his practice before the Commission as a preparer or reviewer of financial statements required to be filed with the Commission, has shown good cause for reinstatement. Therefore, it is accordingly,

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<sup>2</sup> Rule 102(e)(5)(i) provides:

"An application for reinstatement of a person permanently suspended or disqualified under paragraph (e)(1) or (e)(3) of this section may be made at any time, and the applicant may, in the Commission's discretion, be afforded a hearing; however, the suspension or disqualification shall continue unless and until the applicant has been reinstated by the Commission for good cause shown." 17 C.F.R. § 201.102(e)(5)(i).



ORDERED pursuant to Rule 102(e)(5)(i) of the Commission's Rules of Practice that Eric J. Bur, CPA is hereby reinstated to appear and practice before the Commission as an accountant responsible for the preparation or review of financial statements required to be filed with the Commission.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 240**

**Release No. 34-69284; File No. S7-29-11**

**RIN 3235-AL18**

**Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission ("SEC" or "Commission") is affirming recent amendments to Rule 19b-4 under the Securities Exchange Act of 1934 ("Exchange Act") in connection with filings of proposed rule changes by certain registered clearing agencies and is expanding on those amendments in response to comments received (collectively, "Final Rule").

The Commission also is making corresponding technical modifications to the General Instructions for Form 19b-4 under the Exchange Act. The amendments to Rule 19b-4 and the instructions to Form 19b-4 are intended to streamline the rule filing process in areas involving certain activities concerning non-security products that may be subject to duplicative or inconsistent regulation as a result of, in part, certain provisions under Section 763(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").

**EFFECTIVE DATE:** [insert date 60 days after publication in the Federal Register].

**FOR FURTHER INFORMATION CONTACT:** Joseph P. Kamnik, Assistant Director; Gena Lai, Senior Special Counsel; and Neil Lombardo, Attorney, Office of Clearance and Settlement, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010 at (202) 551-5710.

**SUPPLEMENTARY INFORMATION:** The Commission is adopting a Final Rule that

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affirms and expands upon recent amendments to Rule 19b-4 under the Exchange Act concerning categories of proposed rule changes that qualify for effectiveness upon filing under Section 19(b)(3)(A) of the Exchange Act. The Commission also is making a corresponding technical modification to the General Instructions for Form 19b-4 under the Exchange Act.

## I. Introduction

### A. Background on the Commission's Process for Proposed Rule Changes

Section 19(b)(1) of the Exchange Act<sup>1</sup> requires each self-regulatory organization (“SRO”), including any Registered Clearing Agency,<sup>2</sup> to file with the Commission copies of any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO (collectively, “proposed rule change”),<sup>3</sup> which must be submitted on Form 19b-4<sup>4</sup> in accordance with the General Instructions thereto. Once a proposed rule change has been filed, the Commission is required to publish it in the Federal Register to provide an opportunity for public

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> See Section 3(a)(26) of the Exchange Act, 15 U.S.C. 78c(a)(26) (defining the term “self-regulatory organization” to mean any national securities exchange, registered securities association, registered clearing agency, and, for purposes of Section 19(b) and other limited purposes, the Municipal Securities Rulemaking Board) (emphasis added).

<sup>3</sup> 15 U.S.C. 78s(b)(1). Section 3(a)(27) of the Exchange Act defines “rules” to include “the constitution, articles of incorporation, bylaws, and rules, or instruments corresponding to the foregoing . . . and such of the stated policies, practices, and interpretations of such exchange, association, or clearing agency as the Commission, by rule, may determine to be necessary or appropriate in the public interest or for the protection of investors to be deemed to be rules of such exchange, association, or clearing agency.” 15 U.S.C. 78c(a)(27). Rule 19b-4(b) under the Exchange Act defines “stated policy, practice, or interpretation” to mean, in part, “[a]ny material aspect of the operation of the facilities of the self-regulatory organization” or “[a]ny statement made generally available” that “establishes or changes any standard, limit, or guideline” with respect to the “rights, obligations, or privileges” of persons or the “meaning, administration, or enforcement of an existing rule.” 17 CFR 240.19b-4(b).

<sup>4</sup> See 17 CFR 249.819.

comment.<sup>5</sup> A proposed rule change generally may not take effect unless the Commission approves it,<sup>6</sup> or it otherwise becomes effective under Section 19(b).<sup>7</sup>

Section 19(b)(2) of the Exchange Act sets forth the standards and time periods for Commission action either to approve, disapprove, or institute proceedings to determine whether the proposed rule change should be disapproved.<sup>8</sup> The Commission must approve a proposed rule change if it finds that the underlying rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the SRO proposing the rule change.<sup>9</sup>

At the same time, Section 19(b)(3)(A) of the Exchange Act provides that a proposed rule change may become effective upon filing with the Commission, without pre-effective notice and opportunity for comment, if it is appropriately designated by the SRO as: (i) constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the SRO; (ii) establishing or changing a due, fee, or other charge imposed by the SRO on any person, whether or not the person is a member of the SRO; or (iii) relating solely to the administration of the SRO.<sup>10</sup>

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<sup>5</sup> See 15 U.S.C. 78s(b)(1). The SRO is required to prepare the notice of its proposed rule change on Exhibit 1 of Form 19b-4 that the Commission then publishes in the Federal Register.

<sup>6</sup> See 15 U.S.C. 78s(b)(2). However, as provided in Section 19(b)(2)(D) of the Exchange Act, 15 U.S.C. 78s(b)(2)(D), a proposed rule change shall be "deemed to have been approved by the Commission" if the Commission does not take action on a proposal that is subject to Commission approval within the statutory time frames specified in Section 19(b)(2).

<sup>7</sup> See, e.g., 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> See 15 U.S.C. 78s(b)(2).

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

Section 19(b)(3)(B) of the Exchange Act also separately provides that a proposed rule change may be put into effect summarily if it appears to the Commission that such action is necessary for the protection of investors, the maintenance of fair and orderly markets, or the safeguarding of securities or funds, and provides that any proposed rule change so put into effect shall be filed promptly thereafter with the Commission under Section 19(b)(1) of the Exchange Act.<sup>11</sup> Accordingly, a proposed rule change put into effect summarily under Section 19(b)(3)(B) of the Exchange Act is also subject to the procedures of Section 19(b)(2) of the Exchange Act – in other words, that it is summarily effective only until such time as the Commission: (i) enters an order, pursuant to Section 19(b)(2)(A) of the Act, to approve or disapprove such proposed rule change; or (ii) institutes proceedings to determine whether the proposed rule change should be disapproved.<sup>12</sup>

Under Section 19(b)(3)(C) of the Exchange Act, the Commission summarily may temporarily suspend a proposed rule change of an SRO that has taken effect pursuant to either Section 19(b)(3)(A) or 19(b)(3)(B) of the Exchange Act within sixty days of its filing if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>13</sup> If the Commission takes such action, it is then required to institute proceedings to determine whether the proposed rule change should be approved or disapproved.<sup>14</sup>

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<sup>11</sup> 15 U.S.C. 78s(b)(3)(B).

<sup>12</sup> See Securities Exchange Act Release Nos. 11461 (June 11, 1975); 11554 (July 28, 1975); 11555 (July 28, 1975); and 11556 (July 28, 1975). See also 17 CFR 249.819.

<sup>13</sup> 15 U.S.C. 78s(b)(3)(C).

<sup>14</sup> Id. Temporary suspension of a proposed rule change and any subsequent action to approve or disapprove such change shall not affect the validity or force of the rule change during the period it was in effect and shall not be reviewable under Section 25 of the

In addition to the matters expressly set forth in the statute, Section 19(b)(3)(A) also provides the Commission with the authority, by rule and when consistent with the public interest, to designate other types of proposed rule changes that may be effective upon filing with the Commission.<sup>15</sup> The Commission has previously used this authority to designate, under Rule 19b-4 of the Exchange Act, certain rule changes that qualify for effectiveness upon filing under Section 19(b)(3)(A).<sup>16</sup> On July 7, 2011, the Commission adopted an interim final rule (“Interim Final Rule”) to amend Rule 19b-4 to include in the list of categories that qualify for effectiveness upon filing under Section 19(b)(3)(A) of the Exchange Act any matter effecting a change in an existing service of a Registered Clearing Agency that (i) primarily affects the futures clearing operations of the clearing agency with respect to futures that are not security futures and (ii) does

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Exchange Act, nor shall it be deemed to be “final agency action” for purposes of 5 U.S.C. 704. Id.

<sup>15</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>16</sup> For example, Rule 19b-4(f) under the Exchange Act currently permits SROs to declare rule changes to be immediately effective pursuant to Section 19(b)(3)(A) if properly designated by the SRO as: (i) effecting a change in an existing service of a Registered Clearing Agency that: (A) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible; and (B) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service; (ii) effecting a change in an existing order-entry or trading system of an SRO that: (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) does not have the effect of limiting the access to or availability of the system; or (iii) effecting a change that: (A) does not significantly affect the protection of investors or the public interest; (B) does not impose any significant burden on competition; and (C) by its terms, does not become operative for 30 days after the date of the filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest; provided that the SRO has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. See 17 CFR 240.19b-4(f).

not significantly affect any securities<sup>17</sup> clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service.<sup>18</sup> The Interim Final Rule also made corresponding technical modifications to the General Instructions for Form 19b-4. These actions were intended to provide a streamlined process for making effective, subject to certain conditions, proposed rule changes that primarily concern the futures clearing operations of a Registered Clearing Agency and are not linked to securities clearing operations.

**B. Clearing Agencies Deemed Registered Under the Dodd-Frank Act**

Section 763(b) of the Dodd-Frank Act<sup>19</sup> provides that (i) a depository institution registered with the Commodities Futures Trading Commission (“CFTC”) that cleared swaps as a multilateral clearing organization prior to the date of enactment of the Dodd-Frank Act and (ii) a derivatives clearing organization (“DCO”) registered with the CFTC that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act will be deemed registered with the Commission as a clearing agency solely for

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<sup>17</sup> Section 3(a)(10) of the Exchange Act defines “security” to include “any note, stock, treasury stock, security future, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or substitution, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any instrument commonly known as a ‘security’; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing . . . .” 15 U.S.C. 78c(a)(10).

<sup>18</sup> See Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies, Securities Exchange Act Release No. 34-64832 (July 7, 2011), 76 FR 41056 (July 13, 2011).

<sup>19</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

the purpose of clearing security-based swaps (“Deemed Registered Provision”).<sup>20</sup> On July 16, 2011, the Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, became effective,<sup>21</sup> thereby requiring each affected clearing agency to comply with all requirements of the Exchange Act and the rules and regulations thereunder applicable to Registered Clearing Agencies including, for example, the obligation to file proposed rule changes under Section 19(b) of the Exchange Act. The clearing of swaps,<sup>22</sup> futures, options on futures, and forwards is generally regulated by the CFTC in connection with its oversight and supervision of DCOs. DCOs are generally permitted to implement rule changes by self-certifying that the new rule complies with the CEA and the CFTC’s regulations.<sup>23</sup> The changes effected by the Interim Final Rule were intended to eliminate unnecessary delays that could arise due to the differences between the Commission’s rule filing process and the CFTC’s self-certification process, which generally allows rule changes to become effective either before

<sup>20</sup> See Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q-1(1)). Under this Deemed Registered Provision, each of the Chicago Mercantile Exchange Inc. (“CME”), ICE Clear Europe Limited (“ICE Clear Europe”) and ICE Clear Credit LLC (“ICC”), as the successor entity of ICE Trust US LLC, became Registered Clearing Agencies solely for the purpose of clearing security-based swaps. Registered Clearing Agencies that currently conduct a swaps or a futures business are The Options Clearing Corporation (“OCC”), CME, ICE Clear Europe and ICC.

<sup>21</sup> Section 774 of the Dodd-Frank Act states, “[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.”

<sup>22</sup> Section 721 of the Dodd-Frank Act amended Section 1a of the Commodity Exchange Act (“CEA”) to define the term “swap.” Among other things, the definition of “swap” specifically excludes any security-based swap other than a mixed swap. 7 U.S.C. 1a(47)(B)(x). See also Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps; Security-Based Swap Agreement Recordkeeping, 77 FR 48207 (August 13, 2012) (“Adopting Release”); 76 FR 29818 (May 23, 2011) (“Proposing Release”).

<sup>23</sup> See 7 U.S.C. 7a-2(c) and 17 CFR 40.6.



or within ten days after filing.<sup>24</sup>

### C. The Interim Final Rule

The Interim Final Rule amended Rule 19b-4 to expand the list of categories that qualify for effectiveness immediately upon filing pursuant to Section 19(b)(3)(A) of the Exchange Act to include proposed rule changes made by Registered Clearing Agencies with respect to certain futures clearing operations.<sup>25</sup> Specifically, the Interim Final Rule amended Rule 19b-4(f)(4)(ii) to allow a proposed rule change concerning futures clearing operations filed by a Registered Clearing Agency to take effect upon filing with the Commission pursuant to Section 19(b)(3)(A) so long as it is properly designated by the Registered Clearing Agency as effecting a change in a service of the Registered Clearing Agency that meets two conditions.<sup>26</sup> The first condition, set forth in Interim Final Rule 19b-4(f)(4)(ii)(A), is that the proposed rule change must primarily affect the futures clearing operations of the clearing agency with respect to futures that are not security futures.<sup>27</sup> For purposes of this requirement, a Registered Clearing Agency's "futures

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<sup>24</sup> See 7 U.S.C. 7a-2(c) and 17 CFR 40.6.

<sup>25</sup> When an SRO designates a proposed rule change as becoming effective upon filing with the Commission pursuant to Section 19(b)(3)(A) of the Exchange Act, the Commission has the power summarily to temporarily suspend the change within sixty days of its filing if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78s(b)(3)(A). See also *supra* note 14 and accompanying text.

<sup>26</sup> 17 CFR 240.19b-4(f)(4)(ii) (as amended by the Interim Final Rule).

<sup>27</sup> 17 CFR 240.19b-4(f)(4)(ii)(A) (as amended by the Interim Final Rule). For example, rules of general applicability that apply equally to securities clearing operations, including security-based swaps, would not be considered to primarily affect such futures clearing operations. In addition, changes to general provisions in the constitution, articles, or bylaws of the Registered Clearing Agency that address the operations of the entire clearing agency would not be considered to primarily affect such futures clearing operations. See Interim Final Rule, Securities Exchange Act Release No. 64832 (July 7, 2011), 76 FR 41056, 41058 (July 13, 2011).

clearing operations” includes any activity that would require the Registered Clearing Agency to register with the CFTC as a DCO in accordance with the CEA.<sup>28</sup> In addition, to “primarily affect” such futures clearing operations means that the proposed rule change is targeted to affect matters related to the clearing of futures specifically, and that any effect on other clearing operations would be incidental in nature and not significant in extent. Because a security futures product is a security for purposes of the Exchange Act,<sup>29</sup> a Registered Clearing Agency may not invoke Rule 19b-4(f)(4)(ii) to designate proposed rule changes concerning the agency’s security futures operations as taking effect upon filing with the Commission pursuant to Section 19(b)(3)(A). Instead, the Commission reviews such proposed rule changes in accordance with Section 19(b)(2), unless there is another basis for the change to be filed under Section 19(b)(3)(A).

The second condition, contained in Interim Final Rule 19b-4(f)(4)(ii)(B), is that the proposed rule change must not significantly affect any securities clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service.<sup>30</sup> The phrase “significantly affect” is used elsewhere in Rule 19b-4 in the context of defining other categories of proposed rule changes that qualify for effectiveness upon filing

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<sup>28</sup> See 7 U.S.C. 7a-1 (providing that it shall be unlawful for a DCO, unless registered with the CFTC, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a DCO (as described in 7 U.S.C. 1a(9)) with respect to a contract of sale of a commodity for future delivery (or option on such a contract) or option on a commodity, in each case unless the contract or option is (i) otherwise excluded from registration in accordance with certain sections of the CEA or (ii) a security futures product cleared by a Registered Clearing Agency); see also Interim Final Rule, Securities Exchange Act Release No. 64832 (July 7, 2012), 76 FR 41056, 41058 (July 13, 2011).

<sup>29</sup> 15 U.S.C. 78c(a)(10).

<sup>30</sup> 17 CFR 240.19b-4(f)(4)(ii)(B) (as amended by the Interim Final Rule).

under Section 19(b)(3)(A) of the Exchange Act.<sup>31</sup> Accordingly, “significantly affect” has the same meaning and interpretation as that phrase has in Rules 19b-4(f)(4)(i) (as amended by the Interim Final Rule), 19b-4(f)(5), and 19b-4(f)(6). The Commission believes that a Registered Clearing Agency’s “securities clearing operations . . . or any related rights or obligations of the clearing agency or persons using such service” would include activity that would require the Registered Clearing Agency to register as a clearing agency in accordance with the Exchange Act.

## **II. Final Rule**

### **A. Comments Received on the Interim Final Rule**

The Commission received three comment letters on the Interim Final Rule.<sup>32</sup> Two commenters urged the Commission to modify the Interim Final Rule to broaden the list of rule changes that qualify for effectiveness upon filing pursuant to Section 19(b)(3)(A) to include changes related to all products that are regulated by the CFTC.<sup>33</sup>

In their comment letters, both CME and ICE Clear Europe urged the Commission to expand Rule 19b-4(f)(4)(ii) to include proposed rule changes related to the swaps clearing

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<sup>31</sup> See, e.g., 17 CFR 240.19b-4(f)(4)(i) (as amended by the Interim Final Rule) (in respect of a proposed rule change in an existing service of a Registered Clearing Agency that: (1) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (2) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service); see also Interim Final Rule, Securities Exchange Act Release No. 64832 (July 7, 2012), 76 FR 41056, 41059 (July 13, 2011).

<sup>32</sup> Copies of comments received on the proposal are available on the Commission’s website at: <http://www.sec.gov/comments/s7-29-11/s72911.shtml>.

<sup>33</sup> See, e.g., comment letter of Craig Donohue, Chief Executive Office, CME Group, Inc. (Sep. 15, 2011) (“CME Letter”) and comment letter of Shearman & Sterling LLP, on behalf of ICE Clear Europe Limited (Sept. 15, 2011) (“ICE Clear Europe Letter”).

operations of a Registered Clearing Agency.<sup>34</sup> In particular, CME noted that its current business involves the clearing of both futures and swaps, including agricultural swaps, interest rate swaps, certain over-the-counter (“OTC”) commodity products (including gold forwards and freight forwards) and, potentially, energy and foreign exchange swaps.<sup>35</sup> CME raised concerns that, by omitting swaps and certain other OTC products from the types of products covered by Rule 19b-4(f)(4)(ii), it is “now subject to substantial potential delays” when implementing rule changes that deal with products over which the Commission is not its primary regulator.<sup>36</sup> ICE Clear Europe raised similar concerns with respect to its non-security-based swaps business, particularly its longstanding energy derivatives clearing business.<sup>37</sup> Specifically, ICE Clear Europe requested that Rule 19b-4(f)(4)(ii) be expanded to include proposed rule changes that relate solely to swaps, and are not related to security-based swaps.<sup>38</sup>

CME also requested that the Commission revise Rule 19b-4(f)(4)(ii) generally such that only proposed rule changes that relate directly to security-based swap clearing activities would be subject to the Commission’s review in accordance with Section 19(b)(2).<sup>39</sup> CME further requested that Rule 19b-4(f)(4)(ii) permit proposed rule change filings to be made pursuant to Section 19(b)(3)(A) with respect to “rules of general applicability for product categories, such as [credit default swaps], where clearing is offered for both swaps and security-based swaps” and that a Section 19(b)(2) filing not be required for any other swap or “OTC product categories with

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<sup>34</sup> See CME Letter and ICE Clear Europe Letter.

<sup>35</sup> See CME Letter.

<sup>36</sup> Id.

<sup>37</sup> See ICE Clear Europe Letter.

<sup>38</sup> Id.

<sup>39</sup> See CME Letter.

no direct or significant impact on security-based swaps,” and should also not be required for “broad rules of general applicability as to clearing operations that will not have any particular or significant impact on security-based swaps clearing.”<sup>40</sup> CME stated that, at present, its entire business, including the clearing of credit default swaps on broad-based indices, falls under the exclusive jurisdiction of the CFTC, and that the effect of the Interim Final Rule has been to replace the rule filing regime of the CEA with the pre-approval rule filing regime of the Exchange Act. CME stated that it believes the Deemed Registered Provision was intended to allow clearing agencies already authorized to clear and engaged in the clearing of credit default swaps and other products under the authority of the CFTC to continue to do so without undue disruption to its service offerings, and that Congress did not intend to change this fundamental division of responsibilities.

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<sup>40</sup> Id. In its comment letter, CME noted that Executive Order 13563, which the President signed on January 18, 2011, requires, among other things, that all executive branch agencies identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public, in each case where relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law. While this order does not apply to independent agencies, the President separately signed Executive Order 13579 on July 11, 2011, which requires each independent agency to develop and release a public plan to periodically review its existing significant regulations “to determine whether any such regulations should be modified, streamlined, expanded, or repealed so as to make the agency’s regulatory program more effective or less burdensome in achieving the regulatory objectives.” The Commission notes that the purpose of Rule 19b-4(f)(4)(ii) is to reduce burdens that would otherwise apply to Registered Clearing Agencies by virtue of certain statutory provisions contained in the Exchange Act, as amended by the Dodd-Frank Act. Specifically, the Final Rule permits Registered Clearing Agencies to submit to the Commission for effectiveness upon filing proposed rule changes that effect changes in their existing services that primarily affect their clearing of products that are not securities, including futures that are not security futures, swaps that are not securities-based swaps or mixed swaps, and forwards that are not security forwards, and that do not significantly affect the clearing agency’s securities clearing operations or the rights or obligations of the clearing agency with respect to securities clearing or persons using such securities clearing services.

## B. Amendments to the Interim Final Rule

The Commission hereby affirms the amendments effected by the Interim Final Rule. As set forth herein, and after giving consideration to the comments received concerning the Interim Final Rule, the Commission is hereby modifying Rule 19b-4(f)(4)(ii) in two further respects.

### 1. Inclusion of Other Products That Are Not Securities, Including Certain Swaps and Forwards<sup>41</sup>

First, the Commission is revising Rule 19b-4(f)(4)(ii) to add certain rule changes primarily affecting a Registered Clearing Agency's clearing operations for other non-securities products to the list of changes that qualify for effectiveness upon filing pursuant to Section 19(b)(3)(A). In particular, in response to commenters,<sup>42</sup> the Commission is broadening Rule 19b-4(f)(4)(ii)(A) to encompass proposed rule changes that primarily affect not only a Registered Clearing Agency's clearing of futures that are not security futures, but also other products that are not securities, including swaps that are not security-based swaps<sup>43</sup> or mixed swaps,<sup>44</sup> and forwards that are not security forwards.<sup>45</sup> The Commission believes that also including proposed

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<sup>41</sup> Section 721 of the Dodd-Frank Act defines the term "swap" broadly to encompass a variety of derivatives products. The definition includes, for example, interest rate swaps, commodity swaps, currency swaps, equity swaps, and credit default swaps. It also extends to certain types of forward contracts, as well as certain types of options, but excludes, among other things, options on any security or group or index of securities, including any interest therein or based on the value thereof. See 7 U.S.C. § 1a(47).

<sup>42</sup> See CME Letter and ICE Clear Europe Letter.

<sup>43</sup> See 15 U.S.C. 78(c)(68).

<sup>44</sup> See 15 U.S.C. 78(c)(68)(D).

<sup>45</sup> The Commission notes that it would not regard a clearing agency's filing of proposed rule changes relating to a product the legal status of which may not be clear pursuant to Section 19(b)(2) or Section 19(b)(3)(B) of the Act as a determination or presumption by the clearing agency that such proposed rule changes involve products that are securities. Similarly, the Commission's acceptance of proposed rule changes for filing under paragraph (f)(4)(ii) would not constitute a presumption or determination by the Commission that the products involved are not securities. The Commission also notes

rule changes that primarily affect a Registered Clearing Agency's clearing operations with respect to these non-securities products in the list of changes that would qualify for effectiveness upon filing under Section 19(b)(3)(A) is consistent with the Commission's purposes for initially amending Rule 19b-4 pursuant to the Interim Final Rule. Specifically, this approach should help limit potential delays to the effectiveness of rule changes that primarily concern a Registered Clearing Agency's clearing operations with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, subject to the limitations contained in Rule 19b-4(f)(4)(ii)(B).<sup>46</sup>

For purposes of Rule 19b-4(f)(4)(ii)(A), a Registered Clearing Agency's clearing operations with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, would include an activity that would require the Registered Clearing Agency to register with the CFTC as a DCO in accordance with the CEA.<sup>47</sup> In addition, a proposed rule

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that Section 718 of the Dodd-Frank Act ("Section 718") established a process through which the Commission and the CFTC could work together to determine the status of "novel derivative products" that may have elements of both securities and contracts of sale of a commodity for future delivery (or options on such contracts or options on commodities). In this regard, the Commission notes that the filing of a proposed rule change pursuant to Section 19(b)(2) or Section 19(b)(3)(B) of the Act, or paragraph (f)(4)(ii), would not be considered a notice under Section 718 to the Commission.

<sup>46</sup> 17 CFR 240.19b-4(f)(ii)(B) (providing, as the second condition for satisfying Rule 19b-4(f)(ii), that the proposed rule change "[d]oes not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service.").

<sup>47</sup> See 7 U.S.C. 7a-1 (providing that it shall be unlawful for a DCO, unless registered with the CFTC, directly or indirectly to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a DCO (as described in 7 U.S.C. 1a(9)) with respect to a contract of sale of a commodity for future delivery (or option on

change “[p]rimarily affects” a clearing agency’s clearing operations with respect to products that are not securities when it is targeted to matters related only to the clearing of those products.<sup>48</sup> For example, rules of general applicability that would apply equally to securities clearing operations, including security-based swaps, would not be considered to primarily affect a Registered Clearing Agency’s non-securities clearing operations. While CME requested that rules of general applicability be eligible for effectiveness upon filing, the Commission believes rules that would have equal applicability to securities clearing operations must be filed for Commission review in accordance with Section 19(b)(2), which will enable the Commission to fulfill its statutory obligations under the Exchange Act. If rules that have a significant impact on securities operations were permitted to become immediately effective, the Commission would not have the ability to review the impact of the rules against Exchange Act standards before their effectiveness, which would undercut the scope of the Commission’s oversight of registered clearing agencies. In addition, changes to general provisions in the constitution, articles, or bylaws of the Registered Clearing Agency that address the operations of the entire clearing agency also would not be considered to primarily affect such Registered Clearing Agency’s clearing operations with respect to products that are not securities.

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such a contract) or option on a commodity, in each case unless the contract or option is (i) otherwise excluded from registration in accordance with certain sections of the CEA or (ii) a security futures product cleared by a Registered Clearing Agency).

<sup>48</sup> If a proposed rule change filed pursuant to Section 19(b)(3)(A) has an incidental but significant effect on clearing operations with respect to products that are not securities and does not qualify under new Rule 19b-4(f)(4)(ii)(B)(II), the Commission summarily may, within 60 days after the proposed rule change becomes effective under Section 19(b)(3)(A), temporarily suspend the rule change and institute proceedings to determine whether to approve or disapprove the rule change pursuant to the provisions of Section 19(b)(2). Alternatively, as with other filings that do not meet the requirements of Section 19(b)(3)(A) and Rule 19b-4(f), the Commission may reject the filing as technically deficient within seven business days, pursuant to Section 19(b)(10)(B). 15 USC 78s(b)(10)(B).



Further, because security futures, security-based swaps, mixed swaps, security forwards, and options on securities are considered securities for purposes of the Exchange Act,<sup>49</sup> a Registered Clearing Agency would not be permitted to file proposed rule changes related to these lines of business pursuant to Section 19(b)(3)(A) of the Exchange Act in reliance on Rule 19b-4(f)(4)(ii). Instead, such clearing agency would continue to be required to file proposed rule changes related to its clearing of security futures, security-based swaps, mixed swaps, security forwards, options on securities, or other securities products for Commission review in accordance with Section 19(b)(2) of the Exchange Act, unless there is another basis for the proposed rule change to be filed under Section 19(b)(3)(A).

The Commission generally believes that it is appropriate to review proposed rule changes in accordance with the process set forth in Section 19(b)(2) of the Exchange Act whenever the changes “significantly affect” any securities clearing operations of the clearing agency (unless there is another basis for the proposed rule change to be filed under Section 19(b)(3)(A)), even in circumstances when such effects may be indirect.<sup>50</sup>

The Commission is charged with determining whether the rules of a Registered Clearing Agency are designed, among other things, “to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible . . . and,

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<sup>49</sup> 15 U.S.C. 78c(a)(10). As previously noted, however, the definition of “swap” specifically excludes any security-based swap other than a mixed swap. See supra note 22.

<sup>50</sup> For example, in instances where the swap and security-based swap business of a clearing agency are intertwined, such as when a clearing agency has established one clearing fund or pool of financial resources for both products, changes applicable to such swaps are unlikely to meet the requirement that the change not significantly affect any securities clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service.

to protect investors and the public interest.”<sup>51</sup> The Commission’s oversight responsibility over Registered Clearing Agencies extends to the clearing agency as a whole and is entity-based, rather than product-based.<sup>52</sup> If Registered Clearing Agencies did not file proposed rule changes with the Commission that relate to their clearing operations, as required under Section 19(b) of the Exchange Act, the Commission would not be able to meet its statutory oversight responsibilities.

## **2. Addition of the “Fair and Orderly Markets” Provision**

In light of the issues identified by the commenters in connection with the Interim Final Rule, the Commission has determined to further revise Rule 19b-4(f)(4)(ii)(B) by adding a second clause that will permit clearing agencies to file a proposed rule change under Section 19(b)(3)(A) when the rule change primarily affects the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, even when the proposed rule “significantly affects” any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, if the clearing agency can demonstrate that the rule change is “necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards.”

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<sup>51</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>52</sup> See S. Rep. No. 94-75, at 34 (1975), reprinted in 1975 U.S.C.C.A.N. 179, 212 (“The Commission has oversight responsibility with respect to the self-regulatory organizations to insure that they exercise their delegated governmental power effectively to meet regulatory needs in the public interest and that they do not exercise that delegated power in a manner inimical to the public interest or unfair to private interests.”).

A proposed rule change filed by a clearing agency relying on this “fair and orderly markets” provision must, in addition to being filed for approval pursuant to Section 19(b)(3)(A), be separately filed for approval pursuant to Section 19(b)(2), and this second filing must be made within fifteen calendar days after the proposed rule change was filed for approval under Section 19(b)(3)(A). Accordingly, in most cases, a rule that is effective upon filing under Section 19(b)(3)(A) that relies upon the “fair and orderly markets” provision of Rule 19b-4(f)(4)(ii)(B) shall be effective until such time as the Commission enters an order, pursuant to Section 19(b)(2)(A) of the Exchange Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission summarily temporarily suspends the rule change pursuant to Section 19(b)(3)(C) or, alternatively, until such time as the Commission, at the conclusion of proceedings to determine whether to approve or disapprove the proposed rule change, enters an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change.<sup>53</sup>

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<sup>53</sup> Because proposed rule changes filed pursuant to Rule 19b-4(f)(4)(ii)(B)(II) are submitted in accordance with the Commission’s statutory authority set forth in Section 19(b)(3)(A), the Commission would retain the power to summarily temporarily suspend the rule change within 60 days of its filing if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act. See 15 U.S.C. 78s(b)(3)(C). The Commission would then be required to institute proceedings to determine whether the rule should be approved or disapproved. Id. As a practical matter, however, the Commission expects that proposed rule changes filed under the “fair and orderly markets” provision would remain in effect while they are reviewed in accordance with Section 19(b)(2) which, among other things, requires the Commission to approve, disapprove, or institute proceedings to determine whether to disapprove a proposed rule change within 45 days of its date of publication in the Federal Register, subject in certain circumstances to an extension of up to an additional 45 days. The Commission would nonetheless retain the ability, within 60 days after a proposed rule change becomes effective under 19(b)(3)(A), to summarily temporarily suspend the rule change and institute proceedings or, after the 60-day summary suspension deadline, to disapprove the rule change pursuant to the provisions of Section 19(b)(2).

To demonstrate that a proposed rule change is “necessary to maintain fair and orderly markets,” a clearing agency must include in both of its filings with the Commission a detailed explanation of the following: (i) why the proposed rule change is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards; (ii) why the proposed rule change cannot achieve this goal unless it takes effect immediately; (iii) how, and to what extent, markets would be adversely affected if the proposed rule change were not implemented immediately; (iv) whether the proposed rule change is temporary or permanent; (v) how the proposed rule change significantly affects any securities clearing operations of the clearing agency or the rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service; and (vi) why the proposed rule change would have no adverse effect on maintaining fair and orderly markets for securities.

The Commission believes that the new “fair and orderly markets” provision directly addresses the specific concerns raised by commenters, while preserving the core features of the Commission’s existing notice and comment rule filing process. In particular, this provision is intended to respond to commenters’ observations that the pre-effective notice and comment requirement of the Commission’s Section 19(b)(2) rule filing process may unnecessarily burden existing non-securities markets. The new rule provision in Rule 19b-4(f)(4)(ii)(B)(II) allows Registered Clearing Agencies that are also DCOs to have rules that are necessary to maintain fair and orderly markets and that have a significant effect on securities operations of the Registered Clearing Agencies to take effect immediately upon filing, while the traditional notice and comment period under the Exchange Act proceeds thereafter.

The Commission believes the limited period of effectiveness while the notice and comment period proceeds is justified in the specific circumstances contemplated by the Final Rule given the nature of the issues raised by commenters and the substantial protections that will continue to exist under the Final Rule. In particular, the Dodd-Frank Act represents a significant reform of the national market system for securities and the national system for the clearance and settlement of securities transactions in which cooperation between the Commission and the CFTC is explicitly contemplated. Moreover, the clearly established time periods and procedures associated with the Commission's notice and comment process should lead to a greater level of assurance that rules enacted in this manner that will have significant direct or indirect effects on the securities clearing activities of the clearing agency either immediately or in the future will be given due consideration by the Commission with the benefit of views from outside parties.

The Commission does not intend or expect the new "fair and orderly markets" provision to become, in practice, a common method for Registered Clearing Agencies to submit proposed rule changes that affect their clearing operations with respect to products that are not securities, including futures that are not securities futures, swaps that are not securities-based swaps or mixed swaps, and forwards that are not security forwards, but which also affect their securities clearing operations.<sup>54</sup> The "necessary to maintain fair and orderly markets" language central to the new provision is intended to be narrowly circumscribed, and will permit clearing agencies to

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<sup>54</sup> One court that interpreted a "fair and orderly markets" standard appearing in another area of the Exchange Act found the phrase to be an indication that relevant Commission actions are to be evaluated primarily by reference to the Congressional purposes of the Securities Act Amendments of 1975 involving the establishment of a national market system for securities and a national system for the clearance and settlement of securities transactions. See *Ludlow Corp. v. SEC*, 604 F.2d 704 (D.C. Cir. 1979) (discussing origins and purposes of "fair and orderly markets" provision in Section 12(f)(2) of the Exchange Act).

use the new provision for rule filings that may be necessary to respond promptly to major market emergencies and other situations of significant importance to the functioning of markets for products that are not securities. In instances when securities clearing operations are significantly affected, but the proposed rule change is not necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, a Registered Clearing Agency must file the proposed rule change pursuant to Section 19(b)(1) of the Exchange Act for approval under Section 19(b)(2) without reliance on Rule 19b-4(f)(4)(ii)(B)(II).

Finally, the Commission notes that Section 19(b)(2) of the Exchange Act permits the Commission to approve a proposed rule change on an accelerated basis if it finds good cause to do so and publishes its reasons for so finding.<sup>55</sup> The application of this provision will be determined by the Commission on a case-by-case basis depending on the facts and circumstances pertaining to the proposed rule change.

### **3. Conclusion**

The Commission believes that permitting clearing agencies to submit proposed rule changes that meet the two conditions in Rule 19b-4(f)(4)(ii) for immediate effectiveness upon filing pursuant to Section 19(b)(3)(A) of the Exchange Act is consistent with the public interest and the purposes of the Exchange Act. In particular, this approach should help limit the potential for delays by providing a streamlined filing process for rule changes that primarily affect the clearing agency's clearing operations with respect to products that are not securities, including

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<sup>55</sup> See 15 U.S.C. 78s(b)(2)(C)(iii) (“[t]he Commission may not approve a proposed rule change earlier than 30 days after the date of publication under paragraph (1), unless the Commission finds good cause for so doing and publishes the reason for the finding.”).

futures that are not securities futures, swaps that are not securities-based swaps or mixed swaps, and forwards that are not security forwards which, unless such clearing operations were linked to securities clearing operations, would not be subject to regulation by the Commission. In addition, the information provided to the Commission by a Registered Clearing Agency in a filing submitted for review in accordance with Section 19(b)(2) of the Exchange Act is virtually identical to the information required to be included in a filing made pursuant to Section 19(b)(3)(A). At the same time, the Final Rule will specifically require clearing agencies relying on the new “fair and orderly markets” provision to continue to submit to the Section 19(b)(2) approval process while the rule change is in effect, and the Commission will retain the power to temporarily suspend the Registered Clearing Agency’s rule change on a summary basis within sixty days after the rule is filed under Section 19(b)(3)(A) if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>56</sup>

**B. Amendment to the General Instructions for Form 19b-4**

To accommodate the amendment to Rule 19b-4 being adopted today, the Commission also is making a corresponding technical modification to the General Instructions for Form 19b-4 under the Exchange Act. Specifically, the Commission is amending Item 7(b) of the General Instructions for Form 19b-4 (Information to be Included in the Completed Form), which requires the respondent SRO to cite the statutory basis for filing a proposed rule change pursuant to Section 19(b)(3)(A) in accordance with the existing provisions of Rule 19b-4(f). This amendment revises Item 7(b)(iv) to include the option to file the form in accordance with Rule

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<sup>56</sup> 15 U.S.C. 78s(b)(3)(C). If the Commission takes such action, it is then required to institute proceedings to determine whether the proposed rule change should be approved or disapproved.

19b-4(f)(4)(ii), which provides for situations when a Registered Clearing Agency is effecting a change in an existing service that (i) primarily affects the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards and (ii) either (a) does not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, or (b) does significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, but is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards. Additional language is also being added to specify that clearing agencies using the “fair and orderly markets” provision will also be subject to the provisions of Section 19(b)(2) of the Exchange Act, in a manner equivalent to the process now used by the Commission for filings that are summarily approved by the Commission under Section 19(b)(3)(B) of the Exchange Act, and to specify the information clearing agencies must include in order to demonstrate that a proposed rule change is “necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards.”

### **III. Paperwork Reduction Act**

The Commission does not believe that the Final Rule contains any “collection of information” requirements as defined by the Paperwork Reduction Act of 1995, as amended



("PRA").<sup>57</sup> The Final Rule affirms and further modifies recent amendments to Rule 19b-4 under the Exchange Act, such that the list of categories that qualify for effectiveness upon filing under Section 19(b)(3)(A) of the Exchange Act include any matter effecting a change in an existing service of a Registered Clearing Agency that: (i) primarily affects the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not securities-based swaps or mixed swaps, and forwards that are not security forwards; and (ii) either (a) does not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, or (b) does significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, but is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards. In addition, a proposed rule change filed by a Registered Clearing Agency relying on the "fair and orderly markets" provision set forth in new Rule 19b-4(f)(4)(ii)(B)(II) would also be filed for approval pursuant to Section 19(b)(2) of the Exchange Act.<sup>58</sup> Lastly, the Final Rule also makes a corresponding technical modification to

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<sup>57</sup> 44 U.S.C. 3501, et seq.

<sup>58</sup> Accordingly, in most cases, a rule that is effective upon filing under Section 19(b)(3)(A) that relies upon the "fair and orderly markets" provision of Rule 19b-4(f)(4)(ii)(B)(II) shall be effective only until such time as the Commission enters an order, pursuant to Section 19(b)(2)(A) of the Exchange Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission summarily temporarily suspends the rule change pursuant to Section 19(b)(3)(C) or, alternatively, until such time as the Commission, at the conclusion of proceedings to determine whether to approve or disapprove the proposed rule change, enters an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change.

the General Instructions for Form 19b-4 under the Exchange Act.

The Commission does not believe that these amendments would require any new or additional collection of information, as such term is defined in the PRA. The PRA defines a “collection of information” as “the obtaining, causing to be obtained, soliciting or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format, calling for . . . answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, ten or more persons . . . .”<sup>59</sup> The Commission does not believe that the reporting and recordkeeping provisions in this Final Rule contain “collection of information requirements” within the meaning of the PRA because fewer than ten persons are expected to rely on Rule 19b-4(f)(4)(ii). At present, only four Registered Clearing Agencies maintain a futures or swaps clearing business regulated by the CFTC.

#### **IV. Economic Analysis**

##### **A. Introduction**

The Commission is sensitive to the economic effects of the amendments to Rule 19b-4, including their costs and benefits. Section 23(a)<sup>60</sup> of the Exchange Act requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. Section 23(a)(2) of the Exchange Act prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Section 3(f) of the Exchange Act<sup>61</sup> requires the Commission, when engaging in rulemaking that requires it to consider whether an action is

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<sup>59</sup> 44 U.S.C. 3502(3)(A).

<sup>60</sup> 15 U.S.C. 78w(a).

<sup>61</sup> 15 U.S.C. 78c(f).

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. We have considered and discussed below the effects of the rules we are adopting today on efficiency, competition, and capital formation, as well as the benefits and costs associated with the rulemaking.

As noted above, the Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, became effective on July 16, 2011. Accordingly, the four Registered Clearing Agencies that currently maintain a futures, swaps, or forwards clearing business regulated by the CFTC are generally required to file proposed rule changes with the Commission under Section 19(b) of the Exchange Act, and to comply separately with the CFTC's process for self-certification or direct approval of rules or rule amendments.<sup>62</sup> The Commission is sensitive to the increased burdens these obligations will impose, and agrees that it is in the public interest to eliminate any potential inefficiencies and undue delays that could result from the requirement that the Commission review changes to rules primarily affecting clearing operations with respect to products that are not securities, including futures that are not securities futures, swaps that are not securities swaps or mixed swaps, and forwards that are not security forwards before these changes may be considered effective.

In connection with the Interim Final Rule, the Commission identified certain costs and benefits of the amendments to Rule 19b-4 and Form 19b-4, and requested commenters to provide views and supporting information regarding the costs and benefits associated with the proposals, including estimates of these costs and benefits, as well as any costs and benefits not already identified. Although the Commission did not receive any comments on the specific cost-benefit

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<sup>62</sup> These include OCC, CME, ICC, and ICE Clear Europe.

analysis conducted in connection with the Interim Final Rule, one commenter expressed a general view questioning whether the Commission's rulemaking in this area adequately respects the jurisdictional boundaries established by Congress when it passed the Dodd-Frank Act, noting that the requirement to file with the Commission for review in accordance with Section 19(b)(2) proposed rule changes that primarily affect the futures and swaps operations of a clearing agency registered with the Commission and the CFTC ("Dually-Registered Clearing Agency") is an unreasonable outcome under a costs-benefits analysis.<sup>63</sup> Specifically, this commenter argued that the Commission should not impose a rule that subjects a proposed rule change to a "lengthy public comment review process" in cases when the change relates to a matter that falls within the "exclusive or primary jurisdiction" of another agency (i.e., the CFTC).<sup>64</sup> The commenter argued that duplicative regulatory oversight is inherently unreasonable and imposes "tremendous" costs, but did not adduce any empirical evidence to support its assertion.

The Commission disagrees with the commenter's assertion that the rule will result in unnecessarily duplicative regulatory oversight. The Exchange Act imposes upon the Commission an independent statutory responsibility to oversee the operations of Registered Clearing Agencies as a whole, and not solely in regard to specific products.<sup>65</sup> The Commission's role in reviewing rule filings ensures that the Commission has complete information regarding

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<sup>63</sup> See CME Letter.

<sup>64</sup> Id. In its letter, CME also noted that it currently does not clear any security-based swaps and is registered with the Commission solely by operation of the Deemed Registered Provision (although it does have plans to offer clearing services for credit default swaps that are security-based swaps in the near future). See also ICE Clear Europe Letter (expressing the view that "rulemaking in furtherance of the purposes of the Dodd-Frank Act should, as much as possible, (i) respect the jurisdictional boundaries delegated to the CFTC and the Commission under that Act, and (ii) pursue efficiency and reduce the costs of rulemaking wherever possible").

<sup>65</sup> See 15 U.S.C. 78q-1(b); see also supra note 52.

the overall scope of operations and financial condition of the clearing agency, so that the Registered Clearing Agency's ability to continue to provide clearing services for security futures, security-based swaps, mixed swaps, security forwards, options on securities, and other securities products in a manner consistent with the Exchange Act can be fully understood and placed in proper context. Accordingly, the Commission believes that its continued review of rule filings that primarily affect a Dually-Registered Clearing Agency's operations involving futures that are not securities futures, swaps that are not securities swaps or mixed swaps, forwards that are not security forwards, and other non-securities products is a necessary and appropriate part of the Commission's statutory mandate.

With respect to the commenter's assertion concerning unnecessary additional costs, the Commission observes that the Final Rule is not imposing an additional requirement to submit a proposed rule change to the Commission. As previously noted, Section 19(b)(1) of the Exchange Act requires each SRO, including all Registered Clearing Agencies, to file with the Commission copies of "any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO" (emphasis added).<sup>66</sup> On its face, this provision applies to all proposed rule changes without regard to the extent to which the affected product is subject to the jurisdiction of another agency. The changes made to Rule 19b-4 pursuant to the Interim Final Rule were intended to utilize the Commission's statutory authority in Section 19(b)(3)(A) of the Exchange Act to provide relief to Dually-Registered Clearing Agencies and to avoid undue delays that could result from the requirement that the Commission review proposed rule changes primarily concerning a clearing agency's non-security futures clearing operations before they may be considered effective. This Final Rule is intended to affirm and expand this relief to changes to

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<sup>66</sup> See supra note 3.

rules primarily concerning a clearing agency's clearing operations with respect to swaps that are not securities-based swaps or mixed swaps, forwards that are not security forwards, and other non-securities products. The underlying obligation to file proposed rule changes arises entirely from Section 19(b)(1) of the Exchange Act and not from any action taken by the Commission pursuant to the Interim Final Rule or this Final Rule.

Accordingly, and for the reasons discussed below, the Commission believes that its analysis of the benefits and costs of the amendments to Rule 19b-4 and the General Instructions for Form 19b-4, as set forth in the Interim Final Rule and described herein, are appropriate. Further, the Commission believes that any impact on competition would be neutral, as all Registered Clearing Agencies may avail themselves of the Final Rule if the circumstances meet the requirements of the Final Rule. Also, this rule does not increase barriers for new clearing agencies to enter the clearing markets, and implementation of the Final Rule will not favor larger entities over smaller ones, and hence the impact on competition is negligible. Finally, the Commission does not believe that the Final Rule contributes towards the promotion of capital formation of Registered Clearing Agencies in any appreciable manner.

The Commission discusses below a number of the costs and benefits that will attend the Final Rule. Many of these costs and benefits are difficult to quantify with any degree of certainty, particularly as it is difficult to predict the number of rule filings that will qualify for approval pursuant to Section 19(b)(3)(A) under the Final Rule. Thus, while much of the discussion is qualitative in nature, the Commission attempts to quantify certain burdens, when possible. The Commission believes that the changes brought about by the Final Rule—which will require Registered Clearing Agencies to file under Section 19(b)(1) both for Section 19(b)(2) approval and for Section 19(b)(3)(A) approval only in the rare situations in which the

“fair and orderly markets” provision is invoked—will lead to only a negligible increase in the costs associated with filing proposed rule changes. The Commission further believes that these additional costs are justified by the efficiency gains that will result from the Final Rule’s broadening of the types of rule changes that may become effective upon filing.

**B. Justification for the Final Rule**

The Final Rule is intended to improve regulatory processes. Allowing proposed rule changes that (i) primarily affect the clearing of products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards; and (ii) do not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, to be filed under Section 19(b)(3)(A) would further streamline rule filing procedures and reduce the potential for duplicative or inconsistent regulation affecting Registered Clearing Agencies. With regard to the addition of the “fair and orderly markets” provision and its attendant rule filing requirements, clearing agencies and the markets potentially benefit from the expedited effectiveness of the rule change, while a meaningful notice and comment process is preserved without the disruption of a summary suspension of the rule.

**C. Affected Parties**

As indicated in the PRA section above, the Final Rule will affect four Registered Clearing Agencies.

**D. Baseline**

The Interim Final Rule serves as the appropriate baseline for purposes of this analysis. Under the Interim Final Rule, the four Dually-Registered Clearing Agencies may file a proposed

rule change and request that it become effective immediately upon filing if the rule change (i) primarily affects the futures clearing operations of the clearing agency with respect to futures that are not security futures and (ii) does not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service. Registered Clearing Agencies seeking approval for proposed rule changes involving the clearing of other products that are not securities, including swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, providing the changes are not eligible for immediate effectiveness under Section 19(b)(3)(A) pursuant to one of the other eligibility categories, must do so pursuant to Section 19(b)(2), which requires a pre-effective notice and comment period, as well as formal Commission approval. Thus, in the ordinary case, Dually-Registered Clearing Agencies currently may not implement proposed rule changes with respect to certain products that are not securities, including swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards until the Commission: (i) issues a notice of the proposed rule change for a period of time within which the public can comment; (ii) reviews and considers comments received regarding the proposed rule change, if any; and (iii) issues an order approving the proposed rule change. This review process ordinarily takes anywhere from forty-five to sixty calendar days after the Commission receives the proposed rule change from the clearing agency.<sup>67</sup>

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<sup>67</sup> The Commission has fifteen calendar days from the date of receipt of the proposed rule change to deliver notice of the proposed rule change for publication in the Federal Register, providing the clearing agency posted the notice of the proposed rule change, together with the substantive terms of the proposed change, that it delivered to the Commission on its website within two days of sending it to the Commission. 15 U.S.C. 78s(b)(2)(E). The Commission may not approve a proposed rule change until the



Since the Interim Final Rule took effect on July 15, 2011,<sup>68</sup> Dually-Registered Clearing Agencies have utilized it on nine occasions to obtain immediate effectiveness for proposed rule changes that would not otherwise have been eligible to become effective upon filing.<sup>69</sup> An examination of proposed rule filings made during the 2012 calendar year, however, indicates the number of proposed rule changes eligible for immediate effectiveness under Section 19(b)(3)(A) would have more than doubled had the changes contemplated by the Final Rule been in place. Specifically, between January 1 and October 1, 2012, the Commission received 75 rule filings from Dually-Registered Clearing Agencies, 52 of which were not already eligible for immediate effectiveness under Section 19(b)(3)(A). Of these 52, the Commission believes that 23 additional filings, or approximately 44%, likely would have been eligible for filing under Rule 19b-4(f)(4)(ii) had the Final Rule been in effect.<sup>70</sup>

The Commission believes that requiring the Dually-Registered Clearing Agencies to seek

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thirtieth day after publication of the notice in the Federal Register and is required to approve, disapprove, or institute proceedings to determine whether to approve or disapprove a proposed rule change within forty-five days after publication of the notice in the Federal Register. See 15 U.S.C. 78s(b)(2)(C)(iii), (b)(2)(A).

<sup>68</sup> See Exchange Act Release No. 64832 (July 7, 2011), 76 FR 41056 (July 13, 2011).

<sup>69</sup> The Chicago Mercantile Exchange, Inc. filed seven of these proposed rule changes, while The Options Clearing Corporation and ICE Clear Credit LLC each filed one. All of these rule filings were made pursuant to Rule 19b-4(f)(4)(ii), which allows a proposed rule change to take effect upon filing if it primarily affects the clearing agency's futures clearing operations with respect to futures that are not securities futures and does not have a significant effect upon the clearing agency's securities clearing operations.

<sup>70</sup> See, e.g., Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Amend Certain Aspects of the Performance Bond Regime Applicable to Cleared Only OTC FX Swaps, Exchange Act Release No. 66354 (Feb. 8, 2012), 77 FR 8318 (Feb. 14, 2012) (SR-CME-2012-03); Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Regarding Acceptance of Additional Interest Rate Swaps and Related Interbank Rates for Clearing, Exchange Act Release No. 66786 (Apr. 11, 2012), 77 FR 22825 (Apr. 17, 2012) (SR-CME-2012-10).

approval under Section 19(b)(2) for the 23 proposed rule changes described above created inefficiencies and unnecessary delay because the Interim Final Rule did not permit these proposed rule changes—which primarily affected the Dually-Registered Clearing Agencies’ handling of non-security products, and had no significant effect on securities clearing operations or any related rights or obligations—to be filed for immediate effectiveness. As noted, the Section 19(b)(2) process requires the Commission to solicit public comments, review them, and issue an order approving or denying the rule change, a process that can take between 45 and 60 days, and possibly longer. This engenders a substantial degree of timing uncertainty for clearing agencies, as they must await the Commission’s approval order before they can implement the proposed changes. This uncertainty, in turn, raises the transaction costs associated with implementing rule changes. The Commission believes this delay and the associated increase in transactional costs to be unnecessary because these rule changes are similar to the futures-related rule changes that presently qualify for immediate effectiveness under the Interim Final Rule.

**E. Benefits and Costs and Consideration of the Final Rule’s Effects on Efficiency, Competition, and Capital Formation**

**1. Benefits**

Rule 19b-4(f)(4)(ii), as amended by this Final Rule, will streamline the rule filing process by permitting Registered Clearing Agencies to utilize Section 19(b)(3)(A) for proposed rule changes that primarily affect the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards, and either do not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, or do significantly affect any securities clearing operations of the

clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, but are necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards. As such rule changes will become effective upon filing, the Final Rule should eliminate any potential inefficiencies and undue delays that could result from the requirement that the Commission review these proposed rule changes before they take effect. At the same time, the Commission retains the power to temporarily suspend these rule changes summarily within sixty days of their filing if it appears to the Commission that taking such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>71</sup>

As a result, the Commission is providing Registered Clearing Agencies with the ability to make these proposed rule changes effective upon filing, thereby limiting potential delays in implementing changes to the clearing agencies' clearing operations with respect to products that are not securities that may be beneficial to both the clearing agencies and market participants. As the figures cited in the preceding section indicate, the number of proposed rule changes that could become effective upon filing may increase under the Final Rule. This, in turn, should enhance the efficiency of the filing process for affected clearing agencies, without impairing the Commission's ability to review the filings and to determine whether it would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act, to conduct a more thorough analysis of any issues the filings

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<sup>71</sup> 15 U.S.C. 78s(b)(3)(C). If the Commission takes such action, it is then required to institute proceedings to determine whether the proposed rule change should be approved or disapproved.

may present. As noted, these amendments to Rule 19b-4 and the General Instructions for Form 19b-4 by the Commission are intended to streamline the rule filing process in areas involving certain activities concerning products that are not securities that may be subject to duplicative or inconsistent regulation as a result of, in part, certain provisions under Section 763(b) of the Dodd-Frank Act. The Commission recognizes the importance of the proper allocation of regulatory resources and will monitor and evaluate the implementation and effects of these rule changes.

## 2. Costs

As noted above, the Final Rule will expand the list of categories that qualify for effectiveness upon filing under Section 19(b)(3)(A) of the Exchange Act. These amendments will not materially increase or decrease the costs of complying with Rule 19b-4, nor will they modify an SRO's obligation to submit a proposed rule change to the Commission. Rather, the amendments will change the statutory basis under which a rule change is filed. This is because the costs associated with the 19(b)(3)(A) filing would approximately be the same as the 19(b)(2) filing, and, because of the nature of the occasion in which such a filing would be applicable, only under rare circumstances would a clearing agency file under the "fair and orderly markets" provision.

A proposed rule change filed by a Registered Clearing Agency relying on the "fair and orderly markets" provision set forth in Rule 19b-4(f)(4)(ii)(B)(II) would be subject to the procedures of both Section 19(b)(2) and Section 19(b)(3)(A) of the Exchange Act. Accordingly, in most cases, the proposed rule change shall be effective until such time as the Commission enters an order, pursuant to Section 19(b)(2)(A) of the Exchange Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission summarily

temporarily suspends the rule change pursuant to Section 19(b)(3)(C) or, alternatively, until such time as the Commission, at the conclusion of proceedings to determine whether to approve or disapprove the proposed rule change, enters an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change.

This new requirement applicable to Rule 19b-4(f)(4)(ii)(B)(II), which is in addition to the requirements that the Commission considered in connection with the cost-benefit analysis contained in the Interim Final Rule, would impose only a minimal additional burden on Registered Clearing Agencies that rely on the “fair and orderly markets” provision. Although a clearing agency seeking to use this provision would be required to make a separate filing under Section 19(b)(3)(A) in addition to the Section 19(b)(2) filing that is currently required, the information contained in both filings is virtually identical. Moreover, the Commission believes that clearing agencies will use the “fair and orderly markets” provision only on rare occasions, and thus the additional costs of making a Section 19(b)(3)(A) filing will seldom be incurred. The Commission concludes that the incremental costs associated with the Final Rule are negligible.<sup>72</sup>

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<sup>72</sup> The time required to complete a filing varies significantly and is difficult to separate from the time an SRO spends internally developing the proposed rule change. Accordingly, it is difficult to assess the impact of the Final Rule in terms of the additional amount of time SROs will have to devote to filing proposed rule changes. The Commission believes, however, that the Final Rule would have only a negligible effect in this regard. The Commission has estimated that 34 hours is the amount of time that would be required to complete an average proposed rule change filing, and 129 hours is the amount of time required to complete a novel or complex proposed rule change filing. Since the information contained in a Section 19(b)(2) filing is virtually identical to the information required if the same filing were made under Section 19(b)(3)(A), the Commission believes that the 34 hour figure remains an appropriate estimate of the time it would take an SRO to prepare a proposed rule change for filing pursuant to the broadened scope of Section 19(b)(3)(A). Moreover, as the information contained in the Section 19(b)(2) filing that will be required under the “fair and orderly markets” provision is also virtually

The Commission believes that the changes embodied in the Final Rule will not impair its ability to protect investors. Although the Final Rule will expand the types of proposed rule changes eligible to become effective upon filing, such rule changes remain subject to public comment after they take effect. Furthermore, the Commission summarily may temporarily suspend such rule changes within sixty days of filing if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.<sup>73</sup> Given these safeguards, the Commission perceives only minimal, if any, new risks to investors stemming from the Final Rule.

### 3. Effects on Competition

The Commission has also considered whether the Final Rule will have an appreciable effect on competition vis-à-vis the Interim Final Rule. Currently, the market for clearing services is segmented by financial instrument, and clearing agencies often specialize in particular instruments. As such, some market segments may tend to sustain natural monopolies, despite the existence of competitors that could potentially enter those segments.<sup>74</sup> For example, following a period of consolidation facilitated by Section 17(A) of the Exchange Act, only one clearing agency processes equities listed in the United States, and only one clearing agency handles exchange traded options. At the same time, there are three clearing agencies that clear swaps and

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identical to the information contained in the Section 19(b)(3)(A) filing that is currently required, the Commission believes that the time estimates for a rule filing of average complexity and one involving novel issues remain unchanged at 34 and 129 hours, respectively, under all scenarios of the Final Rule.

<sup>73</sup> 15 U.S.C. 78s(b)(3)(C).

<sup>74</sup> A natural monopoly exists when a single provider is more efficient than multiple providers because economies of scale allow the single provider to have lower average costs.

security-based swaps. Although two of these clearing agencies are affiliated, they do not compete with each other; one serves the market in the United States, and the other serves the European market. Further, the affiliate serving the market in the United States has a dominant market share, though the Commission believes this may be subject to change as a result of competition from other clearing agencies.

The Commission believes that the impact of the Final Rule on competition would be neutral, as the Final Rule would apply equally to similarly-situated Registered Clearing Agencies. As noted in the PRA section of this Release, the Final Rule will affect only the four Dually-Registered Clearing Agencies. Every Dually-Registered Clearing Agency that clears any of the products described in the Final Rule may avail itself of the Final Rule's benefits if the circumstances warrant, and may avail itself of the "fair and orderly markets" provision if the proposed rule change also meets those qualifications, namely that the proposed rule change is necessary to maintain fair and orderly markets for futures that are not security futures, swaps that are not security-based swaps or mixed swaps, or forward contracts that are not security forwards. Further, the Final Rule does not increase barriers for clearing agencies to enter this market, and its implementation will not favor larger entities over smaller ones. The Final Rule's impact on competition is therefore negligible.

#### **F. Alternatives Considered**

The Commission considered CME's proposal that the Commission require only proposed rule changes relating directly to security-based swap clearing activities to be subject to the Commission's review in accordance with Section 19(b)(2). Specifically, CME posited that (i) the Commission should defer to the CFTC's rule filing processes with respect to proposed changes involving broad rules of general applicability as to clearing operations that would have

only a peripheral impact on security-based swap clearing, and (ii) the Commission would still have the authority to abrogate rule changes by a clearing agency that do not meet the requirements of the Exchange Act.<sup>75</sup> The Commission believes that, while this approach would increase efficiency for some Registered Clearing Agencies, it would undermine the Commission's ability to carry out its statutory obligations under Section 19(b) and the Exchange Act, as discussed in Section IV.A., above. For example, in June 2012, CME implemented a rule change that altered the amount of CME's capital contribution to its financial safeguards package in connection with losses arising from products other than credit default swaps and interest rate swaps.<sup>76</sup> This amount would be applied to such losses before any amounts are applied from CME's Base Guaranty Fund. Although not directly applicable to products under the Commission's jurisdiction, the proposed rule change affects the operations and financial stability of the clearing agency. In another example, ICE Clear Credit LLC implemented a rule change in 2012 that permitted its participants to use US Treasuries to satisfy the initial margin-related liquidity requirements for all client-related positions cleared in a clearing participant's customer account,<sup>77</sup> representing a rule of general applicability that, pursuant to CME's alternative approach, may not have been subject to Commission review. As the Commission is tasked with ensuring that a clearing agency's rules are designed, among other things, to assure the safeguarding of securities and funds, the Interim Final Rule required, and the Final Rule continues to require, that proposed rule changes of general applicability be subject to the

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<sup>75</sup> See CME Letter.

<sup>76</sup> Securities Exchange Act Rel. No. 67232 (June 21, 2012), 77 FR 38350 (June 27, 2012) (SR-CME-2012-24).

<sup>77</sup> Securities Exchange Act Rel. No. 66825 (Apr. 18, 2012), 77 FR 24546 (Apr. 24, 2012) (SR-ICC-2012-01).



Commission's pre-effective notice and comment process or, if such proposed rule change is filed pursuant to the fair and orderly markets provision in Rule 19b-4(f)(4)(ii)(B), notice and comment after the change is temporarily effective under Section 19(b)(3)(A).

#### V. Regulatory Flexibility Certification

The Regulatory Flexibility Act ("RFA")<sup>78</sup> requires the Commission, in promulgating rules, to consider the impact of those rules on small entities. The Commission certified in the Interim Final Rule release, pursuant to Section 605(b) of the RFA,<sup>79</sup> that the rule would not have a significant impact on a substantial number of small entities. The Commission received no comments on this certification.

For the purposes of Commission rulemaking in connection with the RFA, a small entity includes a clearing agency that: (i) compared, cleared, and settled less than \$500 million in securities transactions during the preceding fiscal year; (ii) had less than \$200 million of funds and securities in its custody or control at all times during the preceding fiscal year (or at any time that it has been in business, if shorter) and (iii) is not affiliated with any person (other than a natural person) that is not a small business or small organization.<sup>80</sup> Under the standards adopted by the Small Business Administration, small entities in the finance industry include the following: (i) for entities engaged in investment banking, securities dealing and securities brokerage activities, entities with \$6.5 million or less in annual receipts; (ii) for entities engaged in trust, fiduciary and custody activities, entities with \$6.5 million or less in annual receipts; and

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<sup>78</sup> 5 U.S.C. 601 et seq.

<sup>79</sup> See 5 U.S.C. 605(b).

<sup>80</sup> 17 CFR 240.0-10(d).

(iii) funds, trusts and other financial vehicles with \$6.5 million or less in annual receipts.<sup>81</sup>

The amendments to Rule 19b-4 and to the General Instructions for Form 19b-4 apply to all Registered Clearing Agencies. There are currently seven clearing agencies with active operations registered with the Commission. Of the seven Registered Clearing Agencies with active operations, four currently maintain a futures or swaps clearing business. Based on the Commission's existing information about these four Registered Clearing Agencies, as well as on the entities likely to register with the Commission in the future, the Commission believes that such entities will not be small entities, but rather part of large business entities that exceed the thresholds defining "small entities" set out above.

For the reasons stated above, the Commission certifies that the amendments to Rule 19b-4 and to the General Instructions for Form 19b-4 would not have a significant economic impact on a substantial number of small entities for the purposes of the RFA.

## **VI. Statutory Basis and Text of Amendments**

Pursuant to the Exchange Act, and particularly Section 19(b) thereof, 15 U.S.C. 78s(b), the Commission amends Rule 19b-4 as set forth below.

### **List of Subjects in 17 CFR Parts 240 and 249**

Brokers, Reporting and recordkeeping requirements, Securities.

### **Text of Rule**

In accordance with the foregoing, Title 17, chapter II of the Code of Federal Regulations is amended as follows:

### **PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934**

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<sup>81</sup> 13 CFR 121.201, Sector 52.

1. The general authority citation for part 240 continues to read as follows:

**Authority:** 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; 12 U.S.C. 5221(e)(3), 15 U.S.C. 8302, and 18 U.S.C. 1350, , unless otherwise noted.

\* \* \* \* \*

2. Revise § 240.19b-4(f)(4)(ii) to read as follows:

**§ 240.19b-4 Filings with respect to proposed rule changes by self-regulatory organizations.**

\* \* \* \* \*

(f) \* \* \*

(4) \* \* \*

(ii)(A) Primarily affects the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards; and

(B) Either

(1) Does not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, or

(2) Does significantly affect any securities clearing operations of the clearing agency or the rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, but is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not

security-based swaps or mixed swaps, and forwards that are not security forwards. Proposed rule changes filed pursuant to this subparagraph II must also be filed in accordance with the procedures of Section 19(b)(1) for approval pursuant to Section 19(b)(2) and the regulations thereunder within fifteen days of being filed under Section 19(b)(3)(A).

\* \* \* \* \*

**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 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

5. Form 19b-4 (referenced in §249.819) is amended by revising Item 7(b)(iv) of the General Instructions for Form 19b-4 as set forth in the attached Appendix A.

**Note: The following Appendix A will not appear in the Code of Federal Regulations.**

By the Commission.

*Elizabeth M. Murphy*

Elizabeth M. Murphy  
Secretary

Dated: April 3, 2013



APPENDIX A

GENERAL INSTRUCTIONS FOR FORM 19b-4

\* \* \* \* \*

Information to be Included in the Completed Form ("Form 19b-4 Information")

\* \* \* \* \*

7. **Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

\* \* \* \* \*

(b) \* \* \*

(iv) Effects a change in an existing service of a registered clearing agency that either (A)(1) does not adversely affect the safeguarding of securities or funds in the custody or control of the clearing agency or for which it is responsible and (2) does not significantly affect the respective rights or obligations of the clearing agency or persons using the service or (B)(1) primarily affects the clearing operations of the clearing agency with respect to products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards and (2) either (a) does not significantly affect any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, or (b) does significantly affect any securities clearing operations of the clearing agency or the rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service, but is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures,

swaps that are not securities-based swaps or mixed swaps, and forwards that are not security forwards, and set forth the basis on which such designation is made, including, in the case of the fair and orderly markets provision, the following: (i) why the proposed rule change is necessary to maintain fair and orderly markets for products that are not securities, including futures that are not security futures, swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards; (ii) why the proposed rule change cannot achieve this goal unless it takes effect immediately; (iii) the nature and the extent of the effect upon the relevant markets if the proposed rule change were not implemented immediately; (iv) whether the proposed rule change is temporary or permanent; (v) how the proposed rule change significantly affects any securities clearing operations of the clearing agency or any rights or obligations of the clearing agency with respect to securities clearing or persons using such securities-clearing service; and (vi) why the proposed rule change would have no adverse effect on maintaining fair and orderly markets for securities.

(c) \* \* \*

NOTE. The Commission has the power under Section 19(b)(3)(C) of the Act summarily to temporarily suspend within sixty days of its filing any proposed rule change which has taken effect upon filing pursuant to Section 19(b)(3)(A) of the Act or was put into effect summarily by the Commission pursuant to Section 19(b)(3)(B) of the Act. In exercising its summary power under Section 19(b)(3)(B), the Commission is required to make one of the findings described above but may not have a full opportunity to make a determination that the proposed rule change otherwise is consistent with the requirements of the Act and the rules and regulations thereunder. The Commission will generally exercise its summary power under Section 19(b)(3)(B) on condition that the proposed rule change to be declared effective summarily shall also be subject

to the filing procedures of Section 19(b)(1) of the Act, for approval pursuant to Section 19(b)(2). Accordingly, in most cases, a summary order under Section 19(b)(3)(B) shall be effective until such time as the Commission enters an order, pursuant to Section 19(b)(2)(A) of the Exchange Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission summarily temporarily suspends the rule change pursuant to Section 19(b)(3)(C) or, alternatively, until such time as the Commission, at the conclusion of proceedings to determine whether to approve or disapprove the proposed rule change, enters an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change. Similarly, the Commission requires that any proposed rule change which has taken effect upon filing pursuant to paragraph (B)(II) of Rule 19b-4(f)(4)(ii) shall also be subject to the filing procedures of Section 19(b)(1) of the Act, for approval pursuant to Section 19(b)(2) of the Act. Accordingly, such rule change shall be effective until such time as the Commission enters an order, pursuant to Section 19(b)(2)(A) of the Exchange Act, to approve such proposed rule change or, depending on the circumstances, until such time as the Commission summarily temporarily suspends the rule change pursuant to Section 19(b)(3)(C) or, alternatively, until such time as the Commission, at the conclusion of proceedings to determine whether to approve or disapprove the proposed rule change, enters an order, pursuant to Section 19(b)(2)(B), approving or disapproving such proposed rule change.

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-69281)**

April 3, 2013

**Order Temporarily Exempting Certain Broker-Dealers from the Recordkeeping, Reporting, and Monitoring Requirements of Rule 13h-1 under the Securities Exchange Act of 1934**

On July 27, 2011, the Securities and Exchange Commission (“Commission”) adopted Rule 13h-1 under the Securities Exchange Act of 1934 (“Exchange Act”) concerning large trader reporting to assist the Commission in both identifying, and obtaining trade information for, market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in U.S. securities (such persons are referred to as “large traders”).<sup>1</sup>

In addition to requiring large traders to register with the Commission by filing and periodically updating Form 13H, Rule 13h-1 requires certain broker-dealers to, among other things, maintain specified records of transactions that they effect, directly or indirectly, for large traders, and to report to the Commission, upon request of the Commission, such records in electronic format.

Initially, the compliance date for the broker-dealer recordkeeping and reporting requirements of Rule 13h-1(d) and (e), respectively, as well as the requirement under Rule 13h-1(f) for broker-dealers to monitor their customers’ accounts for activity that may trigger the large trader identification requirements of Rule 13h-1, was April 30, 2012. The Financial Information

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<sup>1</sup> See Securities Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46960 (Aug. 3, 2011) (“Rule 13h-1 Adopting Release”). The effective date of Rule 13h-1 was October 3, 2011.



Forum ("FIF")<sup>2</sup> and the Securities Industry and Financial Markets Association ("SIFMA")<sup>3</sup> previously requested that the Commission grant certain substantive relief and temporarily exempt registered broker-dealers from the recordkeeping, reporting, and monitoring requirements of the Rule to provide them with additional time to comply.<sup>4</sup>

Pursuant to Exchange Act Section 13(h)(6) and Rule 13h-1(g) thereunder,<sup>5</sup> the Commission, by order, may exempt from the provisions of Rule 13h-1, upon specified terms and conditions or for stated periods, any person or class of persons or any transaction or class of transactions from the provisions of Rule 13h-1 to the extent that such exemption is consistent with the purposes of the Exchange Act.

In response to FIF's and SIFMA's requests, the Commission temporarily exempted broker-dealers from the recordkeeping, reporting, and monitoring requirements, thereby establishing a two-phased approach to implementation.<sup>6</sup> In the first phase, the Commission provided a temporary exemption to extend the compliance date from April 30, 2012 to November 30, 2012 for the broker-dealer recordkeeping and reporting requirements of Rule 13h-1 with respect to a clearing broker-dealer for a large trader where the large trader: (1) is a U.S.-

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<sup>2</sup> See Letter from Manisha Kimmel, Executive Director, Financial Information Forum, to Robert Cook, Director, and David Shillman, Associate Director, Division of Trading and Markets, Commission, dated January 25, 2012 ("FIF Letter"), available at: <http://www.sec.gov/comments/s7-10-10/s71010.shtml>.

<sup>3</sup> See Letter from Ann L. Vlcek, Managing Director and Associate General Counsel, SIFMA, to David S. Shillman, Associate Director, Division, Commission, dated March 29, 2012, available at: <http://www.sec.gov/comments/s7-10-10/s71010.shtml>.

<sup>4</sup> See Securities Exchange Act Release No. 66839 (April 20, 2012), 77 FR 25007 (April 26, 2012) ("April Exemptive Order").

<sup>5</sup> See 15 U.S.C. 78m(h)(6) and 17 CFR 240.13h-1(g), respectively.

<sup>6</sup> The April Exemptive Order also provided an exemption for certain transactions from the definition of the term "transaction" provided in Rule 13h-1(a)(6) for the purpose of determining whether a person is a large trader. See April Exemptive Order, *supra* note 4.

registered broker-dealer,<sup>7</sup> or (2) trades through a sponsored access arrangement<sup>8</sup> (“Phase One”). In the second phase, which concerned the remaining portions of the rule, the Commission provided a temporary exemption to extend the compliance date for the additional broker-dealer recordkeeping, reporting, and monitoring requirements of Rule 13h-1 from April 30, 2012, to May 1, 2013 (“Phase Two”).

With Phase One fully implemented, the Commission now is focusing its attention on FIF’s and SIFMA’s relief requests concerning Phase Two. On February 13, 2013, SIFMA submitted a supplemental letter that outlined its members’ experience in implementing Phase One and also provided additional detail on implementation issues relating to the Phase Two deadline.<sup>9</sup> Because many of the issues presented in Phase One also are implicated in the Phase Two relief request, such as the issues concerning average price account processing and the transmission of execution time information on disaggregated trades, the Commission currently is considering the industry’s experience with Phase One implementation in evaluating the requests for relief concerning Phase Two.

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<sup>7</sup> The reportable activity would include proprietary trading by a large trader broker-dealer where the large trader is trading for its own account.

<sup>8</sup> A “sponsored access arrangement” in this context refers to an arrangement in which a broker-dealer permits a large trader customer to enter orders directly to a trading center where such orders are not processed through the broker-dealer’s own trading system (other than any risk management controls established for purposes of compliance with Rule 15c3-5 under the Exchange Act) and where the orders are routed directly to a trading center, in some cases supported by a service bureau or other third party technology provider. See Securities Exchange Act Release No. 63241 (November 3, 2010), 75 FR 69792 (November 15, 2010) (S7-03-10).

<sup>9</sup> See Letter from Theodore Lazo, Managing Director and Associate General Counsel, SIFMA, to David S. Shillman, Associate Director, Division, Commission, dated February 13, 2013, available at: <http://www.sec.gov/comments/s7-10-10/s71010.shtml>.

The Commission believes that it is appropriate and consistent with the purposes of the Exchange Act to provide a temporary exemption from the Phase Two broker-dealer recordkeeping, reporting, and monitoring requirements of Rule 13h-1 to further extend the compliance date for Phase Two. This temporary exemption from the Rule's requirements should provide the Commission with the necessary time to complete its review of the implementation issues raised by FIF and SIFMA, assess the appropriateness of the requested exemptive relief, announce its response thereto, and allow broker-dealers time to develop, test, and implement any necessary systems changes once the Commission's review is complete.

Accordingly, the Commission is providing a temporary exemption to extend the compliance date to November 1, 2013, solely for the Phase Two broker-dealer recordkeeping, reporting, and monitoring requirements of Rule 13h-1.<sup>10</sup>

IT IS HEREBY ORDERED, pursuant to Exchange Act Section 13(h)(6) and Rule 13h-1(g) thereunder, that broker-dealers subject to the recordkeeping, reporting, and monitoring requirements of Rule 13h-1 (other than clearing broker-dealers for a large trader that either (1) is a U.S.-registered broker-dealer, or (2) trades through a sponsored access arrangement) are temporarily exempted from those requirements until November 1, 2013.

By the Commission.



Elizabeth M. Murphy  
Secretary

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<sup>10</sup> The effective date for Rule 13h-1 remains October 3, 2011. The compliance date for the requirement on large traders to identify to the Commission pursuant to Rule 13h-1(b) was December 1, 2011. The compliance date for Phase One was November 30, 2012.

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

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 69288 / April 3, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-13847

**In the Matter of**

**MORGAN ASSET MANAGEMENT,  
INC., MORGAN KEEGAN & COMPANY,  
INC., JAMES C. KELSOE, JR., AND  
JOSEPH THOMPSON WELLER, CPA**

**Respondents.**

**NOTICE OF PROPOSED PLAN  
OF DISTRIBUTION AND  
OPPORTUNITY FOR COMMENT**

Notice is hereby given, pursuant to Rule 1103 of the United States Securities and Exchange Commission's (the "Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, that the Division of Enforcement has submitted to the Commission a proposed plan for the distribution of monies placed into a Fair Fund in the above-captioned matter.

On June 22, 2011, the Commission issued a Corrected Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission Rules of Practice ("Order"). Exchange Act Rel. No. 64720 (June 22, 2011). The Order stated that Morgan Asset Management, Inc. and Morgan Keegan & Company, Inc. (collectively "Morgan") failed to employ reasonable pricing procedures for subprime mortgage-backed securities and consequently did not calculate accurate net asset values for certain funds offered by Morgan containing those subprime mortgage-backed securities ("Funds"). The Order also stated that James C. Kelsoe, Jr. and Joseph Thompson Weller, CPA caused Morgan's false valuations of the subprime mortgage-backed securities comprising the Funds' portfolios. The Order created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Morgan, Kelsoe, and Weller (collectively "Respondents") simultaneously submitted an Offer of Settlement, agreeing to pay a total of \$100,300,000 in disgorgement, prejudgment interest, and civil money penalties.

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## OPPORTUNITY FOR COMMENT

Pursuant to this Notice, all interested parties are advised that they may print a copy of the Proposed Plan of Distribution from the Commission's public website: <http://www.sec.gov>. Interested parties also may obtain a written copy of the Proposed Plan of Distribution by submitting a written request to: Anik A. Shah, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5631. All persons who desire to comment on the Proposed Plan of Distribution may submit their comments, in writing, no later than thirty (30) days from the date of this Notice:

1. By sending a letter to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090;
2. By using the Commission's Internet comment form (<http://www.sec.gov/litigation/admin.shtml>); or
3. By sending an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Comments submitted by e-mail or via the Commission's website should include "Administrative Proceeding File No. 3-13847" in the subject line. Comments received will be publicly available. Thus, persons should only submit information that they wish to make publicly available.

## PROPOSED PLAN OF DISTRIBUTION

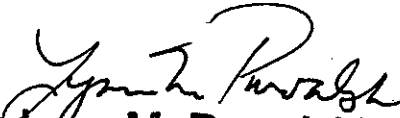
The Fair Fund is comprised of \$100,300,000 in disgorgement, prejudgment interest, and civil money penalties paid by Respondents, plus any accumulated interest and less any federal, state, or local taxes and fees relating to the investment of the Fair Fund. The Proposed Plan of Distribution provides for the distribution of the Fair Fund to investors: (i) harmed by losses resulting from the fraudulent mispricing of the Funds' net asset values during the relevant period including: a) proximately caused losses to those harmed investors who purchased shares at inflated prices and did not sell the shares purchased at similarly inflated prices, and b) losses to those harmed investors who purchased shares prior to the relevant period but who, if proper disclosure had been made and had the Funds' shares been properly valued during the relevant period, potentially would have sold their shares no later than the end of the relevant period; and (ii) who potentially incurred market-related losses resulting from the financial crisis during the relevant period.

The loss calculation for the Proposed Plan of Distribution allows for the Fair Fund to calculate investor losses by taking the dollar value of shareholdings as of January 1, 2007 (without regard to the cost basis for those shares), plus the dollar value of all purchases/acquisitions during the relevant period, less the dollar value of all cash interest or dividends received during the relevant period, less the dollar value of all sales during the relevant period, and less the dollar value of shares owned on August 10, 2007.

The Proposed Plan of Distribution requires harmed investors to submit claims in writing or electronically with documentary evidence, including, but not limited to, evidence of holdings, purchases, and/or sale of any of the Funds' shares during the relevant period within 120 days from the date of the initial mailing, the first publication of the online notice, or a re-mailing by the fund administrator as provided in the Proposed Plan of Distribution.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3574 / April 4, 2013

INVESTMENT COMPANY ACT OF 1940  
Release No. 30446 / April 4, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15263

In the Matter of

ZPR INVESTMENT  
MANAGEMENT, INC. AND  
MAX E. ZAVANELLI

Respondents.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(e), 203 (f),  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940 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 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 ZPR Investment Management, Inc. ("ZPR") and Max E. Zavanelli ("Zavanelli") (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. Between October and December 2008, ZPR, through Zavanelli, distributed advertisements to prospective clients that omitted material information which would have revealed that the firm's historical performance results were underperforming its

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benchmark index rather than outperforming it. At the same time, these advertisements, and others that ZPR distributed to clients and prospective clients, misleadingly stated that the firm was in compliance with the Global Investment Performance Standards ("GIPS Standards") for its performance results.

2. ZPR, through Zavanelli, also distributed advertisements that falsely claimed its performance results had been verified by a GIPS verification firm.

## B. RESPONDENTS

1. ZPR is a Florida corporation with principal offices in Orange City, Florida. ZPR has been an investment adviser registered with the Commission since April 2006. Prior to then, ZPR was an investment adviser registered with the Commission from September 1981 until June 2001, when the firm's assets under management fell below \$25 million and it filed an ADV-W.

2. Zavanelli is 66 and a resident of Deland, Florida. From 1994 through November 2011, Zavanelli was the president, chief operating officer and sole owner of ZPR. He also provided all investment advice to ZPR's clients. In August 1987, the Commission instituted administrative proceedings against Zavanelli, individually, and doing business as Zavanelli Portfolio Research, for violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5) thereunder for making material misrepresentations and omissions concerning the firm's investment results from 1979 through 1985. Specifically, the Commission alleged that Zavanelli reported fictitious results and distributed false advertisements to clients and prospective clients. Without admitting or denying the Commission's allegations, Zavanelli settled to, among other things, a censure and a prohibition from soliciting or accepting new advisory clients for a period of 180 days. See In the Matter of Max Edward Zavanelli, et al., Rel. No. IA-1077 (Aug. 17, 1987).

## C. MISLEADING ADVERTISEMENTS

### Background

1. ZPR was operated by Zavanelli, its principal officer, and the firm has about 6 other employees. ZPR claims to have discretionary authority over approximately 105 client accounts, with assets under management valued at approximately \$125 million. The vast majority of ZPR's clients are retail investors. The firm allocates clients' assets in equities among several strategies, with the majority of the firm's clients allocated to its Fundamental Small Cap Value composite ("Small Cap Composite"), a proprietary investment strategy.

2. Since at least 2007, ZPR has periodically advertised the performance returns for its various composites in several financial magazines that are geared towards retail clients, including *Smart Money* and *Barron's*, in newsletters to clients, and on its website located at [www.zprim.com](http://www.zprim.com).



3. In many of its advertisements, ZPR claimed compliance with the GIPS Standards for its performance results. The GIPS Standards are described as being a set of standardized, ethical principles that provide investment advisory firms with guidance on how to calculate and report their investment results to prospective clients. The GIPS Standards are voluntary and described as being based on the fundamental principles of full disclosure and fair representation of investment performance results. According to the GIPS Standards, the standardization of investment performance reporting gives investors the ability to compare and evaluate investment managers. The GIPS Standards were first released in 1999. The CFA Institute, a global association of investment professionals, created and administers the GIPS Standards.

4. The GIPS Standards require that all advertisements that include a claim of compliance with GIPS and present performance results must adhere to GIPS advertising guidelines. Specifically, the GIPS advertising guidelines, among other things, require that advertisements contain: (1) period-to-date composite performance results; and (2) composite results for either or both of the following time periods: 1-, 3-, and 5-year annualized composite performance returns with the end-of-period date clearly identified; or 5 years of annual composite performance returns. See GIPS at Appendix C, Section B: Advertising Guidelines (effective January 1, 2006); GIPS at Section III.A and III.B: Advertising Guidelines (revised effective January 1, 2011).

#### Misleading Magazine Advertisements

5. Although ZPR claimed in the advertisements that it complied with the GIPS Standards, several advertisements published in *Smart Money* magazine between October and December 2008 did not include, among other things, the composite's period-to-date performance returns as called for by the GIPS advertising guidelines. ZPR omitted to disclose this key information, which would have revealed that the firm's composite was actually underperforming the Russell 2000 Index ("Russell 2000") during a more recent time period. When ZPR stated that these advertisements were GIPS compliant, it became obligated to speak fully about any material facts on that subject whose absence would make the advertisements misleading. In this instance, by not disclosing the period-to-date returns in these advertisements, as required by the GIPS advertising guidelines, ZPR was able to conceal the fact that it was underperforming the market.

6. The following is an excerpt from a ZPR advertisement published in *Smart Money* magazine's October 2008 issue:

**FINDING AN OPPORTUNITY IN A TOUGH MARKET**

Performance Thru 6/30/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	277.60%	71.21%	32.87%
Annualized	14.21%	5.52%	2.88%

Although ZPR claimed compliance with the GIPS Standards in this advertisement, it omitted to disclose ZPR's period-to-date performance returns, which would have shown that the firm was underperforming its benchmark index. This advertisement instead misleadingly showed only *compounded* returns for a 10-year period from July 1, 1998 through June 30, 2008 and compared that to the Russell 2000 and S&P 500 indexes. It also included a 14.21% figure which is only an annualized return of ZPR's 10-year compounded return. These performance figures showed the firm as outperforming the indexes over a long-term period. However, had ZPR included period-to-date returns in this advertisement, it would have been shown to be underperforming the Russell 2000 during a more recent time period. Specifically, ZPR would have reported a period-to-date return for the period from January 1, 2008 through June 30, 2008 of **-17.02%**. This compares to a return of **-9.38%** for the Russell 2000 for the same period.

7. The following is an excerpt from another advertisement published in *Smart Money* magazine's November 2008 issue in which ZPR again claimed compliance with GIPS, but omitted to disclose its period-to-date returns, which would have revealed that it was currently underperforming its benchmark:

**FINDING AN OPPORTUNITY IN A TOUGH MARKET**

Performance Thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 10 Yr. Return	415.14%	148.89%	57.93%
Annualized	17.81%	9.53%	4.68%

Similarly, this advertisement was misleading because it only included performance figures that showed ZPR was outperforming the market over a long-term period. Specifically, the advertisement showed *compounded* returns for a 10-year period from September 1, 1998 through August 31, 2008 and compared that to the Russell 2000 and S&P 500 indexes. In addition, it contained a 17.81% figure which was an annualized return of ZPR's 10-year compounded return. Here, had ZPR included the composite's period-to-date performance record from January 1, 2008 through August 31, 2008, it would have reported a return of **-12.70%**. This compares to a return of **-2.63%** for the Russell 2000 for the same period. Again, ZPR would have been shown to be underperforming during a more recent period.

8. The following is an excerpt from a ZPR advertisement published in *Smart Money's* December 2008 issue:

**THINK LONG TERM**

Performance thru 8/31/08	ZPR Small Cap Value Accounts	Russell 2000 Index	S&P 500 Index
Compounded 20 yr. return	1187.05%	509.76%	565.18%
Compounded 10 yr. Return	357.82%	111.99%	35.20%
Compounded 5 yr. Return	75.45%	47.92%	28.65%

Likewise, this advertisement was misleading because it omitted material information. In this advertisement, ZPR showed 20-year, 10-year, and 5-year *compounded* returns for the period ending September 30, 2008 and compared them to the Russell 2000 and the S&P 500 indexes.<sup>1</sup> However, had ZPR included period-to-date returns in the advertisement, the firm would have reported a **-18.42%** return for the period from January 1, 2008 through September 30, 2008. The Russell 2000's return for the same period was **-10.39%**. Again, ZPR would have been shown to be underperforming during a more recent period.

*False Claims of Compliance with GIPS in Magazine Advertisements and Client Newsletters*

9. The 2008 *Smart Money* magazine advertisements described above were also misleading because of ZPR's false claim that they were in compliance with the GIPS Standards. In addition to those advertisements, in the February and May 2011 issues of *Smart Money* magazine and a March 2011 issue of *Barron's* magazine, ZPR advertised performance returns for its "Global Equity" and "All Asian" composites while claiming compliance with the GIPS Standards. ZPR also falsely claimed that these advertisement where GIPS compliant, when in fact they were not. Specifically, these advertisements failed to include certain GIPS required information such as 3 and 5 year annualized returns or 5 years of annual returns.

10. In addition, during the relevant period, ZPR, through Zavanelli, distributed monthly newsletters to the firm's clients, and made these newsletters available through ZPR's website. Several of ZPR's newsletters disseminated in 2008 and 2009 made reference to the firm's GIPS compliance, but failed to include performance returns that complied with GIPS. For example, ZPR's April and December 2009 newsletters claimed compliance with GIPS. Yet, the performance results included in those newsletters did not include period-to-date returns.

<sup>1</sup> The performance returns in this advertisement actually reflect data through September 30, 2008. The reference to "8/31/08" in the heading of the first column of the advertisement is a typographical error.

False Statements Regarding its GIPS Verification Firm and the SEC's Investigation

11. ZPR, through Zavanelli, also advertised the performance returns for the Small Cap Composite in reports published by Morningstar, Inc.<sup>2</sup> These Morningstar reports were advertisements because they were made available to the public on Morningstar's website and ZPR referenced its Morningstar rating in its *Smart Money* and *Barron's* magazine advertisements. In a Morningstar report containing ZPR's performance figures for the period ending September 30, 2010, the firm stated that its results had been "audited for GIPS compliance for the period December 31, 2000 to the present" by Ashland Partners & Company, LLP ("Ashland"), its GIPS verification firm. This was a false statement. In fact, Ashland resigned as ZPR's GIPS verification firm in July 2010 and its last report attesting to ZPR's compliance with GIPS covered the period ending December 31, 2009.

12. Moreover, in that same Morningstar report and in a later one for the period ending March 31, 2011, ZPR falsely indicated in the disclosure checklist section of the report that it was not under a "pending SEC investigation" at the time.

D. VIOLATIONS

1. As a result of the conduct described above, ZPR willfully violated Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for any investment adviser: (i) to employ any device, scheme, or artifice to defraud any client or prospective client; and (ii) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

2. As a result of the conduct described above, Zavanelli willfully violated or, in the alternative, aided and abetted and caused ZPR's violations of Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for any investment adviser: (i) to employ any device, scheme, or artifice to defraud any client or prospective client; and (ii) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

3. As a result of the conduct described above, ZPR willfully violated, and Zavanelli willfully aided and abetted and caused ZPR's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5), promulgated thereunder, which make it unlawful for any investment adviser to engage in any act, practice, or course of business which is fraudulent, deceptive or manipulative, including publishing, circulating or distributing any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

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<sup>2</sup> Morningstar, Inc. is a provider of stock market analysis and mutual fund and other financial instrument ranking services. Morningstar collects data through monthly surveys of the money managers in its database and makes this information available to the public on its website.

### 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 Respondent ZPR pursuant to Section 203(e) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent Zavanelli pursuant to Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9 of the Investment Company Act;

E. Whether, pursuant to Section 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 206(4) of the Advisers Act, and Rule 206(4)-1(a)(5) thereunder.

### IV.

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

IT IS FURTHER ORDERED that Respondents shall each 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, Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3576 / April 4, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15153**

**In the Matter of**

**Richard F. Tipton,**

**Respondent.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS  
PURSUANT TO SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940 AS  
TO RICHARD F. TIPTON**

**I.**

In these proceedings, instituted on December 21, 2012 pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), respondent Richard F. Tipton ("Respondent") has submitted an Offer of Settlement ("Offer") which the Securities and Exchange Commission ("Commission") has determined to accept.

**II.**

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Investment Advisers Act of 1940 as to Richard F. Tipton ("Order"), as set forth below.

**III.**

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

1. Respondent was employed at Jim Ward & Associates ("JWA") beginning in or about March 2005 and thereafter at JSW Financial Inc. ("JSW") until it ceased operations. Respondent became Vice President and a one-third owner of JSW in or about January 2006. Respondent was responsible for, among other duties at JWA and JSW, investor relations and strategic planning. From 2006 until at least 2008, JSW was investment adviser to Blue Chip Realty Fund LLC ("Blue Chip") and Shoreline Investment Fund, LLC ("Shoreline") and Respondent was associated with JSW. Respondent, age 62, currently is incarcerated and previously was a resident of Palo Alto, California.

2. On December 7, 2011, Respondent pled guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349, before the United

States District Court for the Northern District of California, in United States v. Tipton, Case Number CR-11-00393-003 TEH. On September 26, 2012, a judgment in the criminal case was entered against Respondent. He was sentenced to a prison term of 18 months followed by three years of supervised release.

3. On November 5, 2012, the District Court for the Northern District of California ordered Respondent to pay restitution, on a joint-and-several basis with three other defendants in the criminal action, in an amount to be determined after a restitution hearing, which was held on December 3, 2012. On January 14, 2013, the Court ordered Respondent and three other defendants to pay criminal restitution of \$8,628,963.44 on a joint-and-several basis.

4. The count of the criminal indictment to which Respondent pled guilty alleged, *inter alia*, that Respondent, together with the other officers of JSW, engaged in a scheme to defraud investors in Blue Chip and Shoreline by misrepresenting that investors' money would be and was being used to make loans secured by deeds of trust on real estate. The indictment further alleged that Respondent and the other officers knew that, at least from September 2005 through October 2008, almost none of the money invested in Blue Chip and Shoreline was used for loans secured by deeds of trust, but rather was used to make purported interest payments to earlier investors and for other business expenses. According to the indictment, Respondent thereby knowingly and intentionally conspired to and did devise a material scheme and artifice to defraud and to obtain money and property from investors through JSW by means of materially false and fraudulent pretenses, representations, and promises, and statements containing material omissions, and for the purpose of executing such scheme and artifice to defraud, knowingly and intentionally caused matter to be delivered by the United States Postal Service and private and commercial interstate carriers and transmitted writings and other matter by means of wire in interstate commerce.

5. The conduct that is the basis of Respondent's criminal conviction arises out of the conduct of the business of an investment adviser and occurred while Respondent was associated with an 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's Offer.

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

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

Any reapplication for association by 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 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





## II.

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

## III.

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

1. Bishop, is a California resident and is a California Certified Public Accountant. Bishop is a sole practitioner and conducted audits of the financial statements for Asthma Disease Management, Inc. ("ADMI") for the fiscal year ended May 31, 1993 through the fiscal year ended May 31, 1999.
2. ADMI was, at all relevant times, a Delaware corporation, which had its principal place of business in Berlin, New Jersey. ADMI marketed proprietary asthma disease management programs, focusing on allergy testing and diagnostic techniques by primary care physicians. At all relevant times, ADMI had reporting obligations under Section 15(d) of the Securities Exchange Act of 1934 ("Exchange Act"), and its stock traded over-the-counter in the pink sheets.
3. On September 24, 2002, the Commission filed a complaint against Bishop in SEC v. Asthma Disease Management, Inc., et al. (Civil Action No. 02-CV-7436 (E.D.Pa.)). On March 14, 2013, the court entered an order permanently enjoining Bishop, by consent, from aiding and abetting violations of Sections 10(b) and 15(d) of the Exchange Act and Rules 10b-5, 12b-20, 15d-1 and 15d-3 thereunder.
4. The Commission's complaint alleged, among other things, that ADMI, along with its former president, CEO, and chairman of the board, and two of its directors, engaged in a fraudulent marketing scheme in which they issued false press releases, fraudulently inflated ADMI's assets and disseminated misleading information in Commission filings by omitting the auditor's going concern opinion and by failing to disclose significant stock-based executive compensation and related party transactions. The complaint further alleges that Bishop aided and abetted the fraud by improperly booking a material asset on ADMI's balance sheet, by failing to review ADMI's Forms 10-K before or after they were filed with the Commission, and by failing to conduct her audit of ADMI's financial statements in accordance with generally accepted auditing standards.

IV.

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

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

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

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**

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 3577 / April 4, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15153

**In the Matter of**

**David C. Lin,**

**Respondent.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS  
PURSUANT TO SECTION 203(f) OF  
THE INVESTMENT ADVISERS ACT  
OF 1940 AS TO DAVID C. LIN**

**I.**

In these proceedings, instituted on December 21, 2012 pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), respondent David C. Lin ("Respondent") has submitted an Offer of Settlement ("Offer") which the Securities and Exchange Commission ("Commission") has determined to accept.

**II.**

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Investment Advisers Act of 1940 as to David C. Lin ("Order"), as set forth below.

**III.**

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

1. Respondent was employed at Jim Ward & Associates ("JWA") beginning in or about December 2004 and thereafter at JSW Financial Inc. ("JSW") until it ceased operations. Respondent became Secretary and Counsel, and a one-third owner of JSW, in or about January 2006. Respondent was responsible for, among other duties at JWA and JSW, legal compliance matters and documentation. From 2006 until at least 2008, JSW was investment adviser to Blue Chip Realty Fund LLC ("Blue Chip") and Shoreline Investment Fund, LLC ("Shoreline") and Respondent was associated with JSW. Respondent, age 45, currently is incarcerated and previously was a resident of Sunnyvale, California.

2. On May 15, 2012, Respondent was convicted of one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349; one count

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of wire fraud in violation of Title 18 United States Code, Section 1343; and sixteen counts of mail fraud in violation of Title 18 United States Code, Section 1341, before the United States District Court for the Northern District of California, in United States v. Lin, Case Number CR-11-00393-004 TEH. On September 26, 2012, a judgment in the criminal case was entered against Respondent. He was sentenced to a prison term of 28 months followed by three years of supervised release.

3. On November 5, 2012, the District Court for the Northern District of California ordered Respondent to pay restitution, on a joint-and-several basis with three other defendants in the criminal action, in an amount to be determined after a restitution hearing, which was held on December 3, 2012. On January 14, 2013, the Court ordered Respondent and three other defendants to pay criminal restitution of \$8,628,963.44 on a joint-and-several basis.

4. The counts of the criminal indictment of which Respondent was convicted alleged, *inter alia*, that Respondent, together with the other officers of JSW, engaged in a scheme to defraud investors in Blue Chip and Shoreline by misrepresenting that investors' money would be and was being used to make loans secured by deeds of trust on real estate. The indictment further alleged that Respondent and the other officers knew that, at least from September 2005 through October 2008, almost none of the money invested in Blue Chip and Shoreline was used for loans secured by deeds of trust, but rather was used to make purported interest payments to earlier investors and for other business expenses. The jury found that Respondent thereby knowingly and intentionally conspired to and did devise a material scheme and artifice to defraud and to obtain money and property from investors through JSW by means of materially false and fraudulent pretenses, representations, and promises, and statements containing material omissions, and for the purpose of executing such scheme and artifice to defraud, knowingly and intentionally caused matter to be delivered by the United States Postal Service and private and commercial interstate carriers and transmitted writings and other matter by means of wire in interstate commerce.

5. The conduct that is the basis of Respondent's criminal conviction arises out of the conduct of the business of an investment adviser and occurred while Respondent was associated with an 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's Offer.

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

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

Any reapplication for association by 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 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. 34-69301; File No. SR-NSCC-2012-810)

April 4, 2013

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to Advance Notice Filing to Eliminate the Offset of Its Obligations with Institutional Delivery Transactions that Settle at The Depository Trust Company for the Purpose of Calculating Its Clearing Fund Under Procedure XV of Its Rules & Procedures

I. Introduction

On December 18, 2012, National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-NSCC-2012-810 (“Advance Notice”) pursuant to Section 806(e) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”),<sup>1</sup> entitled the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act” or “Title VIII”) and Rule 19b-4(n) of the Securities Exchange Act of 1934 (“Exchange Act”). The Advance Notice was published in the Federal Register on January 17, 2013.<sup>2</sup> The Commission received two comment letters to the Advance Notice from one commenter.<sup>3</sup> NSCC responded to both comment letters.<sup>4</sup> This publication serves as notice of no objection to the Advance Notice.

<sup>1</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>2</sup> Release No. 34-68621 (Jan. 10, 2013), 78 FR 3960 (Jan. 17, 2013). NSCC also filed a proposed rule change pursuant to Section 19(b)(1) of the Exchange Act on December 17, 2012 seeking Commission approval to permit NSCC to change its rules to reflect the proposed change described herein. The Commission published notice of the proposed rule change on December 28, 2012. Release No. 34-68549 (Dec. 28, 2012), 78 FR 792 (Jan. 4, 2013). The Commission extended the period of review of the proposed rule change on February 5, 2013. Release No. 34-68829 (Feb. 5, 2013), 78 FR 9751 (Feb. 11, 2013).

<sup>3</sup> Comment Letter from Lek Securities Corporation dated January 25, 2013 (<http://sec.gov/comments/sr-nbcc-2012-810/nbcc2012810-1.pdf>), and Comment Letter



## II. Analysis

NSCC filed the Advance Notice to permit it to make rule changes to its Rules & Procedures (“Rules”) designed to eliminate the offset of NSCC obligations with institutional delivery (“ID”) transactions that settle at The Depository Trust Company (“DTC”) for the purpose of calculating the NSCC clearing fund (“Clearing Fund”) under Procedure XV of its Rules, as discussed below.

### A. ID Offset

NSCC maintains a Clearing Fund to have on deposit assets sufficient to satisfy losses that may otherwise be incurred by NSCC as the result of the default of an NSCC member (“Member”) and the resulting closeout of that Member’s unsettled positions under NSCC’s trade guaranty. Each Member is required to contribute to the Clearing Fund pursuant to a formula calculated daily. The Clearing Fund formula accounts for a variety of risk factors through the application of a number of components, including Value-at-Risk (“VaR”)<sup>5</sup> and Market Maker Domination (“MMDOM”).<sup>6</sup>

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from Lek Securities Corporation dated March 18, 2013 (<http://sec.gov/comments/sr-nsc-2012-810/nsc2012810-3.pdf>) (collectively, the “Lek Letters”).

<sup>4</sup> Response Letter from NSCC dated February 22, 2013 (<http://sec.gov/comments/sr-nsc-2012-810/nsc2012810-2.pdf>), and Response Letter from NSCC dated March 21, 2013 (<http://sec.gov/comments/sr-nsc-2012-810/nsc2012810-4.pdf>).

<sup>5</sup> The VaR component of the Clearing Fund calculation is a core component of the formula and is designed to calculate the amount of money that may be lost on a portfolio over a given period of time that is assumed necessary to liquidate the portfolio, within a given level of confidence. See Release No. 34-68621 (Jan. 10, 2013), 78 FR 3960 (Jan. 17, 2013).

<sup>6</sup> The MMDOM component of the Clearing Fund calculation is charged to market makers or firms that clear for them. In calculating the MMDOM, if the sum of the absolute values of net unsettled positions in a security for which the firm in question makes a market is greater than that firm’s excess net capital, NSCC may then charge the firm an

NSCC currently calculates the VaR and MMDOM components of a Member's Clearing Fund required deposit after allowing for a Member's net unsettled NSCC positions in a particular CUSIP to be offset by any pending ID transactions settling at DTC in the same CUSIP, which have been confirmed and/or affirmed through an institutional delivery system acceptable to NSCC ("ID Offset").<sup>7</sup> ID Offset is based on the assumption that in the event of a Member's insolvency NSCC will be able to close out any trade for which there is a corresponding ID transaction settling at DTC by completing that ID transaction.<sup>8</sup>

**B. Potential Inability to Complete ID Transactions**

Generally, when NSCC ceases to act for a Member, it is obligated, for those transactions that it has guaranteed, to pay for deliveries made by non-defaulting Members that are due to the failed Member on the day they are due. If NSCC is unable to complete the ID transactions as contemplated by the current Clearing Fund calculation, then NSCC may need to liquidate a portfolio that could be substantially different than the portfolio for which NSCC collected its Clearing Fund, leaving NSCC potentially under-collateralized and exposed to market risk.

A defaulting Member's pending ID transactions may not be completed for a number of reasons. Completion of an ID transaction by its institutional counterparty is voluntary because

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amount equal to such excess or the sum of each of the absolute values of the affected net unsettled positions, or a combination of both. MMDOM operates to identify concentration within a given CUSIP. See Release No. 34-68621 (Jan. 10, 2013), 78 FR 3960 (Jan. 17, 2013).

<sup>7</sup> For purposes of the ID Offset, NSCC includes ID transactions that are confirmed and/or affirmed on trade date, as well as ID transactions affirmed one day after trade date and remain affirmed through settlement date. See Release No. 34-68621 (Jan. 10, 2013), 78 FR 3960 (Jan. 17, 2013).

<sup>8</sup> ID transactions are included in the ID Offset only if they are on the opposite side of the market from the Member's net NSCC position (i.e., only if they reduce the net position). See Release No. 34-68621 (Jan. 10, 2013), 78 FR 3960 (Jan. 17, 2013).

that counterparty is not a Member, which means it is not bound by NSCC's Rules and is not party to any legally binding contract with NSCC that requires it or its custodian to complete the transaction. Moreover, based on news that a Member may be in distress or insolvent, the institutional counterparty or its investment adviser may take immediate market action with respect to the ID transaction, in order to reduce its market risk, which effectively eliminates the option for NSCC to complete the transactions. Finally, ID transactions settle trade-by-trade between the executing broker and the custodian; the netted ID positions used to offset the NSCC position could be comprised of thousands of individual trades with hundreds of different counterparties. In the event of a Member default, it could be time consuming for NSCC to contact the counterparties individually to get their agreement to complete the ID transactions. Even if NSCC were to get all of the counterparties to agree to complete the ID transactions, this could delay the prompt closeout of the defaulter's open positions and possibly expose NSCC to additional market risk in excess of the Clearing Fund.

Due to the risk that, in the event it ceases to act for a Member with pending ID transactions, NSCC may be unable to complete the pending ID transactions in the timeframe contemplated by its current Clearing Fund calculations and, as a result, may have insufficient margin in its Clearing Fund, as described above, NSCC will eliminate the ID Offset calculation from the VaR and MMDOM components of a Member's Clearing Fund requirement deposit.

### C. Implementation Schedule

In order to mitigate the impact of this rule change on its Members, NSCC will implement the changes set forth in the Advance Notice over an 18-month period. On a date no earlier than 10 days following notice to Members by Important Notice ("Initial Implementation Date"), NSCC will eliminate ID Offset from ID transactions that have only been confirmed, but have not

yet been affirmed. Beginning on a date approximately 12 months from the Initial Implementation Date, and no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate from ID Offset all affirmed ID transactions that have reached settlement date at the time the Clearing Fund calculations are run. Three months later, or approximately 15 months following the Initial Implementation Date, and on a date no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate from ID Offset all affirmed ID transactions that have reached either settlement date or the day prior to settlement date. Finally, on a date approximately 18 months following the Initial Implementation Date, and no earlier than 10 days following notice to Members by Important Notice, NSCC will eliminate ID Offset entirely for all ID transactions. Members will be advised of each proposed implementation date through issuance of NSCC Important Notices, which are publicly available at [www.dtcc.com](http://www.dtcc.com).

### III. Discussion

Although Title VIII does not specify a standard of review for an Advance Notice, the stated purpose of Title VIII is instructive.<sup>9</sup> The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically-important financial market utilities (“FMUs”) and providing an enhanced role for the Federal Reserve Board in the supervision of risk management standards for systemically-important FMUs.<sup>10</sup>

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<sup>9</sup> 12 U.S.C. 5461(b).

<sup>10</sup> Id.

Section 805(a)(2) of the Clearing Supervision Act<sup>11</sup> authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Clearing Supervision Act<sup>12</sup> states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act on October 22, 2012 (“Clearing Agency Standards”).<sup>13</sup> The Clearing Agency Standards became effective on January 2, 2013 and require clearing agencies that perform central counterparty (“CCP”) services to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>14</sup> As such,

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<sup>11</sup> 12 U.S.C. 5464(a)(2).

<sup>12</sup> 12 U.S.C. 5464(b).

<sup>13</sup> Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

<sup>14</sup> The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors of the Federal Reserve System (“Board of Governors”) governing the operations of designated FMUs that are not clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency. See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

it is appropriate for the Commission to review Advance Notices against these risk management standards that the Commission promulgated under Section 805(a) and the objectives and principles of these risk management standards as described in Section 805(b).

As a CCP, NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing certain risks faced by Members and contributing to global financial stability. In this role, however, NSCC is necessarily subject to certain risks in the event of the default of a Member.

NSCC's proposal to eliminate ID Offsets, as described above, is designed to help mitigate the risk that NSCC will be under-collateralized if it ceases to act for a defaulting Member and is unable to complete the offsetting ID transactions in the time currently contemplated by its Clearing Fund calculation. Consistent with Section 805(a), the Commission believes this proposal promotes robust risk management, as well as the safety and soundness of NSCC's operations, while reducing systemic risks and supporting the stability of the broader financial system, by improving NSCC's risk management systems in preparation for a possible Member default via a more accurate representation of risk in its Clearing Fund calculation. As discussed above, NSCC's calculation of its Clearing Fund margin will be more accurate in that it will not include an assumption of trade closeouts following a Member insolvency with respect to trades for which there is a corresponding ID transaction.

Additionally, Commission Rule 17Ad-22(b)(1) regarding measurement and management of credit exposure,<sup>15</sup> adopted as part of the Clearing Agency Standards,<sup>16</sup> requires a CCP to establish, implement, maintain and enforce written policies and procedures reasonably designed

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<sup>15</sup> 17 CFR 240.17Ad-22(b)(1).

<sup>16</sup> Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

to measure its credit exposures to its participants at least once a day and limit its exposures to potential losses from defaults by its participants under normal market conditions so that the operations of the CCP would not be disrupted and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.<sup>17</sup> Here, as described in detail above, NSCC's proposal to eliminate ID Offsets should help to limit its exposure and non-defaulting members' exposure to potential losses from a defaulting Member, while minimizing disruption to its CCP operations, by more accurately reflecting its risks in the calculation of its Clearing Fund margin.

Furthermore, Commission Rules 17Ad-22(d)(4) regarding identification and mitigation of operational risk,<sup>18</sup> and 17Ad-22(d)(11) regarding default procedures,<sup>19</sup> also both adopted as part of the Clearing Agency Standards,<sup>20</sup> require that registered clearing agencies "establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable: ...Identify sources of operational risk and minimize them through the development of appropriate systems, controls, and procedures...",<sup>21</sup> and "...establish default procedures that ensure that the clearing agency can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default,"<sup>22</sup> respectively. Here, as described in detail above, the elimination of ID Offsets should help NSCC better

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<sup>17</sup> 17 CFR 240.17Ad-22(b)(1).

<sup>18</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>19</sup> 17 CFR 240.17Ad-22(d)(11).

<sup>20</sup> Release No. 34-68080 (Oct. 22, 2012), 77 FR 66219 (Nov. 2, 2012).

<sup>21</sup> 17 CFR 240.17Ad-22(d)(4).

<sup>22</sup> 17 CFR 240.17Ad-22(d)(11).

minimize settlement risks and better ensure that it can contain losses and liquidity pressures, and meet its obligations in a timely fashion, by more accurately accounting for those risks in a Clearing Fund calculation that is designed to satisfy potential losses in a timely manner.

In its assessment of the Advance Notice, the Commission assessed whether the issues raised by the Lek Letters relate to the level or nature of risks presented by NSCC's proposal, which is designed to mitigate risks to NSCC, as discussed above. After evaluating NSCC's responses to the Lek Letters, the Commission believes that the issues raised in the Lek Letters relate to the potential competitive effects of NSCC's proposal, not the level or nature of risks presented by it.<sup>23</sup> As such, the issues raised by the Lek Letters are not considered within the context of this Notice of No Objection to the Advance Notice under Title VIII; rather, they are considered within an analysis of the proposal's consistency with Section 17A of the Exchange Act and the applicable rules and regulations thereunder, which the Commission did in its "Order Approving Proposed Rule Change to Eliminate the Offset of [NSCC's] Obligations with Institutional Delivery Transactions that Settle at The Depository Trust Company for the Purpose of Calculating Its Clearing Fund Under Procedure XV of Its Rules & Procedures" (File No. SR-NSCC-2012-10).<sup>24</sup>

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<sup>23</sup> See Lek Letters, supra note 3.

<sup>24</sup> See Release No. 34-69302 (Apr. 4, 2013).



IV. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,<sup>25</sup> that the Commission DOES NOT OBJECT to the proposed rule change described in the Advance Notice (File No. SR-NSCC-2012-810) and that NSCC be and hereby is AUTHORIZED to implement the proposed rule change as of the date of this notice or the date of the "Order Approving Proposed Rule Change to Eliminate the Offset of [NSCC's] Obligations with Institutional Delivery Transactions that Settle at The Depository Trust Company for the Purpose of Calculating Its Clearing Fund Under Procedure XV of Its Rules & Procedures" (File No. SR-NSCC-2012-10),<sup>26</sup> whichever is later.

By the Commission.

*Kevin M. O'Neill*

Kevin M. O'Neill  
Deputy Secretary

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<sup>25</sup> 12 U.S.C. 5465(e)(1)(I).

<sup>26</sup> Release No. 34-69302 (Apr. 4, 2013).



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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3575 / April 4, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15153**

**In the Matter of**

**Edward G. Locker,**

**Respondent.**

**ORDER MAKING FINDINGS AND  
IMPOSING REMEDIAL SANCTIONS  
PURSUANT TO SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940 AS  
TO EDWARD G. LOCKER**

**I.**

In these proceedings, instituted on December 21, 2012 pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), respondent Edward G. Locker ("Respondent") has submitted an Offer of Settlement ("Offer") which the Securities and Exchange Commission ("Commission") has determined to accept.

**II.**

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 203(f) of the Investment Advisers Act of 1940 as to Edward G. Locker ("Order"), as set forth below.

**III.**

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

1. Respondent was employed at Jim Ward & Associates ("JWA") beginning in or about October 2002 and thereafter at JSW Financial Inc. ("JSW") until it ceased operations. From 2003 to 2006, JWA was investment adviser to Blue Chip Realty Fund LLC ("Blue Chip") and Respondent was associated with JWA. Respondent became President and a one-third owner of JSW in or about January 2006. Respondent was responsible for, among other duties at JWA and JSW, investor relations, loan decisions, project management, and property acquisitions. Respondent also directly supervised employees who handled accounting and bookkeeping for JWA and JSW. From 2006 until at least 2008, JSW was investment adviser to Blue Chip and Shoreline Investment Fund, LLC ("Shoreline"), and Respondent was associated with JSW. Respondent, age 37, currently is incarcerated and previously was a resident of Highland Heights, Ohio.

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2. On December 7, 2011, Respondent pled guilty to one count of conspiracy to commit mail and wire fraud in violation of Title 18 United States Code, Section 1349, before the United States District Court for the Northern District of California, in United States v. Locker, Case Number CR-11-00393-002 TEH. On October 16, 2012, a judgment in the criminal case was entered against Respondent. He was sentenced to a prison term of 30 months followed by three years of supervised release.

3. On November 5, 2012, the District Court for the Northern District of California ordered Respondent to pay restitution, on a joint-and-several basis with three other defendants in the criminal action, in an amount to be determined after a restitution hearing, which was held on December 3, 2012. On January 14, 2013, the Court ordered Respondent and three other defendants to pay criminal restitution of \$8,628,963.44 on a joint-and-several basis.

4. The count of the criminal indictment to which Respondent pled guilty alleged, *inter alia*, that Respondent, together with the other officers of JWA and JSW, engaged in a scheme to defraud investors in Blue Chip and Shoreline by misrepresenting that investors' money would be and was being used to make loans secured by deeds of trust on real estate. The indictment further alleged that Respondent and the other officers knew that, at least from September 2005 through October 2008, almost none of the money invested in Blue Chip and Shoreline was used for loans secured by deeds of trust, but rather was used to make purported interest payments to earlier investors and for other business expenses. According to the indictment, Respondent thereby knowingly and intentionally conspired to and did devise a material scheme and artifice to defraud and to obtain money and property from investors through JWA and JSW by means of materially false and fraudulent pretenses, representations, and promises, and statements containing material omissions, and for the purpose of executing such scheme and artifice to defraud, knowingly and intentionally caused matter to be delivered by the United States Postal Service and private and commercial interstate carriers and transmitted writings and other matter by means of wire in interstate commerce.

5. The conduct that is the basis of Respondent's criminal conviction arises out of the conduct of the business of an investment adviser and occurred while Respondent was associated with an 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's Offer.

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

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

Any reapplication for association by 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 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





III.

In view of the foregoing, the Commission finds that Austin is an attorney who has been disbarred from practicing law within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is HEREBY ORDERED that Austin is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69327 / April 5, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3452 / April 5, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15265

In the Matter of

Koninklijke Philips  
Electronics N.V.,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Koninklijke Philips Electronics N.V. ("Philips" or "Respondent").

II.

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

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### III.

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

#### Summary

1. This matter concerns violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by Philips. The violations took place through Philips's operations in Poland from at least 1999 through 2007. The violations relate to improper payments made by employees of Philips's Polish subsidiary, Philips Polska sp. z o.o. ("Philips Poland") to healthcare officials in Poland regarding public tenders proffered by Polish healthcare facilities to purchase medical equipment.

#### Respondent

2. **Koninklijke Philips Electronics N.V.** is a Netherlands-based parent of an affiliation of companies that manufacture and supply goods and services related to healthcare, consumer lifestyle, lighting business sectors (collectively referred to as "Philips"). Philips's New York Registry Shares are listed on the New York Stock Exchange and the company files periodic reports pursuant to Section 12 of the Exchange Act as a foreign private issuer. Philips's common shares are also listed on Euronext Amsterdam.

#### Facts

3. Since at least 1999, Philips has participated in public tenders to sell medical equipment to Polish healthcare facilities. From 1999 through 2007, in at least 30 transactions, employees of Philips Poland made improper payments to public officials of Polish healthcare facilities to increase the likelihood that public tenders for the sale of medical equipment would be awarded to Philips.

4. Representatives of Philips Poland entered into arrangements with officials of various Polish healthcare facilities whereby Philips submitted the technical specifications of its medical equipment to officials drafting the tenders who incorporated the specifications of Philips' equipment into the contracts. Incorporating the specifications of Philips' equipment in the tenders' requirements greatly increased the likelihood that Philips would be awarded the bids.

5. Certain of the healthcare officials involved in the arrangements with Philips also decided whom to award the tenders, and when Philips was awarded the contracts, the officials were paid the improper payments by employees of Philips Poland.

6. The improper payments made by employees of Philips Poland to the Polish healthcare officials usually amounted to 3% to 8% of the contracts' net value.

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



7. At times, Philips Poland employees also kept a portion of the improper payments as a "commission." The Philips Poland employees involved in the improper payments often utilized a third party agent to assist with the improper arrangements and payments to Polish healthcare officials.

8. The improper payments made by employees of Philips Poland to Polish healthcare officials were falsely characterized and accounted for in Philips's books and records as legitimate expenses. At times those expenses were supported by false documentation created by Philips Poland employees and/or third parties. Philips Poland's financial statements are consolidated into Philips' books and records.

### **Discovery, Internal Investigation and Self Report**

9. Philips became aware of misconduct by Philips Poland employees in August 2007, when Polish officials conducted searches of three of Philips' offices in Poland and arrested two Philips Poland employees.

10. In response to the search of Philips' offices and arrests of its employees, Philips conducted an internal audit in 2007. Philips failed to discover the improper payments to Polish healthcare officials in its internal audit, but terminated and disciplined several Philips Poland employees and made substantial changes to Philips Poland's management and significant revisions to the company's internal controls.

11. In December 2009, the Prosecutor's Office in Poznan, Poland, indicted 23 individuals, including three former Philips Poland employees and 16 healthcare officials, for violating laws related to public tenders for the purchase of medical equipment. That indictment described the improper payments discussed in this Order.

12. In response to the Polish authorities' indictment, Philips conducted an internal investigation. The findings of the investigation supported the allegations of the 2009 indictment and revealed that Philips Poland employees had made unlawful payments to Polish healthcare officials, that its books, records and accounts failed to accurately account for the improper payments and that its internal controls failed to ensure that transactions were properly recorded by Philips in its books and records.

13. In early 2010, Philips self-reported its internal investigation to the staff of the Commission and to the Department of Justice. As the internal investigation progressed, Philips shared the results of the investigation with the staff and undertook significant remedial measures.

### **Philips's Remedial Measures**

14. In response to its internal audit and investigation, Philips terminated and disciplined several Philips Poland employees and installed new management at Philips Poland, as stated above. Philips also retained three law firms and two auditing firms to conduct the investigation

and design remedial measures to address weaknesses in its internal controls. Included in changes to internal controls, Philips established strict due diligence procedures related to the retention of third parties, formalized and centralized its contract administration system and enhanced its contract review process, and established a broad-based verification process related to contract payments. In addition, Philips has made significant revisions to its Global Business Principles policies and continually revises the policies to keep them current and relevant. Philips also established and enhanced an anti-corruption training program that includes a certification process and a variety of training applications to ensure broad-based reach and effectiveness.

### Violations

#### A. Standard for the Issuance of a Cease-and-Desist Order

15. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder.

#### B. The Requirements of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act

16. Section 13(b)(2)(A) of the Exchange Act requires reporting companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. 15 U.S.C. § 78m(b)(2)(A).

17. Section 13(b)(2)(B) of the Exchange Act requires reporting companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that the transactions: (i) are executed in accordance with management's general or specific authorization; and (ii) are recorded as necessary to permit preparation of financial statements in conformity with GAAP or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. § 78m(b)(2)(B).

#### C. Philips Violated Sections 13(b)(2)(A) and 13(b)(2)(B)

18. Employees of Philips Poland made improper payments to healthcare officials in Poland to increase the likelihood that Philips would be awarded public tenders to sell medical equipment to Polish healthcare facilities. The payments were improperly recorded in Philip's books and records as legitimate expenses. Philips Poland employees also utilized falsified records to support the false accounting entries. Accordingly, as a result of its misconduct, Philips failed to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected its transactions and the disposition of its assets as required by Section 13(b)(2)(A) of the Exchange Act.

19. Philips Poland's improper payments to healthcare officials in Poland related to at least 30 public tenders over a period of eight years. Philips's internal controls failed to detect or prevent the improper payments and false recordings of those transactions during that time. As a result, Philips failed to devise and maintain a system of internal accounting controls sufficient to

provide reasonable assurances that transactions were properly recorded by Philips in its books and records. Philips also failed to implement an FCPA compliance and training program commensurate with the extent of its international operations. Accordingly, Philips violated Section 13(b)(2)(B) of the Exchange Act.

#### Commission Consideration of Philips's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

#### IV.

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

Accordingly, it is hereby ORDERED that:

20. Pursuant to Section 21C of the Exchange Act, Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

21. Respondent shall, within 10 days of the entry of this Order, pay disgorgement of \$3,120,597 and prejudgment interest of \$1,394,581 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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;
- (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 Koninklijke Philips Electronics N.V. 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 Karen L. Martinez, Assistant Director, Salt Lake Regional Office, Securities and Exchange Commission, 15 W. South Temple Street, Suite 1800, Salt Lake City, Utah 84101.

22. Respondent acknowledges that the Commission is not imposing a civil penalty based upon its cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil penalty. Respondent may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy  
Secretary

*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. 69347 / April 8, 2013

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 3578 / April 8, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15267

In the Matter of

**TIMOTHY J. ROTH,**

Respondent.

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Timothy J. Roth ("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 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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### III.

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

1. From April 2002 until he was terminated on February 28, 2011, Roth was an associated person of Comprehensive Capital Management, Inc. ("CCM"), an investment adviser registered with the Commission, or of a predecessor firm to CCM. From January 2005 until he was terminated on February 28, 2011, Roth was also a registered representative associated with Comprehensive Asset Management and Servicing, Inc. ("CAMAS"), a broker-dealer registered with the Commission. Roth, 57 years old, is a resident of Stonington, Illinois.

2. On March 21, 2013, a final judgment was entered by consent against Roth, permanently enjoining him from future violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j], Rule 10b-5 [17 CFR §240.10b-5] thereunder, and from future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act [15 U.S.C. §§ 80b-b(1), 80b-6(2), and 80b-6(4)] and Rule 206(4)-2 [17 CFR § 275.206(4)-2] thereunder in the civil action entitled Securities and Exchange Commission v. Timothy J. Roth, et al., Civil Action Number 11-cv-02079, in the United States District Court for the Central District of Illinois.

3. The Commission's complaint alleged that CCM and Roth served as investment advisers for the deferred compensation plans of several small businesses located nationwide ("Plans"). A nonqualified deferred compensation plan is an arrangement between an employer and an employee to pay the employee certain compensation in the future. The complaint further alleged that the Plans invested employee-participants' deferred compensation in mutual funds. When a participant sought a distribution from the Plan, mutual fund shares would be transferred from the Plan's brokerage account to a brokerage account held in the name of KeyOp Exercise, Inc. ("KeyOp"). Shares from different Plans were commingled in the KeyOp account. Although the legal ownership of KeyOp changed from time-to-time, throughout the relevant period Roth controlled the company. Roth would then redeem the mutual fund shares, and was then supposed to forward the cash proceeds from the redemption to the Plan or the participant. The complaint further alleges that from October 2010 through February 2011, Roth stole millions of dollars worth of mutual fund shares from the Plans by a) transferring the Plans' mutual fund shares to KeyOp's account even though no such transfer had been requested or authorized by the Plans or their participants, then b) redeeming the shares, and c) funneling the money to various companies and accounts under his control or for his benefit. Finally, the complaint alleged that Roth did not tell the Plans or their participants about the unauthorized transfers.

4. On October 25, 2011, Roth pled guilty to one count of mail fraud in violation of 18 U.S.C. §§ 1341 and 1349 and one count of money laundering in violation of 18 U.S.C. §§ 1957 and 2 before the United States District Court for the Central District of Illinois, in United States v. Timothy J. Roth, No. 11-cr-20048. In connection with that plea, Roth admitted the facts set out in his plea agreement.

5. On January 31, 2013, a judgment in the criminal case was entered against Roth. He was sentenced to a prison term of 151 months and ordered to make restitution in the amount of \$16,151,964.

#### IV.

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

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

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

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. 69348 / April 8, 2013

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 3579 / April 8, 2013

**INVESTMENT COMPANY ACT OF 1940**  
Release No. 30453 / April 8, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15268

**In the Matter of**

**RICHARD P. SANDRU,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE AND CEASE-AND-  
DESIST PROCEEDINGS PURSUANT  
TO SECTIONS 15(b) AND 21C OF THE  
SECURITIES EXCHANGE ACT OF  
1934, SECTIONS 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 Sections 15(b) and 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 Richard P. Sandru ("Respondent" or "Sandru").

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. SUMMARY**

1. This matter involves a fraudulent scheme to misappropriate investment advisory client funds. From at least December 2009 through March 2011 (the

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“relevant period”), while associated with an investment adviser and broker-dealer registered with the Commission, Sandru misappropriated at least \$308,850 in purported “financial planning fees” from at least 47 advisory clients. During the relevant period, Sandru also made oral and written misrepresentations regarding client account values to certain clients to conceal their diminishing account values and induce them to allow him to continue to purchase and sell securities in their accounts and receive advisory fees from their dwindling account balances.

B. RESPONDENT

2. Sandru, age 42, resides in Fort Myers, Florida. From July 1, 2009 until April 29, 2011, Sandru was an investment adviser representative associated with Cambridge Investment Research Advisors, Inc. (“Cambridge IA”), an investment adviser registered with the Commission, and a registered representative associated with Cambridge Investment Research, Inc. (“Cambridge BD”), a broker-dealer registered with the Commission (collectively, “Cambridge”). Before that, from September 20, 2002 until June 29, 2009, Sandru was an investment adviser representative and a registered representative associated with another registered investment adviser and broker-dealer.

C. OTHER RELEVANT ENTITIES

3. Cambridge IA, an Iowa corporation with its principal place of business in Fairfield, Iowa, has been registered with the Commission as an investment adviser since February 3, 2005. Sandru was an investment adviser representative associated with Cambridge IA from July 1, 2009 until April 29, 2011, and worked in the Perrysburg, Ohio branch office.

4. Cambridge BD, an Iowa corporation with its principal place of business in Fairfield, Iowa, has been registered with the Commission as a broker-dealer since December 11, 1995. Sandru was a registered representative associated with Cambridge BD from July 1, 2009 until April 29, 2011, and worked in the Perrysburg, Ohio branch office.

D. BACKGROUND

5. Sandru joined Cambridge on July 1, 2009. While at Cambridge, Sandru was a principal of a Cambridge OSJ and conducted business under the name Sandru Financial Group Ltd. (“Sandru Financial”) and also Reizen Wealth Management LLC (“Reizen”). He supervised two other Cambridge representatives along with various administrative assistants.

6. By the time Sandru left Cambridge at the end of April 2011, he was managing approximately \$47 million in assets for about 180 advisory clients who collectively held about 480 accounts. These accounts were discretionary, and funds were maintained in custodial accounts by a custodian.

E. SANDRU MISAPPROPRIATED FINANCIAL PLANNING FEES FROM CAMBRIDGE ADVISORY CLIENTS

7. From at least December 2009 through March 2011, while associated with Cambridge IA, Sandru misappropriated at least \$308,850 in purported "financial planning" fees from at least 47 advisory clients, by forging their signatures on or adding costs to Financial Planning Engagement agreements ("FPEs") after the clients had already signed them and without his clients' knowledge or authorization. In all cases, Sandru failed to provide the financial planning services described in the FPEs.

8. After Sandru either obtained or forged his clients' signatures on the FPEs, he faxed or sent the FPEs to Cambridge through the Cambridge Logistics and Information Center ("CLIC"), thereby causing Cambridge's corporate accounting office to debit financial planning fees from the client's account. Cambridge then paid Sandru 91% of these financial planning fees as part of his compensation by electronically transferring the funds to Sandru's account by direct deposit. Sandru received approximately \$280,000 in fraudulently obtained financial planning fees.

9. During the relevant period, the fees charged to clients for the purported financial planning services ranged from \$500 to \$5,000 per FPE. At least 107 fraudulent FPEs were submitted to Cambridge by Sandru. Several clients were charged four or five times over several months for unauthorized and unperformed financial planning services.

F. SANDRU MADE ORAL AND WRITTEN MISREPRESENTATIONS REGARDING CLIENT ACCOUNT VALUES

10. While at Cambridge, Sandru also made oral and written misrepresentations regarding client account values to certain clients to conceal their diminishing account values and induce them to allow him to continue to purchase and sell securities in their accounts and receive advisory fees from their dwindling account balances.

11. Beginning in at least 2008, while he was associated with another registered investment adviser and broker-dealer, Sandru lost money through his trading in several client accounts. Sandru had told some of these clients, several of whom were elderly and/or retired, that they would be able to take substantial monthly withdrawals from their accounts for the rest of their lives or at least for many years.

12. Many of these clients followed Sandru to Cambridge. While at Cambridge, to conceal his losses and the clients' inability to take the large monthly withdrawals that he had recommended, Sandru orally and in writing falsely represented to at least six clients that the amounts reflected on their monthly statements from Cambridge were inaccurate and/or that they had other separate or "guaranteed" accounts that contained additional funds.

13. Sandru made these misrepresentations in order to induce his clients to allow him to continue to purchase and sell securities in their accounts and receive advisory fees from their dwindling account balances. He also wanted to preserve his relationship with these clients, many of whom had friends or relatives who were also clients.

14. Based on the inflated account values provided by Sandru, the clients continued to allow Sandru to manage their accounts, and he incurred additional losses through his trading. The clients also continued taking large monthly withdrawals, which further depleted their accounts.

15. Sandru sold securities, including money market funds, in his clients' accounts to cover the large monthly withdrawals that he had previously recommended. When certain clients' funds were completely exhausted, Sandru went as far as to pay their monthly distributions out of his own pocket in order to prevent his scheme from being discovered.

16. By the time that Sandru's scheme was discovered, these clients had little, if anything, left in their accounts. However, before that time, Sandru had collected advisory fees from their dwindling funds.

17. In addition to the \$280,000 in fraudulently obtained purported financial planning fees, Sandru also collected approximately \$127,000 in ill-gotten advisory fees from the defrauded clients from the time that he began misappropriating financial planning fees from and/or providing false account information to these defrauded clients

#### G. VIOLATIONS

18. As a result of the conduct described above, Sandru willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

19. As a result of the conduct described above, Sandru willfully violated, or, in the alternative, willfully aided and abetted and caused Cambridge IA's violations of, Sections 206(1) and 206(2) of the Advisers Act, which prohibit 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 Respondent an opportunity to establish any defenses to such allegations;

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

D. 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

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, whether Respondent should be ordered to pay a civil penalty pursuant to 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 Respondent should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 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 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 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

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

*Commissioner Aquilar  
Commissioner Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69346 / April 8, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-11701

In the Matter of

AIM Advisors, Inc. and AIM Distributors,  
Inc.,

Respondents.

ORDER AUTHORIZING TRANSFER  
OF FUNDS, DISCHARGING FUND  
ADMINISTRATOR, AND  
TERMINATING FAIR FUND

On October 8, 2004, the United States Securities and Exchange Commission (the "Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "2004 Order")<sup>1</sup> against Invesco Funds Group, Inc. ("IFG"), AIM Advisors, Inc., and AIM Distributors, Inc. ("ADI") (collectively "Respondents"), which directed, among other things, that AIM Advisors and ADI pay disgorgement of \$20 million and civil money penalties totaling \$30 million. The 2004 Order further established a Fair Fund to provide for the distribution of these payments and ordered AIM Advisors and ADI to comply with undertakings to retain an independent distribution consultant ("IDC") to develop a plan for distributing the \$50 million to shareholders in the mutual funds affected by the market timing (the "AIM Fair Fund").<sup>2</sup>

On July 6, 2007, the Commission issued a Notice of Proposed Distribution Plan and Opportunity for Comment<sup>3</sup> pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. §201.1103. The Commission received comments and, on May 23, 2008, the Commission issued an Order Approving a Modified Distribution Plan ("AIM

<sup>1</sup> Exchange Act Rel. No. 50506 (October 8, 2004).  
<sup>2</sup> The IFG Fair Fund is not the subject of this Order.  
<sup>3</sup> Exchange Act Rel. No. 56027 (July 6, 2007).

Plan").<sup>4</sup> The Order also appointed Boston Financial Data Services as the Fund Administrator of the AIM Plan. The AIM Plan provided for the distribution of the AIM Fair Fund to injured investors according to the methodology set forth in the AIM Plan.

On May 14, 2009, the Commission issued an Order Directing Disbursement of Fair Fund<sup>5</sup> consisting of a total of \$78,166,976.18. Beginning in June 2009, a total of \$78,037,264.10 was disbursed through wires or checks to injured investors, and on August 19, 2010, the Commission issued an Order Directing Disbursement<sup>6</sup> in the amount of \$13,141,658.77 to the AIM mutual funds harmed by market timing trading activity in proportion to the portion of overall harm each fund suffered. An amount of \$203,758.10 in residual funds remains.

A final accounting of the AIM Fair Fund was submitted pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans. The final accounting was approved by the Commission. Pursuant to the final accounting, \$203,758.10 in residual funds remains for transfer to the U.S. Treasury.

Accordingly, IT IS ORDERED that the AIM Fair Fund is terminated.

IT IS FURTHER ORDERED that the Fund Administrator of the AIM Plan, Boston Financial Data Services, Inc., is discharged.

IT IS FURTHER ORDERED that \$203,758.10 in residual funds shall be transferred to the U.S. Treasury.

IT IS FURTHER ORDERED that any funds returned in the future to the AIM Fair Fund be transferred to the U. S. Treasury.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

<sup>4</sup> Exchange Act Rel. No. 57859 (May 23, 2008).

<sup>5</sup> Exchange Act Rel. No. 59929 (May 14, 2009).

<sup>6</sup> Exchange Act Rel. No. 62746 (August 19, 2010).

*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69345 / April 8, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15266

In the Matter of

Sean Nathan Healy,

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 Sean Nathan Healy ("Respondent" or "Healy").

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 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. Respondent Healy, age 41, was a resident of Weston, Florida until April 2010 when he began serving a 16-year prison sentence as a result of his guilty plea in *U.S. v. Sean Nathan Healy*, CR-09-319 (MDP)(SHR) ("*United States v. Healy*"). Respondent was associated with a broker-dealer within the meaning of Section 15(b) of the Exchange Act in that he worked as a registered representative for several broker-dealers between 1997 and 2001, including Chatfield Dean & Co., Inc.; Stratton Oakmont Inc.; Barron Chase Securities, Inc.; and Guru Investment Services Limited.

2. On November 23, 2009, Healy tendered a guilty plea in *United States v. Healy* to two counts of wire fraud in violation of Title 18 United States Code Sections 1341 and 1342, and one count of unlawful monetary transactions in violation of Title 18 United States Code Section 1957. The charges in *United States v. Healy* were based on Healy's conduct in orchestrating a Ponzi scheme between 2004 and July 2009. In his guilty plea allocution, Healy admitted that he raised approximately \$17 million from investors by promising them that he would use those funds to purchase stocks and commodities on their behalf. Healy further admitted that rather than investing those funds as promised, he funded a lavish lifestyle for himself and his wife, which included the purchase of a \$2.4 million waterfront mansion; \$2 million of in-home improvements; \$1.5 million in men's and women's jewelry; and numerous exotic vehicles and sport cars, including a Bentley and several Ferraris, Lamborghinis and Porsches worth over \$2.3 million. Healy also admitted that he used some of the funds to make Ponzi payments to investors.

3. On April 15, 2010, in a civil action entitled *Securities and Exchange Commission v. Sean Nathan Healy*, Civil Action Number 1:09-CV-1330 ("*SEC v. Healy*"), the United States District Court for the Middle District of Pennsylvania entered by consent a bifurcated judgment against Healy permanently enjoining him from future violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], and Section 17(a) of the Securities Act of 1933 [15 U.S.C. § 77q(a)]. The Commission's complaint in *SEC v. Healy* alleged substantially the same scheme and illicit conduct outlined in the indictment in *United States v. Healy*.

### IV.

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

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

- A. barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and
- B. barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69353 / April 9, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3453 / April 9, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15270

_____	:	
In the Matter of	:	<b>ORDER OF FORTHWITH</b>
	:	<b>SUSPENSION PURSUANT</b>
JAMES C. FIELDS, CPA	:	<b>TO RULE 102(e)(2) OF THE</b>
	:	<b>COMMISSION'S RULES OF</b>
Respondent	:	<b>PRACTICE</b>
_____	:	

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of James C. Fields ("Fields") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. §201.102(e)(2)].<sup>1</sup>

II.

The Commission finds that:

1. Starting in 1994 until at least 2006, Fields was a certified public accountant licensed in Minnesota.
2. On February 26, 2013, a judgment was entered convicting Fields of twenty eight criminal charges, including securities fraud, false statements to company auditors and false statements and false certifications in SEC filings in violation of 15 United States Code Sections 78ff(a), 78j(b) and 78m(b)(5) and 18 United States Code Sections 371, 1350 and 1957 before the United States

<sup>1</sup> Rule 102(e)(2) provides in pertinent part: Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

District Court for the District of Massachusetts, in United States of America v. James C. Fields  
10-CR-10388-DPW.

3. As a result of his conviction, Fields was sentenced to 60 months incarceration to be followed by three years of supervised release, and the payment of restitution to be determined at a later hearing.

III.

In view of the foregoing, the Commission finds that Fields has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that James C. Fields is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69352 / April 9, 2013

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3580 / April 9, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15269

In the Matter of

Anthony John Johnson,

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE  
PROCEEDINGS PURSUANT TO SECTION  
15(b) OF THE SECURITIES EXCHANGE  
ACT OF 1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940  
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") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Anthony John Johnson ("Respondent" or "Johnson").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Johnson, age 42, is a resident of Katonah, New York. From May 2001 through March 2003, during the time in which he engaged in the conduct underlying the first indictment described below in paragraphs 3 and 4, Johnson was a registered representative with Park Capital Securities, LLC ("Park Capital"), a registered broker-dealer. From at least May 2001 through March 2003, Park Capital was also an unregistered investment adviser to its clients, and Johnson was associated with Park Capital. Johnson was responsible for directing and supervising a

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group of stock brokers regarding, among other things, management of investor funds and investor recommendations.

2. From March 2007 through April 2011, during the time in which he engaged in the conduct underlying the second conviction described below in paragraphs 5 and 6, Johnson participated in operating RAHFCO Management Group LLC ("RAHFCO Management"). From 2007 through April 2011, RAHFCO Management was an unregistered investment adviser to two hedge funds – RAHFCO Funds LP and RAHFCO Growth Fund. In his role at RAHFCO Management, Johnson was responsible for, among other duties, the funds' operations and activities, including researching, selecting and monitoring the funds' investments.

#### B. ENTRY OF THE RESPONDENT'S CRIMINAL CONVICTIONS

3. On November 19, 2008, Johnson pled guilty to conspiracy to commit securities, mail, and wire fraud in violation of Title 18 United States Code Section 317 before the United States District Court for the Eastern District of New York in United States v. Johnson, Case Number 07-cr-854-3 (FB). On August 3, 2011, a judgment in the criminal case was entered against Johnson. On August 15, 2011, he was sentenced to 18 months in prison, including a 500 hour residential drug abuse treatment program, and ordered to pay restitution of \$760,823.

4. The criminal indictment in United States v. Johnson, Case Number 07-cr-854-3 (FB), alleged that between March 2002 and March 2003, under the direction and supervision of Johnson and others, brokers at Park Capital engaged in misrepresentations and material omissions to induce retail customers to purchase and refrain from selling certain stock. Additionally, Johnson engaged in manipulative trading by opening an account in the name of his brother, exercising control of the account, and executing highly profitable trades by cross-trading stock between that account and other Park Capital retail customers. Johnson's account profited, while most other customer accounts suffered losses.

5. On June 14, 2012, Johnson pled guilty to one count of mail fraud in violation of Title 18 United States Code Section 1341 before the United States District Court for the Eastern District of New York in United States v. Johnson, Case Number 11-cr-287 (ENV). On August 3, 2012, a judgment in the criminal case was entered against Johnson and Johnson was sentenced to 120 months in prison to run consecutively with the 18-month sentence imposed above and ordered to pay restitution of \$12 million.

6. The criminal information in United States v. Johnson, Case Number 11-cr-287 (ENV), alleged that from approximately August 2010 to April 2011, Johnson operated a Ponzi scheme through Gibraltar Partners Inc. ("Gibraltar"). Johnson, through Gibraltar and other entities, solicited investor money, representing that the funds would be invested. As part of this scheme, Johnson invested some investor money into the RAHFCO hedge funds without disclosing to the Gibraltar investors that RAHFCO hedge funds' trading strategy was failing. The majority of Gibraltar investor funds, however, were not invested, but instead were used to pay back prior Gibraltar 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;

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

C. 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



*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 9, 2013

IN THE MATTER OF  
INTEGRITY BANCSHARES, 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 Integrity Bancshares, Inc. ("Integrity") because Integrity has not filed any reports since its Form 10-Q for the period ended September 30, 2007, filed November 13, 2007.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of Integrity.

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of Integrity is suspended for the period from 9:30 a.m. EDT on April 9, 2013, through 11:59 p.m. EDT on April 22, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3584 / April 10, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15271

In the Matter of

TOBY G. SCAMMELL,

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 Toby G. Scammell ("Respondent" or "Scammell").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From August 3, 2009 to February 12, 2010 (the "Relevant Period"), Respondent was employed as an associate by Madrone Advisors, LLC ("Madrone Advisors").

2. Throughout the Relevant Period, Madrone Capital Partners, LLC ("Madrone Capital," and, together with Madrone Advisors, "Madrone") served as the general partner of Madrone Partners, L.P. and Madrone Holdings, L.P. (collectively, the "Madrone Investment Funds").

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3. Madrone Partners is an investment fund that invests primarily in the securities of operating companies, and Madrone Holdings is an investment fund that invests primarily in the other investment funds that invest primarily in securities.

4. Throughout the Relevant Period, Madrone Advisors provided investment management services to Madrone Capital and to the Madrone Investment Funds.

5. Throughout the Relevant Period, Madrone Capital and Madrone Advisors engaged in the business of advising the Madrone Investment Funds concerning the advisability of investing in or purchasing securities, and the disposition of securities held by the Madrone Investment Funds.

6. Throughout the Relevant Period, Madrone Capital received compensation in the form of a percentage of the Madrone Investment Funds' returns in exchange for providing investment management services to the Madrone Investment Funds.

7. Throughout the Relevant Period, Madrone Advisors received compensation in the form of a service fee from Madrone Capital in exchange for providing investment management services to Madrone Capital and the Madrone Investment Funds.

8. Throughout the Relevant Period, Madrone Capital was an investment adviser.

9. Throughout the Relevant Period, Madrone Advisors was an investment adviser.

10. The Commission has never issued an order exempting Madrone Capital from the definition of "investment adviser" in Section 202(a)(11) of the Advisers Act.

11. The Commission has never issued an order exempting Madrone Advisors from the definition of "investment adviser" in Section 202(a)(11) of the Advisers Act.

12. Throughout the Relevant Period, Respondent's duties for Madrone included researching companies in which the Madrone Investment Funds were considering making an investment.

13. Respondent's research included, among other things, talking to industry analysts, reading research reports, reading industry analyses, and reviewing documents and records relating to companies in which the Madrone Investment Funds were considering making an investment.

14. Throughout the Relevant Period, Respondent's duties for Madrone included performing financial analyses of the companies in the Madrone Investment Funds' portfolios, as well as companies under consideration for investment by the Madrone Investment Funds.

15. Respondent's research and analysis were considered when Madrone Advisors provided investment advice to Madrone Capital.

16. Although Respondent was formally employed by Madrone Advisors, his work was done on behalf of and for the benefit of both Madrone Advisors and Madrone Capital.

17. Respondent, 28 years old, is a resident of California.

B. ENTRY OF THE INJUNCTION

18. On June 15, 2012, a judgment was entered against Scammell, permanently enjoining him from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled *Securities and Exchange Commission v. Toby G. Scammell*, Civil Action Number CV-11- 6597 DSF (MRWx), in the United States District Court for the Central District of California.

19. The Commission's complaint alleged that from August 13, 2009 through August 28, 2009, Scammell spent \$5,465 on highly speculative and risky purchases of options to buy stock ("call options") of Marvel Entertainment, Inc. ("Marvel") that expired within a few weeks. The complaint further alleged that after the announcement on Monday, August 31, 2009 that the Walt Disney Company ("Disney") planned to acquire Marvel, Marvel shares closed up more than 25% from their closing price the previous day. The complaint also alleged that between the announcement of the acquisition on August 31, 2009 and September 9, 2009, Scammell sold all of the Marvel call option contracts he had purchased, reaping a total of more than \$192,497 (or over 3,000%) in profits. The complaint further alleged that Scammell traded on the basis of material nonpublic information regarding Disney's intended acquisition of Marvel which he misappropriated from his girlfriend who worked at Disney on the Marvel acquisition.

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.

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

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. 69366 / April 11, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15272

In the Matter of

MICHAEL J. TURNOCK,

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 Michael J. Turnock ("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. Turnock is the sole owner and managing member of Bridge Premium Finance, LLC (f/k/a Berjac of Colorado, LLC) ("BPF"). BPF is a Colorado limited liability company that purports to be in the business of pooling investor funds to make insurance premium financing loans. Turnock has held Series 6, 22, and 63 securities licenses. At various times during 1997 through 2003, Turnock was associated with brokers or dealers SunAmerica Securities, Inc., Multi-Financial Securities Corporation, and Washington Square Securities, Inc.

2. On March 11, 2013, a final judgment was entered by consent against Turnock, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 5 and 17(a) of the Securities Act of 1933, in the civil action entitled Securities and Exchange Commission v. Bridge Premium Finance, LLC, et al., Civil Action Number 1:12-cv-02131-JLK-BNB, in the United States District Court for the District of Colorado.

3. The Commission's complaint alleged that from in or about 1996 through August 14, 2012, BPF and Turnock raised at least \$15.7 million from more than 120 investors in multiple states through an unregistered offering of promissory notes purportedly to provide capital for BPF's insurance premium financing business. The complaint further alleged that in raising funds from investors, Turnock and BPF engaged in a scheme to defraud by making misleading statements and omissions about the use of investor proceeds, BPF's financial performance and condition, and the safety and security of the investments; by using investor proceeds to make Ponzi-like payments to other investors; and by providing fraudulent account statements to investors that reflected account balances that BPF could not pay. The complaint alleged that by May 2012, BPF owed investors more than \$6.2 million, yet its insurance premium loan portfolio totaled less than \$250,000, and it had total assets of less than \$500,000.

### IV.

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

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 69371 / April 12, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15275**

**In the Matter of**

**ROBERT MOUALLEM,**

**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 Robert Mouallem ("Respondent" or "Mouallem").

**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 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

**III.**

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

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1. Between February 2004 and December 2011, Mouallem was a registered representative associated with Garden State Securities, Inc. ("Garden State"), a broker-dealer registered with the Commission. Mouallem, 57 years old, is a resident of Boca Raton, Florida.

2. On August 20, 2012, after a jury trial, Mouallem was found guilty of conspiracy to commit securities fraud and violate the Travel Act in violation of Title 18 U.S.C. §§ 371 and 3551 et seq., five counts of attempted securities fraud in violation of Title 18 U.S.C. §§ 1348, 2 and 3551 et seq., and commercial bribery in violation of Title 18 U.S.C. §§ 1952(a)(3)(A), 2 and 3551 et seq. before the United States District Court for the Eastern District of New York, in United States v. Stockdale, et al., Crim. Information No. 11-CR-0801. On March 13, 2013, Mouallem was sentenced to a prison term of one year and one day, followed by three years of supervised release and ordered to pay forfeiture in the amount of \$26,610.

3. The counts of the criminal indictment to which Mouallem was found guilty alleged, among other things, that Mouallem, while associated with Garden State, and aware of a kickback agreement arranged by his co-defendants and John Doe ("Doe"), an undercover FBI agent, agreed to assist in selling his co-defendants' shares of stock in Dolphin Digital Media, Inc. ("Dolphin") by matching their sales of Dolphin stock with corresponding purchases of Dolphin stock from discretionary accounts that Mouallem believed were controlled by stock brokers who were working for Doe. Mouallem and his co-defendants, together with Doe, orchestrated five "test transactions" that were to be a prelude to larger future transaction in which Mouallem would assist his co-defendants in liquidating their entire holdings in Dolphin at inflated prices.

#### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Mouallem 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. 69377 / April 15, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15276**

**In the Matter of**

**David Affeldt,**

**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 David Affeldt ("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. Affeldt, 71 years old, is a tax preparer and an attorney admitted to the bar of the District of Columbia and a resident of Potomac, Maryland.

2. On April 5, 2013, a final judgment was entered by consent against Affeldt, permanently enjoining him from future violations of Sections 5(a) and 5(c) of the Securities Act of 1933 ("Securities Act"), and Section 15(a) of the Exchange Act in the civil action entitled Securities and Exchange Commission v. Inofin, Inc., et al., Civil Action Number 11-CV-10633, in the United States District Court for the District of Massachusetts.

3. The Commission's complaint alleged the following facts: Between its founding in 1994 and its involuntary bankruptcy in February 2011, Inofin, Inc. raised approximately \$110 million from investors by selling securities to investors. Neither Inofin, nor its securities offerings were ever registered with the Commission. Beginning in approximately 2003, Inofin's securities sales activities were supported by Affeldt. Originally an Inofin investor, in 2003 Affeldt became a commission-based sales agent for Inofin. Between 2003 and 2010, Affeldt had over one thousand clients for whom he provided tax advice, retirement planning, and tax preparation services. During his consultations with clients, Affeldt discussed the importance of setting aside money for retirement purposes. Clients would routinely ask Affeldt where they could put their money, and Affeldt would mention Inofin as an investment option for those who were looking for a fixed investment or set return. Affeldt told his clients that he was invested in Inofin and that he was receiving a 13% return and that they might receive as much as an 11% return. If his clients were interested, Affeldt provided them with the contact information for Inofin's President, Michael Cuomo, and suggested that they tell Cuomo that they were a client of Affeldt's when they called. Inofin then paid Affeldt a referral fee on each investor that originated from Affeldt. From 2003 through 2010, Inofin paid Affeldt over \$130,000 in investor-based commissions.

### IV.

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

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

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, and is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who

engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock with the right to apply for reentry after 3 years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 69385 / April 17, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15280

**In the Matter of**

**Xvariant, Inc.**  
**(n/k/a China Bionanometer Industries 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 the Respondent named in the caption.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENT**

1. Xvariant, Inc. (n/k/a China Bionanometer Industries Corp.)<sup>1</sup> ("CBIU") (CIK No. 1034764) is a revoked Nevada corporation located in Xian, Shaanxi, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CBIU 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 September 30, 2006, which reported a net loss of \$15,000 for the prior year. As of April 12, 2013, the common stock of CBIU was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc., had five market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

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

## B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports, and, through its failure to maintain a valid address on file with the Commission as required by Commission rules, failed to receive the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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



proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 17, 2013

In the Matter of

Xvariant, Inc.  
(n/k/a China Bionanometer Industries 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 Xvariant, Inc. (n/k/a China Bionanometer Industries Corp.) because it has not filed any periodic reports since the period ended September 30, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on April 17, 2013, through 11:59 p.m. EDT on April 30, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

*Jill M. Peterson*  
By: 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. 69383 / April 17, 2013

ADMINISTRATIVE PROCEEDING

File No. 3-15279

In the Matter of

NewTech Brake 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 the Respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. NewTech Brake Corp. ("NWTB")<sup>1</sup> (CIK No. 1080008) is a void Delaware corporation located in Blainville, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NWTB 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 November 30, 2005, which reported a net loss of \$2,379,448 for the prior nine months. As of April 12, 2013, the common stock of NWTB was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc., had six market makers, and was eligible for the piggyback exception of Exchange Act Rule 15c2-11(f)(3).

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

## B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports, and, through its failure to maintain a valid address on file with the Commission as required by Commission rules, failed to receive the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

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

5. As a result of the foregoing, the 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 the 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 the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the

proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the 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



UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 17, 2013

In the Matter of

NewTech Brake 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 NewTech Brake Corp. because it has not filed any periodic reports since the period ended November 30, 2005.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on April 17, 2013, through 11:59 p.m. EDT on April 30, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

*Jill M. Peterson*  
By: **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. 69404 / April 18, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15286**

**In the Matter of**

**JOSHUA J. SINGER,**

**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 Joshua J. Singer ("Singer" 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. Singer, 32, is a resident of Lino Lakes, Minnesota. Singer is not registered as a broker-dealer or associated with a broker or dealer registered with the Commission.
2. On April 7, 2013, a final judgment was entered by consent against Singer, permanently enjoining him from future violations of Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Collyard, et al., Civil Action No. 11-cv-3656, in the United States District Court for the District of Minnesota.
3. The Commission's complaint alleged that, from approximately August 2007 to November 2009, Singer solicited investors for Bixby Energy Systems, Inc. ("Bixby"), a privately held Delaware corporation with its principal place of business in Ramsey, Minnesota. Specifically, Singer sold over \$1.2 million in Bixby securities to approximately 20 investors. As compensation for his sale of securities, Singer received at least \$107,000 in transaction-based commissions. The complaint further alleged that Singer, while acting as a broker or dealer, effected transactions in, and induced and attempted to induce the purchase or sale of securities, when he was not registered with the Commission as a broker or dealer or associated with an entity registered with the Commission as a broker or dealer.

### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Singer 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 a right to apply for reentry after three years to the appropriate self-regulatory organization or, if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any



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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3589 / April 18, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15285

In the Matter of

DOUGLAS F. WHITMAN,

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 Douglas F. Whitman ("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.

III.

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

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1. Whitman was the sole shareholder, director and officer of the general partner of Whitman Capital, LLC ("Whitman Capital"), an unregistered investment adviser. Whitman was also president of Whitman Capital. Whitman, 55 years old, is a resident of Atherton, California.

2. On March 20, 2013, a final judgment was entered by consent against Whitman, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Douglas F. Whitman, et al., Civil Action Number 12-CV-1055, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged that Whitman and Whitman Capital illegally traded based on material nonpublic information obtained from Whitman's friend and neighbor, Roomy Khan. Khan tipped Whitman with confidential details about Polycom Inc.'s fourth quarter 2005 earnings and Google Inc.'s second quarter 2007 earnings prior to the public announcements of those financial results by the companies. Khan had received the material non-public information that she conveyed to Whitman from a high-ranking executive at Polycom, Inc., and from an employee of an investor relations firm retained by Google, Inc, respectively. Whitman Capital, according to the complaint, garnered nearly \$1 million in ill-gotten gains by trading on Khan's illegal tips.

4. On August 21, 2012, Whitman was convicted of two counts of conspiracy to commit securities fraud in violation of Section 371 of Title 18 of the United States Code, and two counts of securities fraud in violation of Sections 78j(b) and 78ff of Title 15 of the United States Code, Section 2 of Title 18 of the United States Code, and Sections 240.10b-5 and 240.10b-5 of Title 17 of the Code of Federal Regulations before the United States District Court for the Southern District of New York, in United States v. Doug Whitman, 12-CR-125 (JSR). On January 29, 2012, a judgment in the criminal case was entered against Whitman. Whitman was sentenced to a prison term of 24 months, followed by one year of supervised release, ordered to pay forfeiture in the amount of \$935,306, and to a pay a \$250,000 fine.

5. The criminal indictment pursuant to which Whitman was convicted alleged, inter alia, that Whitman participated in a scheme to defraud by executing securities trades based on material, nonpublic information regarding certain inside information pertaining to Polycom, Inc., and Google, Inc., as well as another technology company, that had been misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

#### IV.

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

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

*Commissioner Paredes  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69437 / April 23, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-12372

In the Matter of

WADDELL & REED, INC., WADDELL  
& REED INVESTMENT  
MANAGEMENT COMPANY, AND  
WADDELL & REED SERVICES  
COMPANY,

Respondents.

NOTICE OF PROPOSED PLAN  
OF DISTRIBUTION AND  
OPPORTUNITY FOR COMMENT

Notice is hereby given, pursuant to Rule 1103 of the Securities and Exchange Commission's ("Commission") Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. § 201.1103, that the Division of Enforcement has submitted to the Commission a proposed plan for the distribution of monies placed into a Fair Fund in the above-captioned matter.

On July 24, 2006, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 17A(c) 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, Exchange Act Release No. 54193 (July 24, 2006) (the "Order") against Waddell & Reed, Inc. ("W&R"), Waddell & Reed Investment Management Company ("W&R Investment Management"), and Waddell & Reed Services Company ("W&R Services") (collectively "Respondents"). The Order stated that from at least as early as 1995 through 2003, Respondents permitted a number of individuals and entities to market time certain funds in the W&R Funds mutual fund complex ("W&R Funds"), subject to certain limitations on the number, amount and frequency of trades. Market "Timers" are those investors who engage in frequent buying and selling of shares of the same mutual fund or buying and selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Despite prospectus disclosures and internal procedures that Respondents had in place to prevent or limit the market timing, Respondents permitted Timers to time in the W&R Funds even though they knew that the Timers were harming the funds by diluting other investors' returns. The Order created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Respondents paid on a joint and several

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basis \$40,000,000 in disgorgement plus a civil money penalty in the amount of \$10,000,000 for a total payment of \$50,000,000.

## **OPPORTUNITY FOR COMMENT**

Pursuant to this Notice, all interested parties are advised that they may print a copy of the Proposed Plan of Distribution from the Commission's public website, <http://www.sec.gov>. Interested parties may also obtain a written copy of the Proposed Plan of Distribution by submitting a written request to: Nancy Chase Burton, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-5631. All persons who desire to comment on the Proposed Plan of Distribution may submit their comments, in writing, no later than thirty (30) days from the date of this Notice:

1. By sending a letter to the Office of the Secretary, United States Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-1090;
2. By using the Commission's Internet comment form (<http://www.sec.gov/litigation/admin.shtml>); or
3. By sending an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov).

Comments submitted by e-mail or via the Commission's website should include "Administrative Proceeding File Number 3-12372" in the subject line. Comments received will be publicly available. Persons should submit only information that they wish to make publicly available.


## **DISTRIBUTION PLAN**

The Fair Fund is comprised of \$50,000,000 in disgorgement and a civil penalty paid by Respondents, plus any accumulated interest and less any federal, state, or local taxes and fees and expenses. The Proposed Plan of Distribution provides for investors to receive monies from the Fair Fund that represent their proportionate share of losses suffered by the fund due to market timing by the Timers and a proportionate share of advisory fees paid by funds that suffered losses during the period of market timing from December 1, 1998 through October 31, 2003. The plan is designed to allocate the Fair Fund among the W&R Funds accountholders who held shares in the Accumulative, Continental Income, Core Investment, International Growth, New Concepts, Science & Technology, Small Cap, Value, and Vanguard funds. The methods of calculation of each eligible investor's share of the Fair Fund are intended to result in payment to each eligible investor that restores the impaired value of the investor's investment in the harmed funds plus a partial refund of advisory fees. The Fair Fund is not intended to compensate investors for losses they incurred because of fluctuations in securities markets that were unrelated to Respondents' conduct. Each accountholder with positive net dilution within a fund above a minimum threshold will receive a prorated share of the settlement that is a multiple of their aggregate net dilution within that fund ("Eligible Investor").

Eligible Investors will not need to go through a claims process; rather, they will be determined from W&R Funds' records. The Eligible Investors will not be required to make claims or submit documentation to establish their eligibility.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

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

**INVESTMENT ADVISERS ACT OF 1940**  
**Release No. 3592 / April 24, 2013**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-15300**

**In the Matter of**

**TARA BRYSON,**

**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 Tara Bryson ("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 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 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. Respondent, age 38, resides in West Suffield, Connecticut and is a former employee of New Stream Capital, LLC ("New Stream"), an unregistered investment adviser and Delaware limited liability company organized in October 2002 with its principal place of business in Ridgefield, Connecticut. Respondent worked for New Stream and its predecessor entities from approximately 2004 to 2010.

2. On February 26, 2013, the Commission filed a civil action against Respondent and others in the United States District Court for the District of Connecticut, *SEC v. New Stream Capital, LLC, et al.*, Civil Action No. 3:13-cv-00264-RNC. The Commission's Complaint alleges, *inter alia*, that while employed at New Stream, Respondent engaged in conduct that violated Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and that she aided and abetted violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

3. On April 16, 2013, the United States District Court for the District of Connecticut entered, by consent, a final judgment against Respondent permanently enjoining her from violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206-4(8) thereunder.

### IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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

**SECURITIES EXCHANGE ACT OF 1934**  
Release No. 69461 / April 25, 2013

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 3594 / April 25, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15306

In the Matter of

**MICHAEL W. BOZORA,**

Respondent.

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b)(6) OF  
THE SECURITIES EXCHANGE ACT OF  
1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Michael W. Bozora ("Bozora" 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

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consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Bozora, age 62, resides in Panama City, Panama. He was the part owner of Capital Solutions Management, LP, an investment adviser that was registered with the State of California from approximately 2002 through 2010, the part owner of Capital Solutions Distributors, LLC ("CSD"), a broker-dealer that was registered with the Commission from approximately 2004 through 2010, and was a registered representative associated with CSD and other broker-dealers registered with the Commission.

2. On April 16, 2013, a final judgment was entered by consent against Bozora, permanently enjoining him from future violations of Sections 17(a)(2) and (3) of the Securities Act of 1933, ordering him to pay disgorgement and prejudgment interest totaling \$614,765, and ordering him to pay a \$130,000 civil penalty, in the civil action entitled Securities and Exchange Commission v. True North Finance Corp., et al., Civil Action Number 10-cv-3995, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged, among other things, that Bozora failed to make adequate disclosure of the default of the sole borrower of the Capital Solutions Monthly Income Fund ("Fund"), the Fund's foreclosure on that borrower, and the Fund's loss of investment income resulting from the borrower's default.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Bozora 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. 69462 / April 25, 2013

**INVESTMENT ADVISERS ACT OF 1940**  
Release No. 3595 / April 25, 2013

**ADMINISTRATIVE PROCEEDING**  
File No. 3-15304

**In the Matter of**

**TIMOTHY R. REDPATH,**

**Respondent.**

**ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b)(6) OF  
THE SECURITIES EXCHANGE ACT OF  
1934 AND SECTION 203(f) OF THE  
INVESTMENT ADVISERS ACT OF 1940,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Timothy R. Redpath ("Redpath" 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

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consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

### III.

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

1. Redpath, age 55, resides in Mill Valley, California. He was the part owner of Capital Solutions Management, LP, an investment adviser that was registered with the State of California from approximately 2002 through 2010, the part owner of Capital Solutions Distributors, LLC ("CSD"), a broker-dealer that was registered with the Commission from approximately 2004 through 2010, and was a registered representative associated with CSD and other broker-dealers registered with the Commission.

2. On April 16, 2013, a final judgment was entered by consent against Redpath, permanently enjoining him from future violations of Sections 17(a)(2) and (3) of the Securities Act of 1933, ordering him to pay disgorgement and prejudgment interest totaling \$685,969, and ordering him to pay a \$130,000 civil penalty, in the civil action entitled Securities and Exchange Commission v. True North Finance Corp., et al., Civil Action Number 10-cv-3995, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged, among other things, that Redpath failed to make adequate disclosure of the default of the sole borrower of the Capital Solutions Monthly Income Fund ("Fund"), the Fund's foreclosure on that borrower, and the Fund's loss of investment income resulting from the borrower's default.

### IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Redpath 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. 69459 / April 25, 2013

**ADMINISTRATIVE PROCEEDING**

File No. 3-15302

**In the Matter of**

**Actavision Ventures, Inc.,  
American Resources Group, Inc.,  
Audioscience, Inc.,  
Basset Enterprises, Inc.,  
Cybertex Enterprises, Inc.  
(n/k/a Synvion Corp.), and  
Duct Utility Construction &  
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 Actavision Ventures, Inc., American Resources Group, Inc., Audioscience, Inc., Basset Enterprises, Inc., Cybertex Enterprises, Inc. (n/k/a Synvion Corp.), and Duct Utility Construction & Technologies, Inc.

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. RESPONDENTS**

1. Actavision Ventures, Inc. (CIK No. 1386975) is a forfeited Delaware corporation located in Farmington, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Actavision Ventures is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2009.

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2. American Resources Group, Inc. (CIK No. 225255) is a Colorado corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Resources Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 1993, which reported a net loss of \$10,500 for the prior three months.

3. AudioScience, Inc. (CIK No. 874688) is a Minnesota corporation located in Minnetonka, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). AudioScience is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1994, which reported a net loss of over \$861,000 for the prior three months. On June 20, 1994, AudioScience filed a Chapter 7 petition in the United States Bankruptcy Court for the District of Minnesota, and the case was terminated on September 19, 1997.

4. Basset Enterprises, Inc. (CIK No. 1097752) is a defaulted Nevada corporation located in Shenzhen, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Basset Enterprises is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2010, which reported a net loss of over \$1,200 for the prior three months.

5. Cybertex Enterprises, Inc. (n/k/a Synvion Corp.) (CIK No. 853306) is a dissolved Nevada corporation located in Littleton, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cybertex Enterprises 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, 1995.

6. Duct Utility Construction & Technologies, Inc. (CIK No. 742876) is a delinquent Colorado corporation located in Cincinnati, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Duct Utility & Construction Technologies is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2002, which reported a net loss of over \$1.9 million for the prior six months.

#### B. DELINQUENT PERIODIC FILINGS

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

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

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

### III.

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

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

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

### IV.

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

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

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

*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69460 / April 25, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15303

In the Matter of

DAVID MILLER,

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 David Miller ("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 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. Miller, age 40, was a registered representative associated with Rochdale Securities LLC ("Rochdale") from approximately February 2009 through October 2012. Miller resides in Rockville Centre, New York.

2. Rochdale is a Connecticut-based broker-dealer that has been registered with the Commission since 1986.

3. On April 19, 2013, a judgment was entered by consent against Miller, 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. David Miller, Civil Action Number 3:13-cv-00522-JBA, in the United States District Court for the District of Connecticut.

4. The Commission's complaint alleges that Miller defrauded his employer, Rochdale, by entering a series of buy orders totaling 1,625,000 shares of Apple, Inc. ("Apple") on October 25, 2012, in advance of an Apple earnings announcement. Miller misrepresented to Rochdale that a Rochdale customer had authorized the orders and therefore had assumed the risk of loss on any trades executed pursuant to the orders. Miller expected to profit personally if Apple's stock price were to increase following the October 25 earnings announcement. Apple's stock price instead declined following the October 25 earnings announcement, and the Rochdale customer on whose purported behalf Miller placed the orders denied having authorized Miller to buy 1,625,000 Apple shares. Rochdale then took ownership of the unauthorized Apple position and ultimately lost approximately \$5.3 million, which caused the firm to fall below net capital requirements. The Commission's complaint also alleges that Miller defrauded a separate broker-dealer by placing a sell order on October 25, 2012 for 500,000 Apple shares under the false pretense that he was employed by, and authorized to place the order on behalf of, a third broker-dealer. Miller placed the 500,000 sell order in an effort to hedge his buy orders totaling 1,625,000 Apple shares.

5. On April 15, 2013, Miller pled guilty to one count of conspiracy to commit wire fraud, Title 18 United States Code, Section 371, and one count of wire fraud, Title 18 United States Code, Section 1343, before the United States District Court for the District of Connecticut, in United States v. David Miller, Crim. No. 3:12-mj-00288-HBF (D. Conn.).

6. The counts of the criminal complaint to which Miller pled guilty alleged, inter alia, that Miller defrauded Rochdale and others and conspired to obtain money and property by means of materially false and misleading statements, and that he transmitted or caused to be transmitted by wire false customer orders concerning purported purchase and sale orders for Apple 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 Miller's Offer.

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

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69447 / April 25, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15301

In the Matter of

Enercorp, Inc.,  
FTS Group, Inc.,  
Games, Inc.  
(n/k/a InQBate Corporation),  
Hartmarx Corporation  
(n/k/a XMH Corp. 1), and  
Penn Treaty American Corporation,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Enercorp, Inc. ("ENCP")<sup>1</sup> (CIK No. 313116) is a Colorado corporation located in Auburn Hills, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ENCP is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2009, which reported a net decrease in net assets of \$115,413 for the prior nine months. As of April 22, 2013, the common stock of ENCP was quoted on OTC Link, (formerly "Pink Sheets")

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



operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. FTS Group, Inc. ("FLIP") (CIK No. 1062663) is a revoked Nevada corporation located in Oldsmar, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). FLIP 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 \$1,406,403 for the prior six months. As of April 22, 2013, the common stock of FLIP was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Games, Inc. (n/k/a InQBate Corporation) ("INQB") (CIK No. 1162093) is a void Delaware corporation located in Cincinnati, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). INQB is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2005, which reported a net loss of \$789,314 for the prior three months. As of April 22, 2013, the common stock of INQB was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Hartmarx Corporation (n/k/a XMH Corp. 1) ("HTMXQ") (CIK No. 723371) is a delinquent Delaware corporation located in Chicago, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HTMXQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 2008, which reported a net loss of \$7,448,000 for the prior nine months. On January 23, 2009, HTMXQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of Illinois, which was still pending as of April 22, 2013. As of April 22, 2013, the common stock of HTMXQ was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Penn Treaty American Corporation ("PTYA") (CIK No. 814181) is a Pennsylvania corporation located in Frisco, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PTYA 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, 2006, which reported a net loss of \$33,168,000 for the prior year. As of April 22, 2013, the common stock of PTYA was quoted on OTC Link, had eleven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

#### B. DELINQUENT PERIODIC FILINGS

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

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

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

### III.

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

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

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

### IV.

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

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

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


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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 25, 2013

In the Matter of

**Enercorp, Inc.,  
FTS Group, Inc.,  
Games, Inc.  
(n/k/a InQBate Corporation),  
Hartmarx Corporation  
(n/k/a XMH Corp. 1), and  
Penn Treaty American Corporation,**

**File No. 500-1**

**ORDER OF SUSPENSION OF  
TRADING**

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

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

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Games, Inc. (n/k/a InQBate Corporation) because it has not filed any periodic reports since the period ended September 30, 2005.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Hartmarx Corporation (n/k/a XMH Corp. 1) because it has not filed any periodic reports since the period ended August 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Penn Treaty American Corporation because it has not filed any periodic reports since the period ended December 31, 2006.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on April 25, 2013, through 11:59 p.m. EDT on May 8, 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. 69466 / April 26, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15307

In the Matter of  
  
RICHARD BRUCE MOORE,  
  
Respondent.

ORDER INSTITUTING  
ADMINISTRATIVE PROCEEDINGS  
PURSUANT TO SECTION 15(b) OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
MAKING FINDINGS, AND IMPOSING  
REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Richard Bruce Moore ("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 for: those facts related to his trading in securities of Tomkins plc that are set forth in the Settlement Agreement Between Staff of the Ontario Securities Commission and Richard Bruce Moore, dated March 6, 2013; jurisdiction over him and the subject matter of these proceedings; and the findings contained in Section III.2 below, all of 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. Moore was, from at least January 2010 through October 2010, a managing director and investment banker at CIBC World Markets, Ltd., the Toronto, Canada-based

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investment bank subsidiary of Canadian Imperial Bank of Commerce ("CIBC"). During this time, CIBC also had a New York-based investment bank subsidiary, CIBC World Markets Corp., which was registered with the Commission as a broker-dealer. Through CIBC, Moore was under common control with the registered broker-dealer, and thus was a person associated with it.

2. On April 23, 2013, a final judgment was entered by consent against Moore, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Richard Bruce Moore, No. 13 CIV 2514 (HB), in the United States District Court for the Southern District of New York.

3. The Commission's complaint in that action alleged that on June 28, 2010, Moore knowingly or recklessly misappropriated from his employer information that a CIBC client was working on a potential acquisition of Tomkins plc, a United Kingdom engineering and manufacturing firm, by purchasing for his personal benefit 51,350 Tomkins American Depositary Receipts, which traded on the New York Stock Exchange.

#### IV.

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

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

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 April 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 Jo White, SEC Chair  
April 10, 2013 to Present**

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

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

MARY JO WHITE, CHAIR

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(34 Documents)

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

March 6, 2013

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

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Xytos, Inc. ("Xytos") because of questions regarding the adequacy and accuracy of information Xytos publicly disseminates concerning the company's financial conditions and business operations, and because of potentially manipulative conduct in the trading of Xytos 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.

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 6, 2013 through 11:59 p.m. EDT on March 19, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
April 4, 2013

IN THE MATTER OF

FACE UP ENTERTAINMENT  
GROUP, 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 Face Up Entertainment Group, Inc. ("Face Up") because of questions concerning the adequacy and accuracy of publicly available information about Face Up, including, among other things, its financial condition, the control of the company, its business operations, and trading in its securities. Face Up is a Florida corporation based in Valley Stream, New York and is traded under the symbol "FUEG."

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

THEREFORE, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT, on April 4, 2013 through 11:59 p.m. EDT, on April 17, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Rel. No. 69358 / April 10, 2013

Admin. Proc. File No. 3-15212

In the Matter of  
VIRGINIA K. SOURLIS, ESQ.

ORDER DENYING MOTION TO LIFT  
TEMPORARY SUSPENSION AND  
DIRECTING HEARING

On February 19, 2013, we issued an order instituting proceedings ("OIP") against Virginia K. Sourlis, Esq., pursuant to Commission Rule of Practice 102(e)(3)(i)(B).<sup>1</sup> The OIP temporarily suspended Sourlis, an attorney licensed in New Jersey, from appearing or practicing before the Commission.<sup>2</sup> Sourlis has now filed a petition, pursuant to Rule 102(e)(3)(ii),<sup>3</sup> requesting that her temporary suspension be lifted. For the reasons set forth below, we have determined to deny Sourlis's petition and set the matter down for a hearing.

On May 5, 2011, the Commission filed an amended complaint against Sourlis and others in the United States District Court for the Southern District of New York alleging, among other claims, that, on January 11, 2006, Sourlis issued a false legal opinion letter that facilitated the illegal public offering of millions of shares of Greenstone Holdings, Inc. stock. The amended complaint further alleged that Sourlis thus aided and abetted violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.<sup>4</sup>

On November 20, 2012, the Court found that Sourlis aided and abetted violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder by issuing her false opinion letter. On that date, the court issued an order that granted the Commission summary judgment on liability

<sup>1</sup> 17 CFR § 201.102(e)(3)(i)(B) (authorizing the Commission to temporarily suspend from appearing or practicing before it an attorney who has been "[f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party or found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder").

<sup>2</sup> *Virginia K. Sourlis, Esq.*, Securities Exchange Act Release No. 68952, 2013 WL 603689 (Feb. 19, 2013).

<sup>3</sup> 17 CFR § 201.102(e)(3)(ii).

<sup>4</sup> 15 U.S.C. § 78j(b); 17 CFR § 240.10b-5.

on the Commission's claim that Sourlis aided and abetted violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder.<sup>5</sup>

In issuing the OIP, we found it "appropriate and in the public interest" that Sourlis be temporarily suspended from appearing or practicing before the Commission based on the findings of the Southern District of New York, in an action brought by the Commission, that Sourlis aided and abetted violations of certain antifraud provisions of the federal securities laws. We stated that the temporary suspension would become permanent unless Sourlis filed a petition seeking to lift it within thirty days of service of the OIP, pursuant to Rule 102(e)(3)(ii). We further advised that, pursuant to Rule 102(e)(3)(iii), upon receipt of such a petition, we would either lift the temporary suspension, set the matter down for a hearing, or both.

In her petition, Sourlis challenges the temporary suspension on a number of grounds, including the following: (1) the Commission failed to issue timely the order imposing the temporary suspension; (2) the temporary suspension is based on stale, seven-year old facts and is therefore barred by the statute of limitations set forth in 28 U.S.C. § 2462, due process, and fundamental fairness; (3) the underlying court order is not a final judgment or order and thus renders the temporary suspension premature and unenforceable; (4) a Rule 102(e) suspension is a "penalty" within the meaning of *Johnson v. SEC*;<sup>6</sup> (5) the Commission does not have the authority to impose the suspension because it is a collateral sanction; and (6) future violations are unlikely and scienter was lacking in the underlying violation, making a suspension unwarranted.<sup>7</sup>

The Office of the General Counsel ("OGC") has opposed Sourlis's petition. OGC argues, among other things, that: (1) the Commission timely issued the temporary suspension because such issuance occurred within ninety days of the effectiveness of the underlying district court order; (2) the temporary suspension is not barred because the Rule 102(e)(3) cause of action accrued on November 20, 2012 when the district court entered its order; (3) Rule 102(e)(3) does not require the Commission to wait until an entered order has become final or until final judgment is entered to issue an order of temporary suspension; (4) the temporary suspension serves the remedial purpose of protecting the public interest and the Commission's processes from an adjudicated violator of the securities laws pending an administrative hearing to determine the appropriate sanction; (5) the temporary suspension prohibits Sourlis from appearing and practicing before the Commission as an attorney and does not otherwise affect Sourlis's ability to practice law or to participate in any other securities profession regulated by the Commission; and (6) Sourlis cannot relitigate the district court's findings in this Rule 102(e)(3) proceeding.<sup>8</sup>

<sup>5</sup> *SEC v. Greenstone Holdings, Inc., et al.*, 10 civ. 1302 (MGC) (S.D.N.Y. Nov. 20, 2012).

<sup>6</sup> 87 F.3d 484 (D.C. Cir. 1996).

<sup>7</sup> Sourlis also asserts that the Commission acted improperly while negotiating a settlement of the district court action but does not explain the relevance of such assertion to our determination here.

<sup>8</sup> See 17 CFR § 201.102(e)(3)(iv) (stating that, in any hearing held on a petition filed in accordance with Rule 102(e)(3)(ii), the petitioner may not contest any findings made against him or fact admitted by him in the underlying

(continued...)

Rule 102(e)(3)(iii) provides that, "[w]ithin 30 days after the filing of a petition [to lift a temporary suspension] in accordance with paragraph (e)(3)(ii) of this rule, the Commission *shall* either lift the temporary suspension, or set the matter down for hearing at a time and place designated by the Commission, or both."<sup>9</sup> We have determined to deny Sourlis's petition and set the matter down for a hearing before an administrative law judge.<sup>10</sup> Continuing Sourlis's temporary suspension pending a hearing on the issues raised in her petition serves the public interest and protects the Commission's processes. As discussed, a district court found that Sourlis aided and abetted violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder by issuing a false opinion letter. That finding provided a statutory basis for the Commission to temporarily suspend Sourlis without a preliminary hearing. Sourlis remains licensed as an attorney and has not expressed any intent to stop working in the field of securities law. She thus remains in a position to harm the Commission's processes if the temporary suspension is lifted and she is permitted to appear and practice before the Commission pending the outcome of a hearing.

Under the circumstances, we find it appropriate to continue Sourlis's suspension pending the holding of a public hearing and decision by an administrative law judge. As provided in Rule 102(e)(3)(iii), we will set the matter down for a public hearing. We express no opinion as to the merits of Sourlis's claims.

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

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

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(...continued)

proceeding); *Jilaine H. Bauer, Esq.*, Exchange Act Release No. 68214, 2012 WL 5493356, at \*2 & n.12 (Nov. 13, 2012) (citing *Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at \*4 n.20 (Jan 16, 2007)).

<sup>9</sup> 17 CFR § 201.102(e)(3)(iii) (emphasis added).

<sup>10</sup> The Commission has denied similar petitions in the recent past. *See, e.g., Stewart A. Merkin, Esq.*, Exchange Act Release No. 68981, 2013 WL 661621 (Feb. 25, 2013); *Jilaine H. Bauer, Esq.*, 2012 WL 5493356; *Mitchell Segal, Esq.*, Exchange Act Release No. 67930, 2012 WL 4458283 (Sept. 26, 2012); *Ran H. Furman*, Exchange Act Release No. 65680, 2011 WL 5231425 (Nov. 3, 2011); *Michael C. Pattison, CPA*, Exchange Act Release No. 64598, 2011 WL 2169094 (June 3, 2011); *Carl W. Jasper, CPA*, Exchange Act Release No. 64077, 2011 WL 881508 (Mar. 11, 2011); *William D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170 (May 6, 2009); *Chris G. Gunderson, Esq.*, Exchange Act Release No. 56396, 2007 WL 2668485 (Sept. 12, 2007); *Ulysses "Thomas" Ware*, Exchange Act Release No. 51222, 2005 WL 399675 (Feb. 17, 2005); *Daniel S. Lezak*, Exchange Act Release No. 50729, 2004 WL 2721400 (Nov. 23, 2004); *Herbert M. Campbell, II*, Exchange Act Release No. 43422, 2000 WL 1482918 (Oct. 6, 2000).

ORDERED that the temporary suspension of Virginia K. Sourlis, Esq., entered on February 19, 2013, remain in effect pending a hearing and decision in this matter.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

**COMMODITY FUTURES TRADING COMMISSION**

**17 CFR Part 162**

**RIN: 3038-AD14**

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 248**

**Release Nos. 34-69359, IA-3582, IC-30456; File No. S7-02-12**

**RIN: 3235-AL26**

**Identity Theft Red Flags Rules**

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

**ACTIONS:** Joint final rules and guidelines.

**SUMMARY:** The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (together, the "Commissions") are jointly issuing final rules and guidelines to require certain regulated entities to establish programs to address risks of identity theft. These rules and guidelines implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which amended section 615(e) of the Fair Credit Reporting Act and directed the Commissions to adopt rules requiring entities that are subject to the Commissions' respective enforcement authorities to address identity theft. First, the rules require financial institutions and creditors to develop and implement a written identity theft prevention program designed to detect, prevent, and mitigate identity theft in connection with certain existing accounts or the opening of new accounts. The rules include guidelines to assist entities in the formulation and maintenance of programs that would satisfy the requirements of the rules. Second, the rules establish special requirements for any credit and debit card issuers



that are subject to the Commissions' respective enforcement authorities, to assess the validity of notifications of changes of address under certain circumstances.

**DATES:** Effective Date *[insert date 30 days after date of publication in the Federal Register]*;

Compliance Date *[insert date 30 days plus six months after date of publication in the Federal Register]*.

**FOR FURTHER INFORMATION CONTACT:** CFTC: Sue McDonough, Counsel, at Commodity Futures Trading Commission, Office of the General Counsel, Three Lafayette Centre, 1155 21<sup>st</sup> Street, NW, Washington, DC 20581, telephone number (202) 418-5132, facsimile number (202) 418-5524, e-mail [smcdonough@cftc.gov](mailto:smcdonough@cftc.gov); SEC: with regard to investment companies and investment advisers, contact Andrea Ottomanelli Magovern, Senior Counsel, Amanda Wagner, Senior Counsel, Thoreau Bartmann, Branch Chief, or Hunter Jones, Assistant Director, Office of Regulatory Policy, Division of Investment Management, (202) 551-6792, or with regard to brokers, dealers, or transfer agents, contact Brice Prince, Special Counsel, Joseph Furey, Assistant Chief Counsel, or David Blass, Chief Counsel, Office of Chief Counsel, Division of Trading and Markets, (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

**SUPPLEMENTARY INFORMATION:**

The Commissions are adopting new rules and guidelines on identity theft red flags for entities subject to their respective enforcement authorities. The CFTC is adding new subpart C ("Identity Theft Red Flags") to part 162 of the CFTC's regulations [17 CFR part 162] and the SEC is adding new subpart C ("Regulation S-ID: Identity Theft Red Flags") to part 248 of the SEC's regulations [17 CFR part 248], under the Fair Credit Reporting Act [15 U.S.C. 1681-1681x], the Commodity Exchange Act [7 U.S.C. 1-27f], the Securities Exchange Act of 1934

[15 U.S.C. 78a–78pp], the Investment Company Act of 1940 [15 U.S.C. 80a], and the Investment Advisers Act of 1940 [15 U.S.C. 80b].

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## I. BACKGROUND

The growth and expansion of information technology and electronic communication have made it increasingly easy to collect, maintain, and transfer personal information about individuals.<sup>1</sup> Advancements in technology also have led to increasing threats to the integrity and privacy of personal information.<sup>2</sup> During recent decades, the federal government has taken steps to help protect individuals, and to help individuals protect themselves, from the risks of theft, loss, and abuse of their personal information.<sup>3</sup>

The Fair Credit Reporting Act of 1970 (“FCRA”),<sup>4</sup> as amended in 2003,<sup>5</sup> required several federal agencies to issue joint rules and guidelines regarding the detection, prevention, and

<sup>1</sup> See, e.g., U.S. GOVERNMENT ACCOUNTABILITY OFFICE, INFORMATION SECURITY: FEDERAL GUIDANCE NEEDED TO ADDRESS CONTROL ISSUES WITH IMPLEMENTING CLOUD COMPUTING (May 2010), available at <http://www.gao.gov/new.items/d10513.pdf> (discussing information security implications of cloud computing); DEPARTMENT OF COMMERCE, INTERNET POLICY TASK FORCE, COMMERCIAL DATA PRIVACY AND INNOVATION IN THE INTERNET ECONOMY: A DYNAMIC POLICY FRAMEWORK, at Section I (2010), available at [http://www.ntia.doc.gov/reports/2010/iptf\\_privacy\\_greenpaper\\_12162010.pdf](http://www.ntia.doc.gov/reports/2010/iptf_privacy_greenpaper_12162010.pdf) (reviewing recent technological changes that necessitate a new approach to commercial data protection). See also FRED H. CATE, PRIVACY IN THE INFORMATION AGE, at 13–16 (1997) (discussing the privacy and data security issues that arose during early increases in the use of digital data).

<sup>2</sup> A recent survey found that in 2012, over 5% of Americans were victims of identity fraud. See Javelin Strategy & Research, 2013 IDENTITY FRAUD REPORT: DATA BREACHES BECOMING A TREASURE TROVE FOR FRAUDSTERS (Feb. 2013), available at [https://www.javelinstrategy.com/uploads/web\\_brochure/1303.R\\_2013IdentityFraudBrochure.pdf](https://www.javelinstrategy.com/uploads/web_brochure/1303.R_2013IdentityFraudBrochure.pdf); see also Comment Letter of Tyler Krulla (“Tyler Krulla Comment Letter”) (Apr. 27, 2012) (“In today’s technology driven world it is easier than ever for anyone to acquire and exploit someone’s identity and cause severe financial problems.”).

<sup>3</sup> See, e.g., CONSUMER DATA PRIVACY IN A NETWORKED WORLD: A FRAMEWORK FOR PROTECTING PRIVACY AND PROMOTING INNOVATION IN THE GLOBAL DIGITAL ECONOMY (Feb. 2012), available at <http://www.whitehouse.gov/sites/default/files/privacy-final.pdf> (a White House proposal to establish a consumer privacy bill of rights); The President’s Identity Theft Task Force Report (Sept. 2008), available at <http://www.ftc.gov/os/2008/10/081021taskforcereport.pdf>; Securities and Exchange Commission, ONLINE BROKERAGE ACCOUNTS: WHAT YOU CAN DO TO SAFEGUARD YOUR MONEY AND YOUR PERSONAL INFORMATION, available at <http://www.sec.gov/investor/pubs/onlinebrokerage.htm>.

<sup>4</sup> Pub. L. 91-508, 84 Stat. 1114 (1970), codified at 15 U.S.C. 1681–1681x.

mitigation of identity theft for entities that are subject to their respective enforcement authorities (also known as the “identity theft red flags rules”).<sup>6</sup> Those agencies were the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“Federal Reserve Board”), the Federal Deposit Insurance Corporation (“FDIC”), the Office of Thrift Supervision (“OTS”), the National Credit Union Administration (“NCUA”), and the Federal Trade Commission (“FTC”) (together, the “Agencies”).<sup>7</sup> In 2007, the Agencies issued joint final identity theft red flags rules.<sup>8</sup> At the time the Agencies adopted their rules, the FCRA did not require or authorize the CFTC and SEC to issue identity theft red flags rules. Instead, the Agencies’ rules applied to entities that registered with the CFTC and SEC, such as futures commission merchants, broker-dealers, investment companies, and investment advisers.<sup>9</sup>

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<sup>5</sup> See Fair and Accurate Credit Transactions Act of 2003, Pub. L. 108-159, 117 Stat. 1952 (2003) (“FACT Act”).

<sup>6</sup> See FCRA §§ 615(e)(1)(A)–(B), 15 U.S.C. 1681m(e)(1)(A)–(B). Section 615(e)(1)(A) of the FCRA requires the Agencies to jointly “establish and maintain guidelines for use by each financial institution and each creditor regarding identity theft with respect to account holders at, or customers of, such entities, and update such guidelines as often as necessary.” Section 615(e)(1)(B) requires the Agencies to jointly “prescribe regulations requiring each financial institution and each creditor to establish reasonable policies and procedures for implementing the guidelines established pursuant to [section 615(e)(1)(A)], to identify possible risks to account holders or customers or to the safety and soundness of the institution or customers.”

<sup>7</sup> The FCRA also required the Agencies to prescribe joint rules applicable to issuers of credit and debit cards, to require that such issuers assess the validity of notifications of changes of address under certain circumstances (the “card issuer rules”). See FCRA § 615(e)(1)(C), 15 U.S.C. 1681m(e)(1)(C).

<sup>8</sup> See Identity Theft Red Flags and Address Discrepancies under the Fair and Accurate Credit Transactions Act of 2003, 72 FR 63718 (Nov. 9, 2007) (“2007 Adopting Release”). The rules included card issuer rules. See *supra* note 7. The OCC, Federal Reserve Board, FDIC, OTS, and NCUA began enforcing their identity theft red flags rules on November 1, 2008. The FTC began enforcing its identity theft red flags rules on January 1, 2011.

<sup>9</sup> See 2007 Adopting Release, *supra* note 8.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>10</sup> amended the FCRA to add the CFTC and SEC to the list of federal agencies that must jointly adopt and individually enforce identity theft red flags rules.<sup>11</sup> Thus, the Dodd-Frank Act provides for the transfer of rulemaking responsibility and enforcement authority to the CFTC and SEC with respect to the entities subject to each agency’s enforcement authority. In February 2012, the Commissions jointly proposed for public notice and comment identity theft red flags rules and guidelines and card issuer rules.<sup>12</sup>

The CFTC and SEC received a total of 27 comment letters on the proposal.<sup>13</sup> Most commenters generally supported the proposal, and many stated that the rules would benefit individuals.<sup>14</sup> Commenters expressed concern about the prevalence of identity theft and

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<sup>10</sup> Pub. L. 111-203, 124 Stat. 1376 (2010). The text of the Dodd-Frank Act is available at <http://www.cftc.gov/LawRegulation/OTCDERIVATIVES/index.htm>.

<sup>11</sup> See FCRA § 615(e)(1), 15 U.S.C. 1681m(e)(1). In addition, section 1088(a)(10)(A) of the Dodd-Frank Act added the Commissions to the list of federal administrative agencies responsible for enforcement of rules pursuant to section 621(b) of the FCRA. See *infra* note 24. Section 1100H of the Dodd-Frank Act provides that the Commissions’ new enforcement authority (as well as other changes in various agencies’ authority under other provisions) becomes effective as of the “designated transfer date” to be established by the Secretary of the Treasury, as described in section 1062 of that Act. On September 20, 2010, the Secretary of the Treasury designated July 21, 2011 as the transfer date. See *Designated Transfer Date*, 75 FR 57252 (Sept. 20, 2010).

<sup>12</sup> The Commissions’ joint proposed rules and guidelines were published in the Federal Register on March 6, 2012. See *Identity Theft Red Flags Rules*, 77 FR 13450 (Mar. 6, 2012) (“Proposing Release”). For ease of reference, unless the context indicates otherwise, our general use of the terms “identity theft red flags rules” or “rules” in this release will refer to both the identity theft red flags rules and guidelines. In addition, unless the context indicates otherwise, the general use of these terms in this preamble and Section III of this release will refer to both the identity theft red flags rules and guidelines, and the card issuer rules (which are discussed in further detail later in this release).

<sup>13</sup> Comments on the proposal, including comments referenced in this release, are available on the SEC’s website at <http://www.sec.gov/comments/s7-02-12/s70212.shtml> and the CFTC’s website at <http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1171>.

<sup>14</sup> See, e.g., Comment Letter of MarketCounsel (Apr. 25, 2012) (“MarketCounsel Comment Letter”) (“MarketCounsel supports the Commission’s attempt to help protect individuals from the risk of theft, loss, and abuse of their personal information through the Proposed Rule.”); Comment Letter of Erik Speicher (“Erik Speicher Comment Letter”) (Mar. 17, 2012) (“Identity theft is a major

supported our efforts to reduce it.<sup>15</sup> Commenters also supported the Commissions' proposal to adopt rules that would be substantially similar to the rules the Agencies adopted in 2007.<sup>16</sup> Some commenters raised questions about the scope of the proposal and the meaning of certain definitions.<sup>17</sup> One commenter stated that benefits to consumers would outweigh the costs of the rules,<sup>18</sup> while another took issue with the estimated costs of complying with the rules.<sup>19</sup>

Today, the CFTC and SEC are adopting the identity theft red flags rules. The final rules are substantially similar to the rules the Commissions proposed,<sup>20</sup> and to the rules the Agencies

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concern of all citizens. The effects and burdens associated with having ones [sic] identity stolen necessitate these proposed regulations. The affirmative duty placed on the covered entities will better protect all of us from the possibility of having our identity stolen.”); Comment Letter of Lauren L. (Mar. 12, 2012) (“Lauren L. Comment Letter”) (“[R]equirements to implement an identity theft prevention plan and to verify change of personal information [have] the [potential] to protect people.”).

<sup>15</sup> See, e.g., Tyler Krulla Comment Letter; Lauren L. Comment Letter (“I agree with the proposed changes. With the market shifting to an IT based world, identity theft is increasing. Therefore, more stringent rules and regulations should be in place to protect those that may be affected.”).

<sup>16</sup> See, e.g., Comment Letter of the Investment Company Institute (May 1, 2012) (“ICI Comment Letter”).

<sup>17</sup> See, e.g., Comment Letter of the Investment Adviser Association (May 7, 2012) (“IAA Comment Letter”) (requesting that the SEC and CFTC clarify the definitions of “financial institution” and “creditor” and exclude investment advisers from the categories of entities specifically mentioned in the scope section of the rule); Comment Letter of the Options Clearing Corporation (May 3, 2012) (“OCC Comment Letter”) (requesting that the SEC and CFTC clarify the definition of “creditor” and expressly exclude clearing organizations from the scope section of the rule); Comment Letter of the Financial Services Roundtable and the Securities Industry and Financial Markets Association (May 2, 2012) (“FSR/SIFMA Comment Letter”) (requesting that the SEC specifically exclude certain categories of entities from the definitions of “financial institution” and “covered account,” and that the SEC and CFTC specifically define the types of accounts that would qualify as covered accounts).

<sup>18</sup> See Erik Speicher Comment Letter.

<sup>19</sup> See FSR/SIFMA Comment Letter. We discuss estimated costs and benefits in the Section III of this release.

<sup>20</sup> See *infra* Section II.A.1.ii (discussing a revision to proposed definition of “creditor”); see also § 248.201(b)(2)(i) (SEC) (revising the term “non U.S. based financial institution or creditor,” which was included in the proposed definition of “board of directors,” to “foreign financial institution or creditor,” for clarity and consistency with the CFTC’s and Agencies’ respective identity theft red flags rules).

adopted in 2007.<sup>21</sup> The final rules apply to “financial institutions” and “creditors” subject to the Commissions’ respective enforcement authorities, and as discussed further below, do not exclude any entities registered with the Commissions from their scope. The Commissions recognize that entities subject to their respective enforcement authorities, whose activities fall within the scope of the rules, should already be in compliance with the Agencies’ joint rules. The rules we are adopting today do not contain requirements that were not already in the Agencies’ rules, nor do they expand the scope of those rules to include new categories of entities that the Agencies’ rules did not already cover. The rules and this adopting release do contain examples and minor language changes designed to help guide entities within the SEC’s enforcement authority in complying with the rules, which may lead some entities that had not previously complied with the Agencies’ rules to determine that they fall within the scope of the rules we are adopting today.

## **II. EXPLANATION OF THE FINAL RULES AND GUIDELINES**

### **A. Final Identity Theft Red Flags Rules**

Sections 615(e)(1)(A) and (B) of the FCRA, as amended by the Dodd-Frank Act, require that the Commissions jointly establish and maintain guidelines for “financial institutions” and “creditors” regarding identity theft, and adopt rules requiring such institutions and creditors to establish reasonable policies and procedures for the implementation of those guidelines.<sup>22</sup> Under the final rules, a financial institution or creditor that offers or maintains “covered accounts” must establish an identity theft red flags program designed to detect, prevent, and mitigate identity theft. To that end, the final rules discussed below specify: (1) which financial institutions and

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<sup>21</sup> See 2007 Adopting Release.

<sup>22</sup> 15 U.S.C. 1681m(e)(1)(A) and (B). Key terms such as “financial institution” and “creditor” are defined in the rules and discussed later in this Section.

creditors must develop and implement a written identity theft prevention program (“Program”); (2) the objectives of the Program; (3) the elements that the Program must contain; and (4) the steps financial institutions and creditors need to take to administer the Program.

1. *Which Financial Institutions and Creditors Are Required to Have a Program*

The “scope” subsections of the rules generally set forth the types of entities that are subject to the Commissions’ identity theft red flags rules.<sup>23</sup> Under these subsections, the rules apply to entities over which Congress recently granted the Commissions enforcement authority under the FCRA.<sup>24</sup> The Commissions’ scope provisions are similar to those contained in the rules adopted by the Agencies, which limit the rules’ scope to entities that are within the Agencies’ respective enforcement authorities.<sup>25</sup>

As noted above, the CFTC’s “scope” subsection “applies to financial institutions and creditors that are subject to” the CFTC’s enforcement authority under the FCRA.<sup>26</sup> The CFTC’s proposed definitions of “financial institution” and “creditor” describe the entities to which its identity theft red flags rules and guidelines apply. In the Proposing Release, the CFTC defined

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<sup>23</sup> § 162.30(a) (CFTC); § 248.201(a) (SEC).

<sup>24</sup> Section 1088(a)(10)(A) of the Dodd-Frank Act amended section 621(b) of the FCRA to add the Commissions to the list of federal agencies responsible for enforcement of the FCRA. As amended, section 621(b) of the FCRA specifically provides that enforcement of the requirements imposed under the FCRA “shall be enforced under . . . the Commodity Exchange Act, with respect to a person subject to the jurisdiction of the [CFTC]; [and under] the Federal securities laws, and any other laws that are subject to the jurisdiction of the [SEC], with respect to a person that is subject to the jurisdiction of the [SEC] . . . .” 15 U.S.C. 1681s(b)(1)(F)–(G). *See also* 15 U.S.C. 1681a(f) (defining “consumer reporting agency”).

<sup>25</sup> *See, e.g.*, 12 CFR 334.90(a) (stating that the FDIC’s red flags rule “applies to a financial institution or creditor that is an insured state nonmember bank, insured state licensed branch of a foreign bank, or a subsidiary of such entities (except brokers, dealers, persons providing insurance, investment companies, and investment advisers)”; 12 CFR 717.90(a) (stating that the NCUA’s red flags rule “applies to a financial institution or creditor that is a federal credit union”).

<sup>26</sup> § 162.30(a); *see also supra* note 24.



“financial institution” as having the same meaning as in section 603(t) of the FCRA.<sup>27</sup> In addition, the CFTC’s proposed definition of “financial institution” also specified that the term includes any futures commission merchant (“FCM”), retail foreign exchange dealer (“RFED”), commodity trading advisor (“CTA”), commodity pool operator (“CPO”), introducing broker (“IB”), swap dealer (“SD”), or major swap participant (“MSP”) that directly or indirectly holds a transaction account belonging to a consumer.<sup>28</sup> Similarly, in the CFTC’s proposed definition of “creditor,” the CFTC applies the definition of “creditor” from 15 U.S.C. 1681m(e)(4) to any FCM, RFED, CTA, CPO, IB, SD, or MSP that “regularly extends, renews, or continues credit; regularly arranges for the extension, renewal, or continuation of credit; or in acting as an assignee of an original creditor, participates in the decision to extend, renew, or continue credit.”<sup>29</sup> The CFTC has determined that the final identity theft red flags rules apply to these entities because of the increased likelihood that these entities open or maintain covered accounts, or pose a reasonably foreseeable risk to customers, or to the safety and soundness of the financial institution or creditor, from identity theft. This approach is consistent with the general scope of part 162 of the CFTC’s regulations.<sup>30</sup>

One commenter suggested that the CFTC follow the SEC’s approach and simply

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<sup>27</sup> See 15 U.S.C. 1681a(t) (defining “financial institution” to include certain banks and credit unions, and “any other person that, directly or indirectly, holds a transaction account (as defined in Section 19(b) of the Federal Reserve Act) belonging to a consumer”). Section 19(b) of the Federal Reserve Act defines a transaction account as “a deposit or account on which the depositor or account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders or withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third parties or others.” 12 U.S.C. 461(b)(1)(C).)

<sup>28</sup> § 162.30(b)(7).

<sup>29</sup> § 162.30(b)(5).

<sup>30</sup> § 162.1(b) (specifying that “[t]his part applies to certain consumer information held by ... futures commission merchants, retail foreign exchange dealers, commodity trading advisors, commodity pool operators, introducing brokers, major swap participants and swap dealers.”)

cross-reference the FCRA definition of “financial institution” and the FCRA definition of “creditor” as amended by the Red Flag Program Clarification Act of 2010 (“Clarification Act”)<sup>31</sup> rather than including named entities in the definition.<sup>32</sup> The commenter argued that cross-referencing the FCRA definitions, as amended by the Clarification Act, rather than including specific types of entities that are subject to the CFTC’s enforcement authority in the definitions of “financial institution” and “creditor,” would be more consistent with the SEC’s and the Agencies’ regulations and would allow the agencies to easily adapt to any changes to the FCRA over time.<sup>33</sup>

After considering these concerns, the CFTC has concluded that if it were to follow the SEC’s approach and simply cross-reference the FCRA definitions of “financial institution” and “creditor,” the general scope provisions of 17 CFR part 162 would still apply and specify that part 162 applies to FCMs, RFEDs, CTAs, CPOs, IBs, MSPs, and SDs. As a practical matter, a cross-reference to the FCRA definitions of “financial institution” and “creditor” would not change the result because under the general scope provisions of part 162, the CFTC’s identity theft red flags rules would still apply to the same list of entities. As a result, the CFTC believes that it should retain the same definition of “financial institution” and “creditor” contained in the Proposing Release.

The SEC’s “scope” subsection provides that the final rules apply to a financial institution or creditor, as defined by the FCRA, that is:

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<sup>31</sup> In December 2010, President Obama signed into law the Red Flag Program Clarification Act of 2010, which amended the definition of “creditor” in the FCRA for purposes of identity theft red flags rules. Red Flag Program Clarification Act of 2010, Pub. L. 111-319 (2010) (inserting new section 4 at the end of section 615(e) of the FCRA), *codified at* 15 U.S.C. 1681m(e)(4).

<sup>32</sup> IAA Comment Letter.

<sup>33</sup> The commenter also noted that the CFTC’s proposed definition of “creditor” would include certain entities such as CPOs and CTAs—entities that do not extend credit.

- A broker, dealer or any other person that is registered or required to be registered under the Securities Exchange Act of 1934 (“Exchange Act”);
- An investment company that is registered or required to be registered under the Investment Company Act of 1940 (“Investment Company Act”), that has elected to be regulated as a business development company (“BDC”) under that Act, or that operates as an employees’ securities company (“ESC”) under that Act; or
- An investment adviser that is registered or required to be registered under the Investment Advisers Act of 1940 (“Investment Advisers Act”).<sup>34</sup>

The types of entities listed by name in the scope section are the registered entities regulated by the SEC that are most likely to be financial institutions or creditors, *i.e.*, brokers or dealers (“broker-dealers”), investment companies, and investment advisers.<sup>35</sup> The scope section also includes any other entities that are registered or are required to register under the Exchange

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<sup>34</sup> § 248.201(a).

<sup>35</sup> The SEC’s final rules define the scope of the identity theft red flags rules, section 248.201(a), differently than Regulation S-AM, the affiliate marketing rule the SEC adopted under the FCRA, defines its scope. *See* 17 CFR 248.101(b) (providing that Regulation S-AM applies to any brokers or dealers (other than notice-registered brokers or dealers), any investment companies, and any investment advisers or transfer agents registered with the SEC). Section 214(b) of the FACT Act, pursuant to which the SEC adopted Regulation S-AM, did not specify the types of entities that would be subject to the SEC’s rules, and did not state that the affiliate marketing rules should apply to all persons subject to the SEC’s enforcement authority. By contrast, the Dodd-Frank Act specifies that the SEC’s identity theft red flags rules should apply to a “person that is subject to the jurisdiction” of the SEC. *See* Dodd-Frank Act §§ 1088(a)(8), (10). Therefore, the SEC’s identity theft red flags rules apply to BDCs, ESCs, and “any . . . person that is registered or required to be registered under the Securities Exchange Act of 1934,” as well as to those entities within the scope of Regulation S-AM.

The scope of the SEC’s final rules also differs from that of Regulation S-P, 17 CFR part 248, subpart A, the privacy rule the SEC adopted in 2000 pursuant to the Gramm-Leach-Bliley Act. Pub. L. 106-102 (1999). Regulation S-P was adopted under Title V of that Act, which, unlike the FCRA, limited the SEC’s regulatory authority to: (i) brokers and dealers; (ii) investment companies; and (iii) investment advisers registered under the Investment Advisers Act. *See* 15 U.S.C. 6805(a)(3)–(5).

Act.<sup>36</sup> Some types of entities required to register under the Exchange Act, such as nationally recognized statistical rating organizations (“NRSROs”), self-regulatory organizations (“SROs”), municipal advisors, and municipal securities dealers, are not listed by name in the scope section because they may be less likely to qualify as financial institutions or creditors under the FCRA.<sup>37</sup> Nevertheless, if any entity of a type not listed qualifies as a financial institution or creditor, it is covered by the SEC’s rules. The scope section does not include entities that are not themselves registered or required to register with the SEC (with the exception of certain non-registered investment companies that nonetheless are regulated by the SEC<sup>38</sup>), even if they register securities under the Securities Act of 1933 or the Exchange Act, or report information under the federal securities laws.<sup>39</sup>

The SEC received four comment letters arguing that it should specifically exclude certain

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<sup>36</sup> The Dodd-Frank Act defines a “person regulated by the [SEC],” for other purposes of the Act, as certain entities that are registered or required to be registered with the SEC, and certain employees, agents, and contractors of those entities. *See* Dodd-Frank Act § 1002(21).

<sup>37</sup> The SEC believes that municipal advisors and municipal securities dealers may be less likely to qualify as financial institutions because they may be less likely to maintain transaction accounts for consumers. A commenter agreed with us that municipal advisors and municipal securities dealers may be less likely to qualify as financial institutions. *See* FSR/SIFMA Comment Letter. For further discussion, see *infra* notes 43–47 and accompanying text.

<sup>38</sup> As noted above, the scope of the final rules covers BDCs and ESCs, which typically do not register as investment companies with the SEC but are regulated by the SEC. BDCs file with the SEC notices of reliance on the BDC provisions of the Investment Company Act and the SEC’s rules thereunder. *See* Form N-54A (“Notification of Election to be Subject to Sections 55 through 65 of the Investment Company Act of 1940 Filed Pursuant to Section 54(a) of the Act”) [17 CFR 274.53]. ESCs operate pursuant to individual exemptive orders issued by the SEC that govern the companies’ operations. *See* Investment Company Act § 6(b) [15 U.S.C. 80a-6(b)].

<sup>39</sup> *See, e.g.,* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 22, 2011) [76 FR 39646 (July 6, 2011)] (adopting rules related to investment advisers exempt from registration with the SEC, including “exempt reporting advisers”).

entities from the scope of the rules.<sup>40</sup> These commenters recommended that the scope section exclude registered investment advisers,<sup>41</sup> clearing organizations,<sup>42</sup> SROs, municipal securities dealers, municipal advisors, or NRSROs.<sup>43</sup> The commenters argued that these entities are unlikely to be financial institutions or creditors and that, without a specific exclusion, the scope of the rules is unclear and the rules would require these entities to periodically review their operations to ensure compliance with rules that are not relevant to their businesses.<sup>44</sup> Another commenter recommended that the rules not list any of the types of entities subject to the rules, because such a list could confuse entities that are on the list but do not qualify as financial institutions or creditors.<sup>45</sup>

We appreciate these concerns, and seek to minimize potential unnecessary burdens on regulated entities. As we acknowledge above, the entities that are not listed in the rule's scope section may be less likely to qualify as financial institutions or creditors under the FCRA, *e.g.*,

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<sup>40</sup> See IAA Comment Letter; Comment Letter of the National Society of Compliance Professionals, Inc. (May 4, 2012) ("NSCP Comment Letter"); OCC Comment Letter; FSR/SIFMA Comment Letter.

<sup>41</sup> See, *e.g.*, IAA Comment Letter ("[W]e believe a cleaner approach would be to eliminate investment advisers from the entities specifically mentioned in the scope section."); NSCP Comment Letter ("We would urge the Commission to specifically exclude investment advisers from the scope of the rule since it is our view that any adviser that is a financial institution would already be covered by FCRA."). For further discussion, see *infra* notes 55–60 and 73–76 and accompanying text.

<sup>42</sup> See OCC Comment Letter ("[W]e encourage the Commissions to expressly exclude clearing organizations from the scope of the Proposed Rules because, as explained below, clearing organizations like OCC should not be considered 'creditors' for these purposes."). For further discussion, see *infra* note 75.

<sup>43</sup> See FSR/SIFMA Comment Letter ("Specifically, we ask that the SEC exclude ... those entities that are unlikely to be deemed financial institutions or creditors under the FCRA, such as NRSROs, SROs, municipal advisors, municipal securities dealers, and registered investment advisers.").

<sup>44</sup> See, *e.g.*, NSCP Comment Letter.

<sup>45</sup> See MarketCounsel Comment Letter.

because they do not hold transaction accounts for consumers.<sup>46</sup> The Dodd-Frank Act required the SEC to adopt identity theft red flags rules with respect to persons that are “subject to the jurisdiction of the Securities and Exchange Commission.”<sup>47</sup> Expressly excluding from certain requirements of the rules any entities that are registered with the SEC, are subject to the SEC’s enforcement authority, and are covered by the scope of the rules likely would not effectively implement the purposes of the Dodd-Frank Act and the FCRA, which are described in this release. In addition, we continue to believe that specifically listing in the scope section the entities that are likely to be subject to the rules — if they qualify as financial institutions or creditors — will provide useful guidance to those entities in determining their status under the rules. Therefore, we are adopting the scope section of the rules as proposed.

i. *Definition of Financial Institution*

As discussed above, the Commissions’ final red flags rules apply to “financial institutions” and “creditors.” As in the proposed rules, the Commissions are defining the term “financial institution” in the final rules by reference to the definition of the term in section 603(t) of the FCRA.<sup>48</sup> That section defines a financial institution to include certain banks and credit unions, and “any other person that, directly or indirectly, holds a transaction account (as defined in section 19(b) of the Federal Reserve Act) belonging to a consumer.”<sup>49</sup> Section 19(b) of the

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<sup>46</sup> See *supra* note 37 and accompanying text. For further discussion of the extent to which investment advisers, which are specifically listed in the rules’ scope section, may qualify as financial institutions or creditors, see *infra* notes 55–60 and 73–76 and accompanying text.

<sup>47</sup> 15 U.S.C. 1681s(b)(1)(G).

<sup>48</sup> 15 U.S.C. 1681a(t). See § 162.30(b)(7) (CFTC); § 248.201(b)(7) (SEC). The Agencies also defined “financial institution,” in their identity theft red flags rules, by reference to the FCRA. See, e.g., 16 CFR 681.1(b)(7) (FTC) (“Financial institution has the same meaning as in 15 U.S.C. 1681a(t).”).

<sup>49</sup> 15 U.S.C. 1681a(t). In full, the FCRA defines “financial institution” to mean “a State or National bank, a State or Federal savings and loan association, a mutual savings bank, a State or Federal

Federal Reserve Act defines “transaction account” to include an “account on which the ... account holder is permitted to make withdrawals by negotiable or transferable instrument, payment orders of withdrawal, telephone transfers, or other similar items for the purpose of making payments or transfers to third persons or others.”<sup>50</sup> Section 603(c) of the FCRA defines “consumer” as an individual;<sup>51</sup> thus, to qualify as a financial institution, an entity must hold a transaction account belonging to an individual. The following are illustrative examples of an SEC-regulated entity that could fall within the meaning of the term “financial institution” because it holds transaction accounts belonging to individuals: (i) a broker-dealer that offers custodial accounts; (ii) a registered investment company that enables investors to make wire transfers to other parties or that offers check-writing privileges; and (iii) an investment adviser that directly or indirectly holds transaction accounts and that is permitted to direct payments or transfers out of those accounts to third parties.<sup>52</sup>

A few commenters raised concerns about the SEC’s statements in the Proposing Release regarding the possibility that some investment advisers could be financial institutions under certain circumstances. These commenters argued that investment advisers generally do not “hold” transaction accounts, thus meaning that they would not be financial institutions under the

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credit union, or any other person that, directly or indirectly, holds a transaction account [as defined in section 19(b) of the Federal Reserve Act] belonging to a consumer.” *Id.*

<sup>50</sup> 12 U.S.C. 461(b)(1)(C). Section 19(b) further states that a transaction account “includes demand deposits, negotiable order of withdrawal accounts, savings deposits subject to automatic transfers, and share draft accounts.” *Id.*

<sup>51</sup> 15 U.S.C. 1681a(c).

<sup>52</sup> The CFTC’s definition specifies that financial institution “includes any futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, swap dealer, or major swap participant that directly or indirectly holds a transaction account belonging to a consumer.” *See* § 162.30(b)(7).

definition.<sup>53</sup> One commenter requested that we state that investment advisers who are authorized to withdraw assets from investors' accounts to pay bills, or otherwise direct payments to third parties, on behalf of investors do not "indirectly" hold such accounts and therefore are not financial institutions.<sup>54</sup>

The SEC has concluded otherwise. As described below, some investment advisers do hold transaction accounts, both directly and indirectly, and thus may qualify as financial institutions under the rules as we are adopting them. As discussed further in Section III of this release, SEC staff anticipates that the following examples of circumstances in which certain entities, particularly investment advisers, may qualify as financial institutions may lead some of these entities that had not previously complied with the Agencies' rules to now determine that they should comply with Regulation S-ID.<sup>55</sup>

Investment advisers who have the ability to direct transfers or payments from accounts belonging to individuals to third parties upon the individuals' instructions, or who act as agents on behalf of the individuals, are susceptible to the same types of risks of fraud as other financial institutions, and individuals who hold transaction accounts with these investment advisers bear the same types of risks of identity theft and loss of assets as consumers holding accounts with

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<sup>53</sup> See, e.g., IAA Comment Letter ("Investment advisers are not banks or credit unions and do not hold transaction accounts, such as custodial accounts or accounts with check-writing privileges. Instead, any cash or securities managed by investment advisers must be held in custody with financial institutions that are qualified custodians (broker-dealers or banks, primarily).").

<sup>54</sup> See MarketCounsel Comment Letter ("MarketCounsel requests additional clarification in the Proposed Rule to make it clear that an investment adviser will not be deemed to *indirectly* hold a transaction account simply because it has control over, or access to, the transaction account.").

<sup>55</sup> SEC staff understands, based on comment letters and communications with industry representatives, that a number of investment advisers may not currently have identity theft red flags Programs. See MarketCounsel Comment Letter; IAA Comment Letter. SEC staff also expects, based on Investment Adviser Registration Depository (IARD) data, that certain private fund advisers could potentially meet the definition of "financial institution" or "creditor." See *infra* note 190.



other financial institutions. If such an adviser does not have a program in place to verify investors' identities and detect identity theft red flags, another individual may deceive the adviser by posing as an investor. The red flags program of a bank or other qualified custodian<sup>56</sup> that maintains physical custody of an investor's assets would not adequately protect individuals holding transaction accounts with such advisers, because the adviser could give an order to withdraw assets, but at the direction of an impostor.<sup>57</sup> Investors who entrust their assets to registered investment advisers that directly or indirectly hold transaction accounts should receive the protections against identity theft provided by these rules.

For instance, even if an investor's assets are physically held with a qualified custodian, an adviser that has authority, by power of attorney or otherwise, to withdraw money from the investor's account and direct payments to third parties according to the investor's instructions would hold a transaction account. However, an adviser that has authority to withdraw money from an investor's account solely to deduct its own advisory fees would not hold a transaction account, because the adviser would not be making the payments to third parties.<sup>58</sup>

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<sup>56</sup> See 17 CFR § 275.206(4)-2(d)(6) (setting forth the entities that fall within the definition of "qualified custodian").

<sup>57</sup> See, e.g., Byron Acohido, *Cybercrooks fool financial advisers to steal from clients*, USA TODAY, Aug. 26, 2012, available at <http://usatoday30.usatoday.com/money/perfi/basics/story/2012-08-26/wire-transfer-fraud/57335540/1> (last visited March 4, 2013) ("In a new twist, cyber-robbers are using ginned-up e-mail messages in attempts to con financial advisers into wiring cash out of their clients' online investment accounts. If the adviser falls for it, a wire transfer gets legitimately executed, and cash flows into a bank account controlled by the thieves—leaving the victim in a dispute with the financial adviser over getting made whole.").

<sup>58</sup> See *supra* note 50 and accompanying text.

Registered investment advisers to private funds also may directly or indirectly hold transaction accounts.<sup>59</sup> If an individual invests money in a private fund, and the adviser to the fund has the authority, pursuant to an arrangement with the private fund or the individual, to direct such individual's investment proceeds (*e.g.*, redemptions, distributions, dividends, interest, or other proceeds related to the individual's account) to third parties, then that adviser would indirectly hold a transaction account. For example, a private fund adviser would hold a transaction account if it has the authority to direct an investor's redemption proceeds to other persons upon instructions received from the investor.<sup>60</sup>

ii. *Definition of Creditor*

The Commissions' final definitions of "creditor" refer to the definition of "creditor" in the FCRA as amended by the Clarification Act.<sup>61</sup> The FCRA now defines "creditor," for purposes of the red flags rules, as a creditor as defined in the Equal Credit Opportunity Act<sup>62</sup> ("ECOA") (*i.e.*, a person that regularly extends, renews or continues credit,<sup>63</sup> or makes those

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<sup>59</sup> A "private fund" is "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act, but for section 3(c)(1) or 3(c)(7) of that Act." 15 U.S.C. § 80b-2(a)(29).

<sup>60</sup> On the other hand, an investment adviser may not hold a transaction account if the adviser has a narrowly-drafted power of attorney with an investor under which the adviser has no authority to redirect the investor's investment proceeds to third parties or others upon instructions from the investor.

<sup>61</sup> See § 162.30(b)(5) (CFTC); § 248.201(b)(5) (SEC); *see also supra* note 31.

<sup>62</sup> Section 702(e) of the ECOA defines "creditor" to mean "any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of an original creditor who participates in the decision to extend, renew, or continue credit." 15 U.S.C. 1691a(e).

<sup>63</sup> The Commissions are defining "credit" by reference to its definition in the FCRA. See § 162.30(b)(4) (CFTC); § 248.201(b)(4) (SEC). That definition refers to the definition of credit in the ECOA, which means "the right granted by a creditor to a debtor to defer payment of debt or to incur debts and defer its payment or to purchase property or services and defer payment therefor." The Agencies defined "credit" in the same manner in their identity theft red flags rules. See, *e.g.*, 16 CFR 681.1(b)(4) (FTC) (defining "credit" as having the same meaning as in 15

arrangements) that “regularly and in the course of business ... advances funds to or on behalf of a person, based on an obligation of the person to repay the funds or repayable from specific property pledged by or on behalf of the person.”<sup>64</sup> The FCRA excludes from this definition a creditor that “advances funds on behalf of a person for expenses incidental to a service provided by the creditor to that person ....”<sup>65</sup>

The CFTC’s definition of “creditor” includes certain entities (such as FCMs and CTAs) that regularly extend, renew or continue credit or make those credit arrangements.<sup>66</sup> The proposed definition applies the definition of “creditor” from 15 U.S.C. 1681m(e)(4) to “any futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, swap dealer, or major swap participant that regularly extends, renews, or continues credit; regularly arranges for the extension, renewal, or continuation of credit; or in acting as an assignee of an original creditor, participates in the decision to extend, renew, or continue credit.”<sup>67</sup> One commenter stated that the proposed definition was overly broad and unclear because it did not appear to include derivative clearing

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U.S.C. 1681a(r)(5), which defines “credit” as having the same meaning as in section 702 of the ECOA).

<sup>64</sup> 15 U.S.C. 1681m(e)(4)(A)(iii). The FCRA defines a “creditor” also to include a creditor (as defined in the ECOA) that “regularly and in the ordinary course of business (i) obtains or uses consumer reports, directly or indirectly, in connection with a credit transaction; (ii) furnishes information to consumer reporting agencies ... in connection with a credit transaction ....” 15 U.S.C. 1681m(e)(4)(A)(i)–(ii).

<sup>65</sup> FCRA § 615(e)(4)(B), 15 U.S.C. 1681m(e)(4)(B). The Clarification Act does not define the extent to which the advancement of funds for expenses would be considered “incidental” to services rendered by the creditor. The legislative history indicates that the Clarification Act was intended to ensure that lawyers, doctors, and other small businesses that may advance funds to pay for services such as expert witnesses, or that may bill in arrears for services provided, should not be considered creditors under the red flags rules. *See* 156 Cong. Rec. S8288-9 (daily ed. Nov. 30, 2010) (statements of Senators Thune and Dodd).

<sup>66</sup> *See* § 162.30(b)(5).

<sup>67</sup> *See* § 162.30(b)(7).

organizations (“DCOs”) such as the Options Clearing Corporation, while the SEC’s definition could be read to include DCOs, and recommended that DCOs be explicitly excluded from the definition.<sup>68</sup> The commenter further requested that the Commissions specifically exclude DCOs from the scope of the Proposed Rules.

As the commenter noted, the CFTC’s definition of “creditor” excludes DCOs because DCOs are not included on the list of entities that may qualify as creditors under the rule. Under the proposed CFTC rules, a “creditor” includes any FCM, RFED, CTA, CPO, IB, SD, or MSP that regularly extends, renews, or continues credit or makes credit arrangements. Unlike DCOs, the listed entities which are included in the CFTC definition of “creditor” engage in retail customer business and maintain retail customer accounts. These entities are included as potential creditors in the definition because they are the CFTC registrants most likely to collect personal consumer data. Moreover, this list of potential creditors is consistent with the general scope provisions of the part 162 rules, which also apply to FCMs, RFEDs, CTAs, CPOs, IBs, SDs, or MSPs.<sup>69</sup> Accordingly, the CFTC declines to provide a specific exclusion for DCOs from the scope of the rule.

As proposed, the SEC’s definition of “creditor” referred to the definition of “creditor” under FCRA, and stated that it “includes lenders such as brokers or dealers offering margin accounts, securities lending services, and short selling services.”<sup>70</sup> The SEC proposed to name these entities in the definition because they are likely to qualify as “creditors,” since the funds advanced in these accounts do not appear to be for “expenses incidental to a service provided.”

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<sup>68</sup> OCC Comment Letter.

<sup>69</sup> See § 162.1(b).

<sup>70</sup> See proposed § 248.201(b)(5).

One commenter, the Options Clearing Corporation, argued that the proposed definition's reference to securities lending services could be read to mean that an intermediary in securities lending transactions is a "creditor" under the SEC's rules, even if the entity does not meet FCRA's definition of "creditor."<sup>71</sup> The SEC intended the proposed definition of "creditor" to be limited to the FCRA definition, and to include relevant examples of activities that could qualify an entity as a creditor. In order to clarify this definition and avoid an inadvertently broad meaning of the term "creditor," we are revising the definition to rely on FCRA's statutory definition of the term and omit the references to specific types of lending, such as margin accounts, securities lending services, and short selling services.<sup>72</sup>

Some commenters stated that most investment advisers would probably not qualify as creditors under the definition.<sup>73</sup> One commenter believed that the proposal might have implied that investment advisers were subject to a different standard than other entities under the definition of "creditor," and requested that we clarify that investment advisers may, like all other entities, take advantage of the exception in the definition to advance funds on behalf of a person for expenses incidental to a service provided by the creditor to that person.<sup>74</sup> Our final rules do not treat investment advisers differently than any other entity under the definition of "creditor."<sup>75</sup>

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<sup>71</sup> OCC Comment Letter.

<sup>72</sup> See § 248.201(b)(5).

<sup>73</sup> See, e.g., MarketCounsel Comment Letter; NSCP Comment Letter ("We agree with the proposal that investment advisers are not creditors for purposes of the proposal because advisers generally do not bill in arrears. We are not aware of any situation where an investment adviser would advance funds and we would note that such advisers would likely run afoul of state rules that prohibit an adviser from loaning funds or borrowing funds from a client.").

<sup>74</sup> MarketCounsel Comment Letter.

<sup>75</sup> The definition of "creditor" in FCRA also authorizes the Agencies and the Commissions to include other entities in the definition of "creditor" if the Commissions determine that those entities offer or maintain accounts that are subject to a reasonably foreseeable risk of identity theft. 15 U.S.C. 1681m(e)(4)(C). One commenter urged the Commissions not to exercise this

An investment adviser could potentially qualify as a creditor if it “advances funds” to an investor that are not for expenses incidental to services provided by that adviser. For example, a private fund adviser that regularly and in the ordinary course of business lends money, short-term or otherwise, to permit investors to make an investment in the fund, pending the receipt or clearance of an investor’s check or wire transfer, could qualify as a creditor.<sup>76</sup>

iii. *Definition of Covered Account and Other Terms*

Under the final rules, a financial institution or creditor must establish a red flags Program if it offers or maintains “covered accounts.” As in the proposed rules, the Commissions are defining the term “covered account” in the final rules as: (i) an account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions; and (ii) any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers<sup>77</sup> or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.<sup>78</sup> The CFTC’s definition includes a margin account as an example of a covered account.<sup>79</sup> The SEC’s definition includes, as examples of a covered account, a

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authority, and particularly not to include clearing organizations as creditors under the definition. See OCC Comment Letter (“We believe there is no reasonable basis for concluding that the securities loan clearing services offered by OCC as described above would pose a reasonably foreseeable risk of identity theft or that such services should cause OCC to be considered a ‘creditor.’”). The Commissions did not propose to specifically include clearing organizations in the definition of “creditor” under this authority, and the final rules do not include any additional types of entities in the definition of “creditor” that are not already included in the statutory definition.

<sup>76</sup> However, a private fund adviser would not qualify as a creditor solely because its private funds regularly borrow money from third-party credit facilities pending receipt of investor contributions, as the definition of “creditor” does not include “indirect” creditors.

brokerage account with a broker-dealer or an account maintained by a mutual fund (or its agent) that permits wire transfers or other payments to third parties.<sup>80</sup>

The Commissions are defining an “account” as a “continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes.”<sup>81</sup> The CFTC’s definition specifically includes an extension of credit, such as the purchase of property or services involving a deferred payment.<sup>82</sup> The SEC’s

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<sup>77</sup> To be a financial institution, an entity must hold a transaction account with at least one “consumer” (defined as an “individual” in 15 U.S.C. 1681a(c)). However, once an entity is a financial institution, it must periodically determine whether it offers or maintains “covered accounts” to or on behalf of its customers, which may be individuals or business entities. Sections 162.30(b)(6) (CFTC) and 248.201(b)(6) (SEC) define “customer” to mean a person that has a covered account with a financial institution or creditor. The Commissions are including this definition for two reasons. First, this definition is the same as the definition of “customer” in the Agencies’ final rules. Second, because the definition uses the term “person,” it covers various types of business entities (e.g., small businesses) that could be victims of identity theft. 15 U.S.C. 1681a(b). Although the definition of “customer” is broad, not every account held by or offered to a customer will be considered a covered account, as the identification of covered accounts under the identity theft red flags rules is based on a risk-based determination. *See infra* notes 95–100 and accompanying text.

<sup>78</sup> § 162.30(b)(3) (CFTC) and § 248.201(b)(3) (SEC). The Agencies’ 2007 Adopting Release (which included an identical definition of the term “account”) noted that “the definition of ‘account’ still applies to fiduciary, agency, custodial, brokerage and investment advisory activities.” 2007 Adopting Release *supra* note 8, at 63721.

<sup>79</sup> *See* § 162.30(b)(3)(i).

<sup>80</sup> *See* § 248.201(b)(3)(i).

<sup>81</sup> § 162.30(b)(1) (CFTC) and § 248.201(b)(1) (SEC). Two commenters requested further guidance on the meaning of “continuing relationship” in the proposed definition of the term “account.” Comment Letter of Nathaniel Washburn (April 12, 2012); Comment Letter of Chris Barnard (“Chris Barnard Comment Letter”) (Mar. 29, 2012). The SEC and the CFTC’s definition of “account” is the same as that adopted by the Agencies. The Agencies’ 2007 Adopting Release provides further guidance on the meaning of continuing relationship, noting that it is designed to exclude single, non-continuing transactions by non-customers. 2007 Adopting Release *supra* note 8, at 63721.

<sup>82</sup> § 162.30(b)(1).

definition includes, as examples of accounts, “a brokerage account, a mutual fund account (*i.e.*, an account with an open-end investment company), and an investment advisory account.”<sup>83</sup>

In the Proposing Release, the Commissions noted that “entities that adopt red flags Programs would focus their attention on ‘covered accounts’ for indicia of possible identity theft.”<sup>84</sup> In response to this statement, one commenter recommended revising the definition of “covered account” such that entities adopting red flags Programs would focus particularly on protecting various types of information provided by customers, rather than focusing on particular categories of accounts.<sup>85</sup> The Commissions have decided not to revise the definition of “covered account” as suggested by this commenter, because the Commissions believe that by focusing the rules on the types of accounts that might pose a reasonably foreseeable risk of identity theft, financial institutions and creditors are best able to protect the information that customers provide in the course of holding these accounts. Moreover, the current definition and scope of the term “covered account” are similar to the provisions of the other Agencies’ identity theft red flags rules.<sup>86</sup> As discussed below, the Commissions believe that the final rules’ terms should be defined as the Agencies defined them in their respective final rules, where appropriate, to foster consistent regulations.<sup>87</sup>

Two commenters argued that insurance company separate accounts are unlikely to be covered accounts because they are not established for personal, family, or household purposes

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<sup>83</sup> § 248.201(b)(1).

<sup>84</sup> 77 FR 13450, 13454.

<sup>85</sup> See Comment Letter of Kenneth Orgoglioso (May 7, 2012).

<sup>86</sup> See, e.g., 16 CFR 681.1(b)(3).

<sup>87</sup> See *infra* note 93 and accompanying text.



and do not pose a reasonably foreseeable risk of identity theft.<sup>88</sup> They contended that insurance company separate accounts are investment vehicles underlying variable life and annuity insurance products, and generally individual customers do not have a direct relationship with these accounts. One of the commenters requested that the definition of “covered account” specifically exclude insurance company separate accounts.<sup>89</sup> The commenter noted that because third parties and customers do not have direct access to insurance company separate accounts, there is little risk of identity theft in these accounts.<sup>90</sup>

The final rules require all financial institutions and creditors to assess whether they offer or maintain covered accounts. Although, as discussed above, some commenters suggested that insurance company separate accounts may not qualify as covered accounts under the definition, the final rule does not exclude insurance company separate accounts from the definition of “covered account” because it would be impracticable to provide an exhaustive list of account types that are not covered accounts. Similarly, one commenter requested that the SEC list all of the types of accounts that would be “covered accounts” under the rules.<sup>91</sup> The rules provide examples of covered accounts, but we cannot anticipate all of the types of accounts that could be covered accounts. Any list that attempts to encompass all types of covered accounts would likely be under-inclusive and would not take into account future business practices.<sup>92</sup> The

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<sup>88</sup> Comment Letter of the American Council of Life Insurers (May 7, 2012); FSR/SIFMA Comment Letter.

<sup>89</sup> FSR/SIFMA Comment Letter.

<sup>90</sup> *See id.* (“Further, third parties, including customers, do not have direct access to Separate Accounts, which means that the types of identity theft risks anticipated by the proposed Red Flags Rules are essentially nonexistent.”).

<sup>91</sup> *Id.*

<sup>92</sup> For example, an institution that holds only business accounts may decide later to offer accounts for personal, family, or household purposes that permit multiple payments. The rule’s requirement that a financial institution or creditor periodically determine whether it holds covered

definition of “covered account” is deliberately designed to be flexible to allow the financial institution or creditor to determine which accounts pose a reasonably foreseeable risk of identity theft and protect them accordingly. Therefore, we are adopting the definitions of “account” and “covered account” as they were proposed.

The identity theft red flags rules also define several other terms as the Agencies defined them in their final rules, where appropriate, to foster consistent regulations.<sup>93</sup> In addition, terms that the SEC’s rules do not define have the same meaning they have in FCRA.<sup>94</sup>

iv. *Determination of Whether a Covered Account is Offered or Maintained*

As under the proposed rules, under the final rules, each financial institution or creditor must periodically determine whether it offers or maintains covered accounts.<sup>95</sup> As a part of this periodic determination, a financial institution or creditor must conduct a risk assessment that

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accounts is designed to require that these entities re-evaluate whether they in fact hold any covered accounts. *See infra* notes 95 and 96 and accompanying text.

<sup>93</sup> See § 162.30(b)(4) (CFTC) and § 248.201(b)(4) (SEC) (definition of “credit”); § 162.30(b)(6) (CFTC) and § 248.201(b)(6) (SEC) (definition of “customer”); § 162.30(b)(7) (CFTC) and § 248.201(b)(7) (SEC) (definition of “financial institution”); § 162.30(b)(10) (CFTC) and § 248.201(b)(10) (SEC) (definition of “red flag”); § 162.30(b)(11) (CFTC) and § 248.201(b)(11) (SEC) (definition of “service provider”).

The Agencies defined “identity theft” in their identity theft red flags rules by referring to a definition previously adopted by the FTC. *See, e.g.*, 12 CFR 334.90(b)(8) (FDIC). The FTC defined “identity theft” as “a fraud committed or attempted using the identifying information of another person without authority.” *See* 16 CFR 603.2(a). The FTC also has defined “identifying information,” a term used in its definition of “identity theft.” *See* 16 CFR 603.2(b). The Commissions are defining the terms “identifying information” and “identity theft” by including the same definitions of the terms as they appear in 16 CFR 603.2. *See* § 162.30(b)(8) and (9) (CFTC); § 248.201(b)(8) and (9) (SEC). One commenter suggested that we add the following highlighted language to the definition of “identity theft” so that it would read a “fraud, deception, or other crime committed or attempted using the identifying information of another person without authority.” Chris Barnard Comment Letter. Changing the definition of “identity theft” so that it differs from the definition used by the Agencies could lead to higher compliance costs, reduce comparability of the Agencies’ rules in contravention of the statutory mandate, and pose difficulties for entities within the enforcement authority of multiple agencies. Accordingly, we are adopting the definition of “identity theft” as it was proposed.

<sup>94</sup> *See* § 248.201(b)(12)(vi) (SEC).

takes into consideration: (1) the methods it provides to open its accounts; (2) the methods it provides to access its accounts; and (3) its previous experiences with identity theft.<sup>96</sup> A financial institution or creditor should consider whether, for example, a reasonably foreseeable risk of identity theft may exist in connection with accounts it offers or maintains that may be opened or accessed remotely or through methods that do not require face-to-face contact, such as through email or the Internet, or by telephone. In addition, if financial institutions or creditors offer or maintain accounts that have been the target of identity theft, they should factor those experiences into their determination. The Commissions anticipate that entities will be able to demonstrate that they have complied with applicable requirements, including their recurring determinations regarding covered accounts.<sup>97</sup>

The Commissions acknowledge that some financial institutions or creditors regulated by the Commissions do not offer or maintain accounts for personal, family, or household purposes,<sup>98</sup> and engage predominantly in transactions with businesses, where the risk of identity theft is minimal. In these instances, the financial institution or creditor may determine after a preliminary risk assessment that the accounts it offers or maintains do not pose a reasonably foreseeable risk to customers or to its own safety and soundness from identity theft, and therefore it does not need to develop and implement a Program because it does not offer or maintain any

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<sup>95</sup> § 162.30(c) (CFRC) and § 248.201(c) (SEC).

<sup>96</sup> § 162.30(c) (CFRC) and § 248.201(c) (SEC).

<sup>97</sup> *See, e.g.*, FREQUENTLY ASKED QUESTIONS: IDENTITY THEFT RED FLAGS AND ADDRESS DISCREPANCIES at I.1, available at <http://www.ftc.gov/os/2009/06/090611redflagsfaq.pdf> (noting in joint interpretive guidance provided by the Agencies' staff that, while the Agencies' 2007 identity theft rules do not contain specific record retention requirements, financial institutions and creditors must be able to demonstrate that they have complied with the rules' requirements).

<sup>98</sup> *See* § 162.30(b)(3)(i) (CFRC) and § 248.201(b)(3)(i) (SEC).

“covered accounts.”<sup>99</sup> Alternatively, the financial institution or creditor may determine that only a limited range of its accounts present a reasonably foreseeable risk to customers, and therefore may decide to develop and implement a Program that applies only to those accounts or types of accounts.<sup>100</sup> As proposed, under the final rules, a financial institution or creditor that initially determines that it does not need to have a Program is required to periodically reassess whether it must develop and implement a Program in light of changes in the accounts that it offers or maintains and the various other factors set forth in sections 162.30(c) (CFTC) and 248.201(c) (SEC).

## 2. *The Objectives of the Program*

The final rules provide that each financial institution or creditor that offers or maintains one or more covered accounts must develop and implement a written Program designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account.<sup>101</sup> These provisions also require that each Program be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities. Thus, the final rules are designed to be scalable, by permitting Programs that take into account the operations of smaller institutions. We received no comment on the proposed objectives of the Program and are adopting them as proposed.

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<sup>99</sup> See § 162.30(b)(3)(ii) (CFTC) and § 248.201(b)(3)(ii) (SEC). For example, an FCM that is otherwise subject to the identity theft red flags rules and that handles accounts only for large, institutional investors might make a risk-based determination that because it is subject to a low risk of identity theft, it does not need to develop and implement a Program. Similarly, a money market fund that is otherwise subject to the identity theft red flags rules but that permits investments only by other institutions and separately verifies and authenticates transaction requests might make such a risk-based determination that it need not develop a Program.

<sup>100</sup> Even a Program limited in scale, however, needs to comply with all of the provisions of the rules. See, e.g., § 162.30(d)–(f) (CFTC) and § 248.201(d)–(f) (SEC) (program requirements).

<sup>101</sup> See § 162.30(d)(1) (CFTC) and § 248.201(d)(1) (SEC).

### 3. *The Elements of the Program*

The final rules set out the four elements that financial institutions and creditors must include in their Programs.<sup>102</sup> These elements are being adopted as proposed and are identical to the elements required under the Agencies' final identity theft red flags rules.<sup>103</sup>

First, the final rules require a financial institution or creditor to develop a Program that includes reasonable policies and procedures to identify relevant red flags<sup>104</sup> for the covered accounts that the financial institution or creditor offers or maintains, and incorporate those red flags into the Program.<sup>105</sup> Rather than singling out specific red flags as mandatory or requiring specific policies and procedures to identify possible red flags, this first element provides financial institutions and creditors with flexibility in determining which red flags are relevant to their businesses and the covered accounts they manage over time. The list of factors that a financial institution or creditor should consider (as well as examples) are included in Section II of the guidelines, which appear at the end of the final rules.<sup>106</sup> Given the changing nature of identity theft, the Commissions believe that this element allows financial institutions or creditors to respond and adapt to new forms of identity theft and the attendant risks as they arise.

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<sup>102</sup> See § 162.30(d)(2) (CFRC) and § 248.201(d)(2) (SEC).

<sup>103</sup> See 2007 Adopting Release, *supra* note 8, at 63726–63730.

<sup>104</sup> § 162.30(b)(10) (CFRC) and § 248.201(b)(10) (SEC) define “red flag” to mean a pattern, practice, or specific activity that indicates the possible existence of identity theft.

<sup>105</sup> See § 162.30(d)(2)(i) (CFRC) § 248.201(d)(2)(i) (SEC). The board of directors, appropriate committee thereof, or designated senior management employee may determine that a Program designed by a parent, subsidiary, or affiliated entity is also appropriate for use by the financial institution or creditor. In making such a determination, the board (or committee or designated employee) must conduct an independent review to ensure that the Program is suitable and complies with the requirements of the red flags rules. See 2007 Adopting Release, *supra* note 8, at 63730.

<sup>106</sup> See Section II.B.2 below.

Second, the final rules require financial institutions and creditors to have reasonable policies and procedures to detect the red flags that the Program incorporates.<sup>107</sup> This element does not provide a specific method of detection. Instead, section III of the guidelines provides examples of various means to detect red flags.<sup>108</sup>

Third, the final rules require financial institutions and creditors to have reasonable policies and procedures to respond appropriately to any red flags that they detect.<sup>109</sup> This element incorporates the requirement that a financial institution or creditor assess whether the red flags that are detected evidence a risk of identity theft and, if so, determine how to respond appropriately based on the degree of risk. Section IV of the guidelines sets out a list of aggravating factors and examples that a financial institution or creditor should consider in determining the appropriate response.<sup>110</sup>

Finally, the rules require financial institutions and creditors to have reasonable policies and procedures to periodically update the Program (including the red flags determined to be relevant), to reflect changes in risks to customers and to the safety and soundness of the financial institution or creditor from identity theft.<sup>111</sup> As discussed above, financial institutions and creditors are required to determine which red flags are relevant to their businesses and the covered accounts they offer or maintain. The Commissions are requiring a periodic update, rather than immediate or continuous updates, to be parallel with the identity theft red flags rules of the Agencies and to avoid unnecessary regulatory burdens. Section V of the guidelines

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<sup>107</sup> See § 162.30(d)(2)(ii) (CFTC) and § 248.201(d)(2)(ii) (SEC).

<sup>108</sup> See Section II.B.3 below.

<sup>109</sup> See § 162.30(d)(2)(iii) (CFTC) and § 248.201(d)(2)(iii) (SEC).

<sup>110</sup> See Section II.B.4 below.

<sup>111</sup> See § 162.30(d)(2)(iv) (CFTC) and § 248.201(d)(2)(iv) (SEC).

provides a set of factors that should cause a financial institution or creditor to update its Program.<sup>112</sup> We received no comment on the proposed elements of Programs and are adopting them as proposed.

#### 4. *Administration of the Program*

The final rules provide direction to financial institutions and creditors regarding the administration of Programs as a means of enhancing the effectiveness of those Programs.<sup>113</sup> First, the final rules require that a financial institution or creditor obtain approval of the initial written Program from either its board of directors, an appropriate committee of the board of directors, or if the entity does not have a board, from a designated senior management employee.<sup>114</sup> This requirement highlights the responsibility of the board of directors in approving a Program. One commenter asked us to clarify that an entity that already has an existing Program in place, in compliance with the other Agencies' rules, need not have the board reapprove the Program to comply with this requirement.<sup>115</sup> We agree that if a financial institution or creditor already has a Program in place, the board is not required to reapprove the existing Program in response to this requirement, provided the Program otherwise meets the requirements of the final rules.

Second, the final rules provide that financial institutions and creditors must involve the board of directors, an appropriate committee thereof, or a designated senior management

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<sup>112</sup> See Section II.B.5 below.

<sup>113</sup> See § 162.30(e) (CFTC) and § 248.201(e) (SEC).

<sup>114</sup> See § 162.30(e)(1) (CFTC) and § 248.201(e)(1) (SEC), *see also* § 162.30(b)(2) (CFTC) and § 248.201(b)(2) (SEC).

<sup>115</sup> ICI Comment Letter.

employee in the oversight, development, implementation, and administration of the Program.<sup>116</sup>

The designated senior management employee who is responsible for the oversight of a broker-dealer's, investment company's or investment adviser's Program may be the entity's chief compliance officer.<sup>117</sup> Third, the final rules provide that financial institutions and creditors must train staff, as necessary, to effectively implement their Programs.<sup>118</sup>

Finally, the rules provide that financial institutions and creditors must exercise appropriate and effective oversight of service provider arrangements.<sup>119</sup> The Commissions believe that it is important that the rules address service provider arrangements so that financial institutions and creditors remain legally responsible for compliance with the rules, irrespective of whether such financial institutions and creditors outsource their identity theft red flags detection, prevention, and mitigation operations to a service provider.<sup>120</sup> The final rules do not prescribe a specific manner in which appropriate and effective oversight of service provider arrangements must occur. Instead, the requirement provides flexibility to financial institutions and creditors in maintaining their service provider arrangements, while making clear that such institutions and

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<sup>116</sup> See § 162.30(e)(2) (CFTC) and § 248.201(e)(2) (SEC). Section VI of the guidelines elaborates on this provision.

<sup>117</sup> See, e.g., rule 38a-1(a)(4) under the Investment Company Act (addressing the chief compliance officer position), 17 CFR 270.38a-1(a)(4); rule 206(4)-7(c) under the Investment Advisers Act, 17 CFR 275.206(4)-7 (same).

<sup>118</sup> See § 162.30(e)(3) (CFTC) and § 248.201(e)(3) (SEC).

<sup>119</sup> See § 162.30(e)(4) (CFTC) and § 248.201(e)(4) (SEC). § 162.30(b)(11) (CFTC) and § 248.201(b)(11) (SEC) define the term "service provider" to mean a person that provides a service directly to the financial institution or creditor.

<sup>120</sup> For example, a financial institution or creditor that uses a service provider to open accounts on its behalf, could reserve for itself the responsibility to verify the identity of a person opening a new account, may direct the service provider to do so, or may use another service provider to verify identity. Ultimately, however, the financial institution or creditor remains responsible for ensuring that the activity is conducted in compliance with a Program that meets the requirements of the identity theft red flags rules.



creditors are still required to fulfill their legal compliance obligations.<sup>121</sup> We received no comments on the substance of this aspect of the proposal<sup>122</sup> and are adopting the requirements related to the administration of Programs as proposed.

## **B. Final Guidelines**

As amended by the Dodd-Frank Act, section 615(e)(1)(A) of the FCRA provides that the Commissions must jointly “establish and maintain guidelines for use by each financial institution and each creditor regarding identity theft with respect to account holders at, or customers of, such entities, and update such guidelines as often as necessary.”<sup>123</sup> Accordingly, the Commissions are jointly adopting guidelines in an appendix to the final identity theft red flags rules that are intended to assist financial institutions and creditors in the formulation and maintenance of a Program that satisfies the requirements of the rules. These guidelines are substantially similar to the guidelines adopted by the Agencies.

The final rules require each financial institution or creditor that is required to implement a Program to consider the guidelines and include in its Program those guidelines that are appropriate.<sup>124</sup> The Program needs to contain reasonable policies and procedures to fulfill the requirements of the final rules, even if a financial institution or creditor determines that one or

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<sup>121</sup> These legal compliance obligations include, but are not limited to, the maintenance of records in connection with any service provider arrangements. *See* 17 CFR 240.17a-4(b)(7) (requiring that each broker-dealer maintain a record of all written agreements entered into by the broker-dealer relating to its business as such); 17 CFR 275.204-2(a)(10) (requiring that each investment adviser maintain a record of all written agreements entered into by the investment adviser with any client or otherwise relating to the business of the investment adviser as such).

<sup>122</sup> *But see infra* note 143 and accompanying text (discussing a comment received on the costs associated with this aspect of the proposal).

<sup>123</sup> 15 U.S.C. 1681m(e)(1)(A).

<sup>124</sup> *See* § 162.30(f) (CFTC) and § 248.201(f) (SEC).

more guidelines are not appropriate for its circumstances. We received no comment on the guidelines, and the Commissions are adopting them as proposed.

*1. Section I of the Guidelines—Identity Theft Prevention Program*

Section I of the guidelines makes clear that a financial institution or creditor may incorporate into its Program, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or creditor from identity theft. An example of such existing policies, procedures, and other arrangements may include other policies, procedures, and arrangements that the financial institution or creditor has developed to prevent fraud or otherwise ensure compliance with applicable laws and regulations.

*2. Section II of the Guidelines—Identifying Relevant Red Flags*

Section II(a) of the guidelines sets out several risk factors that a financial institution or creditor must consider in identifying relevant red flags for covered accounts, as appropriate. These risk factors are: (i) the types of covered accounts a financial institution or creditor offers or maintains; (ii) the methods it provides to open or access its covered accounts; and (iii) its previous experiences with identity theft. Thus, for example, red flags relevant to one type of covered account may differ from those relevant to another type of covered account. Under the guidelines, a financial institution or creditor also should consider identifying as relevant those red flags that directly relate to its previous experiences with identity theft.

Section II(b) of the guidelines sets out examples of sources from which financial institutions and creditors should derive relevant red flags. As discussed in the Proposing Release, this section of the guidelines does not require financial institutions and creditors to incorporate relevant red flags strictly from these sources. Instead, financial institutions and creditors must consider them when developing a Program.

Section II(c) of the guidelines identifies five categories of red flags that financial institutions and creditors must consider including in their Programs, as appropriate:

- Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services;
- Presentation of suspicious documents, such as documents that appear to have been altered or forged;
- Presentation of suspicious personal identifying information, such as a suspicious address change;
- Unusual use of, or other suspicious activity related to, a covered account; and
- Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor.

Supplement A to the guidelines includes a non-comprehensive list of examples of red flags from each of these categories.

### 3. *Section III of the Guidelines—Detecting Red Flags*

Section III of the guidelines provides examples of policies and procedures that a financial institution or creditor must consider including in its Program's policies and procedures for the purpose of detecting red flags. As discussed in the Proposing Release, entities that are currently subject to the Agencies' identity theft red flags rules,<sup>125</sup> the federal customer identification program ("CIP") rules<sup>126</sup> or other Bank Secrecy Act rules,<sup>127</sup> the Federal Financial Institutions

<sup>125</sup> See 2007 Adopting Release, *supra* note 8.

<sup>126</sup> See, e.g., 31 CFR 1023.220 (broker-dealers), 1024.220 (mutual funds), and 1026.220 (futures commission merchants and introducing brokers). The CIP regulations implement section 326 of the USA PATRIOT Act, codified at 31 U.S.C. 5318(I).

Examination Council's guidance on authentication,<sup>128</sup> or the Interagency Guidelines Establishing Information Security Standards<sup>129</sup> may already be engaged in detecting red flags. These entities may wish to integrate the policies and procedures already developed for purposes of complying with these rules and standards into their Programs. However, such policies and procedures may need to be supplemented.<sup>130</sup>

4. *Section IV of the Guidelines—Preventing and Mitigating Identity Theft*

Section IV of the guidelines states that a Program's policies and procedures should provide for appropriate responses to the red flags that a financial institution or creditor has detected, that are commensurate with the degree of risk posed by each red flag. In determining an appropriate response, under the guidelines, a financial institution or creditor is required to consider aggravating factors that may heighten the risk of identity theft. Section IV of the guidelines also provides several examples of appropriate responses. These examples are identical to those included in the Agencies' final guidelines. Financial institutions and creditors also may consider adopting measures to prevent and mitigate identity theft that are not listed in the guidelines.

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<sup>127</sup> See, e.g., 31 CFR 103.130 (anti-money laundering programs for mutual funds).

<sup>128</sup> See "Authentication in an Internet Banking Environment," available at [http://www.ffiec.gov/pdf/authentication\\_guidance.pdf](http://www.ffiec.gov/pdf/authentication_guidance.pdf).

<sup>129</sup> See 12 CFR part 30, app. B (national banks); 12 CFR part 208, app. D-2 and part 225, app. F (state member banks and bank holding companies); 12 CFR part 364, app. B (state non-member banks); 12 CFR part 570, app. B (savings associations); 12 CFR part 748, app. A (credit unions).

<sup>130</sup> For example, the CIP rules were written to implement section 326 (31 U.S.C. 5318(*l*)) of the USA PATRIOT Act (Pub. L. 107-56 (2001)), and certain types of "accounts," "customers," and products are exempted or treated specially in the CIP rules because they pose a lower risk of money laundering or terrorist financing. Such special treatment may not be appropriate to accomplish the broader objective of detecting, preventing, and mitigating identity theft.

5. *Section V of the Guidelines—Updating the Identity Theft Prevention Program*

Section V of the guidelines includes a list of factors on which a financial institution or creditor could base the periodic updates to its Program. These factors are: (i) the experiences of the financial institution or creditor with identity theft; (ii) changes in methods of identity theft; (iii) changes in methods to detect, prevent, and mitigate identity theft; (iv) changes in the types of accounts that the financial institution or creditor offers or maintains; and (v) changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

6. *Section VI of the Guidelines—Methods for Administering the Identity Theft Prevention Program*

Section VI of the guidelines provides additional guidance for financial institutions and creditors to consider in administering their Programs. These guideline provisions are substantially identical to those prescribed by the Agencies in their final guidelines.

i. *Oversight of Identity Theft Prevention Program*

Section VI(a) of the guidelines states that oversight by the board of directors, an appropriate committee of the board, or a designated senior management employee should include: (i) assigning specific responsibility for the Program's implementation; (ii) reviewing reports prepared by staff regarding compliance by the financial institution or creditor with the final rules; and (iii) approving material changes to the Program as necessary to address changing identity theft risks.

ii. *Reporting to the Board of Directors*

Section VI(b) of the guidelines states that staff of the financial institution or creditor responsible for development, implementation, and administration of its Program should report to

the board of directors, an appropriate committee of the board, or a designated senior management employee, at least annually, on compliance by the financial institution or creditor with the final rules. In addition, section VI(b) of the guidelines provides that the report should address material matters related to the Program and evaluate issues such as recommendations for material changes to the Program.<sup>131</sup>

iii. *Oversight of Service Provider Arrangements*

Section VI(c) of the guidelines provides that whenever a financial institution or creditor engages a service provider to perform an activity in connection with one or more covered accounts, the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft. As discussed in the Proposing Release, the Commissions believe that these guidelines make clear that a service provider that provides services to multiple financial institutions and creditors may do so in accordance with its own program to prevent identity theft, as long as the service provider's program meets the requirements of the identity theft red flags rules.

Section VI(c) of the guidelines also includes, as an example of how a financial institution or creditor may comply with this provision, that a financial institution or creditor could require the service provider by contract to have policies and procedures to detect relevant red flags that may arise in the performance of the service provider's activities, and either report the red flags to the financial institution or creditor, or to take appropriate steps to prevent or mitigate identity

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<sup>131</sup> The other issues referenced in the guideline are: (i) the effectiveness of the policies and procedures of the financial institution or creditor in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts; (ii) service provider arrangements; and (iii) significant incidents involving identity theft and management's response.

theft. In those circumstances, the Commissions expect that the contractual arrangements would include the provision of sufficient documentation by the service provider to the financial institution or creditor to enable it to assess compliance with the identity theft red flags rules.

7. *Section VII of the Guidelines—Other Applicable Legal Requirements*

Section VII of the guidelines identifies other applicable legal requirements from the FCRA and USA PATRIOT Act that financial institutions and creditors should keep in mind when developing, implementing, and administering their Programs.

8. *Supplement A to the Guidelines*

Supplement A to the guidelines provides illustrative examples of red flags that financial institutions and creditors are required to consider incorporating into their Programs, as appropriate. These examples are substantially similar to the examples identified in the Agencies' final guidelines. The examples are organized under the five categories of red flags that are set forth in section II(c) of the guidelines.

The Commissions recognize that some of the examples of red flags may be more reliable indicators of identity theft, while others are more reliable when detected in combination with other red flags. The Commissions intend that Supplement A to the guidelines be flexible and allow a financial institution or creditor to tailor the red flags it chooses for its Program to its own operations. Although the final rules do not require a financial institution or creditor to justify to the Commissions failure to include in its Program a specific red flag from the list of examples, a financial institution or creditor has to account for the overall effectiveness of its Program, and ensure that the Program is appropriate to the entity's size and complexity, and to the nature and scope of its activities.

### C. Final Card Issuer Rules

Section 615(e)(1)(C) of the FCRA provides that the CFTC and SEC must “prescribe regulations applicable to card issuers to ensure that, if a card issuer receives notification of a change of address for an existing account, and within a short period of time (during at least the first 30 days after such notification is received) receives a request for an additional or replacement card for the same account, the card issuer may not issue the additional or replacement card, unless the card issuer applies certain address validation procedures.”<sup>132</sup>

Accordingly, the Commissions are adopting rules that set out the duties of card issuers regarding changes of address.<sup>133</sup> These rules are similar to the final card issuer rules adopted by the Agencies.<sup>134</sup> The rules apply only to a person that issues a debit or credit card (“card issuer”) and that is subject to the enforcement authority of either Commission.<sup>135</sup> The Commissions did not receive any comments on the card issuer rules, and are adopting them as proposed.

As discussed in the Proposing Release, the CFTC is not aware of any entities subject to its enforcement authority that issue debit or credit cards and, as a matter of practice, believes that it is highly unlikely that CFTC-regulated entities would issue debit or credit cards. As also discussed in the Proposing Release, the SEC understands that a number of entities within its enforcement authority issue cards in partnership with affiliated or unaffiliated banks and financial institutions, but that these cards are generally issued by the partner bank, and not by the SEC-regulated entity. The SEC therefore expects that no entities within its enforcement authority will be subject to the card issuer rules.

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<sup>132</sup> 15 U.S.C. 1681m(e)(1)(C).

<sup>133</sup> See § 162.32 (CFTC) and § 248.202 (SEC).

<sup>134</sup> See, e.g., 16 CFR 681.3 (FTC).

<sup>135</sup> See *supra* Section II.A.1.



### III. RELATED MATTERS

#### A. Cost-Benefit Considerations (CFTC) and Economic Analysis (SEC)

##### CFTC:

Section 15(a) of the CEA<sup>136</sup> requires the CFTC to consider the costs and benefits of its actions before promulgating a regulation under the CEA or issuing certain orders. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of the following five broad areas of market and public concern: (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The CFTC considers the costs and benefits resulting from its discretionary determinations with respect to the section 15(a) considerations.<sup>137</sup> In the paragraphs that follow, the CFTC summarizes the proposal and comments to the same before considering the costs and benefits of the final rule in light of the 15(a) considerations.

##### Cost-Benefit Considerations of Identity Theft Red Flags Rules

*Background and Proposal.* As discussed above, section 1088 of the Dodd-Frank Act transferred authority over certain parts of FCRA from the Agencies to the CFTC and the SEC for entities they regulate. On February 28, 2012, the CFTC, together with the SEC, issued proposed rules to help protect investors from identity theft by ensuring that FCMs, IBs, CPOs, and other CFTC-regulated entities create programs to detect and respond appropriately to red flags.<sup>138</sup> The proposed rules, which were substantially similar to rules adopted in 2007 by the FTC and other

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<sup>136</sup> 7 U.S.C. 19(a).

<sup>137</sup> *Id.*

<sup>138</sup> 77 FR 13450 (Mar. 6, 2012).

federal financial regulatory agencies, would require CFTC-regulated entities to adopt written identity theft programs that include reasonable policies and procedures to: (1) identify relevant red flags; (2) detect the occurrence of red flags; (3) respond appropriately to the detected red flags; and (4) periodically update their programs. The proposed rules also included guidelines and examples of red flags to help regulated entities administer their programs.

In its proposed consideration of costs and benefits pursuant to CEA section 15(a), the CFTC stated that section 162.30 should not result in any significant new costs or benefits because it generally reflects a statutory transfer of enforcement authority from the FTC to the CFTC. The CFTC requested comment on all aspects of its proposed consideration of costs and benefits.

*Comments.* The CFTC received two comments on its consideration of the costs and benefits of the joint proposal. These two commenters were divided on the reasonableness of the Commissions' estimated costs of compliance. In a letter focused on the SEC's proposed regulations (which are, of course, substantially similar to the CFTC's proposed regulations), one commenter stated that because Regulation S-ID "is substantially similar to" the existing FTC rules and guidelines, broker-dealers should not bear "any new costs in coming into compliance with proposed Regulation S-ID."<sup>139</sup> This commenter further stated that "broker-dealers should already have in place a program that complies with the FTC rule. While firms will need to update some of their procedures to reflect the SEC's new responsibility for the oversight of the application of this rule, many of the changes would be cosmetic and grammatical in nature."<sup>140</sup> In marked contrast, another comment letter, submitted on behalf of the Financial Services

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<sup>139</sup> See NSCP Comment Letter.

<sup>140</sup> *Id.*

Roundtable (“FSR”) and the Securities Industry and Financial Markets Association (“SIFMA”), stated that the “consensus of our members is that the estimated compliance costs for the proposed Rules are extremely low and unrealistic.”<sup>141</sup>

The FSR/SIFMA Comment Letter also stated that the FSR and SIFMA members estimated that the initial compliance burden to implement the rules would average 2,000 hours for each line of business conducted by a “large, complex financial institution,” noting that the estimate would vary based on the number of “covered accounts” for each line of business. In addition, this comment letter also stated that continuing compliance monitoring for such an institution would average 400 hours annually. They did not provide any data or information from which the CFTC could replicate its estimates.

The FSR/SIFMA Comment Letter also stated that “financial institutions with an existing Red Flags program would experience an incremental burden due to reassessing the scope of the ‘covered accounts’ and reevaluating whether a business activity would be defined as a ‘financial institution’ or as a ‘creditor’ for purposes of the Agencies’ Rules.”<sup>142</sup> The letter did not attribute a time estimate to this “incremental burden.”

Finally, the FSR/SIFMA Comment Letter contended that the Commissions’ “estimated compliance costs further fail to consider the cost to third-party service providers, many of which may be required to implement an identity theft program even though they are not financial institutions or creditors.”<sup>143</sup>

*CFTC Response to Comments Regarding Costs and Benefits.* In considering the costs

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<sup>141</sup> See FSR/SIFMA Comment Letter.

<sup>142</sup> *Id.*

<sup>143</sup> *Id.*

and benefits of the final rules, the CFTC assumes that each CFTC-regulated entity covered by the final rules is already in existence and acting in compliance with the law, including the FTC's identity theft rules.<sup>144</sup> Under this assumption, the CFTC believes, as one of the commenters did,<sup>145</sup> that entities will incur few if any new costs in complying with the CFTC's regulations because they are largely unchanged in terms of scope and substance from the FTC's rules. The CFTC believes that the costs of compliance for such entities may actually decrease as a result of the additional guidance provided in this rulemaking. Without such guidance from the CFTC, entities might incur the costs of seeking advice from third parties. With respect to the comment that CFTC-regulated entities will experience an "incremental burden" in reassessing covered accounts and determining whether their activities fall within the scope of the rules,<sup>146</sup> the CFTC notes that the FTC's identity theft rules also include the requirement to periodically reassess covered accounts, and thus costs associated with this requirement are not new costs.

With regard to the estimate in the FSR/SIFMA Comment Letter that a "large, complex financial institution" will incur 2,000 hours of "initial compliance burden,"<sup>147</sup> the CFTC is unaware of any such institution that is not already acting in compliance with the FCRA and the FTC's rules. But even if such a large, complex financial institution exists and is not already in compliance with FCRA and the FTC's rules, the "initial burden" that such an entity would incur is largely attributable to the FCRA, as amended by the Dodd-Frank Act. As discussed above,

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<sup>144</sup> As discussed above, the final rules implement a shift in oversight of identity theft red flags rules for CFTC-regulated entities from the FTC to the CFTC. The rules do not contain new requirements, nor do they substantially expand the scope of the FTC's rules. Most entities should already be in compliance with the FTC's existing rules, which the FTC began enforcing on January 1, 2011.

<sup>145</sup> See NSCP Comment Letter.

<sup>146</sup> See *supra* note 142 and accompanying text.

<sup>147</sup> See FSR/SIFMA Comment Letter.

Congress mandated that the CFTC promulgate rules to bring its regulated entities into compliance with FCRA, and the CFTC has elected to do so in a manner that imposes minimal incremental cost on CFTC-regulated entities. In response to the comments concerning the costs to “third-party service providers,” the CFTC stresses these costs have already been taken into account, as CFTC-regulated entities that have outsourced identity theft detection, prevention, and mitigation operations to affiliates or third-party service providers have effectively shifted a burden that the CFTC-regulated entities otherwise would have carried themselves.

One commenter also stated that since it maintains no covered accounts and has no plans to, it should be specifically excluded from the scope of the rules to avoid any potential that it would be subject to the requirements of the final rules. According to this commenter, to include it within the scope of the final rules would require it needlessly to incur compliance costs associated with periodically reassessing whether they maintain any covered accounts and documenting the same.<sup>148</sup>

The majority of the per-entity costs associated with the final rules would be incurred by those financial institutions and creditors that maintain covered accounts.<sup>149</sup> Additionally, even if financial institutions and creditors do not currently maintain, or intend to maintain, covered accounts, such entities must nevertheless periodically assess whether they maintain covered accounts, as certain accounts may be deemed to be “covered accounts” if reasonably foreseeable identity theft risks are associated with these accounts.<sup>150</sup> Moreover, the CFTC reiterates that the final rules do not contain any new requirements or significantly expand the scope of the

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<sup>148</sup> See OCC Comment Letter.

<sup>149</sup> See *infra* notes 151 and 152.

<sup>150</sup> See *supra* notes 95–100 and accompanying text.

pre-existing FTC rules. Therefore, no financial institutions or creditors, regardless of whether they maintain covered accounts, should incur any additional costs other than the costs already being incurred under the previous regulatory framework.

*Consideration of Costs and Benefits in Light of CEA Section 15(a).* As discussed above, the Dodd-Frank Act shifted enforcement authority over CFTC-regulated entities that are subject to section 615(e) of the FCRA from the FTC to the CFTC. Section 615(e) of the FCRA, as amended by the Dodd-Frank Act, requires that the CFTC, jointly with the Agencies and the SEC, adopt identity theft red flags rules. To carry out this requirement, the CFTC is adopting section 162.30, which is substantially similar to the identity theft red flags rules adopted by the Agencies in 2007.

Section 162.30 will shift oversight of identity theft rules of CFTC-regulated entities from the FTC to the CFTC. These entities should already be in compliance with the FTC's existing identity theft red flags rules, which the FTC began enforcing on January 1, 2011. Because section 162.30 is substantially similar to those existing rules, these entities should not bear any significant costs in coming into compliance with section 162.30. The new regulation does not contain new requirements, nor does it expand the scope of the rules significantly. The new regulation does contain examples and minor language changes designed to help guide entities within the CFTC's enforcement authority in complying with the rules, which the CFTC expects will mitigate costs of compliance. Moreover, section 162.30 would not impose any significant new costs on new entities since any newly-formed entities would already be covered under the FTC's existing rules.

In the analysis for the Paperwork Reduction Act of 1995 ("PRA") below, the staff identified certain initial and ongoing hour burdens and associated time costs related to

compliance with section 162.30. However, these costs are not new costs, but are current costs associated with compliance with the Agencies' existing rules. CFTC-regulated entities will incur these hours and costs regardless of whether the CFTC adopts section 162.30. These hours and costs would be transferred from the Agencies' PRA allotment to the CFTC. No new costs should result from the adoption of section 162.30.

These existing costs related to section 162.30 would include, for newly-formed CFTC-regulated entities, the one-time cost for financial institutions and creditors to conduct initial assessments of covered accounts, create a Program, obtain board approval of the Program, and train staff.<sup>151</sup> The existing costs would also include the ongoing cost to periodically review and update the Program, report periodically on the Program, and conduct periodic assessments of

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<sup>151</sup> CFTC staff estimates that the one-time burden of compliance would include 2 hours to conduct initial assessments of covered accounts, 25 hours to develop and obtain board approval of a Program, and 4 hours to train staff. CFTC staff estimates that, of the 31 hours incurred, 12 hours would be spent by internal counsel at an hourly rate of \$354, 17 hours would be spent by administrative assistants at an hourly rate of \$66, and 2 hours would be spent by the board of directors as a whole, at an hourly rate of \$4000, for a total cost of \$13,370 per entity for entities that need to come into compliance with proposed subpart C to Part 162. This estimate is based on the following calculations:  $\$354 \times 12 \text{ hours} = \$4,248$ ;  $\$66 \times 17 = \$1,122$ ;  $\$4,000 \times 2 = \$8,000$ ;  $\$4,248 + \$1,122 + \$8,000 = \$13,370$ .

As discussed in the PRA analysis, CFTC staff estimates that there are 702 CFTC-regulated entities that newly form each year and that would fall within the definitions of "financial institution" or "creditor." Of these 702 entities, 54 entities would maintain covered accounts. *See infra* note 168 and text following note 168. CFTC staff estimates that 2 hours of internal counsel's time would be spent conducting an initial assessment to determine whether they have covered accounts and whether they are subject to the proposed rule (or 702 entities). The cost associated with this determination is \$497,016 based on the following calculation:  $\$354 \times 2 = \$708$ ;  $\$708 \times 702 = \$497,016$ . CFTC staff estimates that 54 entities would bear the remaining specified costs for a total cost of \$683,748 ( $54 \times \$12,662 = \$683,748$ ). *See* SIFMA's Office Salaries in the Securities Industry 2011.

Staff also estimates that in response to Dodd-Frank, there will be approximately 125 newly registered SDs and MSPs. Staff believes that each of these SDs and MSPs will be a financial institution or creditor with covered accounts. The additional cost of these SDs and MSPs is \$1,671,250 ( $125 \times \$13,370 = \$1,671,250$ ).

covered accounts.<sup>152</sup>

The benefits related to adoption of section 162.30, which already exist in connection with the Agencies' identity theft red flags rules, would include a reduction in the risk of identity theft for investors (consumers) and cardholders, and a reduction in the risk of losses due to fraud for financial institutions and creditors. It is not practicable for the CFTC to estimate with precision the dollar value associated with the benefits that will inure to the public from the adoption of section 162.30, as the quantity or value of identity theft deterred or prevented is not knowable. The CFTC, however, recognizes that the cost of any given instance of identity theft may be substantial to the individual involved. Joint adoption of identity theft red flags rules in a form that is substantially similar to the Agencies' identity theft red flags rules might also benefit financial institutions and creditors because entities regulated by multiple federal agencies could comply with a single set of standards, which would reduce potential compliance costs. As is true of the Agencies' identity theft red flags rules, the CFTC has designed section 162.30 to provide financial institutions and creditors significant flexibility in developing and maintaining a Program that is tailored to the size and complexity of their business and the nature of their

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<sup>152</sup> CFTC staff estimates that the ongoing burden of compliance would include 2 hours to conduct periodic assessments of covered accounts, 2 hours to periodically review and update the Program, and 4 hours to prepare and present an annual report to the board, for a total of 8 hours. CFTC staff estimates that, of the 8 hours incurred, 7 hours would be spent by internal counsel at an hourly rate of \$354 and 1 hour would be spent by the board of directors as a whole, at an hourly rate of \$4,000, for a total hourly cost of \$6,500. This estimate is based on the following calculations rounded to two significant digits:  $\$354 \times 7 \text{ hours} = \$2,478$ ;  $\$4,000 \times 1 \text{ hour} = \$4,000$ ;  $\$2,478 + \$4,000 = \$6,478 \approx \$6,500$ .

As discussed in the PRA analysis, CFTC staff estimates that 2,946 existing CFTC-regulated entities would be financial institutions or creditors, of which 260 maintain covered accounts. CFTC staff estimates that 2 hours of internal counsel's time would be spent conducting periodic assessments of covered accounts and that all financial institutions or creditors subject to the proposed rule (or 2,946 entities) would bear this cost for a total cost of \$2,100,000 based on the following calculations rounded to two significant digits:  $\$354 \times 2 = \$708$ ;  $\$708 \times 2,946 = \$2,085,768 \approx \$2,100,000$ . CFTC staff estimates that 260 entities would bear the remaining specified ongoing costs for a total cost of \$1,500,000 ( $260 \times \$5,770 = \$1,500,200 \approx \$1,500,000$ ).



operations, as well as in satisfying the address verification procedures.

Accordingly, as previously discussed, section 162.30 should not result in any significant new costs or benefits, because it generally reflects a statutory transfer of enforcement authority from the FTC to the CFTC, does not include any significant new requirements, and does not include new entities that were not previously covered by the Agencies' rules.

*Section 15(a) Analysis.* As stated above, the CFTC is required to consider costs and benefits of proposed CFTC action in light of (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. These rules protect market participants and the public by detecting, preventing, and mitigating identity theft, an illegal act that may be costly to them in both time and money.<sup>153</sup> Because, however, these rules create no new requirements — rather, as explained above, the CFTC is adopting rules that reflect requirements already in place — the impact of the rules on the protection of market participants and the public will remain the same. The Commission is not aware of any effect of these rules on the efficiency, competitiveness, and financial integrity of futures markets, price discovery, sound risk management practices, or other public interest considerations. Customers of CFTC registrants will continue to benefit from these rules in the same way they have benefited from the rules as they were administered by the Agencies.

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According to the Javelin 2011 Identity Fraud Survey Report, consumer costs (the average out-of-pocket dollar amount victims pay) increased in 2010. See *Javelin 2011 Identity Fraud Survey Report* (2011). The report attributed this increase to new account fraud, which showed longer periods of misuse and detection and therefore more dollar losses associated with it than any other type of fraud. Notwithstanding the increase in cost, the report stated that the number of identity theft victims has decreased in recent years. *Id.*

### Cost-Benefit Considerations of Card Issuer Rules

With respect to specific types of identity theft, section 615(e) of the FCRA identified the scenario involving credit and debit card issuers as being a possible indicator of identity theft. Accordingly, the card issuer rules in section 162.32 set out the duties of card issuers regarding changes of address. The card issuer rules will apply only to a person that issues a debit or credit card and that is subject to the CFTC's enforcement authority. The card issuer rules require a card issuer to comply with certain address validation procedures in the event that such issuer receives a notification of a change of address for an existing account from a cardholder, and within a short period of time (during at least the first 30 days after such notification is received) receives a request for an additional or replacement card for the same account. The card issuer may not issue the additional or replacement card unless it complies with those procedures. The procedures include: (1) notifying the cardholder of the request in writing or electronically either at the cardholder's former address, or by any other means of communication that the card issuer and the cardholder have previously agreed to use; or (2) assessing the validity of the change of address in accordance with established policies and procedures.

Section 162.32 will shift oversight of card issuer rules of CFTC-regulated entities from the FTC to the CFTC. These entities should already be in compliance with the FTC's existing card issuer rules, which the FTC began enforcing on January 1, 2011. Because section 162.32 is substantially similar to those existing card issuer rules, these entities should not bear any new costs in coming into compliance. The new regulation does not contain new requirements, nor does it expand the scope of the rules to include new entities that were not already previously covered by the Agencies' card issuer rules.

The existing costs related to section 162.32 would include the cost for card issuers to

establish policies and procedures that assess the validity of a change of address notification submitted shortly before a request for an additional card and, before issuing an additional or replacement card, either notify the cardholder at the previous address or through another previously agreed-upon form of communication, or alternatively assess the validity of the address change through existing policies and procedures. As discussed in the PRA analysis, CFTC staff does not expect that any CFTC-regulated entities would be subject to the requirements of section 162.32.

The benefits related to adoption of section 162.32, which already exist in connection with the Agencies' card issuer rules, would include a reduction in the risk of identity theft for cardholders, and a reduction in the risk of losses due to fraud for card issuers. However, it is not practicable for the CFTC to estimate with precision the dollar value associated with the benefits that will inure to the public from these card issuer rules. As is true of the Agencies' card issuer rules, the CFTC has designed section 162.32 to provide card issuers significant flexibility in developing and maintaining a Program that is tailored to the size and complexity of their business and the nature of their operations.

Accordingly, as previously discussed, the card issuer rules should not result in any significant new costs or benefits, because they generally reflect a statutory transfer of enforcement authority from the FTC to the CFTC, do not include any significant new requirements, and do not include new entities that were not previously covered by the Agencies' rules.

*Section 15(a) Analysis.* As stated above, the CFTC is required to consider costs and benefits of proposed CFTC action in light of (1) protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4)

sound risk management practices; and (5) other public interest considerations. These rules protect market participants and the public by preventing identity theft, an illegal act that may be costly to them in both time and money.<sup>154</sup> Because, however, these rules create no new requirements—rather, as explained above, the CFTC is adopting rules that reflect requirements already in place—their cost and benefits have no incremental impact on the five section 15(a) factors. Customers of CFTC registrants will continue to benefit from these rules in the same way they have benefited from the rules as they were administered by the Agencies.

**SEC:**

The SEC is sensitive to the costs and benefits imposed by its rules. As discussed above, the Dodd-Frank Act shifted enforcement authority over SEC-regulated entities that are subject to section 615(e) of the FCRA from the Agencies to the SEC. Section 615(e) of the FCRA, as amended by the Dodd-Frank Act, requires that the SEC, jointly with the Agencies and the CFTC, adopt identity theft red flags rules and guidelines. To carry out this requirement, the SEC is adopting Regulation S-ID, which is substantially similar to the identity theft red flags rules and guidelines adopted by the Agencies in 2007, and whose scope covers the same categories of SEC-regulated entities that were covered under the Agencies' red flags rules.

Regulation S-ID requires a financial institution or creditor that is subject to the SEC's enforcement authority and that offers or maintains covered accounts to develop, implement, and administer a written identity theft prevention Program. A financial institution or creditor must design its Program to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. A financial institution or creditor also must appropriately tailor its Program to its size and complexity, and to the nature and scope of its

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<sup>154</sup> *See id.*

activities. In addition, a financial institution or creditor must take certain steps to comply with the requirements of the identity theft red flags rules, including training staff, providing annual reports to the board of directors, an appropriate committee thereof, or a designated senior management employee, and, if applicable, oversight of service providers.

Section 615(e)(1)(C) of the FCRA singles out change of address notifications sent to credit and debit card issuers as a possible indicator of identity theft, and requires the SEC to prescribe regulations concerning such notifications. Accordingly, the card issuer rules in this release set out the duties of card issuers regarding changes of address. The card issuer rules apply only to SEC-regulated entities that issue credit or debit cards.<sup>155</sup> The card issuer rules require a card issuer to comply with certain address validation procedures in the event that such issuer receives a notification of a change of address for an existing account, and within a short period of time (during at least the first 30 days after it receives such notification) receives a request for an additional or replacement card for the same account. The card issuer may not issue the additional or replacement card unless it complies with those procedures. The procedures include: (1) notifying the cardholder of the request either at the cardholder's former address, or by any other means of communication that the card issuer and the cardholder have previously agreed to use; or (2) assessing the validity of the change of address in accordance with established policies and procedures.

The baseline we use to analyze the economic effects of Regulation S-ID is the identity theft red flags regulatory scheme administered by the Agencies. Regulation S-ID, as discussed above, implements the transfer of oversight of identity theft red flags rules for SEC-regulated entities from the Agencies to the SEC. Entities that qualify as a financial institution or creditor

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<sup>155</sup> See § 248.202(a) (defining scope of the SEC's rules).

and offer or maintain covered accounts should already have existing identity theft red flags Programs. Regulation S-ID does not contain new requirements, nor does it expand the scope of the Agencies' rules to include new entities that the Agencies' rules did not previously cover. Regulation S-ID does contain examples and minor language changes designed to help guide entities within the SEC's enforcement authority in complying with the rules. Because Regulation S-ID is substantially similar to the Agencies' rules, the entities within its scope should not bear new costs in coming into compliance with Regulation S-ID.<sup>156</sup>

### *Costs*

The costs of complying with section 248.201 of Regulation S-ID include both ongoing costs and initial, one-time costs.<sup>157</sup> These are the same costs that were associated with the requirements of the Agencies' red flags rules, and these costs will continue to apply after the adoption of the SEC's identity theft red flags rules (section 248.201 of Regulation S-ID). The ongoing costs include the costs to periodically review and update the Program, report on the

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<sup>156</sup> See, e.g., NSCP Comment Letter ("Because proposed Regulation S-ID is substantially similar to [the Agencies'] existing rules and guidelines, broker-dealer firms should not bear any new costs in coming into compliance with proposed Regulation S-ID."). As previously indicated, the SEC staff understands that a number of investment advisers may not currently have identity theft red flags Programs. See *supra* note 55 and *infra* notes 186 and 190. The new guidance in this release may lead some of these entities to determine that they should comply with Regulation S-ID. Although the costs and benefits of Regulation S-ID discussed below would be new to these entities, the costs would result not from Regulation S-ID but instead from the entities' recognition that these rules and the previously-existing rules apply to them. In that regard, the initial, one-time costs of Regulation S-ID could be up to \$756 for each investment adviser that qualifies as a financial institution or creditor, and additional one-time costs of \$13,885 for each such investment adviser that maintains covered accounts. See *infra* notes 158 and 159. Not all investment advisers will bear the full extent of these costs, however, as some may already have in place certain identity theft protections. And, the guidance in this release could have the benefit of further reducing identity theft. See *infra* discussion of benefits in Part III.A of this release.

<sup>157</sup> See *infra* note 182 and accompanying text.

Program, and conduct assessments of covered accounts.<sup>158</sup> All entities that qualify as financial institutions or creditors and that maintain covered accounts will bear these costs. Existing entities subject to Regulation S-ID should already bear, and will continue to be subject to, the ongoing costs.

Initial, one-time costs relate to the initial assessments of covered accounts, creation of a Program, board approval of the Program, and the training of staff.<sup>159</sup> New entities will bear these

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<sup>158</sup> Unless otherwise stated, all cost estimates for personnel time are derived from SIFMA's Management & Professional Earnings in the Securities Industry 2011, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, entity size, employee benefits, and overhead. The estimates in this release, both for salary rates and numbers of entities affected, have been updated from those in the Proposing Release to reflect recent SIFMA management and professional salary data.

SEC staff estimates that the ongoing burden of compliance will include 2 hours to conduct periodic assessments of covered accounts, 2 hours to periodically review and update the Program, and 4 hours to prepare and present an annual report to the board, for a total of 8 hours. SEC staff estimates that, of the 8 hours incurred, 7 hours will be spent by internal counsel at an hourly rate of \$378 and 1 hour will be spent by the board of directors as a whole, at an hourly rate of \$4500, for a total hourly cost of \$7146 per entity. This estimate is based on the following calculations:  $\$378 \times 7 \text{ hours} = \$2646$ ;  $\$4500 \times 1 \text{ hour} = \$4500$ ;  $\$2646 + \$4500 = \$7146$ . The cost estimate for the board of directors is derived from estimates made by SEC staff regarding typical board size and compensation that is based on information received from fund representatives and publicly available sources.

As discussed in the PRA analysis, SEC staff estimates that 10,339 existing SEC-regulated entities will be financial institutions or creditors under Regulation S-ID, and approximately 90%, or 9305, of these entities will maintain covered accounts. See *infra* notes 190 and 191 and accompanying text. SEC staff estimates that 2 hours of internal counsel's time will be spent conducting periodic assessments of covered accounts and that all financial institutions or creditors subject to the rule (or 10,339 entities) will bear this cost for a total cost of \$7,816,284 based on the following calculations:  $\$378 \times 2 = \$756$ ;  $\$756 \times 10,339 = \$7,816,284$ . SEC staff estimates that 9305 entities will bear the remaining specified ongoing costs for a total cost of \$59,458,950 ( $(\$378 \times 5) + (\$4500 \times 1) = \$59,458,950$ ).

<sup>159</sup> SEC staff estimates that the incremental one-time burden of compliance includes 2 hours to conduct initial assessments of covered accounts, 25 hours to develop and obtain board approval of a Program, and 4 hours to train staff. SEC staff estimates that, of the 31 hours incurred, 12 hours will be spent by internal counsel at an hourly rate of \$378, 17 hours will be spent by administrative assistants at an hourly rate of \$65, and 2 hours will be spent by the board of directors as a whole, at an hourly rate of \$4500, for a total cost of \$14,641 per new entity. This estimate is based on the following calculations:  $\$378 \times 12 \text{ hours} = \$4536$ ;  $\$65 \times 17 = \$1105$ ;  $\$4500 \times 2 = \$9000$ ;  $\$4536 + \$1105 + \$9000 = \$14,641$ . The cost estimate for administrative assistants is derived from SIFMA's Office Salaries in the Securities Industry 2011, modified to

costs.

As discussed above, the final rules require financial institutions and creditors to tailor their Programs to the size and complexity of the entity and to the nature and scope of the entity's activities. Ongoing and one-time costs will therefore depend on the size and complexity of the SEC-regulated entity. Entities may already have other policies and procedures in place that are designed to reduce the risks of identity theft for their customers. The presence of other related policies and procedures could reduce the ongoing and one-time costs of compliance.

Two commenters agreed with the SEC that the substantial similarity of Regulation S-ID to the Agencies' rules should minimize any compliance costs for entities that have previously complied with the Agencies' rules,<sup>160</sup> and another commenter stated that the benefits of reduced risk of identity theft would outweigh the costs associated with the rules.<sup>161</sup> Another commenter raised concerns with the cost estimates in the Proposing Release, and argued that actual costs of

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account for an 1800-hour work-year and multiplied by 2.93 to account for bonuses, entity size, employee benefits, and overhead.

As discussed in the PRA analysis, SEC staff estimates that there are 1271 SEC-regulated entities that newly form each year and that could be financial institutions or creditors, of which 668 are likely to qualify as financial institutions or creditors. *See infra* note 186. Of these 668 entities that are likely to qualify as financial institutions or creditors, SEC staff estimates that approximately 90%, or 601, of these entities will maintain covered accounts. *See infra* note 188 and accompanying text. SEC staff estimates that 2 hours of internal counsel's time will be spent conducting an initial assessment of covered accounts and that all newly-formed financial institutions or creditors subject to Regulation S-ID (or 668 entities) will bear this cost for a total cost of \$505,008 based on the following calculation:  $\$378 \times 2 = \$756$ ;  $\$756 \times 668 = \$505,008$ . SEC staff estimates that the 601 entities that will maintain covered accounts will bear the remaining specified costs for a total cost of \$8,344,885 ( $601 \times ((\$378 \times 10) + (\$65 \times 17) + (\$4500 \times 2)) = \$8,344,885$ ).

<sup>160</sup> See NSCP Comment Letter ("Because proposed Regulation S-ID is substantially similar to [the Agencies'] existing rules and guidelines, broker-dealer firms should not bear any new costs in coming into compliance with proposed Regulation S-ID."); ICI Comment Letter ("We commend the Commission for proposing requirements that are consistent with those that have applied to certain SEC registrants since 2008 pursuant to rules of the [FTC] under [the FACT Act]. This consistency will facilitate registrants' transition from compliance with the FTC's rule to the Commission's rule with little or no disruption or added expense.")

<sup>161</sup> See Eric Speicher Comment Letter.



compliance could be much greater than estimated.<sup>162</sup> This commenter provided hour burden estimates for large, complex financial institutions that were significantly higher than the estimates made for those entities in the Proposing Release. Additionally, the commenter stated that the Commissions' estimated compliance costs did not consider the costs to third-party service providers that may be required to implement an identity theft red flags Program, even though they are not financial institutions or creditors. The commenter also noted, however, that burdens placed upon entities currently complying with the Agencies' rules would be the same burdens that each of these entities already incurs in regularly assessing whether it maintains covered accounts and evaluating whether it falls within the rules' scope.

We note that the commenter who suggested that significantly higher hour burdens would be associated with the rules focused on large, complex financial institutions. Regulation S-ID requires each financial institution and creditor to tailor its Program to its size and complexity, and to the nature and scope of its activities. Our estimates take into account the hour burdens for small financial institutions and creditors, which we understand, based on discussions with industry representatives, to be significantly less than the estimates provided by this commenter. We also note that costs to service providers have already been taken into account, as SEC-regulated entities that have outsourced identity theft detection, prevention, and mitigation operations to service providers have effectively shifted a burden that the SEC-regulated entities otherwise would have carried themselves.<sup>163</sup> As mentioned above, the costs of Regulation S-ID

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<sup>162</sup> See FSR/SIFMA Comment Letter. FSR/SIFMA estimated that "the initial compliance burden to implement the [proposed rules] would average 2,000 hours for each line of business conducted by a large, complex financial institution ..." and that "the continuing compliance monitoring for a large, complex financial institution ... would average 400 hours annually." FSR/SIFMA also noted that "financial institutions with an existing Red Flags program would experience an incremental burden" in connection with the SEC's rules.

<sup>163</sup> See *infra* Section III.C. (describing the SEC's PRA collection of information requirements).

are not new, and existing entities should already have identity theft red flags Programs and bear the ongoing costs associated with Regulation S-ID.

The existing costs related to the card issuer rules (section 248.202 of Regulation S-ID) include the cost for card issuers to establish policies and procedures that assess the validity of a change of address notification submitted shortly before a request for an additional or replacement card and, before issuing an additional or replacement card, either notify the cardholder at the previous address or through another previously agreed-upon form of communication, or alternatively assess the validity of the address change through existing policies and procedures. As discussed in the PRA analysis, SEC staff does not expect that any SEC-regulated entities will be subject to the card issuer rules.

In the PRA analysis below, the staff identifies certain ongoing and initial hour burdens and associated time costs related to compliance with Regulation S ID. These hour burdens and costs are consistent with those associated with the requirements of the Agencies' existing rules.

#### *Benefits*

The benefits related to adoption of Regulation S-ID, which already exist in connection with the Agencies' identity theft red flags rules, include a reduction in the risk of identity theft for investors (consumers) and cardholders, and a reduction in the risk of losses due to fraud for financial institutions and creditors. The SEC is the federal agency best positioned to oversee the financial institutions and creditors subject to its enforcement authority because of its experience in overseeing these entities. Adoption of Regulation S-ID therefore may have the added benefit of increasing entities' adherence to their identity theft red flags Programs, thus further reducing the risk of identity theft for investors. As is true of the Agencies' identity theft red flags rules, the SEC has designed Regulation S-ID to provide financial institutions, creditors, and card

issuers significant flexibility in developing and maintaining a Program that is tailored to the size and complexity of their business and the nature of their operations, as well as in satisfying the address verification procedures. Many of the benefits and costs discussed are difficult to quantify, in particular when discussing the potential reduction in the risk of identity theft. The SEC staff cannot quantify the benefits of the potential reduction in the risk of identity theft because of the uncertainty of its effect on customer behavior. Therefore, we discuss much of the benefits qualitatively but, where possible, the SEC staff attempted to quantify the costs.

### *Alternatives*

In analyzing the costs and benefits that could result from the implementation of Regulation S-ID, the SEC also considered the costs and benefits of any plausible alternatives to the final rules as set forth in this release. As discussed above, section 615(e) of the FCRA, as amended by the Dodd-Frank Act, requires that the SEC, jointly with the Agencies and the CFTC, adopt identity theft red flags rules and guidelines that are substantially similar to those adopted by the Agencies. The rules the SEC promulgates should achieve a similar outcome with respect to the reduction in the risk of identity theft as the rules of other Agencies. Alternatives to the identity theft red flags rules that would achieve a similar outcome may impose additional costs, especially for those entities that would need to alter existing Programs to conform to a new set of rules. The SEC does provide additional guidance in this release to better enable entities to determine whether they fall within the rules' scope. Although the SEC could have provided different guidance with this release, the SEC believes that the release provides sufficient guidance to enable entities to determine whether they need to adopt identity theft red flags Programs. Lastly, for the reasons discussed above, the SEC is not exempting certain entities from certain requirements of the identity theft red flags rules. The SEC believes that if an entity

determines that it is a financial institution or a creditor that offers or maintains covered accounts, then the risk of identity theft that the rules are designed to address is present. Under such circumstances, we believe that the benefits of the rules justify the costs to the financial institution or creditor subject to the rules and, therefore, no exemptions are appropriate.

#### **B. Analysis of Effects on Efficiency, Competition, and Capital Formation**

Section 3(f) of the Exchange Act and section 2(c) of the Investment Company Act require the SEC, whenever it engages in rulemaking and must consider or determine if an action is necessary, appropriate, or consistent with the public interest, to consider, in addition to the protection of investors, whether the action would promote efficiency, competition, and capital formation. In addition, section 23(a)(2) of the Exchange Act requires the SEC, when making rules under the Exchange Act, to consider the impact the rules may have upon competition. Section 23(a)(2) of the Exchange Act prohibits the SEC from adopting any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>164</sup>

As discussed in the cost-benefit analysis above, Regulation S-ID will carry out the requirement in the Dodd-Frank Act that the SEC adopt rules governing identity theft protections, pursuant to section 615(e) of the FCRA with regard to entities that are subject to the SEC's enforcement authority. This requirement was designed to transfer regulatory oversight of identity theft red flags rules for SEC-regulated entities from the Agencies to the SEC. Regulation S-ID is substantially similar to the identity theft red flags rules adopted by the

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<sup>164</sup> See *infra* Section IV (setting forth statutory authority under, among other things, the Exchange Act and Investment Company Act for rulemakings).

Agencies in 2007, and does not contain new requirements. The entities covered by Regulation S-ID should already be in compliance with existing identity theft red flags rules.

For the reasons discussed above, Regulation S-ID should have a negligible effect on efficiency, competition, and capital formation because it does not include new requirements and does not include new entities that were not previously covered by the Agencies' rules.<sup>165</sup> The SEC thereby finds that, pursuant to Exchange Act section 23(a)(2), the adoption of Regulation S-ID would not result in any burden on competition, efficiency, or capital formation that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

### C. Paperwork Reduction Act

#### CFTC:

Provisions of sections 162.30 and 162.32 contain collection of information requirements within the meaning of the PRA. The CFTC submitted the proposal to the Office of Management and Budget ("OMB") for review and public comment, in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is "Part 162 Subpart C—Identity Theft." Responses to this new collection of information are mandatory.

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<sup>165</sup> See *infra* note 182 (discussing the entities that the SEC staff expects, based on discussions with industry representatives and a review of applicable law, will fall within the scope of Regulation S-ID). The SEC staff understands, however, that a number of investment advisers may not currently have identity theft red flags Programs. See *supra* note 55. The guidance in this release regarding situations in which certain SEC-regulated entities could qualify as financial institutions or creditors should not produce any significant effects. These entities may experience a negligible increase to business efficiency due to the industry-specific guidance in this release regarding the types of activities that could cause an entity to fall within the scope of Regulation S-ID. The guidance should also have a negligible effect on capital formation. Prior to Regulation S-ID, investors preferring to base their capital allocations on the existence of identity theft red flags Programs could have allocated capital with entities adhering to the Agencies' rules. The guidance therefore should have a negligible effect on the amount of capital allocated for investment purposes. In addition, all entities that conclude based on this guidance that they are subject to the final rules will be subject to the same requirements, and experience the same costs and benefits, as all other entities currently adhering to the Agencies' existing rules. The guidance therefore should have a negligible effect on competition.

### 1. *Information Provided by Reporting Entities/Persons*

Under part 162, subpart C, CFTC regulated entities – which presently would include approximately 260 CFTC registrants<sup>166</sup> plus 125 new CFTC registrants pursuant to Title VII of the Dodd-Frank Act<sup>167</sup> – are required to design, develop and implement reasonable policies and procedures to identify relevant red flags, and potentially to notify cardholders of identity theft risks. In addition, CFTC-regulated entities are required to: (i) collect information and keep records for the purpose of ensuring that their Programs met requirements to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account; (ii) develop and implement reasonable policies and procedures to identify, detect and respond to relevant red flags, as well as periodic reports related to the Program; and

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<sup>166</sup> See the NFA's Internet web site at <http://www.nfa.futures.org/NFA-registration/NFA-membership-and-dues.HTML> for the most up-to-date number of CFTC regulated entities. For the purposes of the PRA calculation, CFTC staff used the number of registered FCMs, CTAs, CPOs, IBs and RFEDs on the NFA's Internet web site as of November 20, 2012. The NFA's site states that there are 3,485 CFTC registrants as of October 31, 2012. (The total number of registrants also includes 7 exchanges which are not subject to this rule and not included in the calculation.) Of the 3,485 registrants, there are 104 FCMs, 1,284 IBs, 1,041 CTAs, 1,035 CPOs, and 14 RFEDs. CFTC staff has observed that approximately 50 percent of all CPOs (518) are dually registered as CTAs. Moreover, CFTC staff also has observed that all entities registering as RFEDs (14) also register as FCMs. Based on these observations, the CFTC has determined that the total number of entities is 2,946 (this total excludes the 7 exchanges that are not subject to this rule, the 518 CPOs that are also registered as CTAs, and the 14 RFEDs that are also registered as FCMs).

Of the total 2,946 entities, all of the FCMs (104) are likely to qualify as financial institutions or creditors carrying covered accounts, approximately 10 percent of CTAs (104) and CPOs (52) are likely to qualify as financial institutions or creditors carrying covered accounts and none of the IBs are likely to qualify as a financial institution or creditor carrying covered accounts, for a total of 260 financial institutions or creditors that would bear the initial one-time burden of compliance with the CFTC's rules.

<sup>167</sup> CFTC staff estimates that 125 SDs and MSPs will register with the CFTC upon the issuance of final rules under the Dodd-Frank Act further defining the terms "swap dealers" and "major swap participants" and setting forth a registration regime for these entities. The CFTC estimates the number of MSPs to be quite small, at six or fewer.

(iii) from time to time, notify cardholders of possible identity theft with respect to their covered accounts, as well as assess the validity of those accounts.

These burden estimates assume that CFTC-regulated entities already comply with the identity theft red flags rules jointly adopted by the FTC with the Agencies, as of January 1, 2011. Consequently, these entities may already have in place many of the customary protections addressing identity theft and changes of address required by these regulations.

Burden means the total time, effort, or financial resources expended by persons to generate, maintain, retain, disclose or provide information to or for a federal agency. Because compliance with identity theft red flags rules jointly adopted by the FTC with the Agencies may have occurred, the CFTC estimates the time and cost burdens of complying with part 162 to be both one-time and ongoing burdens. However, any initial or one-time burdens associated with compliance with part 162 would apply only to newly-formed entities, and the ongoing burden to all CFTC-regulated entities.

*i. Initial Burden*

The CFTC estimates that the one-time burden of compliance with part 162 for its regulated entities with covered accounts would be: (i) 25 hours to develop and obtain board approval of a Program; (ii) 4 hours for staff training; and (iii) 2 hours to conduct an initial assessment of covered accounts, totaling 31 hours. Of the 31 hours, the CFTC estimates that 15 hours would involve internal counsel, 14 hours expended by administrative assistants, and 2 hours by the board of directors in total, for those newly-regulated entities.

The CFTC estimates that approximately 702 FCMs, CTAs and CPOs<sup>168</sup> would need to conduct an initial assessment of covered accounts. As noted above, the CFTC estimates that approximately 125 newly registered SDs and MSPs would need to conduct an initial assessment of covered accounts. The total number of newly registered CFTC registrants would be 827 entities. Each of these 827 entities would need to conduct an initial assessment of covered accounts, for a total of 1,654 hours.<sup>169</sup> Of these 827 entities, CFTC staff estimates that approximately 179 of these entities may maintain covered accounts. Accordingly, the CFTC estimates the one-time burden for these 179 entities to be 5,191 hours,<sup>170</sup> for a total burden among newly registered entities of 6,845 hours.<sup>171</sup>

*ii. Ongoing Burden*

The CFTC staff estimates that the ongoing compliance burden associated with part 162 would include: (i) 2 hours to periodically review and update the Program, review and preserve contracts with service providers, and review and preserve any documentation received from such

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<sup>168</sup> Based on a review of new registrations typically filed with the CFTC each year, CFTC staff estimates that approximately 7 FCMs, 225 IBs, 400 CTAs, and 140 CPOs are newly formed each year, for a total of 772 entities. CFTC staff also has observed that approximately 50 percent of all CPOs are duly registered as CTAs. With respect to RFEDs, CFTC staff has observed that all entities registering as RFEDs also register as FCMs. Based on these observations, CFTC has determined that the total number of newly-formed financial institutions and creditors is 702 (772 – 70 CPOs that are also registered as CTAs). Each of these 702 financial institutions or creditors would bear the initial one-time burden of compliance with the proposed rules.

Of the total 702 newly-formed entities, staff estimates that all of the FCMs are likely to carry covered accounts, 10 percent of CTAs and CPOs are likely to carry covered accounts, and none of the IBs are likely to carry covered accounts, for a total of 54 newly-formed financial institutions or creditors carrying covered accounts that would be required to conduct an initial one-time burden of compliance with subpart C or Part 162.

<sup>169</sup> This estimate is based on the following calculation: 827 entities x 2 hours = 1,654 hours.

<sup>170</sup> This estimate is based on the following calculation: 179 entities x 29 hours = 5,191 hours.

<sup>171</sup> This estimate is based on the following calculation: 1,654 hours for all newly registered CFTC registrants + 5,191 hours for the one-time burden of newly registered entities with covered accounts, for a total of 6,845 hours.



providers; (ii) 4 hours to prepare and present an annual report to the board; and (iii) 2 hours to conduct periodic assessments to determine if the entity offers or maintains covered accounts, for a total of 8 hours. The CFTC staff estimates that of the 8 hours expended, 7 hours would be spent by internal counsel, and 1 hour would be spent by the board of directors as a whole.

The CFTC estimates that approximately 3,071 entities may maintain covered accounts, and that they would be required to periodically review their accounts to determine if they comply with these rules, for a total of 6,142 hours for these entities.<sup>172</sup> Of these 3,071 entities, the CFTC estimates that approximately 385 maintain covered accounts, and thus would need to incur the additional burdens related to complying with the rule, for a total of 2,310 hours.<sup>173</sup> The total ongoing burden for all CFTC registrants is 8,452 hours.<sup>174</sup>

**SEC:**

Provisions of sections 248.201 and 248.202 contain "collection of information" requirements within the meaning of the PRA. In the Proposing Release, the SEC solicited comment on the collection of information requirements. The SEC also submitted the proposed collections of information to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title for this collection of information is "Part 248, Subpart C—Regulation S-ID." In response to this submission, the OMB issued control number 3235-0692.<sup>175</sup>

Responses to the new collection of information provisions are mandatory, and the information,

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<sup>172</sup> This estimate is based on the following calculation: 3,071 entities x 2 hours = 6,142 hours. (The Proposing Release contained an arithmetic error in the calculation for the total ongoing burden for all CFTC registrants. The total number of hours was erroneously calculated to total 76,498 hours rather than 6,498. See 77 FR 13450, 13467.)

<sup>173</sup> This estimate is based on the following calculation: 385 entities x 6 hours = 2,310 hours.

<sup>174</sup> This estimate is based on the following calculation: 6,142 hours + 2,310 hours = 8,452 hours.

<sup>175</sup> An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

when provided to the SEC in connection with staff examinations or investigations, is kept confidential to the extent permitted by law.

1. *Description of the Collections*

Under Regulation S-ID, SEC-regulated entities are required to develop and implement reasonable policies and procedures to identify, detect and respond to relevant red flags and, in the case of entities that issue credit or debit cards, to assess the validity of, and communicate with cardholders regarding, address changes. Section 248.201 of Regulation S-ID includes the following “collections of information” by SEC-regulated entities that are financial institutions or creditors if the entity maintains covered accounts: (1) creation and periodic updating of a Program that is approved by the board of directors, an appropriate committee thereof, or a designated senior management employee; (2) periodic staff reporting on compliance with the identify theft red flags rules and guidelines, as required to be considered by section VI of the guidelines; and (3) training of staff to implement the Program. Section 248.202 of Regulation S-ID includes the following “collections of information” by SEC-regulated entities that are credit or debit card issuers: (1) establishment of policies and procedures that assess the validity of a change of address notification if a request for an additional or replacement card on the account follows soon after the address change; and (2) notification of a cardholder, before issuance of an additional or replacement card, at the previous address or through some other previously agreed-upon form of communication, or alternatively, assessment of the validity of the address change request through the entity’s established policies and procedures.

SEC-regulated entities that must comply with the collections of information required by Regulation S-ID should already be in compliance with the identity theft red flags rules that the

Agencies jointly adopted in 2007.<sup>176</sup> The requirements of those rules are substantially similar and comparable to the requirements of Regulation S-ID.<sup>177</sup>

In addition, SEC staff understands that most SEC-regulated entities that are financial institutions or creditors may otherwise have in place many of the protections regarding identity theft and changes of address that Regulation S-ID requires because they are usual and customary business practices that they engage in to minimize losses from fraud. Furthermore, SEC staff believes that many of them are likely to have already effectively implemented most of the requirements as a result of having to comply (or an affiliate having to comply) with other, existing statutes, regulations and guidance, such as the federal CIP rules implementing section 326 of the USA PATRIOT Act,<sup>178</sup> the Interagency Guidelines Establishing Information Security Standards that implement section 501(b) of the Gramm-Leach-Bliley Act (GLBA),<sup>179</sup> section 216 of the FACT Act,<sup>180</sup> and guidance issued by the Agencies or the Federal Financial Institutions Examination Council regarding information security, authentication, identity theft, and response programs.<sup>181</sup>

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<sup>176</sup> SEC staff, however, understands that a number of investment advisers may not currently have identity theft red flags Programs. *See supra* note 55. Under the new guidance, for entities having now determined that they should comply with Regulation S-ID, the collections of information required by Regulation S-ID and the estimates of time and costs discussed below may be new. As discussed further below, SEC staff estimates that there are approximately 3791 investment advisers that are currently registered with the SEC and are likely to qualify as financial institutions or creditors. SEC staff is unable to estimate how many of these investment advisers previously complied with the Agencies' identity theft red flags rules.

<sup>177</sup> *See* 2007 Adopting Release, *supra* note 8, at Section VI.A (discussing the PRA analysis with respect to the Agencies' identity theft red flags rules); "FTC Extends Enforcement Deadline for Identity Theft Red Flags Rule" at <http://www.ftc.gov/opa/2010/05/redflags.shtm>.

<sup>178</sup> 31 U.S.C. 5318(l) (requiring verification of the identity of persons opening accounts).

<sup>179</sup> 15 U.S.C. 6801.

<sup>180</sup> 15 U.S.C. 1681w.

<sup>181</sup> *See* 2007 Adopting Release, *supra* note 8, at nn.55–57 (describing applicable statutes, regulations, and guidance).

SEC staff estimates of time and cost burdens represent the one-time burden of complying with Regulation S-ID for newly-formed SEC-regulated entities, and the ongoing costs of compliance for all SEC-regulated entities.<sup>182</sup> SEC staff estimates also attribute all burdens to entities that are directly subject to the requirements of the rulemaking. An entity directly subject to Regulation S-ID that outsources activities to a service provider is, in effect, shifting to that service provider the burden that it would otherwise have carried itself. Under these circumstances, the burden is, by contract, shifted from the entity that is directly subject to Regulation S-ID to the service provider, but the total amount of burden is not increased. Thus, service provider burdens are already included in the burden estimates provided for entities that are directly subject to Regulation S-ID. The time and cost estimates made here are based on conversations with industry representatives and on a review of comments received on the proposed rules as well as the estimates made in the regulatory analyses of the identity theft red flags rules previously issued by the Agencies.

2. *Section 248.201 (duties regarding the detection, prevention, and mitigation of identity theft)*

The collections of information required by section 248.201 apply to SEC-regulated entities that are financial institutions or creditors.<sup>183</sup> As stated above, SEC staff expects that SEC-regulated entities should already have incurred initial or one-time burdens associated with

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<sup>182</sup> Based on discussions with industry representatives and a review of applicable law, SEC staff expects that, of the SEC-regulated entities that fall within the scope of Regulation S-ID, most broker-dealers, many investment companies (including almost all open-end investment companies and ESCs), and some registered investment advisers will likely qualify as financial institutions or creditors. SEC staff expects that other SEC-regulated entities described in the scope section of Regulation S-ID, such as BDCs, transfer agents, NRSROs, SROs, and clearing agencies may be less likely to be financial institutions or creditors as defined in the rules, and therefore we do not include these entities in our estimates.

<sup>183</sup> § 248.201(a).

compliance with Regulation S-ID because they should already be in compliance with the substantially identical requirements of the Agencies' identity theft red flags rules.<sup>184</sup> Any initial or one-time burden estimates associated with compliance with section 248.201 of Regulation S-ID apply only to newly-formed entities. The ongoing burden estimates apply to all SEC-regulated entities that are financial institutions or creditors. Existing entities subject to Regulation S-ID should already bear, and will continue to be subject to, this burden. In the Proposing Release, the SEC solicited comment on its estimates of the burdens associated with the collections of information required by section 248.201; one commenter raised concerns with the estimates in the Proposing Release, arguing that actual burdens could be greater than estimated.<sup>185</sup>

i. *Initial Burden*

SEC staff estimates that the one-time burden of compliance with section 248.201 for SEC-regulated financial institutions and creditors with covered accounts is: (i) 25 hours to develop and obtain board approval of a Program; (ii) 4 hours to train staff; and (iii) 2 hours to conduct an initial assessment of covered accounts, for a total of 31 hours. SEC staff estimates that, of the 31 hours incurred, 12 hours will be spent by internal counsel, 17 hours will be spent by administrative assistants, and 2 hours will be spent by the board of directors as a whole for newly-formed entities.

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<sup>184</sup> See 2007 Adopting Release, *supra* note 8, at Section VI.A (discussing the PRA analysis with respect to the Agencies' identity theft red flags rules). Because the requirements of Regulation S-ID are substantially identical to the requirements of the Agencies' identity theft red flags rules, the SEC staff took the Agencies' PRA analysis into account in estimating the regulatory burdens of Regulation S-ID.

<sup>185</sup> See *supra* note 162 and accompanying text.

SEC staff estimates that approximately 668 SEC-regulated financial institutions and creditors are newly formed each year.<sup>186</sup> Each of these 668 entities will need to conduct an initial assessment of covered accounts, for a total of 1336 hours.<sup>187</sup> Of these 668 entities, SEC staff estimates that approximately 90% (or 601) maintain covered accounts.<sup>188</sup> Accordingly, SEC staff estimates that the total initial burden for the 601 newly formed SEC-regulated entities that are likely to qualify as financial institutions or creditors and maintain covered accounts is 18,631 hours, and the total initial burden for all newly formed SEC-regulated entities is 18,765 hours.<sup>189</sup>

ii. *Ongoing Burden*

SEC staff estimates that the ongoing burden of compliance with section 248.201 includes: (i) 2 hours to conduct periodic assessments to determine if the entity offers or maintains covered accounts; (ii) 4 hours to prepare and present an annual report to the board; and (iii) 2 hours to periodically review and update the Program, including review and preservation of

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<sup>186</sup> Based on a review of new registrations typically filed with the SEC each year, SEC staff estimates that approximately 900 investment advisers, 231 broker-dealers, 139 investment companies, and 1 ESC typically apply for registration with the SEC or otherwise are newly formed each year, for a total of 1271 entities that could be financial institutions or creditors. Of these, SEC staff estimates that all of the investment companies, ESCs, and broker-dealers are likely to qualify as financial institutions or creditors, and 33% (or 297) of investment advisers are likely to qualify, for a total of 668 total financial institutions or creditors that will bear the initial one-time burden of assessing covered accounts under Regulation S-ID. Information regarding the method used to estimate that 33% of investment advisers are likely to qualify as financial institutions or creditors can be found in note 190 below.

<sup>187</sup> This estimate is based on the following calculation: 668 entities x 2 hours = 1336 hours.

<sup>188</sup> In the Proposing Release, the SEC requested comment on the estimate that approximately 90% of all financial institutions and creditors maintain covered accounts; the SEC received no comments on this estimate.

<sup>189</sup> These estimates are based on the following calculations: 601 financial institutions and creditors that maintain covered accounts x 31 hours = 18,631 hours; 17,429 hours (601 financial institutions and creditors that maintain covered accounts x 29 hours) + 1336 hours (burden for all SEC-regulated entities that are financial institutions or creditors to conduct an initial assessment of covered accounts) = 18,765 hours.

contracts with service providers, and review and preservation of any documentation received from service providers, for a total of 8 hours. SEC staff estimates that, of the 8 hours incurred, 7 hours will be spent by internal counsel and 1 hour will be spent by the board of directors as a whole.

SEC staff estimates that there are 10,339 SEC-regulated entities that are either financial institutions or creditors, and that all of these are required to periodically review their accounts to determine if they offer or maintain covered accounts, for a total of 20,678 hours for these entities.<sup>190</sup> Of these 10,339 entities, SEC staff estimates that approximately 90%, or 9305, maintain covered accounts, and thus will bear the additional burdens related to complying with

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<sup>190</sup> Based on a review of entities that the SEC regulates, SEC staff estimates that, as of July 1, 2012, there are approximately 11,622 investment advisers, 4706 broker-dealers, 1692 active open-end investment companies, and 150 ESCs. Of these, SEC staff estimates that all of the broker-dealers, open-end investment companies and ESCs are likely to qualify as financial institutions or creditors, and approximately 3791 investment advisers (or about 33%, as explained further below) are likely to qualify, for a total of 10,339 total financial institutions or creditors that will bear the ongoing burden of assessing covered accounts under Regulation S-ID. (The SEC staff estimates that the other types of entities that are covered by the scope of the SEC's rules will not be financial institutions or creditors and therefore will not be subject to the rules' requirements. *See supra* note 182.) The total hours estimate is based on the following calculation: 10,339 entities x 2 hours = 20,678 hours.

The SEC staff estimate that 33% of SEC-registered investment advisers will be subject to the requirements of Regulation S-ID is based on the following calculation. According to Investment Adviser Registration Depository (IARD) data, there are approximately 11,622 investment advisers registered with the SEC as of July 1, 2012. Of these advisers, approximately 7327 could potentially be subject to the rule as financial institutions because they indicate they have customers who are natural persons. We estimate that approximately 16%, or 1202 of these 7327 advisers, hold transaction accounts belonging to natural persons and therefore would qualify as financial institutions under the rule. Additionally, 4055 of the 11,622 advisers registered with the SEC have private fund clients. We expect that most of the funds advised by these advisers would have at least one natural person investor, and thus they could potentially meet the definition of "financial institution." In addition, some of these private fund advisers may engage in lending activities that would also qualify them as creditors under the rule. In order to avoid duplication, however, we are deducting 1466 private fund advisers from the total number of advisers we estimate will be subject to the rule, because they also indicated on Form ADV that they have individual or high net worth clients and are already accounted for in our estimates above. Accordingly, the staff estimates that approximately 3791 (*i.e.*, 1202 + 4055 - 1466) advisers registered with the SEC will be subject to the rule. These 3791 advisers are about 33% of the 11,622 SEC-registered advisers.

the rules.<sup>191</sup> Accordingly, SEC staff estimates that the total ongoing burden for these 9305 financial institutions and creditors that maintain covered accounts will be 74,440 hours.<sup>192</sup> The estimated total ongoing burden for the 10,339 SEC-regulated entities that are financial institutions or creditors covered by Regulation S-ID will be 76,508 hours.<sup>193</sup>

2. *Section 248.202 (duties of card issuers regarding changes of address).*

The collections of information required by section 248.202 apply only to SEC-regulated entities that issue credit or debit cards.<sup>194</sup> SEC staff understands that SEC-regulated entities generally do not issue credit or debit cards, but instead have arrangements with other entities, such as banks, that issue cards on their behalf. These other entities, which are not regulated by the SEC, are already subject to substantially similar change of address obligations pursuant to the Agencies' identity theft red flags rules. In addition, SEC staff understands that card issuers already assess the validity of change of address requests and, for the most part, have automated the process of notifying the cardholder or using other means to assess the validity of changes of address. Therefore, implementation of this requirement poses no further burden.

SEC staff does not expect that any SEC-regulated entities will be subject to the information collection requirements of section 248.202. Accordingly, SEC staff estimates that

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<sup>191</sup> In the Proposing Release, the SEC requested comment on the estimate that approximately 90% of all financial institutions and creditors maintain covered accounts; the SEC received no comments on this estimate. *See supra* note 188 and accompanying text. If a financial institution or creditor does not maintain covered accounts, there will be no ongoing annual burden for purposes of the PRA.

<sup>192</sup> This estimate is based on the following calculation: 9305 financial institutions and creditors that maintain covered accounts x 8 hours = 74,440 hours.

<sup>193</sup> This estimate is based on the following calculation: 20,678 hours (10,339 financial institutions and creditors x 2 hours (for review of accounts)) + 55,830 hours (9305 financial institutions and creditors that maintain covered accounts x 6 hours (for report to board, and review and update of Program)) = 76,508 hours.

<sup>194</sup> § 248.202(a).



there is no hourly or cost burden for SEC-regulated entities related to section 248.202. In the Proposing Release, the SEC solicited comment on this same estimate of the burdens associated with the collections of information required by section 248.202 and received no comments on its burden estimate.

#### **D. Regulatory Flexibility Act**

##### **CFTC:**

The Regulatory Flexibility Act (“RFA”) requires that federal agencies consider whether the rules they propose will have a significant economic impact on a substantial number of small entities and, if so, provide a regulatory flexibility analysis respecting the impact.<sup>195</sup> The CFTC has already established certain definitions of “small entities” to be used in evaluating the impact of its rules on such small entities in accordance with the RFA.<sup>196</sup> The CFTC’s final identity theft red flags regulations affect FCMs, RFEDs, IBs, CTAs, CPOs, SDs, and MSPs. SDs and MSPs are new categories of registrants. Accordingly, the CFTC has noted in other rule proposals that it has not previously addressed the question of whether such persons were, in fact, small entities for purposes of the RFA.<sup>197</sup>

In this regard, the CFTC has previously determined that FCMs should not be considered to be small entities for purposes of the RFA, based, in part, upon FCMs’ obligation to meet the minimum financial requirements established by the CFTC to enhance the protection of customers’ segregated funds and protect the financial condition of FCMs generally.<sup>198</sup> Like

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<sup>195</sup> See 5 U.S.C. 601–612.

<sup>196</sup> 47 FR 18618 (Apr. 30, 1982).

<sup>197</sup> See 75 FR 81519 (Dec. 28, 2010); 76 FR 6708 (Feb. 8, 2011); 76 FR 6715 (Feb. 8, 2011).

<sup>198</sup> See, e.g., 75 FR 81519 (Dec. 28, 2010).

FCMs, SDs will be subject to minimum capital and margin requirements, and are expected to comprise the largest global financial institutions—and the CFTC is required to exempt from designation as an SD entities that engage in a de minimis level of swaps dealing in connection with transactions with or on behalf of customers. Accordingly, for purposes of the RFA, the CFTC has determined that SDs not be considered “small entities” for essentially the same reasons that it has previously determined FCMs not to be small entities.<sup>199</sup>

The CFTC also has previously determined that large traders are not “small entities” for RFA purposes, with the CFTC considering the size of a trader’s position to be the only appropriate test for the purpose of large trader reporting.<sup>200</sup> The CFTC also has noted that MSPs maintain substantial positions in swaps, creating substantial counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets.<sup>201</sup> Accordingly, for purposes of the RFA, the CFTC has determined that MSPs not be considered “small entities” for essentially the same reasons that it has previously determined large traders not to be small entities.<sup>202</sup>

The CFTC did not receive any comments on its analysis of the application of the RFA to SDs and MSPs. Moreover, the CFTC has issued final rules in which it determined that the registration and regulation of SDs and MSPs would not have a significant economic impact on a substantial number of small entities.<sup>203</sup>

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<sup>199</sup> *Id.*

<sup>200</sup> *See* 47 FR 18618 (Apr. 30, 1982).

<sup>201</sup> *See, e.g.*, 75 FR 81519 (Dec. 28, 2010).

<sup>202</sup> *Id.*

<sup>203</sup> *See, e.g.*, 77 FR 2613 (Jan. 19, 2012); 77 FR 20128 (Apr. 3, 2012).

Further, the CFTC has determined that the requirements on financial institutions and creditors, and card issuers set forth in the identity theft red flags rules, respectively, will not have a significant economic impact on a substantial number of small entities because many of these entities are already complying with the identity theft red flags rules of the Agencies. Moreover, the CFTC believes that the rules include a great deal of flexibility to assist its regulated entities in complying with such rules and guidelines.

In accordance with 5 U.S.C. 605(b), the CFTC Chairman, on behalf of the CFTC, certifies that these rules will not have a significant economic impact on a substantial number of small entities.

**SEC:**

The SEC has prepared the following Final Regulatory Flexibility Analysis (“FRFA”) regarding Regulation S-ID in accordance with 5 U.S.C. 604. The SEC included an Initial Regulatory Flexibility Analysis (“IRFA”) in the Proposing Release in February 2012.<sup>204</sup>

1. *Need for Regulation S-ID*

The FACT Act, which amended FCRA to address identity theft red flags, was enacted in part to help prevent the theft of consumer information. The statute contains several provisions relating to the detection, prevention, and mitigation of identity theft. Section 1088(a) of the Dodd-Frank Act amended section 615(e) of the FCRA by adding the SEC (and CFTC) to the list of federal agencies required to adopt rules related to the detection, prevention, and mitigation of identity theft. Regulation S-ID implements the statutory directives in section 615(e) of the FCRA, which require the SEC to adopt identity theft rules jointly with the Agencies and the CFTC.

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<sup>204</sup> See Proposing Release, *supra* note 12.

Section 615(e) requires the SEC to adopt rules that require financial institutions and creditors to establish policies and procedures to implement guidelines established by the SEC that address identity theft with respect to account holders and customers. Section 615(e) also requires the SEC to adopt rules applicable to credit and debit card issuers to implement policies and procedures to assess the validity of change of address requests.

2. *Significant Issues Raised by Public Comment*

In the Proposing Release, we requested comment on the IRFA. None of the comment letters we received specifically addressed the IRFA. None of the comment letters made specific comments about Regulation S-ID's impact on smaller financial institutions and creditors.

3. *Small Entities Subject to the Rule*

For purposes of the Regulatory Flexibility Act ("RFA"), an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. SEC staff estimates that approximately 119 of the 1692 active open-end investment companies registered on Form N-1A meet this definition.<sup>205</sup>

Under SEC rules, for purposes of the Investment Advisers Act and the RFA, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than \$25 million; (ii) did not have total assets of \$5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of \$25 million or more, or any person (other than a natural person) that had total assets of \$5 million or

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<sup>205</sup> This information is based on staff analysis of information from filings on Form N-SAR and from databases compiled by third-party information providers, including Lipper Inc.

more on the last day of its most recent fiscal year.<sup>206</sup> Based on information in filings submitted to the SEC, 561 of the approximately 11,622 investment advisers registered with the SEC are small entities.<sup>207</sup>

For purposes of the RFA, a broker-dealer is a small business if it had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to rule 17a-5(d) of the Exchange Act or, if not required to file such statements, a broker-dealer that had total capital (net worth plus subordinated liabilities) of less than \$500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter) and if it is not an affiliate of an entity that is not a small business.<sup>208</sup> SEC staff estimates that approximately 797 broker-dealers meet this definition.<sup>209</sup>

#### 4. *Projected Reporting, Recordkeeping, and Other Compliance Requirements*

Section 615(e) of the FCRA, as amended by section 1088 of the Dodd-Frank Act, requires the SEC to adopt rules that require financial institutions and creditors to establish reasonable policies and procedures to implement guidelines established by the SEC that address identity theft with respect to account holders and customers. Section 248.201 of Regulation S-ID implements this mandate by requiring a covered financial institution or creditor that offers or

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<sup>206</sup> 17 CFR 275.0-7(a).

<sup>207</sup> This information is based on data from the Investment Adviser Registration Depository (IARD) as of July 1, 2012.

<sup>208</sup> 17 CFR 240.0-10(c).

<sup>209</sup> This estimate is based on information provided in FOCUS Reports filed with the SEC as of July 1, 2012. There are approximately 4706 broker-dealers registered with the SEC.

maintains certain accounts to create an identity theft prevention Program that detects, prevents, and mitigates the risk of identity theft applicable to these accounts.

Section 615(e) also requires the SEC to adopt rules applicable to credit and debit card issuers to implement policies and procedures to assess the validity of change of address requests. Section 248.202 of Regulation S-ID implements this requirement by requiring credit and debit card issuers to establish reasonable policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a credit or debit card account and within a short period of time afterwards (within 30 days), the issuer receives a request for an additional or replacement card for the same account.

Because all SEC-regulated entities, including small entities, should already be in compliance with the substantially similar identity theft red flags rules that the Agencies began enforcing in 2008 and 2011,<sup>210</sup> Regulation S-ID should not impose new compliance, recordkeeping, or reporting burdens. If a SEC-regulated small entity is not already in compliance with the existing identity theft red flags rules issued by the Agencies, the burden of compliance with Regulation S-ID should be minimal because we understand that these entities already engage in various activities to minimize losses due to fraud as part of their usual and customary business practices. In particular, the rules allow these entities to consolidate their existing policies and procedures into their written Program and may require some additional staff training. Accordingly, the impact of the requirements should be largely incremental and not significant, and we do not anticipate that Regulation S-ID will disproportionately affect small entities.

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<sup>210</sup> See *supra* note 8.

The SEC has estimated the costs of Regulation S-ID for all entities (including small entities) in the PRA and economic analysis included in this release. No new classes of skills are required to comply with Regulation S-ID. SEC staff does not anticipate that small entities will face unique or special burdens when complying with Regulation S-ID.

5. *Agency Action to Minimize Effect on Small Entities*

The RFA directs the SEC to consider significant alternatives that would accomplish our stated objective, while minimizing any significant economic impact on small issuers. In connection with Regulation S-ID, the SEC considered the following alternatives: (i) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance requirements under Regulation S-ID for small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of Regulation S-ID, or any part thereof, for small entities.

Regulation S-ID requires covered financial institutions and creditors that offer or maintain certain accounts to create an identity theft prevention Program and report to the board of directors, an appropriate committee thereof, or a designated senior management employee at least annually on compliance with the regulations. Credit and debit card issuers are required to respond to a change of address request by notifying the cardholder or using other means to assess the validity of a change of address.

The standards in Regulation S-ID are flexible, and take into account a covered financial institution or creditor's size and sophistication, as well as the costs and benefits of alternative compliance methods. A Program under Regulation S-ID should be tailored to the risk of identity theft in a financial institution or creditor's covered accounts, thereby permitting small entities

whose accounts pose a low risk of identity theft to avoid much of the cost of compliance.

Because small entities maintain covered accounts that pose a risk of identity theft for consumers just as larger entities do, providing an exemption from Regulation S-ID for small entities could subject consumers with covered accounts at small entities to a higher risk of identity theft.

Pursuant to section 615(e) of the FCRA, as amended by section 1088 of the Dodd-Frank Act, the SEC and the CFTC are jointly adopting identity theft red flags rules that are substantially similar and comparable to the identity theft red flags rules previously adopted by the Agencies. Providing a new exemption for small entities, or further consolidating or simplifying the regulations for small entities, could result in significant differences between the identity theft red flags rules adopted by the Commissions and the rules adopted by the Agencies. Because SEC-regulated entities, including small entities, should already be in compliance with the substantially similar identity theft red flags rules that the Agencies began enforcing in 2008 and 2011, SEC staff does not expect that small entities will need a delayed effective or compliance date beyond that already provided to all entities subject to the rules.

#### **IV. STATUTORY AUTHORITY AND TEXT OF AMENDMENTS**

The CFTC is amending Part 162 under the authority set forth in sections 1088(a)(8), 1088(a)(10), and 1088(b) of the Dodd-Frank Act,<sup>211</sup> and sections 615(e), 621(b), 624, and 628 of the FCRA.<sup>212</sup>

The SEC is adopting Regulation S-ID under the authority set forth in sections 1088(a)(8), 1088(a)(10), and 1088(b) of the Dodd-Frank Act,<sup>213</sup> section 615(e) of the FCRA,<sup>214</sup> sections 17

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<sup>211</sup> Pub. L. No. 111-203, §§ 1088(a)(8), 1088(a)(10), and § 1088(b), 124 Stat. 1376 (2010).

<sup>212</sup> 15 U.S.C 1681m(e), 1681s(b), 1681s-3 and note, and 1681w(a)(1).

<sup>213</sup> Pub. L. No. 111-203, §§ 1088(a)(8), 1088(a)(10), 1088(b), 124 Stat. 1376 (2010).



and 23 of the Exchange Act,<sup>215</sup> sections 31 and 38 of the Investment Company Act,<sup>216</sup> and sections 204 and 211 of the Investment Advisers Act.<sup>217</sup>

## **List of Subjects**

### *17 CFR Part 162*

Cardholders, Card issuers, Commodity pool operators, Commodity trading advisors, Confidential business information, Consumer reports, Credit, Creditors, Consumer, Customer, Fair and Accurate Credit Transactions Act, Fair Credit Reporting Act, Financial institutions, Futures commission merchants, Gramm-Leach-Bliley Act, Identity theft, Introducing brokers, Major swap participants, Privacy, Red flags, Reporting and recordkeeping requirements, Retail foreign exchange dealers, Self-regulatory organizations, Service provider, Swap dealers.

### *17 CFR Part 248*

Affiliate marketing, Brokers, Cardholders, Card issuers, Confidential business information, Consumers, Consumer financial information, Consumer reports, Credit, Creditors, Customers, Dealers, Fair and Accurate Credit Transactions Act, Fair Credit Reporting Act, Financial institutions, Gramm-Leach-Bliley Act, Identity theft, Investment advisers, Investment companies, Privacy, Red flags, Reporting and recordkeeping requirements, Securities, Security measures, Self-regulatory organizations, Service providers, Transfer agents.

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<sup>214</sup> 15 U.S.C. 1681m(e).

<sup>215</sup> 15 U.S.C. 78q and 78w.

<sup>216</sup> 15 U.S.C. 80a-30 and 80a-37.

<sup>217</sup> 15 U.S.C. 80b-4 and 80b-11.

## TEXT OF FINAL RULES

### Commodity Futures Trading Commission

For the reasons stated above in the preamble, the Commodity Futures Trading Commission is amending 17 CFR part 162 to read as follows:

1. Add subpart C to part 162 read as follows:

#### **Subpart C—Identity Theft Red Flags**

Sec.

162.22–162.29 [Reserved]

162.30 Duties regarding the detection, prevention, and mitigation of identity theft.

#### **Subpart C—Identity Theft Red Flags**

##### **§ 162.30 Duties regarding the detection, prevention, and mitigation of identity theft.**

(a) *Scope of this subpart.* This section applies to financial institutions or creditors that are subject to administrative enforcement of the FCRA by the Commission pursuant to Sec.

621(b)(1) of the FCRA, 15 U.S.C. 1681s(b)(1).

(b) *Special definitions for this subpart.* For purposes of this section, and Appendix B, the following definitions apply:

(1) Account means a continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes. Account includes an extension of credit, such as the purchase of property or services involving a deferred payment.

(2) The term *board of directors* includes:

(i) In the case of a branch or agency of a foreign bank, the managing official in charge of the branch or agency; and

(ii) In the case of any other creditor that does not have a board of directors, a designated senior management employee.

(3) *Covered account* means:

(i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a margin account; and

(ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

(4) *Credit* has the same meaning in Sec. 603(r)(5) of the FCRA, 15 U.S.C. 1681a(r)(5).

(5) *Creditor* has the same meaning as in 15 U.S.C. 1681m(e)(4), and includes any futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, swap dealer, or major swap participant that regularly extends, renews, or continues credit; regularly arranges for the extension, renewal, or continuation of credit; or in acting as an assignee of an original creditor, participates in the decision to extend, renew, or continue credit.

(6) *Customer* means a person that has a covered account with a financial institution or creditor.

(7) *Financial institution* has the same meaning as in 15 U.S.C. 1681a(t) and includes any futures commission merchant, retail foreign exchange dealer, commodity trading advisor, commodity pool operator, introducing broker, swap dealer, or major swap participant that directly or indirectly holds a transaction account belonging to a consumer.

(8) *Identifying information* means any name or number that may be used, alone or in conjunction with any other information, to identify a specific person, including any—

(i) Name, Social Security number, date of birth, official State or government issued driver's license or identification number, alien registration number, government passport number, employer or taxpayer identification number;

(ii) Unique biometric data, such as fingerprint, voice print, retina or iris image, or other unique physical representation;

(iii) Unique electronic identification number, address, or routing code; or

(iv) Telecommunication identifying information or access device (as defined in 18 U.S.C. 1029(e)).

(9) *Identity theft* means a fraud committed or attempted using the identifying information of another person without authority.

(10) *Red Flag* means a pattern, practice, or specific activity that indicates the possible existence of identity theft.

(11) *Service provider* means a person that provides a service directly to the financial institution or creditor.

(c) *Periodic identification of covered accounts.* Each financial institution or creditor must periodically determine whether it offers or maintains covered accounts. As a part of this determination, a financial institution or creditor shall conduct a risk assessment to determine whether it offers or maintains covered accounts described in paragraph (b)(3)(ii) of this section, taking into consideration:

(1) The methods it provides to open its accounts;

(2) The methods it provides to access its accounts; and

(3) Its previous experiences with identity theft.

(d) *Establishment of an Identity Theft Prevention Program*—(1) Program requirement.

Each financial institution or creditor that offers or maintains one or more covered accounts must develop and implement a written Identity Theft Prevention Program that is designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. The Identity Theft Prevention Program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities.

(2) *Elements of the Identity Theft Prevention Program.* The Identity Theft Prevention Program must include reasonable policies and procedures to:

(i) Identify relevant Red Flags for the covered accounts that the financial institution or creditor offers or maintains, and incorporate those Red Flags into its Identity Theft Prevention Program;

(ii) Detect Red Flags that have been incorporated into the Identity Theft Prevention Program of the financial institution or creditor;

(iii) Respond appropriately to any Red Flags that are detected pursuant to paragraph (d)(2)(ii) of this section to prevent and mitigate identity theft; and

(iv) Ensure the Identity Theft Prevention Program (including the Red Flags determined to be relevant) is updated periodically, to reflect changes in risks to customers and to the safety and soundness of the financial institution or creditor from identity theft.

(e) *Administration of the Identity Theft Prevention Program.* Each financial institution or creditor that is required to implement an Identity Theft Prevention Program must provide for the continued administration of the Identity Theft Prevention Program and must:

(1) Obtain approval of the initial written Identity Theft Prevention Program from either its board of directors or an appropriate committee of the board of directors;

(2) Involve the board of directors, an appropriate committee thereof, or a designated employee at the level of senior management in the oversight, development, implementation and administration of the Identity Theft Prevention Program;

(3) Train staff, as necessary, to effectively implement the Identity Theft Prevention Program; and

(4) Exercise appropriate and effective oversight of service provider arrangements.

(f) *Guidelines.* Each financial institution or creditor that is required to implement an Identity Theft Prevention Program must consider the guidelines in appendix B of this part and include in its Identity Theft Prevention Program those guidelines that are appropriate.

#### **§ 162.31 [Reserved]**

#### **§ 162.32 Duties of card issuers regarding changes of address.**

(a) *Scope.* This section applies to a person described in § 162.30(a) of this part that issues a debit or credit card (card issuer).

(b) *Definition of cardholder.* For purposes of this section, a cardholder means a consumer who has been issued a credit or debit card.

(c) *Address validation requirements.* A card issuer must establish and implement reasonable policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a consumer's debit or credit card account and, within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account. Under these circumstances, the card issuer may not issue an additional or replacement

card, until, in accordance with its reasonable policies and procedures and for the purpose of assessing the validity of the change of address, the card issuer:

(1)(i) Notifies the cardholder of the request:

(A) At the cardholder's former address; or

(B) By any other means of communication that the card issuer and the cardholder have previously agreed to use; and

(ii) Provides to the cardholder a reasonable means of promptly reporting incorrect address changes; or

(2) Otherwise assesses the validity of the change of address in accordance with the policies and procedures the card issuer has established pursuant to § 162.30 of this part.

(d) *Alternative timing of address validation.* A card issuer may satisfy the requirements of paragraph (c) of this section if it validates an address pursuant to the methods in paragraph (c)(1) or (c)(2) of this section when it receives an address change notification, before it receives a request for an additional or replacement card.

(e) *Form of notice.* Any written or electronic notice that the card issuer provides under this paragraph must be clear and conspicuous and provided separately from its regular correspondence with the cardholder.

2. Add Appendix B to part 162 to read as follows:

**Appendix B to Part 162—Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation**

Section 162.30 of this part requires each financial institution or creditor that offers or maintains one or more covered accounts, as defined in § 162.30(b)(3) of this part, to develop and provide for the continued administration of a written Identity Theft Prevention Program to detect,

prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. These guidelines are intended to assist financial institutions and creditors in the formulation and maintenance of an Identity Theft Prevention Program that satisfies the requirements of § 162.30 of this part.

I. The Identity Theft Prevention Program

In designing its Identity Theft Prevention Program, a financial institution or creditor may incorporate, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

II. Identifying Relevant Red Flags

(a) *Risk factors*. A financial institution or creditor should consider the following factors in identifying relevant Red Flags for covered accounts, as appropriate:

- (1) The types of covered accounts it offers or maintains;
- (2) The methods it provides to open its covered accounts;
- (3) The methods it provides to access its covered accounts; and
- (4) Its previous experiences with identity theft.

(b) *Sources of Red Flags*. Financial institutions and creditors should incorporate relevant Red Flags from sources such as:

- (1) Incidents of identity theft that the financial institution or creditor has experienced;
- (2) Methods of identity theft that the financial institution or creditor has identified that reflect changes in identity theft risks; and
- (3) Applicable supervisory guidance.



(c) *Categories of Red Flags.* The Identity Theft Prevention Program should include relevant Red Flags from the following categories, as appropriate. Examples of Red Flags from each of these categories are appended as Supplement A to this Appendix B.

(1) Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services;

(2) The presentation of suspicious documents;

(3) The presentation of suspicious personal identifying information, such as a suspicious address change;

(4) The unusual use of, or other suspicious activity related to, a covered account; and

(5) Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor.

### III. Detecting Red Flags

The Identity Theft Prevention Program's policies and procedures should address the detection of Red Flags in connection with the opening of covered accounts and existing covered accounts, such as by:

(a) Obtaining identifying information about, and verifying the identity of, a person opening a covered account; and

(b) Authenticating customers, monitoring transactions, and verifying the validity of change of address requests, in the case of existing covered accounts.

#### IV. Preventing and Mitigating Identity Theft

The Identity Theft Prevention Program's policies and procedures should provide for appropriate responses to the Red Flags the financial institution or creditor has detected that are commensurate with the degree of risk posed. In determining an appropriate response, a financial institution or creditor should consider aggravating factors that may heighten the risk of identity theft, such as a data security incident that results in unauthorized access to a customer's account records held by the financial institution or creditor, or third party, or notice that a customer has provided information related to a covered account held by the financial institution or creditor to someone fraudulently claiming to represent the financial institution or creditor or to a fraudulent Internet website. Appropriate responses may include the following:

- (a) Monitoring a covered account for evidence of identity theft;
- (b) Contacting the customer;
- (c) Changing any passwords, security codes, or other security devices that permit access to a covered account;
- (d) Reopening a covered account with a new account number;
- (e) Not opening a new covered account;
- (f) Closing an existing covered account;
- (g) Not attempting to collect on a covered account or not selling a covered account to a debt collector;
- (h) Notifying law enforcement; or
- (i) Determining that no response is warranted under the particular circumstances.

## V. Updating the Identity Theft Prevention Program

Financial institutions and creditors should update the Identity Theft Prevention Program (including the Red Flags determined to be relevant) periodically, to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft, based on factors such as:

- (a) The experiences of the financial institution or creditor with identity theft;
- (b) Changes in methods of identity theft;
- (c) Changes in methods to detect, prevent, and mitigate identity theft;
- (d) Changes in the types of accounts that the financial institution or creditor offers or maintains; and
- (e) Changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

## VI. Methods for Administering the Identity Theft Prevention Program

(a) *Oversight of Identity Theft Prevention Program.* Oversight by the board of directors, an appropriate committee of the board, or a designated senior management employee should include:

- (1) Assigning specific responsibility for the Identity Theft Prevention Program's implementation;
- (2) Reviewing reports prepared by staff regarding compliance by the financial institution or creditor with § 162.30 of this part; and
- (3) Approving material changes to the Identity Theft Prevention Program as necessary to address changing identity theft risks.

(b) *Reports.* (1) *In general.* Staff of the financial institution or creditor responsible for development, implementation, and administration of its Identity Theft Prevention Program should report to the board of directors, an appropriate committee of the board, or a designated senior management employee, at least annually, on compliance by the financial institution or creditor with § 162.30 of this part.

(2) *Contents of report.* The report should address material matters related to the Identity Theft Prevention Program and evaluate issues such as: The effectiveness of the policies and procedures of the financial institution or creditor in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts; service provider arrangements; significant incidents involving identity theft and management's response; and recommendations for material changes to the Identity Theft Prevention Program.

(c) *Oversight of service provider arrangements.* Whenever a financial institution or creditor engages a service provider to perform an activity in connection with one or more covered accounts the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft. For example, a financial institution or creditor could require the service provider by contract to have policies and procedures to detect relevant Red Flags that may arise in the performance of the service provider's activities, and either report the Red Flags to the financial institution or creditor, or to take appropriate steps to prevent or mitigate identity theft.

## VII. Other Applicable Legal Requirements

Financial institutions and creditors should be mindful of other related legal requirements that may be applicable, such as:

(a) For financial institutions and creditors that are subject to 31 U.S.C. 5318(g), filing a Suspicious Activity Report in accordance with applicable law and regulation;

(b) Implementing any requirements under 15 U.S.C. 1681c-1(h) regarding the circumstances under which credit may be extended when the financial institution or creditor detects a fraud or active duty alert;

(c) Implementing any requirements for furnishers of information to consumer reporting agencies under 15 U.S.C. 1681s-2, for example, to correct or update inaccurate or incomplete information, and to not report information that the furnisher has reasonable cause to believe is inaccurate; and

(d) Complying with the prohibitions in 15 U.S.C. 1681m on the sale, transfer, and placement for collection of certain debts resulting from identity theft.

*Supplement A to Appendix B*

In addition to incorporating Red Flags from the sources recommended in section II(b) of the Guidelines in Appendix B of this part, each financial institution or creditor may consider incorporating into its Identity Theft Prevention Program, whether singly or in combination, Red Flags from the following illustrative examples in connection with covered accounts:

*Alerts, Notifications or Warnings from a Consumer Reporting Agency*

1. A fraud or active duty alert is included with a consumer report.
2. A consumer reporting agency provides a notice of credit freeze in response to a request for a consumer report.
3. A consumer reporting agency provides a notice of address discrepancy, as defined in Sec. 603(f) of the Fair Credit Reporting Act (15 U.S.C. 1681a(f)).

4. A consumer report indicates a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer, such as:

- a. A recent and significant increase in the volume of inquiries;
- b. An unusual number of recently established credit relationships;
- c. A material change in the use of credit, especially with respect to recently established credit relationships; or
- d. An account that was closed for cause or identified for abuse of account privileges by a financial institution or creditor.

#### *Suspicious Documents*

- 5. Documents provided for identification appear to have been altered or forged.
- 6. The photograph or physical description on the identification is not consistent with the appearance of the applicant or customer presenting the identification.
- 7. Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.
- 8. Other information on the identification is not consistent with readily accessible information that is on file with the financial institution or creditor, such as a signature card or a recent check.
- 9. An application appears to have been altered or forged, or gives the appearance of having been destroyed and reassembled.

#### *Suspicious Personal Identifying Information*

10. Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or creditor. For example:

- a. The address does not match any address in the consumer report; or

b. The Social Security Number (SSN) has not been issued, or is listed on the Social Security Administration's Death Master File.

11. Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example, there is a lack of correlation between the SSN range and date of birth.

12. Personal identifying information provided is associated with known fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor.

For example:

a. The address on an application is the same as the address provided on a fraudulent application; or

b. The phone number on an application is the same as the number provided on a fraudulent application.

13. Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

a. The address on an application is fictitious, a mail drop, or a prison; or

b. The phone number is invalid, or is associated with a pager or answering service.

14. The SSN provided is the same as that submitted by other persons opening an account or other customers.

15. The address or telephone number provided is the same as or similar to the address or telephone number submitted by an unusually large number of other persons opening accounts or by other customers.

16. The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

17. Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.

18. For financial institutions or creditors that use challenge questions, the person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.

*Unusual Use of, or Suspicious Activity Related to, the Covered Account*

19. Shortly following the notice of a change of address for a covered account, the institution or creditor receives a request for a new, additional, or replacement means of accessing the account or for the addition of an authorized user on the account.

20. A new revolving credit account is used in a manner commonly associated with known patterns of fraud. For example:

- a. The majority of available credit is used for cash advances or merchandise that is easily convertible to cash (*e.g.*, electronics equipment or jewelry); or
- b. The customer fails to make the first payment or makes an initial payment but no subsequent payments.

21. A covered account is used in a manner that is not consistent with established patterns of activity on the account. There is, for example:

- a. Nonpayment when there is no history of late or missed payments;
- b. A material increase in the use of available credit;
- c. A material change in purchasing or spending patterns;



d. A material change in electronic fund transfer patterns in connection with a deposit account; or

e. A material change in telephone call patterns in connection with a cellular phone account.

22. A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).

23. Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.

24. The financial institution or creditor is notified that the customer is not receiving paper account statements.

25. The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

*Notice from Customers, Victims of Identity Theft, Law Enforcement Authorities, or Other Persons Regarding Possible Identity Theft in Connection With Covered Accounts Held by the Financial Institution or Creditor*

26. The financial institution or creditor is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

## Securities and Exchange Commission

For the reasons stated in the preamble, the Securities and Exchange Commission is amending 17 CFR part 248 as follows:

### Part 248—REGULATIONS S-P, S-AM, AND S-ID

3. The authority citation for part 248 is revised to read as follows:

*Authority:* 15 U.S.C. 78q, 78q-1, 78o-4, 78o-5, 78w, 78mm, 80a-30, 80a-37, 80b-4, 80b-11, 1681m(e), 1681s(b), 1681s-3 and note, 1681w(a)(1), 6801–6809, and 6825; Pub. L. 111-203, §§ 1088(a)(8), (a)(10), and § 1088(b), 124 Stat. 1376 (2010).

4. Revise the heading for part 248 to read as set forth above.

5. Add subpart C to part 248 to read as follows:

#### Subpart C—Regulation S-ID: Identity Theft Red Flags

Sec.

248.201 Duties regarding the detection, prevention, and mitigation of identity theft.

248.202 Duties of card issuers regarding changes of address.

Appendix A to Subpart C of Part 248 – Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation

#### Subpart C—Regulation S-ID: Identity Theft Red Flags

##### § 248.201 Duties regarding the detection, prevention, and mitigation of identity theft.

(a) *Scope.* This section applies to a *financial institution or creditor*, as defined in the Fair Credit Reporting Act (15 U.S.C. 1681), that is:

(1) A broker, dealer or any other person that is registered or required to be registered under the Securities Exchange Act of 1934;

(2) An investment company that is registered or required to be registered under the Investment Company Act of 1940, that has elected to be regulated as a business development company under that Act, or that operates as an employees' securities company under that Act; or

(3) An investment adviser that is registered or required to be registered under the Investment Advisers Act of 1940.

(b) *Definitions.* For purposes of this subpart, and Appendix A of this subpart, the following definitions apply:

(1) *Account* means a continuing relationship established by a person with a financial institution or creditor to obtain a product or service for personal, family, household or business purposes. Account includes a brokerage account, a *mutual fund* account (*i.e.*, an account with an open-end investment company), and an investment advisory account.

(2) The term *board of directors* includes:

(i) In the case of a branch or agency of a foreign financial institution or creditor, the managing official of that branch or agency; and

(ii) In the case of a financial institution or creditor that does not have a board of directors, a designated employee at the level of senior management.

(3) *Covered account* means:

(i) An account that a financial institution or creditor offers or maintains, primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, such as a brokerage account with a broker-dealer or an account maintained by a mutual fund (or its agent) that permits wire transfers or other payments to third parties; and

(ii) Any other account that the financial institution or creditor offers or maintains for which there is a reasonably foreseeable risk to customers or to the safety and soundness of the

financial institution or creditor from identity theft, including financial, operational, compliance, reputation, or litigation risks.

(4) *Credit* has the same meaning as in 15 U.S.C. 1681a(r)(5).

(5) *Creditor* has the same meaning as in 15 U.S.C. 1681m(e)(4).

(6) *Customer* means a person that has a covered account with a financial institution or creditor.

(7) *Financial institution* has the same meaning as in 15 U.S.C. 1681a(t).

(8) *Identifying information* means any name or number that may be used, alone or in conjunction with any other information, to identify a specific person, including any—

(i) Name, Social Security number, date of birth, official State or government issued driver's license or identification number, alien registration number, government passport number, employer or taxpayer identification number;

(ii) Unique biometric data, such as fingerprint, voice print, retina or iris image, or other unique physical representation;

(iii) Unique electronic identification number, address, or routing code; or

(iv) Telecommunication identifying information or access device (as defined in 18 U.S.C. 1029(e)).

(9) *Identity theft* means a fraud committed or attempted using the identifying information of another person without authority.

(10) *Red Flag* means a pattern, practice, or specific activity that indicates the possible existence of identity theft.

(11) *Service provider* means a person that provides a service directly to the financial institution or creditor.

(12) *Other definitions.*

(i) *Broker* has the same meaning as in section 3(a)(4) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(4)).

(ii) *Commission* means the Securities and Exchange Commission.

(iii) *Dealer* has the same meaning as in section 3(a)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(5)).

(iv) *Investment adviser* has the same meaning as in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)).

(v) *Investment company* has the same meaning as in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), and includes a separate series of the investment company.

(vi) Other terms not defined in this subpart have the same meaning as in the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*).

(c) *Periodic Identification of Covered Accounts.* Each financial institution or creditor must periodically determine whether it offers or maintains covered accounts. As a part of this determination, a financial institution or creditor must conduct a risk assessment to determine whether it offers or maintains covered accounts described in paragraph (b)(3)(ii) of this section, taking into consideration:

(1) The methods it provides to open its accounts;

(2) The methods it provides to access its accounts; and

(3) Its previous experiences with identity theft.

(d) *Establishment of an Identity Theft Prevention Program—*

(1) *Program requirement.* Each financial institution or creditor that offers or maintains one or more covered accounts must develop and implement a written Identity Theft Prevention

Program (Program) that is designed to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. The Program must be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities.

(2) *Elements of the Program.* The Program must include reasonable policies and procedures to:

(i) Identify relevant Red Flags for the covered accounts that the financial institution or creditor offers or maintains, and incorporate those Red Flags into its Program;

(ii) Detect Red Flags that have been incorporated into the Program of the financial institution or creditor;

(iii) Respond appropriately to any Red Flags that are detected pursuant to paragraph (d)(2)(ii) of this section to prevent and mitigate identity theft; and

(iv) Ensure the Program (including the Red Flags determined to be relevant) is updated periodically, to reflect changes in risks to customers and to the safety and soundness of the financial institution or creditor from identity theft.

(e) *Administration of the Program.* Each financial institution or creditor that is required to implement a Program must provide for the continued administration of the Program and must:

(1) Obtain approval of the initial written Program from either its board of directors or an appropriate committee of the board of directors;

(2) Involve the board of directors, an appropriate committee thereof, or a designated employee at the level of senior management in the oversight, development, implementation and administration of the Program;

(3) Train staff, as necessary, to effectively implement the Program; and

(4) Exercise appropriate and effective oversight of service provider arrangements.

(f) *Guidelines.* Each financial institution or creditor that is required to implement a Program must consider the guidelines in Appendix A to this subpart and include in its Program those guidelines that are appropriate.

**§ 248.202 Duties of card issuers regarding changes of address.**

(a) *Scope.* This section applies to a person described in § 248.201(a) that issues a credit or debit card (card issuer).

(b) *Definitions.* For purposes of this section:

(1) *Cardholder* means a consumer who has been issued a *credit card* or *debit card* as defined in 15 U.S.C. 1681a(r).

(2) *Clear and conspicuous* means reasonably understandable and designed to call attention to the nature and significance of the information presented.

(3) Other terms not defined in this subpart have the same meaning as in the Fair Credit Reporting Act (15 U.S.C. 1681 *et seq.*).

(c) *Address validation requirements.* A card issuer must establish and implement reasonable written policies and procedures to assess the validity of a change of address if it receives notification of a change of address for a consumer's debit or credit card account and, within a short period of time afterwards (during at least the first 30 days after it receives such notification), the card issuer receives a request for an additional or replacement card for the same account. Under these circumstances, the card issuer may not issue an additional or replacement card, until, in accordance with its reasonable policies and procedures and for the purpose of assessing the validity of the change of address, the card issuer:

(1)(i) Notifies the cardholder of the request:

(A) At the cardholder's former address; or

(B) By any other means of communication that the card issuer and the cardholder have previously agreed to use; and

(ii) Provides to the cardholder a reasonable means of promptly reporting incorrect address changes; or

(2) Otherwise assesses the validity of the change of address in accordance with the policies and procedures the card issuer has established pursuant to § 248.201.

(d) *Alternative timing of address validation.* A card issuer may satisfy the requirements of paragraph (c) of this section if it validates an address pursuant to the methods in paragraph (c)(1) or (c)(2) of this section when it receives an address change notification, before it receives a request for an additional or replacement card.

(e) *Form of notice.* Any written or electronic notice that the card issuer provides under this paragraph must be clear and conspicuous and be provided separately from its regular correspondence with the cardholder.

#### **Appendix A to Subpart C of Part 248—Interagency Guidelines on Identity Theft Detection, Prevention, and Mitigation**

Section 248.201 requires each financial institution and creditor that offers or maintains one or more covered accounts, as defined in § 248.201(b)(3), to develop and provide for the continued administration of a written Program to detect, prevent, and mitigate identity theft in connection with the opening of a covered account or any existing covered account. These guidelines are intended to assist financial institutions and creditors in the formulation and maintenance of a Program that satisfies the requirements of § 248.201.



## I. The Program

In designing its Program, a financial institution or creditor may incorporate, as appropriate, its existing policies, procedures, and other arrangements that control reasonably foreseeable risks to customers or to the safety and soundness of the financial institution or creditor from identity theft.

## II. Identifying Relevant Red Flags

(a) *Risk Factors*. A financial institution or creditor should consider the following factors in identifying relevant Red Flags for covered accounts, as appropriate:

- (1) The types of covered accounts it offers or maintains;
- (2) The methods it provides to open its covered accounts;
- (3) The methods it provides to access its covered accounts; and
- (4) Its previous experiences with identity theft.

(b) *Sources of Red Flags*. Financial institutions and creditors should incorporate relevant Red Flags from sources such as:

- (1) Incidents of identity theft that the financial institution or creditor has experienced;
- (2) Methods of identity theft that the financial institution or creditor has identified that reflect changes in identity theft risks; and
- (3) Applicable regulatory guidance.

(c) *Categories of Red Flags*. The Program should include relevant Red Flags from the following categories, as appropriate. Examples of Red Flags from each of these categories are appended as Supplement A to this Appendix A.

- (1) Alerts, notifications, or other warnings received from consumer reporting agencies or service providers, such as fraud detection services;

- (2) The presentation of suspicious documents;
- (3) The presentation of suspicious personal identifying information, such as a suspicious address change;
- (4) The unusual use of, or other suspicious activity related to, a covered account; and
- (5) Notice from customers, victims of identity theft, law enforcement authorities, or other persons regarding possible identity theft in connection with covered accounts held by the financial institution or creditor.

### III. Detecting Red Flags

The Program's policies and procedures should address the detection of Red Flags in connection with the opening of covered accounts and existing covered accounts, such as by:

- (a) Obtaining identifying information about, and verifying the identity of, a person opening a covered account, for example, using the policies and procedures regarding identification and verification set forth in the Customer Identification Program rules implementing 31 U.S.C. 5318(I) (31 CFR 1023.220 (broker-dealers) and 1024.220 (mutual funds)); and
- (b) Authenticating customers, monitoring transactions, and verifying the validity of change of address requests, in the case of existing covered accounts.

### IV. Preventing and Mitigating Identity Theft

The Program's policies and procedures should provide for appropriate responses to the Red Flags the financial institution or creditor has detected that are commensurate with the degree of risk posed. In determining an appropriate response, a financial institution or creditor should consider aggravating factors that may heighten the risk of identity theft, such as a data security incident that results in unauthorized access to a customer's account records held by the financial

institution, creditor, or third party, or notice that a customer has provided information related to a covered account held by the financial institution or creditor to someone fraudulently claiming to represent the financial institution or creditor or to a fraudulent website. Appropriate responses may include the following:

- (a) Monitoring a covered account for evidence of identity theft;
- (b) Contacting the customer;
- (c) Changing any passwords, security codes, or other security devices that permit access to a covered account;
- (d) Reopening a covered account with a new account number;
- (e) Not opening a new covered account;
- (f) Closing an existing covered account;
- (g) Not attempting to collect on a covered account or not selling a covered account to a debt collector;
- (h) Notifying law enforcement; or
- (i) Determining that no response is warranted under the particular circumstances.

V. Updating the Program

Financial institutions and creditors should update the Program (including the Red Flags determined to be relevant) periodically, to reflect changes in risks to customers or to the safety and soundness of the financial institution or creditor from identity theft, based on factors such as:

- (a) The experiences of the financial institution or creditor with identity theft;
- (b) Changes in methods of identity theft;
- (c) Changes in methods to detect, prevent, and mitigate identity theft;
- (d) Changes in the types of accounts that the financial institution or creditor offers or

maintains; and

(e) Changes in the business arrangements of the financial institution or creditor, including mergers, acquisitions, alliances, joint ventures, and service provider arrangements.

## VI. Methods for Administering the Program

(a) *Oversight of Program.* Oversight by the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management should include:

(1) Assigning specific responsibility for the Program's implementation;

(2) Reviewing reports prepared by staff regarding compliance by the financial institution or creditor with § 248.201; and

(3) Approving material changes to the Program as necessary to address changing identity theft risks.

(b) *Reports.*

(1) *In general.* Staff of the financial institution or creditor responsible for development, implementation, and administration of its Program should report to the board of directors, an appropriate committee of the board, or a designated employee at the level of senior management, at least annually, on compliance by the financial institution or creditor with § 248.201.

(2) *Contents of report.* The report should address material matters related to the Program and evaluate issues such as: the effectiveness of the policies and procedures of the financial institution or creditor in addressing the risk of identity theft in connection with the opening of covered accounts and with respect to existing covered accounts; service provider arrangements; significant incidents involving identity theft and management's response; and recommendations for material changes to the Program.

(c) *Oversight of service provider arrangements.* Whenever a financial institution or

creditor engages a service provider to perform an activity in connection with one or more covered accounts the financial institution or creditor should take steps to ensure that the activity of the service provider is conducted in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft. For example, a financial institution or creditor could require the service provider by contract to have policies and procedures to detect relevant Red Flags that may arise in the performance of the service provider's activities, and either report the Red Flags to the financial institution or creditor, or to take appropriate steps to prevent or mitigate identity theft.

#### VII. Other Applicable Legal Requirements

Financial institutions and creditors should be mindful of other related legal requirements that may be applicable, such as:

(a) For financial institutions and creditors that are subject to 31 U.S.C. 5318(g), filing a Suspicious Activity Report in accordance with applicable law and regulation;

(b) Implementing any requirements under 15 U.S.C. 1681c-1(h) regarding the circumstances under which credit may be extended when the financial institution or creditor detects a fraud or active duty alert;

(c) Implementing any requirements for furnishers of information to consumer reporting agencies under 15 U.S.C. 1681s-2, for example, to correct or update inaccurate or incomplete information, and to not report information that the furnisher has reasonable cause to believe is inaccurate; and

(d) Complying with the prohibitions in 15 U.S.C. 1681m on the sale, transfer, and placement for collection of certain debts resulting from identity theft.

### *Supplement A to Appendix A*

In addition to incorporating Red Flags from the sources recommended in section II.b. of the Guidelines in Appendix A to this subpart, each financial institution or creditor may consider incorporating into its Program, whether singly or in combination, Red Flags from the following illustrative examples in connection with covered accounts:

#### *Alerts, Notifications or Warnings from a Consumer Reporting Agency*

1. A fraud or active duty alert is included with a consumer report.
2. A consumer reporting agency provides a notice of credit freeze in response to a request for a consumer report.
3. A consumer reporting agency provides a notice of address discrepancy, as referenced in Sec. 605(h) of the Fair Credit Reporting Act (15 U.S.C. 1681c(h)).
4. A consumer report indicates a pattern of activity that is inconsistent with the history and usual pattern of activity of an applicant or customer, such as:
  - a. A recent and significant increase in the volume of inquiries;
  - b. An unusual number of recently established credit relationships;
  - c. A material change in the use of credit, especially with respect to recently established credit relationships; or
  - d. An account that was closed for cause or identified for abuse of account privileges by a financial institution or creditor.

#### *Suspicious Documents*

5. Documents provided for identification appear to have been altered or forged.
6. The photograph or physical description on the identification is not consistent with the appearance of the applicant or customer presenting the identification.

7. Other information on the identification is not consistent with information provided by the person opening a new covered account or customer presenting the identification.

8. Other information on the identification is not consistent with readily accessible information that is on file with the financial institution or creditor, such as a signature card or a recent check.

9. An application appears to have been altered or forged, or gives the appearance of having been destroyed and reassembled.

*Suspicious Personal Identifying Information*

10. Personal identifying information provided is inconsistent when compared against external information sources used by the financial institution or creditor. For example:

- a. The address does not match any address in the consumer report; or
- b. The Social Security Number (SSN) has not been issued, or is listed on the Social Security Administration's Death Master File.

11. Personal identifying information provided by the customer is not consistent with other personal identifying information provided by the customer. For example, there is a lack of correlation between the SSN range and date of birth.

12. Personal identifying information provided is associated with known fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

- a. The address on an application is the same as the address provided on a fraudulent application; or
- b. The phone number on an application is the same as the number provided on a fraudulent application.

13. Personal identifying information provided is of a type commonly associated with fraudulent activity as indicated by internal or third-party sources used by the financial institution or creditor. For example:

- a. The address on an application is fictitious, a mail drop, or a prison; or
- b. The phone number is invalid, or is associated with a pager or answering service.

14. The SSN provided is the same as that submitted by other persons opening an account or other customers.

15. The address or telephone number provided is the same as or similar to the address or telephone number submitted by an unusually large number of other persons opening accounts or by other customers.

16. The person opening the covered account or the customer fails to provide all required personal identifying information on an application or in response to notification that the application is incomplete.

17. Personal identifying information provided is not consistent with personal identifying information that is on file with the financial institution or creditor.

18. For financial institutions and creditors that use challenge questions, the person opening the covered account or the customer cannot provide authenticating information beyond that which generally would be available from a wallet or consumer report.



*Unusual Use of, or Suspicious Activity Related to, the Covered Account*

19. Shortly following the notice of a change of address for a covered account, the institution or creditor receives a request for a new, additional, or replacement means of accessing the account or for the addition of an authorized user on the account.

20. A covered account is used in a manner that is not consistent with established patterns of activity on the account. There is, for example:

- a. Nonpayment when there is no history of late or missed payments;
- b. A material increase in the use of available credit;
- c. A material change in purchasing or spending patterns; or
- d. A material change in electronic fund transfer patterns in connection with a deposit account.

21. A covered account that has been inactive for a reasonably lengthy period of time is used (taking into consideration the type of account, the expected pattern of usage and other relevant factors).

22. Mail sent to the customer is returned repeatedly as undeliverable although transactions continue to be conducted in connection with the customer's covered account.

23. The financial institution or creditor is notified that the customer is not receiving paper account statements.

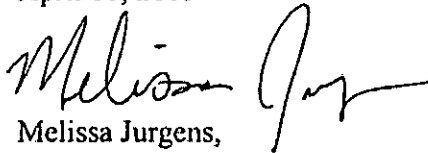
24. The financial institution or creditor is notified of unauthorized charges or transactions in connection with a customer's covered account.

*Notice from Customers, Victims of Identity Theft, Law Enforcement Authorities, or Other Persons Regarding Possible Identity Theft in Connection With Covered Accounts Held by the Financial Institution or Creditor*

25. The financial institution or creditor is notified by a customer, a victim of identity theft, a law enforcement authority, or any other person that it has opened a fraudulent account for a person engaged in identity theft.

By the Commodity Futures Trading Commission.

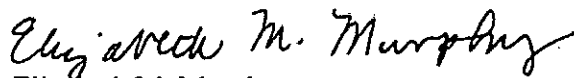
April 10, 2013



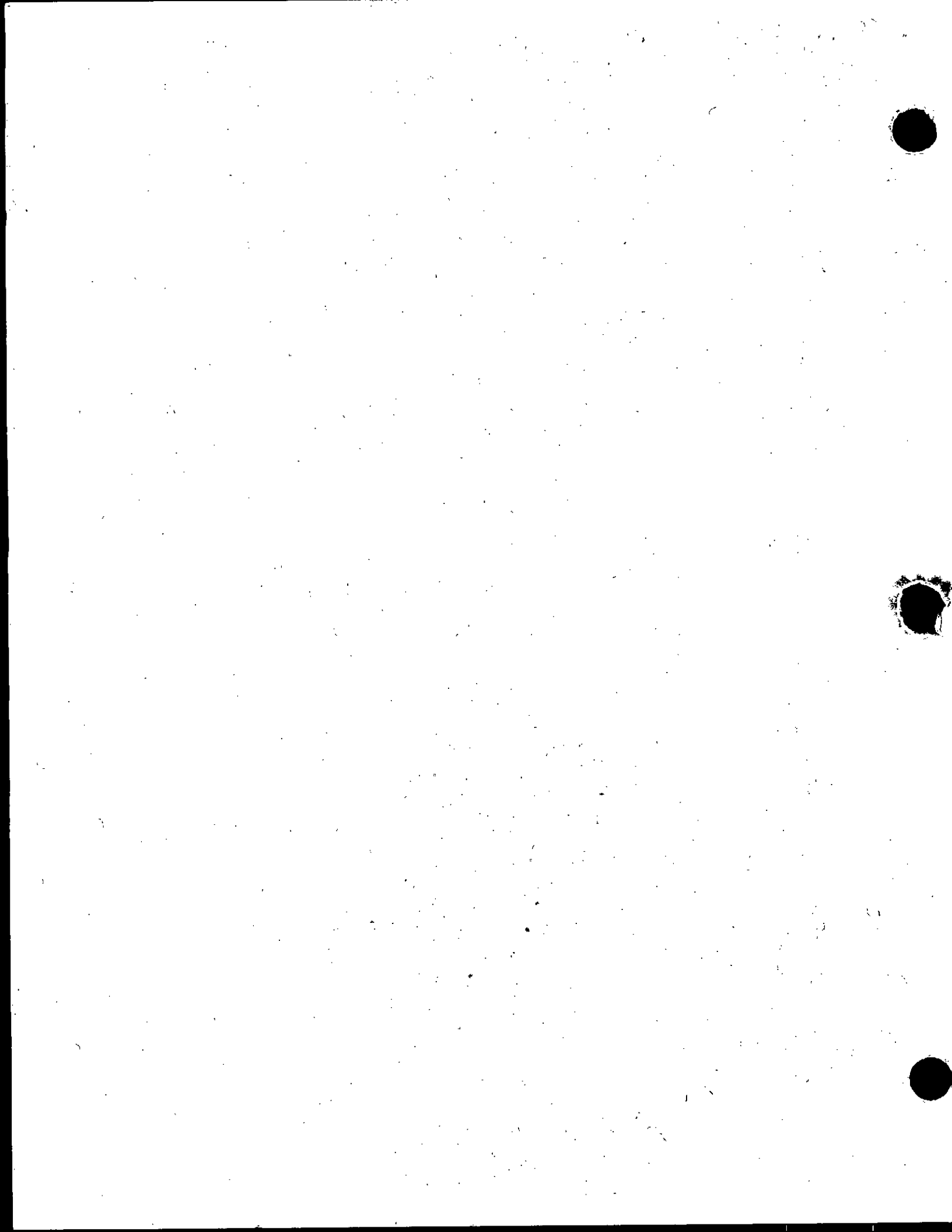
Melissa Jurgens,  
Secretary of the Commodity Futures Trading Commission

By the Securities and Exchange Commission.

April 10, 2013



Elizabeth M. Murphy,  
Secretary of the Securities and Exchange Commission



SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-30462 ; 812-14148]

The Royal Bank of Scotland plc, et al.; Notice of Application and Temporary Order

April 12, 2013

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

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

Summary: Applicants have received a temporary order exempting them from section 9(a) of the Act, with respect to a guilty plea entered on April 12, 2013, by RBS Securities Japan Limited (the "Settling Firm") in the U.S. District Court for the District of Connecticut ("District Court") in connection with a plea agreement between the Settling Firm and the U.S. Department of Justice ("DOJ"), until the Commission takes final action on an application for a permanent order. Applicants have also applied for a permanent order.

Applicants: The Royal Bank of Scotland plc ("RBS plc"), Citizens Investment Advisors ("Citizens IA"), a separately identifiable department of RBS Citizens, N.A., and the Settling Firm (each an "Applicant" and collectively, the "Applicants").<sup>1</sup>

Filing Date: The application was filed on April 12, 2013.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on May 7, 2013, and

<sup>1</sup> Applicants request that any relief granted pursuant to the application also apply to any existing or future company of which the Settling Firm is or may become an affiliated person within the meaning of section 2(a)(3) of the Act (together with the Applicants, the "Covered Persons") with respect to any activity contemplated by section 9(a) of the Act.

should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: RBS plc, RBS, Gogarburn, PO Box 1000, Edinburgh, EH12 1HQ, Scotland; Citizens IA, c/o RBS Citizens, N.A., Mail Stop RC 03-30, One Citizens Plaza, Providence, Rhode Island 02903; Settling Firm, Shin-Marunouchi Center Building, 1-6-2 Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan.

For Further Information Contact: Bruce R. MacNeil, Senior Counsel, at (202) 551-6817 or Daniele Marchesani, Branch Chief, at (202) 551-6821 (Division of Investment Management, Exemptive Applications Office).

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

Applicants' Representations:

1. Each Applicant is either a direct or indirect wholly-owned subsidiary of The Royal Bank of Scotland Group plc ("RBSG"). RBSG and RBS plc, a company organized under the laws of Scotland, are international banking and financial services companies that provide a wide range of products and services to companies around the world. Citizens IA, an investment adviser registered under the Investment Advisers Act of 1940, is a separately identifiable department of RBS Citizens, N.A. Citizens IA serves as investment sub-adviser to Aquila Narragansett Tax-Free Income Fund (the "Fund") (such activity, "Fund Service Activities").

The Settling Firm, a company with its principal place of business in Tokyo, Japan, engages in securities business operations, including derivatives trading.

2. On April 12, 2013, the Fraud Section of the Criminal Division and the Antitrust Division of the DOJ filed a one-count criminal information (the "Information") in the District Court charging one count of wire fraud, in violation of Title 18, United States Code, Section 1343. The Information charges that between approximately 2006 and at least 2010, the Settling Firm engaged in a scheme to defraud counterparties to interest rate derivatives trades executed on its behalf by secretly manipulating benchmark interest rates to which the profitability of those trades was tied. The Information charges that, in furtherance of this scheme, on or about October 5, 2009, the Settling Firm committed wire fraud in violation of Title 18, United States Code, Section 1343 by transmitting, or causing the transmission of, (i) an electronic chat between a derivatives trader employed by the Settling Firm and an RBS plc derivatives trader, (ii) a subsequent submission for the London InterBank Offered Rate for Japanese Yen ("Yen LIBOR") to Thomson Reuters, and (iii) a subsequent publication of a Yen LIBOR rate through international and interstate wires.

3. Pursuant to a plea agreement (the "Plea Agreement"), attached as exhibit to the application, the Settling Firm entered a plea of guilty (the "Guilty Plea") on April 12, 2013, in the District Court. In the Plea Agreement, the Settling Firm, among other things, agreed to a fine of \$50 million. Applicants expect that the District Court will enter a judgment against the Settling Firm that will require remedies that are materially the same as set forth in the Plea Agreement. In addition, RBS plc entered into a deferred prosecution agreement with DOJ (the "Deferred Prosecution Agreement") relating to submissions of the Yen LIBOR and other benchmark interest rates. In the Deferred Prosecution Agreement, RBS plc has agreed to, among other things, (i) continue to provide full cooperation with DOJ and any other law enforcement or

government agency designated by DOJ until the conclusion of all investigations and prosecutions arising out of the conduct described in the Deferred Prosecution Agreement; (ii) strengthen its internal controls as required by certain other U.S. and non-U.S. regulatory agencies that have addressed the misconduct described in the Deferred Prosecution Agreement; and (iii) the payment of \$150 million, which includes amounts incurred by the Settling Firm for criminal penalties arising from the Judgment. The individuals at the Settling Firm and at any other Covered Person who were identified by the Settling Firm, RBS plc or any U.S. or non-U.S. regulatory or enforcement agencies as being responsible for the conduct underlying the Plea Agreement, including the conduct described in any of the exhibits thereto (the "Conduct"), have either resigned or have been terminated.<sup>2</sup>

Applicants' Legal Analysis:

1. Section 9(a)(1) of the Act provides, in pertinent part, that a person may not serve or act as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company or registered unit investment trust, if such person within ten years has been convicted of any felony or misdemeanor arising out of such person's conduct, as, among other things, a broker or dealer. Section 2(a)(10) of the Act defines the term "convicted" to include a plea of guilty. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(1) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(1). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under

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<sup>2</sup> The Applicants note that a junior level employee of a Covered Person (the "Employee") who was not responsible for the Conduct remains employed by a Covered Person. The Applicants have concluded that the Employee was not responsible for the Conduct and the Employee has not been identified by any U.S. or non-U.S. regulatory or enforcement agencies as being responsible for the Conduct. The Applicants acknowledge that the Commission has not been asked to determine, and has not determined, whether or not the Employee is responsible for the Conduct.

common control with, the other person. Applicants state that the Settling Firm is an affiliated person of each of the other Applicants within the meaning of section 2(a)(3). Applicants state that the Guilty Plea would result in a disqualification of each Applicant for ten years under section 9(a) of the Act because the Settling Firm would become the subject of a conviction described in 9(a)(1).

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

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

4. Applicants assert that the Conduct did not involve any of the Applicants' Fund Service Activities, and that the Settling Firm does not serve in any of the capacities described in section 9(a) of the Act. Additionally, Applicants assert that the Conduct did not involve the Fund or the assets of the Fund. Applicants further assert that (i) none of the current or former directors, officers or employees of the Applicants (other than certain personnel of the Settling Firm and RBS plc who were not involved in any of the Applicants' Fund Service Activities) had any knowledge of, or had any involvement in, the Conduct; (ii) no former employee of the Settling Firm or of any other Covered Person who previously has been or who subsequently may



be identified by the Settling Firm, RBS plc or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct will be an officer, director, or employee of any Applicant or of any other Covered Person; (iii) no employee of the Settling Firm or of any Covered Person who was involved in the Conduct had any, or will not have any future, involvement in the Covered Persons' activities in any capacity described in section 9(a) of the Act; and (iv) because the personnel of the Applicants (other than certain personnel of the Settling Firm and RBS plc who were not involved in any of the Applicants' Fund Service Activities) did not have any involvement in the Conduct, shareholders of the Fund were not affected any differently than if the Fund had received services from any other non-affiliated investment adviser. Applicants have agreed that neither they nor any of the other Covered Persons will employ any of the former employees of the Settling Firm or any other Covered Person who previously have been or who subsequently may be identified by the Settling Firm, RBS plc or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct in any capacity without first making a further application to the Commission pursuant to section 9(c).

5. Applicants further represent that the inability of Citizens IA to continue providing Fund Service Activities would result in potential hardships for both the Fund and its shareholders. Applicants state that they will distribute written materials, including an offer to meet in person to discuss the materials, to the board of trustees of the Fund, including the directors who are not "interested persons," as defined in section 2(a)(19) of the Act, of such Fund, and their independent legal counsel as defined in rule 0-1(a)(6) under the Act, if any, regarding the Guilty Plea, any impact on the Fund, and the application. The Applicants will provide the Fund with all information concerning the Plea Agreement and the application that is

necessary for the Fund to fulfill its disclosure and other obligations under the federal securities laws.

6. Applicants also state that, if Citizens IA was barred from providing Fund Service Activities to the Fund, the effect on its business and employees would be severe.

7. Applicants state that none of the Applicants has previously applied for an exemptive order under section 9(c) of the Act.

Applicants' Conditions:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Neither the Applicants nor any of the other Covered Persons will employ any of the former employees of the Settling Firm or of any other Covered Person who previously has been or who subsequently may be identified by the Settling Firm, RBS plc or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct, in any capacity, without first making a further application to the Commission pursuant to section 9(c).

Temporary Order:

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

Accordingly

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and the other Covered Persons are granted a temporary exemption from the provisions of section 9(a), effective forthwith, solely with respect to the Guilty Plea, subject to the conditions in the application, until the date the Commission takes final action on their application for a permanent order.

By the Commission.



Elizabeth M. Murphy  
Secretary



*Chairman White  
Commissioner Gallagher  
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 69379 / April 15, 2013**

**INVESTMENT ADVISERS ACT OF 1940  
Release No. 3585 / April 15, 2013**

**INVESTMENT COMPANY ACT OF 1940  
Release No. 30463 / April 15, 2013**

**ADMINISTRATIVE PROCEEDING  
File No. 3-15277**

**In the Matter of**

**SCOTT REIMAN,**

**Respondent.**

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST  
PROCEEDINGS, PURSUANT TO SECTION  
21C OF THE SECURITIES EXCHANGE  
ACT OF 1934, SECTION 203(f) 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**

**I.**

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Scott Reiman ("Respondent").

**II.**

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

behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

### III.

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

#### Summary

1. These proceedings arise out of insider trading in the securities of Delta Petroleum Corporation ("Delta Petroleum") in advance of the December 31, 2007 announcement that Tracinda Corporation ("Tracinda") had agreed to purchase a 35 percent stake in Delta Petroleum for \$684 million (the "Tracinda Announcement"). During the weeks leading up to the Tracinda Announcement, Reiman received material nonpublic information from Delta Petroleum's chief executive officer, Roger Parker ("Parker"), and then traded on the basis of that information reaping ill-gotten profits.

#### Respondent

2. Reiman, age 48, is the founder and president of Hexagon, Inc., a private company that invests in marketable securities, real estate, private equity, venture capital, and oil and gas. At the time of the conduct alleged herein, Hexagon, Inc. was an investment adviser. Reiman is a resident of Denver, Colorado.

#### Other Relevant Entities

3. Delta Petroleum was a Delaware corporation based in Denver, Colorado that engaged in the exploration, acquisition, development, production and sale of natural gas and crude oil. In December 2011, Delta Petroleum filed for bankruptcy. In August 2012, the reorganized company, Par Petroleum, emerged from bankruptcy. Delta Petroleum's securities were registered pursuant to Section 12(b) of the Exchange Act and, prior to Delta Petroleum's bankruptcy, its common stock traded on the Nasdaq under the symbol "DPTR." Delta Petroleum had internal policies protecting its confidential information.

4. Tracinda is a private investment company owned by Kirk Kerkorian. Tracinda is headquartered in Beverly Hills, California.

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

## Facts

5. In late November 2007, Parker and representatives of Tracinda began discussions regarding Tracinda making a substantial equity investment in Delta Petroleum. At the time, Delta Petroleum was seeking an infusion of capital to, among other things, increase its drilling operations.

6. On November 28, 2007, Parker and Reiman spoke by telephone. Minutes after the call, Reiman arranged to purchase 11,300 shares of Delta Petroleum stock and 1,000 Delta Petroleum call option contracts<sup>2</sup> with a strike price of \$17.50 and an expiration date of March 2008. At the time, Delta Petroleum's stock price was approximately \$13.60.

7. On December 3, 2007, Parker and others met with Tracinda's management in Las Vegas, Nevada to discuss Delta Petroleum's business and the potential investment. That same day, Parker placed a telephone call to Reiman. Following the telephone call, Reiman arranged to buy an additional 500 Delta Petroleum call option contracts.

8. Following the December 3, 2007 meeting in Las Vegas, Parker and others affiliated with Delta Petroleum continued to discuss the potential investment with Tracinda's management. On December 14, 2007, Delta Petroleum, along with its investment banking representatives, made a presentation to Tracinda's management concerning Delta Petroleum's business and expected future performance.

9. Also on December 14, 2007, shortly after speaking with Parker, Reiman purchased 500 additional Delta Petroleum call options.

10. On December 17, 2007, the Delta Petroleum Board of Directors was informed of Tracinda's interest in making an investment in Delta Petroleum and the board authorized Delta Petroleum's management to pursue further discussions with Tracinda.

11. Following additional discussions and negotiations between Tracinda and Delta Petroleum, on December 22, 2007, Tracinda formally communicated an offer to purchase a 35 percent stake of Delta Petroleum for \$19.00 per share.

12. On December 29, 2007, Delta Petroleum's board of directors voted to approve Tracinda's offer.

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<sup>2</sup> A call option is a financial contract between two parties that gives the buyer the right, but not the obligation, to buy an agreed quantity of stock during a specified time period for a specified price, known as the strike price. A buyer pays a fee, or premium, to purchase this right. A buyer of a call option generally stands to gain if the price of the stock increases.

13. On December 31, 2007, before market open, Delta Petroleum announced that Tracinda had agreed to acquire a 35 percent stake in Delta Petroleum for \$684 million, a price that represented a premium of 23 percent to Delta Petroleum's closing price of \$15.51 on the preceding trading day, December 28, 2007. In reaction to the Tracinda Announcement, the price of Delta Petroleum's stock rose \$3.34 or approximately 19% on December 31 and closed at \$18.85.

14. As a result of this sharp increase in Delta Petroleum's stock price following the Tracinda Announcement, Reiman reaped substantial illicit profits based on his trading of Delta Petroleum securities leading up to December 31, 2007.

15. As a result of the conduct described above, Reiman willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibits fraudulent conduct in connection with the purchase or sale of securities.

#### IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED, effective immediately, that:

A. Reiman shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Reiman is barred 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 [15 U.S.C. § 781] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)] for a period of five (5) years from entry of this Order.

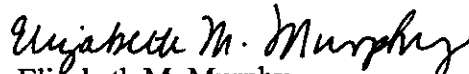
C. Reiman is barred from association with any broker, dealer, investment adviser as defined under 15 U.S.C. § 80b-2(a)(11), municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser as defined under 15 U.S.C. § 80b-2(a)(11), or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent,

whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Reiman shall, within 14 days of the entry of this Order, pay disgorgement of \$398,000, prejudgment interest of \$93,567, and a civil penalty of \$398,000, for a total of \$889,567 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways: (1) by making direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or (2) by paying 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 Scott Reiman as a Respondent in these proceedings, and the file number of these proceedings; and a copy of the cover letter and check or money order must be sent to Sanjay Wadhwa, Associate Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, Suite 400, New York, New York 10281.

By the Commission.

  
Elizabeth M. Murphy  
Secretary



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69380 / April 16, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15278

In the Matter of

NOBLE INNOVATIONS, INC.

Respondent.

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

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 Noble Innovations, Inc. ("Noble" 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 Pursuant to Section 12(j) of the Securities Exchange Act of 1934, Making Findings, and Revoking Registration of Securities ("Order"), as set forth below.

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### III.

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

A. Noble is a revoked Nevada corporation located in Phoenix, Arizona and was engaged in developing and marketing its tankless water heater. The common stock of Noble has been registered under Section 12(g) of the Exchange Act since September 22, 2008, and was traded on the OTC Bulletin Board from January 24, 2007 through April 27, 2010. It is currently quoted on the OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc.

B. Noble has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, while its common stock was registered with the Commission in that it has not filed an Annual Report on Form 10-K since April 16, 2010 or periodic or quarterly reports on Form 10-Q for any fiscal period subsequent to its fiscal quarter ending September 30, 2009.

### IV.

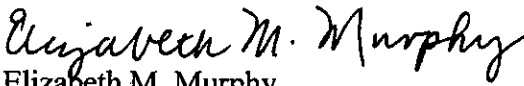
Section 12(j) of the Exchange Act provides as follows:

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 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

Commissioner Aquino  
not participating

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69405 / April 18, 2013  
Admin. Proc. File No. 3-15209

In the Matter of the Application of

Gilbert Torres Martinez  
4407 Wyoming Street  
Dallas, TX 75211

for Review of Disciplinary Action Taken by FINRA

ORDER GRANTING  
MOTION TO DISMISS  
APPLICATION FOR REVIEW

I.

Gilbert Torres Martinez, formerly a registered representative associated with Wells Fargo Advisors, LLC, a FINRA member firm, seeks review of a FINRA disciplinary action.<sup>1</sup> FINRA barred him from associating with any FINRA member in any capacity, effective January 14, 2013, because he failed to respond to two requests for information it issued pursuant to FINRA Rule 8210.<sup>2</sup> On February 27, 2013, FINRA filed a motion to dismiss Martinez's application for review, arguing that Martinez failed to exhaust his administrative remedies.<sup>3</sup> For the reasons set forth below, we have determined to grant FINRA's motion and dismiss the appeal.

<sup>1</sup> 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. For a more detailed discussion of its creation 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., see *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at \*1 n.2 (Nov. 9, 2012).

<sup>2</sup> 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).

<sup>3</sup> Martinez did not oppose that motion or respond in any other way. See 17 C.F.R. § 201.154(b) (stating that briefs in opposition to a motion shall be filed within five days after service of the motion).

## II.

**A. Martinez failed to respond to two requests for information issued by FINRA pursuant to Rule 8210.**

Martinez was associated with Wells Fargo from July 3, 2007 until May 14, 2012. On June 6, 2012, Wells Fargo filed a Uniform Termination Notice for Securities Industry Registration on Form U5,<sup>4</sup> disclosing that it terminated Martinez's association with the firm, effective May 14, 2012, because he had allegedly opened bank accounts without the consent of a bank customer.<sup>5</sup>

On July 18, 2012, FINRA sent Martinez a letter by both first-class and certified mail, pursuant to FINRA Rule 8210, to his address-of-record as contained in the Central Registration Depository, which Martinez is required to keep current.<sup>6</sup> That letter asked him 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 Wells Fargo. The deadline for his response was August 1. Martinez failed to respond.

On August 9, FINRA sent Martinez a second Rule 8210 request to his CRD address by first-class and certified mail, asking for the same information as in its earlier letter, a copy of which it attached. The second request set a deadline of August 23 and warned Martinez that he could be subject to disciplinary action if he failed to respond.<sup>7</sup>

<sup>4</sup> 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.

<sup>5</sup> On the Form U5, Wells Fargo characterized the allegations as involving violations of "investment-related statutes, regulations, rules or industry standards of conduct." See Question 7F on Martinez's Form U5, which Martinez submitted as an attachment to his application for review.

<sup>6</sup> The letter sent by certified mail was returned as "unclaimed," but there is nothing in the record to indicate that the other letter was not received. Both letters were sent to Martinez's last known residential address listed in CRD. As part of the registration process, associated persons such as Martinez 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 CRD address. 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). In his application for review, Martinez claims, "I moved from my previous residence four months ago and my mail was not delivered to me as it should of have [sic]." Martinez does not provide evidence to support this assertion, and he acknowledges that he failed to update his CRD address until very recently.

<sup>7</sup> Again, there is no evidence in the record that the letter FINRA sent by first-class mail was returned. The tracking information for the letter sent by certified mail does not indicate whether it was received.

Although Martinez did not respond in writing to the second letter, he spoke by telephone on August 15 with the FINRA investigator who sent the two earlier Rule 8210 requests. The investigator described Martinez as "hostile and uncooperative" during that call; he was "offended that FINRA was asking him about his employment, and asked [the investigator] if [he] knew who [he] was dealing with."<sup>8</sup> The investigator informed Martinez that, if he did not respond to FINRA's Rule 8210 request, FINRA would pursue a disciplinary action against him, after which Martinez immediately hung up the phone.

#### **B. FINRA sanctioned Martinez.**

On October 11, 2012, FINRA notified Martinez in writing, pursuant to FINRA Rule 9552(a),<sup>9</sup> that it intended to suspend him from associating with any member firm in any capacity on November 5, 2012 unless he took corrective action before that date by complying with its Rule 8210 requests. That notice also advised Martinez that he could request a hearing under Rule 9552(e), which, if made timely, would stay the effective date of the suspension.<sup>10</sup> The notice further warned Martinez that, if the suspension was imposed, FINRA would automatically bar him from associating with any member firm in any capacity on January 14, 2013 unless he requested termination of the suspension based on full compliance.<sup>11</sup> Martinez failed to take any action to comply with the outstanding requests or request a hearing.

On November 5, 2012, FINRA sent Martinez 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 Martinez that an automatic bar would be imposed on January 14, 2013 if he did not fully comply with the notice of suspension, which required him to fully

<sup>8</sup> Decl. of Michael D. Malden in Support of FINRA's Mot. to Dismiss Martinez's Application for Review and to Stay Briefing Schedule at 2.

<sup>9</sup> FINRA Rule 9552(a) states that if an associated person fails to provide the staff with requested information pursuant to FINRA rules, the association may provide written notice "specifying the nature of the failure and stating that a failure to take corrective action within 21 days after service of the notice will result in [a] suspension."

<sup>10</sup> 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 Rule 9551 through 9556."

<sup>11</sup> 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.

FINRA served the October 11, 2012 written notice on Martinez by overnight courier service and first-class mail at the same CRD address it used earlier in sending the Rule 8210 requests—shortly after which Martinez contacted the FINRA investigator by telephone. 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). Again, there is no evidence that the letter sent by first-class mail was returned. The tracking information for the overnight courier service does not indicate whether the pre-suspension notice was received.

respond to FINRA's two earlier Rule 8210 information requests and file a request to terminate his suspension.<sup>12</sup>

Martinez 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 January 14, 2013. On that date, FINRA sent Martinez a letter notifying him that he was barred and could appeal its decision by filing an application for review with the Commission.<sup>13</sup>

On February 11, 2013, after receiving a telephone call from Martinez, FINRA e-mailed copies of the October 11, 2011 pre-suspension notice, the November 5, 2012 notice of suspension, and the January 14, 2013 bar notice to Martinez. FINRA also sent hard copies of these letters via USPS Express Mail to a new address Martinez provided over the telephone.<sup>14</sup>

### III.

In a letter received by our Office of the Secretary on February 13, 2013,<sup>15</sup> Martinez stated that he "seek[s] to appeal the suspension from Association with any FINRA member dated November 5, 2012 and Bar from Association with any FINRA member (Rule 9552) dated January 14, 2013."<sup>16</sup> Martinez asserts in this letter that, among other things, "no violations of the federal securities laws or FINRA, NASD, NYSE, or MSRB rules have occurred" and that there were no "misappropriate Bank customer funds in connection with [his] termination."<sup>17</sup> As noted, FINRA asks that we dismiss Martinez's application because, in challenging FINRA's action, he "failed to avail himself of FINRA's procedures."<sup>18</sup> According to FINRA, "Martinez ignored

<sup>12</sup> 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 November 5, 2012 nonetheless is consistent with the notice of suspension sent on October 11, 2012 and complies with the service requirements applicable to a notice of suspension. *See supra* note 11.

FINRA served the letter on Martinez at the same CRD address by overnight courier service and by first-class mail. The courier returned the notice to FINRA on November 13, 2012. There is no evidence that the letter sent by first-class mail was returned.

<sup>13</sup> FINRA sent that letter to Martinez by overnight courier service and by first-class mail to his CRD address. The courier returned the notice to FINRA on January 22, 2013. Once again, there is no evidence that the letter sent by first-class mail was returned. FINRA also sent this notice to an address it identified in a public records database as Martinez's second most recent address, after the CRD address. FINRA sent the notice to this second address via USPS Express Mail and first-class mail. There is no evidence that either copy of the letter sent to the second address was returned.

<sup>14</sup> FINRA did not elaborate on what Martinez said during the call, other than that he provided the new mailing address.

<sup>15</sup> The letter is dated January 12, 2013, despite its explicit reference to FINRA correspondence dated January 14, 2013.

<sup>16</sup> Martinez's Application for Review at 1.

<sup>17</sup> *Id.*

<sup>18</sup> FINRA's Mot. to Dismiss Martinez's Application for Review and to Stay Briefing Schedule at 1.

FINRA's numerous notices, and he did not take any action required by FINRA's rules to contest his impending bar."<sup>19</sup> We agree that Martinez's failure to exhaust his appeal rights before FINRA precludes our consideration of his appeal.

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."<sup>20</sup> 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."<sup>21</sup> 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.<sup>22</sup>

The July 18 and August 9, 2012 Rule 8210 requests, which sought specific information related to Martinez's termination by Wells Fargo, warned Martinez that "failure to comply . . . may subject you to disciplinary action." The October 11, 2012 notice of suspension stated that FINRA intended to suspend Martinez on November 5, 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 Martinez did not take corrective action or request a hearing.

<sup>19</sup> *Id.*

<sup>20</sup> *MFS Secs. Corp.*, Exchange Act Release No. 47626, 2003 SEC LEXIS 789, at \*22 & n.29 (Apr. 3, 2003) (citing *Royal Secs. 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).

<sup>21</sup> *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); *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); *see also MFS Secs. 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).

<sup>22</sup> *MFS Secs. Corp. v. SEC*, 380 F.3d 611, 621-22 (2d Cir. 2004).

The October 11 and November 5 notices further informed Martinez that, after the suspension took effect, he could request its termination based on full compliance. As noted, he never did so.

Martinez does not dispute that he failed to respond to FINRA's informational requests or otherwise cooperate with FINRA's investigation. Nor does he claim that he tried to challenge the resulting disciplinary sanction through FINRA's appeal procedures. Rather, he blames his failure on what he claims was FINRA's use of an old mailing address which, he suggests, resulted in his not receiving the informational requests and related correspondence.<sup>23</sup> As Martinez seems to concede, however, it was his responsibility to update his CRD address, as expressly required by FINRA rules,<sup>24</sup> and we have repeatedly held that not doing so is no defense to a failure to respond.<sup>25</sup> Moreover, Martinez does not dispute that, whatever the address used by FINRA, he received sufficient notice of the FINRA staff's inquiries to prompt him to contact the staff by telephone, during which conversation his obligation to cooperate was orally reiterated, as were the implications of not cooperating. Under these circumstances, and given the well-established precedent discussed above, we see no basis for denying FINRA's motion to dismiss.<sup>26</sup>

<sup>23</sup> He also states that he "look[s] after an aging father and . . . go[es] out of town constantly," which presumably are additional reasons for his failure to respond. Martinez's Application for Review at 1. Such circumstances, if true, do not excuse his failure to cooperate.

<sup>24</sup> See *supra* note 6.

<sup>25</sup> See, e.g., *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); *Robert J. Langley*, Exchange Act Release No. 50917, 57 SEC 1125, 2004 SEC LEXIS 3048 at \*9 (Dec. 22, 2004) ("Rule 8210(d) does not require NASD to take any affirmative action to track down a registered representative who has failed to provide NASD with a current address"); *Warren B. Minton Jr.*, Exchange Act Release No. 46709, 55 SEC 1170, 2002 SEC LEXIS 2712 at \*13 (Oct. 23, 2002) (holding that registered representatives have a "continuing duty" to notify NASD of address changes) (citing cases); *Ashton Noshir Gowadia*, Exchange Act Release No. 40410, 53 SEC 786, 1998 SEC LEXIS 1887 at \*11 (Sept. 8, 1998) (finding that registered representative's assumption that member firm had updated his CRD address does not mitigate representative's failure to do so); *Nazmi C. Hassanieh*, Exchange Act Release No. 35029, 52 SEC 87, 1994 SEC LEXIS 3862 at \*9 (Nov. 30, 1994) (noting that the obligation to keep CRD address current is crucial to NASD's investigative efforts because, otherwise, investigations "could easily be avoided by an individual's moving without leaving a forwarding address").

<sup>26</sup> To date, Martinez has not complied with the two Rule 8210 requests. Though he states that he attached "copies of the documents and information you previously requested" to his application [Martinez's Application for Review at 1], all he attached were the Form U5 termination notice by Wells Fargo and the January 14, 2013 bar notice and November 5, 2012 suspension notice that FINRA sent him. These documents are not responsive to the informational request at issue in this matter, and in no way alter our conclusion to dismiss Martinez's appeal.



\* \* \*

Accordingly, IT IS ORDERED that FINRA's motion to dismiss the application for review filed by Gilbert Torres Martinez is GRANTED.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

Commissioner Aguilar  
not participating

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

**CORRECTED COPY**

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69406 / April 18, 2013

Admin. Proc. File No. 3-15056

In the Matter of the Application of

JOSEPH S. AMUNDSEN  
3537 Chain Dam Road  
Easton, PA 18045

For Review of Disciplinary Action Taken by  
  
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY  
PROCEEDINGS

Violations of Membership and Conduct Rules

Misstatements and Omissions on Forms U4

Applicant, a registered representative of a member firm of a registered securities association, failed to disclose both an injunction entered against him in connection with investment-related activity and the revocation of his license to act as a CPA. *Held*, association's findings of violation and sanctions imposed are *sustained*.

APPEARANCES:

*Joseph S. Amundsen, pro se.*

*Alan Lawhead and Megan Rauch, for the Financial Industry Regulatory Authority, Inc.*

Appeal filed: September 27, 2012  
Last brief received: December 31, 2012

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## I.

Joseph S. Amundsen, formerly a registered representative of various FINRA member firms,<sup>1</sup> seeks review of a FINRA disciplinary action.<sup>2</sup> FINRA found that during the course of more than six years Amundsen violated NASD Interpretive Material 1000-1 and Rule 2110 and FINRA Rules 1122 and 2010 by failing to disclose, on thirty-six Uniform Applications for Securities Industry Registration or Transfer ("Forms U4") he completed for thirty-four employers, an injunction entered against him in connection with investment-related activity and the revocation of his license to act as a certified public accountant in California.<sup>3</sup> FINRA further found

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<sup>1</sup> As of the date of this opinion, Amundsen was not registered with any FINRA member firm. We take official notice of this information on BrokerCheck, an electronic database maintained by FINRA and available at [www.finra.org/Investors/toolsCalculators/BrokerCheck](http://www.finra.org/Investors/toolsCalculators/BrokerCheck) (all websites referenced in this decision were last visited on April 18, 2013). See 17 C.F.R. § 201.323 (rule of practice relating to official notice).

<sup>2</sup> This case was instituted after the creation of The Financial Industry Regulatory Authority, Inc. in July 2007; however, some of the conduct at issue took place before that date. We therefore apply conduct rules of both FINRA and its predecessor, NASD, as relevant.

<sup>3</sup> NASD IM-1000-1 prohibits the filing, in connection with registration as a registered representative, of information that is "incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or the failure to correct such filing." On August 17, 2009, IM-1000-1 was replaced by FINRA Rule 1122. FINRA Regulatory Notice 09-33, 2009 FINRA LEXIS 96, at \*6-7 (June 2009). FINRA Rule 1122 provides that "[n]o member or person associated with a member shall file with FINRA information with respect to membership or registration which is incomplete or inaccurate so as to be misleading, or which could in any way tend to mislead, or fail to correct such filing after notice thereof."

NASD Conduct Rule 2110 requires members to observe "high standards of commercial honor and just and equitable principles of trade." NASD Rule 0115(a) made NASD Rule 2110 applicable with equal force to members and their associated persons. On December 15, 2008, NASD Rule 2110 was adopted as FINRA Rule 2010, and NASD Rule 0115(a) was adopted (with minor, non-substantive changes) as FINRA Rule 0140(a). See FINRA Notice to Members 08-57, 2008 FINRA LEXIS 50, at \*30-32 (Oct. 2008). Under the Commission's "long-standing and judicially-recognized policy," a violation of another Commission or self-regulatory organization rule or regulation constitutes a violation of the rule prohibiting conduct inconsistent with just and equitable principles of trade. See *Stephan G. Gluckman*, Exchange Act Release No. 41628, 54 SEC 175, 1999 SEC LEXIS 1395, at \*22 (July 20, 1999); see also, e.g., *Thomas W. Heath III*, Exchange Act Release No. 59223, 2009 SEC LEXIS 14, at \*12 n.8 (Jan. 9, 2009) (citing and quoting *Gluckman*), *petition denied*, 586 F.3d 122 (2d Cir. 2009).

that Amundsen was subject to statutory disqualification.<sup>4</sup> FINRA barred Amundsen and ordered him to pay costs. We base our findings on an independent review of the record.

## II.

This case concerns false answers Amundsen provided on regulatory filings connected to his employment in the securities industry between 2003 and 2009. As found by FINRA, Amundsen falsely answered questions asking whether he had ever been enjoined in connection with investment-related activity and whether he had ever had a professional license revoked.

**A. Amundsen was enjoined from appearing or practicing before the Commission, after which his California CPA license was revoked.**

On February 15, 1983, the United States District Court for the Northern District of California entered, by consent, a final judgment of permanent injunction (the "Judgment") in a civil action brought against Amundsen by the Commission.<sup>5</sup> The Judgment permanently enjoined Amundsen (i) from engaging in any fraudulent conduct in the offer or sale, or in connection with the purchase or sale, of "any security of Olympic Gas & Oil, Inc. or any other issuer," and (ii) from "appearing or practicing before the Commission in any way."<sup>6</sup>

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<sup>4</sup> See Exchange Act § 3(a)(39)(F), 15 U.S.C. § 78c(a)(39) (enumerating conditions under which a person is subject to statutory disqualification). Under Article III, § 3 of FINRA's By-Laws, a statutorily disqualified person cannot become or remain associated with a FINRA member unless the disqualified person's member firm applies for, and is granted, in FINRA's discretion, relief from the statutory disqualification. Denials of a firm's application to retain its membership if it employs a statutorily disqualified individual are reviewable by the Commission. See, e.g., *Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 SEC LEXIS 2977 (Sept. 10, 2010) (dismissing application for review of denial of membership continuance application); *Timothy P. Pedregon Jr.*, Exchange Act Release No. 61791, 2010 SEC LEXIS 1164 (Mar. 26, 2010) (same).

<sup>5</sup> *SEC v. Amundsen*, No. C83-00711 WHA (N.D. Cal. Feb. 15, 1983).

<sup>6</sup> *Id.* at 2-3.

The complaint in the action against Amundsen was based on allegations that Amundsen had violated federal antifraud provisions, § 17(a) of the Securities Act of 1933,<sup>7</sup> § 10(b) of the Securities Exchange Act of 1934,<sup>8</sup> and Exchange Act Rule 10b-5,<sup>9</sup> in connection with audit work performed for Olympic Gas & Oil, Inc. More specifically, the complaint alleged that Amundsen, a certified public accountant, had issued and signed an audit report that falsely stated (i) that Olympic's financial statements fairly presented its financial positions and results of its operations in conformity with generally accepted accounting principles, and (ii) that the audit was conducted in accordance with generally accepted auditing standards.<sup>10</sup> The complaint further alleged that Amundsen's audit report was included with the registration statement that Olympic filed with the Commission to register its common stock, and that the audit report was distributed to broker-dealers and investors in connection with offers and sales of Olympic stock. Without admitting or denying these allegations, Amundsen consented to the entry of the Judgment.<sup>11</sup>

On October 10, 1986, the California Board of Accountancy revoked Amundsen's license to practice as a CPA in California.<sup>12</sup> The board found that Amundsen's injunction against practicing

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<sup>7</sup> 15 U.S.C. § 77q(a),

<sup>8</sup> *Id.*, § 78j(b).

<sup>9</sup> 17 C.F.R. § 240.10b-5.

<sup>10</sup> Among other things, the complaint alleged that the sales and costs of sales in Olympic's income statement for the fiscal year ended February 28, 1979 were materially overstated in that the reported figures for sales and costs of sales were generated by the successive sales and purchases of money market investments (with sales of such investments included in Olympic's sales figures and the purchase price of those investments included in Olympic's costs of sales), and that neither the income statement nor the notes to the financial statements disclosed the nature of the reported income or the accounting method used to recognize sales and costs of sales. With respect to Amundsen's audit, the complaint alleged, among other things, that Amundsen (i) issued an audit report containing an unqualified opinion without receiving or examining required disclosures regarding sales and costs of sales, (ii) failed to take steps to test sales or costs of sales, and (iii) altered his workpapers before providing them to Commission staff.

<sup>11</sup> *Amundsen, supra* note 5. At the hearing before the FINRA panel, Amundsen admitted that he read the complaint and the judgment in 1983.

<sup>12</sup> Amundsen obtained his California CPA license on December 8, 1972.

before the Commission gave it cause to take disciplinary action against Amundsen, and that it was in the public interest to revoke his license.

**B. Approximately twenty years after the injunction was entered, Amundsen obtained a CPA license and began working in the securities industry.**

For about twenty years in the 1980s and 1990s, Amundsen owned a small building materials company and worked as a painter, also maintaining a small accounting practice until his license was revoked. Around 1995, however, he developed arthritis, and could no longer handle the physical labor involved in the building trades, so after holding a series of part-time jobs, he decided to resume work as an accountant. In the late summer of 2002, Amundsen again became licensed to practice as an accountant, first in New York and then in California.<sup>13</sup>

Shortly thereafter, Amundsen began working in the securities industry. He worked through two firms: Gettenberg Associates, a consulting firm that provided financial and operations principals for broker-dealer firms, and Buchanan Associates, a full-service compliance firm for small broker-dealers. Gettenberg asked Amundsen to become a financial and operations principal ("FINOP") for Sort Securities, LLC, a FINRA member firm, which Amundsen agreed to do. Thus, on November 4, 2003, Amundsen filed a Form U4 with FINRA through Sort Securities, the first of the thirty-six Forms U4 at issue in this proceeding.

As relevant here, the Form U4 asked whether "any domestic or foreign court ever enjoined [the registrant] in connection with any investment related activity?" (the "Injunction Question"),

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<sup>13</sup> The record does not reflect whether New York or California regulators considered the permanent injunction entered against Amundsen in deciding to license or relicense him. Amundsen testified only that he re-took and passed the required California examination and was thereupon given a "clean license." NAC Tr. at 28.

with "investment-related" defined as "pertain[ing] to securities,"<sup>14</sup> and whether the registrant had "ever had an authorization to act as an attorney, accountant, or federal contractor that was revoked or suspended?" (the "Revocation Question"). On the Form U4 filed through Sort Securities, and on every other Form U4 at issue, Amundsen responded "No" to both the Injunction and the Revocation Questions, despite the events described above.

Amundsen subsequently passed the Series 27 examination, qualifying him to act as a FINOP, and became registered with FINRA as a FINOP through Sort Securities on November 19, 2003. Amundsen later passed examinations that qualified him to act as a securities agent, general securities representative, general securities principal, and registered options principal. Over the course of the next six years, Amundsen filed, or caused to be filed, at least thirty-five additional Forms U4 to enable him to act as a FINOP or in other capacities with at least thirty-three additional FINRA member firms.<sup>15</sup>

**C. Amundsen sought, unsuccessfully, to have the injunction vacated.**

In October 2010, Amundsen asked the district court that had entered the Judgment to vacate the injunction. Amundsen based his motion on three arguments: (i) that he had rehabilitated himself (through good behavior, a stable family life, and continuing education) and he agreed to

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<sup>14</sup> This definition was contained in the instructions for completing Form U4.

<sup>15</sup> Exhibit A to the Complaint filed in this proceeding showed that Amundsen was registered with thirty-four member firms and filed, or caused to be filed, thirty-six Forms U4 between November 4, 2003 and January 26, 2010. Amundsen admitted that he filed these forms, or caused them to be filed. Although the record shows that Amundsen may have filed an additional Form U4 in connection with his association with a thirty-fifth member firm, we base our findings, as FINRA did, on the numbers shown in the complaint. *See Dep't of Enf. v. Amundsen*, Complaint No. 2010021916601, 2012 FINRA Discip. LEXIS 54, at \*5 n.3 (NAC Sept. 20, 2012). The minor discrepancy in numbers has no effect on our decision.

comply with all Commission and PCAOB<sup>16</sup> requirements going forward; (ii) that the legal basis of the injunction was unsound because when he agreed to settle the Commission's action against him, he was unaware that his audit report could not be filed with Olympic's registration statement without his consent, which he did not give, and there was therefore no basis for the action against him; and (iii) that the procedural basis for the injunction was unsound because when he agreed to settle, (a) Commission staff told him that the offer to settle was "a really good deal" and that if he had been able to afford counsel, his counsel would have given him the same advice, (b) he never met the judge and did not realize "that the settlement was in fact an open ended judgment," and (c) he thereby "was denied his right of due process to understand the judgment [or] how to disclose such actions in future job applications."<sup>17</sup>

The court denied Amundsen's motion, finding that Amundsen's asserted facts did not warrant relief and that there was no demonstrated reason to vacate the injunction.<sup>18</sup> Amundsen thereupon appealed to the United States Court of Appeals for the Ninth Circuit, asserting, among other things, that the Commission never had jurisdiction to bring the charges, that Olympic's

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<sup>16</sup> "The Public Company Accounting Oversight Board is an independent executive agency created by the Sarbanes-Oxley Act of 2002." *Free Enterprise Fund v. PCAOB*, 537 F.3d 667, 686 (D.C. Cir. 2008). It was established "to oversee the audits of companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate and independent audit reports." [No name in original], Exchange Act Release No. 68921, 2013 SEC LEXIS 495, at \*1 (Feb. 13, 2013).

<sup>17</sup> Request to Vacate Injunction at 2 (unnumbered), *SEC v. Amundsen*, No. C83-00711 WHA (N.D. Cal. Oct. 4, 2010).

<sup>18</sup> *SEC v. Amundsen*, No. C83-00711 WHA (N.D. Cal. Nov. 15, 2010) (order denying defendant's motion to vacate injunction).



financial statements met GAAP standards, and that the Olympic audit was done with all professional care. The Ninth Circuit affirmed the district court's order.<sup>19</sup>

**D. FINRA filed a disciplinary action against Amundsen and held a hearing on the charges.**

On May 18, 2011, FINRA filed a complaint against Amundsen alleging that he had willfully failed to disclose the license revocation and the injunction imposed by the Judgment on approximately thirty-six Forms U4.<sup>20</sup> At the ensuing hearing, a FINRA examiner testified that Amundsen answered "No" to both the Injunction Question and the Revocation Question on each of the thirty-six Forms U4 at issue.

Amundsen did not deny that he had been enjoined or that his CPA license had been revoked. But he contended that his answer to the Injunction Question was correct because the Judgment was based on his audit of a private company that was filed with the Commission without his consent, and he understood the injunction as barring him only from auditing public companies. The injunction involved only accounting, he argued, not investment-related activity, and thus the

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<sup>19</sup> *SEC v. Amundsen*, No. 10-17759, 470 F. App'x 651, 2012 U.S. App. LEXIS 4512, at \*1-2 (9th Cir. 2012). Before filing his appeal, Amundsen delivered a motion for reconsideration to the clerk of the district court. However, the motion was not docketed until after Amundsen had filed his appeal. The district court denied the motion for reconsideration, *SEC v. Amundsen*, No. C83-00711 WHA (N.D. Cal. Feb. 2, 2011) (order denying defendant's motion for reconsideration), and it does not appear that Amundsen appealed that denial.

After the Ninth Circuit denied his appeal, Amundsen filed a "Petition for Remand to District Court," which the court construed as a petition for panel rehearing and denied. Order, *SEC v. Amundsen*, No. 10-17759 (9th Cir. July 24, 2012). In the same order, the court stated, "No further filings shall be accepted in this closed case." *Id.* Nonetheless, Amundsen made several additional filings with the court, which rejected them. We take official notice of the court's docket.

<sup>20</sup> The complaint also alleged that Amundsen willfully failed to amend the false answers he had provided on the Forms U4. However, FINRA construed the complaint as having a single cause of action—willful failure to disclose material information on thirty-six Forms U4—and made only passing reference to the failure-to-amend charged in the complaint. Accordingly, we focus our analysis on Amundsen's failure to disclose the injunction and the revocation when he filed each of the Forms U4.

correct answer was "No."<sup>21</sup> With respect to the Revocation Question, Amundsen stated that he considered "No" the correct answer because his CPA license had been reissued before he completed and signed the Forms U4.<sup>22</sup>

Amundsen testified that he determined that the two questions should be answered "No" "[i]n conjunction with" Gettenberg and Buchanan, the two firms that helped place him with broker-dealer firms. But he acknowledged that he did not actually show a copy of the injunction to the person with whom he spoke at Gettenberg,<sup>23</sup> and he later said that he was unsure whether he had any discussion with Gettenberg and Buchanan about whether Form U4 required disclosure of the injunction.

Amundsen testified that he "[a]bsolutely" accepted responsibility for the answers contained in all thirty-six of the Forms U4 at issue.<sup>24</sup> He maintained, however, that he did not

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<sup>21</sup> Although Amundsen admitted at the hearing that the Judgment was in an action instituted by the Commission, which, he conceded, regulates trading in securities, he nonetheless continued to maintain that the injunction was not investment-related because when he audited Olympic, it was not a public company: "This is not an investment related activity. It was an audit of a public – of a private company. I don't see how you can say that this – this answer is wrong. It's obviously correct, in my opinion." Hearing Tr. at 30. It is not clear why Amundsen allegedly thought it would matter whether his audit was of a private or a public company, since both private and public companies can issue securities. Similarly, even if, as Amundsen asserted, he understood the injunction to bar him only from auditing public companies, it is unclear why he would believe that auditing public companies would not constitute investment-related activity. We agree with FINRA that Amundsen failed to offer a coherent explanation for his position as to why "No" was the correct answer to the Injunction Question, but since Amundsen is not pressing this argument on review, we need not further explore the issue.

<sup>22</sup> Amundsen also said that in connection with CPA certification, he was asked, "[S]ince the last filing, has your license ever been revoked?" Because he would answer "No" to that question, he testified, he answered the Revocation Question the same way. On appeal before FINRA's National Adjudicatory Council, Amundsen stated that he thought the Revocation Question meant to ask whether he had practiced as an accountant without a license.

<sup>23</sup> Hearing Tr. at 74. Before the NAC, Amundsen argued that when he looked at the documents related to the 1983 Judgment after receiving a letter from FINRA in 2010 related to his statutory disqualification, *see infra* note 64, "that was the first time after 30 years I'd seen them." NAC Tr. at 49.

<sup>24</sup> Hearing Tr. at 57. In completing each Form U4, Amundsen was required to sign an acknowledgment and consent that included the following language: "I swear or affirm that I have read and understood the items and instructions on this form and that my answers (including attachments) are true and complete to the best of my knowledge." *E.g.*, R. 1097-98 (Amundsen's Form U4 for registration with Semanza Securities, LLC (May 13, 2009)).

complete each of the thirty-six Forms U4 individually; instead, after he filled out the first one, the U4s were "rolled over per the FINRA system, not through my work."<sup>25</sup> By "rolled over," Amundsen apparently meant that portions of the form were automatically populated with information he originally entered. Amundsen testified that he did not review each of the U4s at issue, but he admitted that he signed each one.<sup>26</sup>

Amundsen testified that he understood that FINRA asked the Injunction Question and the Revocation Question on Form U4 because it was "interested in full disclosure."<sup>27</sup> Although Amundsen acknowledged that he had an obligation to provide full disclosure to FINRA, he testified that he believed, even at the time of the hearing, that he had provided full disclosure "[u]nder the circumstances."<sup>28</sup>

Amundsen further testified that he believed it was important to firms that would be employing him to know that he was subject to a permanent injunction that prohibited him from auditing public companies and that his accounting license had previously been revoked. But when asked whether he disclosed the license revocation to any of the thirty-four firms in question, Amundsen did not answer "Yes." Instead, he responded that the information was a matter of public record, and if they had any questions, they could have asked him.<sup>29</sup>

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<sup>25</sup> Hearing Tr. at 36.

<sup>26</sup> *Id.* at 35-36.

<sup>27</sup> *Id.* at 68.

<sup>28</sup> *Id.* at 68-69.

<sup>29</sup> At one point during the hearing, Amundsen testified that he took the initiative in informing firms that he was enjoined from auditing public companies: "I brought it up with them." *Id.* at 38. Before the NAC, however, he admitted that he did not discuss the injunction and revocation with the employing firms when he first associated with them, but rather waited until after FINRA notified him in 2010 that he was statutorily disqualified.

**E. FINRA found that Amundsen willfully failed to disclose the injunction and revocation and sanctioned him.**

On December 30, 2011, the hearing panel issued a decision finding that Amundsen willfully failed to disclose the injunction and the license revocation on the Forms U4, and that this willful failure to disclose violated NASD IM-1000-1 and Rule 2110 and FINRA Rules 1122 and 2010.<sup>30</sup> Having heard Amundsen testify, the panel found his explanations as to why he did not disclose the injunction and the license revocation, as well as his explanation as to how the answers on the Forms U4 were "self-populated" or "rolled over," not credible.<sup>31</sup> As a sanction for his misconduct, the hearing panel barred Amundsen from associating with any FINRA member firm; it also ordered Amundsen to pay costs.

Amundsen appealed the decision to FINRA's National Adjudicatory Council,<sup>32</sup> which affirmed the hearing panel's findings as to liability and sanctions.<sup>33</sup> The NAC found that Amundsen "offered no credible, coherent support for his position" that "No" was the correct answer to the Injunction Question, and it agreed with the hearing panel's assessment that Amundsen's explanation about why he answered "No" to the Revocation Question lacked credibility. It also rejected Amundsen's argument that the injunction was unlawful and that the disciplinary action against him should therefore be dismissed. The NAC found that Amundsen

<sup>30</sup> *Dep't of Enf. v. Amundsen*, Complaint No. 2010021916601, 2011 FINRA Discip. LEXIS 63 (OHO Dec. 30, 2011), *aff'd*, 2012 FINRA Discip. LEXIS 54 (NAC Sept. 20, 2012).

<sup>31</sup> The panel found that Amundsen had provided no evidence to support the "rolling-over" explanation, and stated that the explanation was "completely contradicted by the Hearing Panel's own experience." 2011 FINRA Discip. LEXIS 63, at \*9-10.

<sup>32</sup> The NAC serves as the appellate body for FINRA's disciplinary proceedings and the committee that sets the association's sanctions policy. FINRA Manual, at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4735](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4735) (By-Laws of FINRA Regulation, Inc., Art. V, §§ 5.1 (Authority)); FINRA website, at <http://www.finra.org/Industry/Enforcement/SanctionGuidelines/p016371> (March 2006 Revisions to the NASD Sanction Guidelines—FAQ).

<sup>33</sup> *Amundsen*, 2012 FINRA Discip. LEXIS 54, at \*1, 33-34.

"has been subject to statutory disqualification because he was enjoined in 1983 in connection with the purchase or sale of securities"<sup>34</sup> and further found that Amundsen's willful submission of material false information on Forms U4 was an additional basis for his statutory disqualification.<sup>35</sup>

In considering sanctions, the NAC found that the information Amundsen failed to disclose was "highly material" and that disclosure of that information would create serious doubt for member firms regarding Amundsen's commitment to accuracy with respect to regulatory compliance and his ability to provide accurate financial information. It characterized Amundsen's interpretation of the relevant Form U4 questions as "self-serving [and] implausible" and found that his active concealment of the Judgment and the license revocation demonstrated "deliberativeness rather than mere oversight."<sup>36</sup> The NAC found that nothing in the record other than Amundsen's testimony supported his assertion that he told at least some firms about the Judgment, and that to the extent he disclosed anything, the disclosure was "grossly inadequate" because his interpretation of the Judgment was "patently wrong" and he did not give any of the firms a copy of the Judgment.<sup>37</sup> Further, the NAC was "troubled" by Amundsen's failure to express any remorse for having exposed the firms that employed him to risk and possible liability based on their employment of a statutorily disqualified individual.<sup>38</sup> The NAC found that Amundsen's assertions that disclosure of the license revocation to potential employers was unimportant because the information was available on the Internet demonstrated "intentional and complete disregard for the

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<sup>34</sup> *Id.* at \*20.

<sup>35</sup> *Id.* at \*15-21.

<sup>36</sup> *Id.* at \*29.

<sup>37</sup> *Id.* at \*30.

<sup>38</sup> *Id.* at \*27.

disclosure required by FINRA rules and the Form U4."<sup>39</sup> Finding that Amundsen lacked the integrity and fitness required of those employed in the securities industry, the NAC concluded that a bar (which it found to be consistent with FINRA's Sanction Guidelines) would "best serve to protect the investing public and deter others from failing to disclose material information when seeking registration through a FINRA member."<sup>40</sup> This appeal followed.

### III.

#### A. **Amundsen violated NASD IM-1000-1 and Conduct Rule 2110 and FINRA Rules 1122 and 2010 by providing incorrect answers on his Forms U4.**

As discussed further below, we find that Amundsen violated NASD IM-1000-1 and Conduct Rule 2110 and FINRA Rules 1122 and 2010 by providing incorrect answers to the Injunction Question and the Revocation Question on the thirty-six Forms U4 at issue. Before addressing the specific details of Amundsen's case, however, we provide a brief discussion of the policy issues involved.

Registered representatives like Amundsen bear that designation because they represent their firms to the public. Before they can align themselves with any member firm, they must complete and file with FINRA a Form U4. Form U4 is a critically important regulatory tool. As we recently observed, "Form U4 is used by all self-regulatory organizations (including FINRA), state regulators, and broker-dealers to determine and monitor the fitness of securities professionals who seek initial or continued registration with a member firm."<sup>41</sup> Members of the public can also access

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<sup>39</sup> *Id.* at \*28.

<sup>40</sup> *Id.* at \*33 (citing *McCarthy v. SEC*, 406 F.3d 179, 188-89 (2d Cir. 2005)).

<sup>41</sup> *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 SEC LEXIS 3496, at \*26 (Nov. 9, 2012) (citing *Rosario R. Ruggiero*, Exchange Act Release No. 37070, 52 SEC 725, 1996 SEC LEXIS 990, at \*8-9 (Apr. 5, 1996)), *appeal docketed*, No. 13-31 (2d Cir. Jan. 8, 2013).

the information reported in the form, via BrokerCheck,<sup>42</sup> and can use that information when deciding to whom they want to entrust their money.<sup>43</sup> "The form is critical to the effectiveness of the screening process used to determine who may enter (and remain in) the industry. It ultimately serves as a means of protecting the investing public."<sup>44</sup>

Because Form U4 is so important, every Form U4 filed with FINRA must be accurate, and must be kept current through supplemental amendments that are to be filed within thirty days of learning of the facts and circumstances giving rise to the amendment.<sup>45</sup> "The duty to provide accurate information and to amend the Form U4 to provide current information assures regulatory organizations, employers, and members of the public that they have all material, current information about the securities professional with whom they are dealing."<sup>46</sup>

Given the size of FINRA's membership, FINRA "cannot investigate the veracity of every detail in each document filed with it, [and] must depend on its members to report to it accurately

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<sup>42</sup> According to FINRA's website:

BrokerCheck is a free tool to help investors research the professional backgrounds of current and former FINRA-registered brokerage firms and brokers, as well as investment adviser firms and representatives. It should be the first resource investors turn to when choosing whether to do business or continue to do business with a particular firm or individual.

FINRA website, at <http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/>.

<sup>43</sup> See, e.g., *Scott Mathis*, Exchange Act Release No. 61120, 2009 SEC LEXIS 4376, at \*29 (Dec. 7, 2009) (information about respondent's tax liens, if disclosed on Form U4, would have allowed potential investors to assess "whether [respondent's] tax problems and large financial obligations had a bearing on their confidence in him"), *petition denied*, 671 F.3d 210 (2d Cir. 2012).

<sup>44</sup> *Tucker*, 2012 SEC LEXIS 3496, at \*26 (internal citation omitted; citing additional authority).

<sup>45</sup> FINRA By-Laws of the Corporation, Art. V, § 2(c). To ensure that registrants are aware of this requirement, Form U4 expressly requires registrants to acknowledge their obligation to keep their Forms U4 current by filing timely supplemental amendments.

<sup>46</sup> *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 SEC LEXIS 3719, at \*17-18 (Oct. 20, 2011).

and clearly in a manner that is not misleading."<sup>47</sup> Thus, NASD IM-1000-1 and FINRA Rule 1122 prohibit the filing, in connection with membership or registration as a registered representative, of information so incomplete or inaccurate as to be misleading.<sup>48</sup> Moreover, filing a misleading Form U4 violates not only IM-1000-1 and FINRA Rule 1122, but also the standard of just and equitable principles of trade to which every person associated with a NASD or FINRA member is held under Rule 2110 or Rule 2010 respectively.<sup>49</sup>

Each time Amundsen associated with a new firm, he completed a new Form U4, certified that he understood the questions, and certified that his answers were accurate and complete.<sup>50</sup> However, on the thirty-six forms at issue, Amundsen falsely answered "No" to the Injunction Question and the Revocation Question although the plain language of those questions required an affirmative response based on facts he knew.

Amundsen's false answers to the Injunction Question and the Revocation Question violated his duty under IM-1000-1 and its successor, Rule 1122, to provide full, accurate, and non-misleading information in connection with his registration and his duty under Rules 1122 and 2010 to act consistently with just and equitable principles of trade. By concealing the injunction and the revocation of his accountant's license, Amundsen deprived regulators, broker-dealers, and members of the investing public of critical information necessary to determine whether he was

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<sup>47</sup> *Robert E. Kauffman*, Exchange Act Release No. 33219, 51 SEC 838, 1993 SEC LEXIS 3163, at \*3 (Nov. 18, 1993), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (Table). We note that as of mid-April 2013, there were more than 4,000 FINRA member firms with approximately 630,000 registered representatives in more than 160,000 branch offices. FINRA website, at <http://www.finra.org/AboutFINRA>.

<sup>48</sup> NASD IM-1000-1. "This rule applies to Form U4." *Mathis*, 2009 SEC LEXIS 4376, at \*16.

<sup>49</sup> *Tucker*, 2012 SEC LEXIS 3496, at \*30 (citing *Mathis*, 2009 SEC LEXIS 4376, at \*16, and other authority).

<sup>50</sup> *See supra* note 24.



trustworthy and could fulfill the high standards of conduct required of securities industry registrants.

Amundsen's misconduct had repercussions beyond the violation of his own disclosure responsibilities. By failing to disclose the injunction, he concealed from the firms that employed him that he was statutorily disqualified and prevented them from assessing whether they wanted to seek FINRA's approval to have Amundsen associate with them despite the disqualification,<sup>51</sup> or on what terms they would want such association.<sup>52</sup> Additionally, Amundsen's misconduct potentially exposed each of the thirty-four firms that employed him to the risk of disciplinary action based on their having employed a statutorily disqualified person without having obtained FINRA's approval to do so.<sup>53</sup>

Amundsen's actions also reflect poorly on his commitment to his regulatory responsibilities in general. Answering the questions falsely allowed Amundsen to be hired repeatedly over a six-year period without the kind of scrutiny that would otherwise have been given to someone with his history. Thus, he put his own interests in employment in the securities industry above the legitimate interests of regulators, firms, and investors in having truthful

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<sup>51</sup> See *supra* note 4 (discussing consequences of statutory disqualification).

<sup>52</sup> Presumably the firms would also have wanted to evaluate the question whether Amundsen could function satisfactorily as a FINOP in light of his injunction from appearing or practicing before the Commission. See NASD Rule 1022 (explaining that FINOP's duties include "[f]inal approval and responsibility for the accuracy of financial reports submitted to any duly established securities regulatory body," "[f]inal preparation of such reports," and "[s]upervision of individuals who assist in such reports").

Amundsen's vague testimony that he discussed the injunction with some firms does not establish that he adequately informed them about the injunction and the license revocation, especially in light of his repeated attempts to downplay the importance of those events. Moreover, as noted above, the record does not show that these discussions were held before Amundsen completed the Forms U4 and started working at the firms. See *supra* note 29 and accompanying text.

<sup>53</sup> See *Amundsen*, 2012 FINRA Discip. LEXIS 54, at \*27.

information on which to base their dealings with him. A history of multiple false filings like Amundsen's is highly problematic in any person participating in an industry that "presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."<sup>54</sup>

We find, as FINRA did, that Amundsen's testimony about why he answered the questions "No" rather than "Yes"—the Injunction Question because he believed the injunction did not involve "investment-related" activity and the Revocation Question because his license had been reinstated by the time he completed the forms (or because he answered a CPA certification question that way)—lacked credibility.<sup>55</sup> It is well established that securities industry professionals "'must take responsibility for compliance' with [Form U4] and 'cannot be excused for lack of knowledge, understanding or appreciation of its requirements.'"<sup>56</sup> Indeed, Amundsen stated that he "absolutely" accepted responsibility for the answers on the thirty-six Forms U4 at issue. As FINRA found, the Judgment (which Amundsen admits he read) and the definition of "investment-related" in Form U4 are written in plain language, and the Revocation Question is explicit and unambiguous.<sup>57</sup> If Amundsen was nonetheless unsure about how the questions should

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<sup>54</sup> *Conrad P. Seghers*, Investment Advisers Act Release No. 2656, 2007 SEC LEXIS 2238, at \*28 (Sept. 26, 2007), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

<sup>55</sup> We concur with the panel's credibility findings, which are entitled to considerable weight. *Janet Gurley Katz*, Exchange Act Release No. 61449, 2010 SEC LEXIS 994, at \*49 & n.22 (Feb. 1, 2010), *petition denied*, 647 F.3d 1156 (D.C. Cir. 2011); *see also Laurie Jones Canady*, Exchange Act Release No. 41250, 54 SEC 65, 1999 SEC LEXIS 669, at \*27 (Apr. 5, 1999).

<sup>56</sup> *Tucker*, 2012 SEC LEXIS 3496, at \*36 (quoting *Guang Lu*, Exchange Act Release No. 51047, 58 SEC 43, 2005 SEC LEXIS 117, at \*22 (Jan. 14, 2005), *aff'd*, 179 F. App'x 702, 2006 U.S. App. LEXIS 24875 (D.C. Cir. 2006), and citing additional authority).

<sup>57</sup> *Cf. Mathis*, 2009 SEC LEXIS 4376, at \*21 (rejecting applicant's claim that the question was ambiguous, noting that it "contains no limitations on the kind of liens required to be disclosed").

be answered, it was incumbent on him to find out.<sup>58</sup> Amundsen, as the individual directly impacted by the injunction and the license revocation, was in the best position to provide accurate information about those subjects, and it is thus appropriate that he bore primary responsibility for correctly answering the questions on the Forms U4 that pertained to those topics.<sup>59</sup>

Whatever discussions Amundsen may have had with Gettenberg and Buchanan do not affect his obligation to provide complete and accurate information on each Form U4 he completed.<sup>60</sup> Nor does the alleged availability on the Internet of information regarding the Judgment and the license revocation affect this obligation. Firms, regulators, and investors must be able to rely on Form U4 as a source of truthful answers to the questions posed there. Whether they

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<sup>58</sup> Cf. *Jason A. Craig*, Exchange Act Release No. 59137, 2008 SEC LEXIS 2844, at\* 14 (Dec. 22, 2008) ("If Craig had any doubt about the disposition of his conviction, it was his duty to determine whether the information he was providing on Form U4 was complete and accurate.").

<sup>59</sup> Cf. *Tucker*, 2102 SEC LEXIS 3496, at \*37 (reaching similar conclusion with respect to responsibility of registered representative who filed bankruptcy petitions and against whom tax lien and judgment were entered for answering questions about those subjects on Form U4). *But see also id.* at \*38 n.46 (discussing firm's obligations to also take steps to ensure that the information contained in registration documents it submits is accurate).

<sup>60</sup> We find, as FINRA did, that Amundsen's testimony about his discussions with Gettenberg and Buchanan was evasive. Amundsen identified only one individual with whom he allegedly spoke about the injunction and provided no specifics about when any such discussions took place or what they allegedly covered. Amundsen does not contend that anyone at either firm advised him that he need not disclose the injunction (or the revocation) on Form U4; rather, he phrased all alleged conclusions impersonally, testifying, "[T]he feeling was that this was an injunction against auditing a public company," Hearing Tr. at 27, and "[T]he issue [of the Commission's complaint against him] was brought up. The understanding was . . . it was an injunction against auditing a public company." *Id.* at 28. But even if individuals at those firms had told Amundsen that he could appropriately answer "No" to the Injunction and Revocation Questions, Amundsen would still be responsible for his answers. As we have previously held, "a member firm's own interpretations of the securities laws and rules do not protect associated persons. To hold otherwise would permit every broker-dealer to interpret the laws and rules to its liking and would result in enormous inconsistency of enforcement." *Thomas R. Alton*, Exchange Act Release No. 36058, 52 SEC 380, 1995 SEC LEXIS 1975, at \*8 n.12 (Aug. 4, 1995); *see also Barry C. Wilson*, Exchange Act Release No. 37867, 52 SEC 1070, 1996 SEC LEXIS 3012, at \*9 n.12 (Oct. 25, 1996) (noting that "failings on the part of certain firm personnel do not excuse misconduct by others").

could have found additional relevant information, or even the same information, by searching the Internet is beside the point.<sup>61</sup>

**B. Amundsen is statutorily disqualified.**

A person is subject to a statutory disqualification under Exchange Act § 3(a)(39)(F) if, among other things, he or she "is enjoined from any action, conduct, or practice specified in Exchange Act Section 15(b)(4)(C)."<sup>62</sup> Among the injunctions specified in § 15(b)(4)(C) are injunctions "from engaging in . . . any conduct or practice . . . in connection with the purchase or sale of any security."<sup>63</sup> Because the Judgment enjoined Amundsen from engaging in fraudulent activity "in connection with the purchase or sale of any security of [Olympic] or any other issuer," Amundsen has been subject to statutory disqualification since the injunction was issued in 1983.<sup>64</sup>

<sup>61</sup> Cf. *Tucker*, 2012 SEC LEXIS 3496, at \*38 n.45 (rejecting argument that employing firm knew about respondent's tax liens, which were not reported on Form U4, because employer had obtained credit reports that disclosed those liens: "[V]iolative Form U4 disclosures are not excused by the availability of relevant information through third parties.").

<sup>62</sup> 15 U.S.C. § 78c(a)(39)(F). For information about the origins of statutory disqualification, see *Tucker*, 2012 SEC LEXIS 3496, at \*40 & n.49.

<sup>63</sup> 15 U.S.C. § 78o(b)(4)(C).

<sup>64</sup> By letter dated April 16, 2010, FINRA notified one of the firms that employed Amundsen as a FINOP that Amundsen was subject to statutory disqualification as a result of the injunction.

As a result of the injunction, Amundsen was also subject to disqualification under NASD's and FINRA's By-Laws. Under Article III, § 4(h) of NASD's By-Laws, a person is subject to "disqualification" with respect to association with a member firm if the person is "permanently . . . enjoined by order, judgment, or decree of any court of competent jurisdiction . . . from engaging in or continuing any conduct or practice . . . in connection with the purchase or sale of any security." NASD Manual at 1307 (Nov. 2003). Under Article III, § 4 of FINRA's By-Laws, a person is subject to "disqualification" with respect to association with a member firm if the person is subject to any "statutory disqualification" as defined by Exchange Act § 3(a)(39). [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=4607](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=4607).

Amundsen attached to his opening brief an April 30, 2010 letter written by an attorney representing Amundsen, which states that the Judgment is not a basis for statutory disqualification under § 3(a)(39) because it "enjoins only conduct in connection with the sale of one specific security and restrained Mr. Amundsen from appearing and practicing before [the Commission only] as an accountant." Letter from Andrew J. Goodman, GSB Law, to Ms. Lorraine Lee, Manager, Statutory Disqualification Policy, FINRA (April 30, 2010), at 1 (unnumbered). Insofar as Amundsen is making this argument on appeal, we reject it. The attorney's characterization of the injunction is incorrect, since it enjoins Amundsen from certain conduct "in the offer or sale of any security of Olympic Gas & Oil,

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Amundsen's willful provision of material false information on the thirty-six Forms U4 discussed in this opinion is also a basis for statutory disqualification.<sup>65</sup> Under Exchange Act § 3(a)(39)(F), a person who "has willfully made or caused to be made in any application . . . to become associated with a member of a self-regulatory organization . . . any statement which was at the time, and in light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state . . . any material fact which is required to be stated therein," is subject to statutory disqualification.<sup>66</sup>

A willful violation under the federal securities laws means "that the person charged with the duty knows what he is doing."<sup>67</sup> It is not necessary to additionally find that the respondent "was aware of the rule he violated or that he acted with a culpable state of mind."<sup>68</sup> A failure to disclose is willful under Exchange Act § 3(a)(39)(F) if the respondent of his own volition provides false answers on his Form U4.<sup>69</sup> Here, Amundsen acted willfully by voluntarily supplying false answers to the Injunction Question and the Revocation Question on the Forms U4 while he was aware of the injunction and the revocation. These false answers were neither involuntary nor

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Inc. or any other issuer" (emphasis added), and it enjoins Amundsen "from appearing or practicing before the Commission in any way" (emphasis added).

<sup>65</sup> See *Tucker*, 2012 SEC LEXIS 3496, at \*40-48 (finding statutory disqualification under § 3(a)(39)(F) where respondent voluntarily supplied false answers to questions on Form U4 while he was aware of correct information that should have been disclosed).

<sup>66</sup> 15 U.S.C. § 78c(a)(39)(F).

<sup>67</sup> *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)).

<sup>68</sup> *Craig*, 2008 SEC LEXIS 2844, at \*13. *Accord Mathis*, 671 F.3d at 217; *Wonsover*, 205 F.3d at 414; *Neaton*, 2011 SEC LEXIS 3719, at \*21.

<sup>69</sup> *Mathis*, 2009 SEC LEXIS 4376, at \*19; see also *Mathis*, 671 F.3d at 216 (finding that the Commission "did not abuse its discretion when it concluded that Mathis willfully failed to disclose . . . tax liens within the meaning of [Exchange Act] § 3(a)(39)(F) because he 'voluntarily provided false answers on his Form U4'").

inadvertent; the questions were clearly and straightforwardly formulated, as was the definition of "investment-related" for purposes of the Injunction Question.<sup>70</sup> We find ample support in the record for FINRA's determination that Amundsen's testimony about his belief in the accuracy of his answers was not credible. And he gave those answers repeatedly. His evasive testimony about his alleged discussions regarding the injunction with Gettenberg and Buchanan, which were not shown to have been based on an accurate description of the injunction or to have occurred before Amundsen completed any particular Form U4, does not detract from our conclusion that Amundsen's conduct was willful. And in any event, Amundsen does not contend that he discussed the license revocation with Gettenberg and Buchanan. Thus, the willfulness of his answers to the Revocation Question is unaffected by any such discussions.<sup>71</sup>

We also find that the information Amundsen excluded from the thirty-six Forms U4 at issue was material. Information not disclosed on a Form U4 is material if the omitted information would have "significantly altered the total mix of information made available," or "would have assumed actual significance in the deliberations of the representative's employers, regulators, and investors."<sup>72</sup> The injunction was significant because it was a remedial sanction imposed by consent judgment entered by a court in a Commission enforcement action alleging that Amundsen violated antifraud provisions of the federal securities laws and because, by enjoining Amundsen from appearing or practicing before the Commission, it limited the potential scope of his professional

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<sup>70</sup> As previously noted, *see supra* note 14, the instructions for completing Form U4 defined "investment-related" as "pertain[ing] to securities."

<sup>71</sup> An Exchange Act statutory disqualification can be triggered by a single willful violation. *See* Exchange Act § 3(a)(39)(F), 15 U.S.C. § 78c(a)(39)(F) (covering any material misstatement or omission willfully made on any application for association with a member firm).

<sup>72</sup> *Tucker*, 2012 SEC LEXIS 3496, at \*47 (quoting *Mathis*, 2009 SEC LEXIS 3276, at \*29 & n.27, \*31).

practice. The license revocation was significant because it similarly curtailed Amundsen's professional activities and reflected disciplinary action taken by a professional licensing board. The materiality of such information is particularly evident when, as in this case, its disclosure was required by specific questions on the Form U4. We have previously recognized that "[e]ssentially all the information that is reportable on the Form U4 is material."<sup>73</sup> Thus we find, as FINRA did, that Amundsen's willful failure to disclose the injunction and the revocation on the thirty-six Forms U4 results in statutory disqualification.

**C. Amundsen's procedural objections are without merit.**

Amundsen does not challenge the basis for FINRA's action, *i.e.*, the fact that he incorrectly answered the Injunction Question and the Revocation Question on the thirty-six Forms U4 at issue. Instead, he focuses on what he claims were procedural errors by FINRA. Specifically, he claims that FINRA staff improperly suppressed a district court finding that he sought to introduce—a January 19, 2012 order of the United States District Court for the Northern District of California that Amundsen contends dealt with "the same issues" involved in this review proceeding.<sup>74</sup> He asserts that FINRA's Department of Enforcement filed a motion to exclude the district court order when he attempted to submit it while the matter was pending before the NAC, and that the NAC's

<sup>73</sup> *Id.* at \*47 (quoting *Dep't of Enf. v. Knight*, Complaint No. C10020060, 2004 NASD Discip. LEXIS 5, at \*13 (NAC Apr. 27, 2004)); *see also Heath*, 586 F.3d at 138-39 (noting deference accorded to SROs in interpreting their rules).

<sup>74</sup> Amundsen's Opening Br. at 1 (unnumbered). Amundsen's brief states that he appealed the hearing panel's decision on December 30, 2011, the same day it was issued, "on the grounds that the panel did not know of the Court's decision." *Id.* at 2. Of course, the court's January 19, 2012 decision did not yet exist when the hearing panel issued its decision in December 2011. The record document that Amundsen cites in support of this assertion shows that on December 30, 2011, Amundsen asked FINRA's Office of Hearing Officers for "an appeal and a stay of any actions," based in part on his assertion that an "initial decision" in federal district court would be made "on or about January 10, 2012[2]," and that "[a]ll indications are that the Court will rule in Amundsen's favor." Letter from Joseph Amundsen to FINRA Office of Hearing Officers (Dec. 30, 2011).

decision was "based on the resulting assumption that Amundsen had no right [to bring] the District Court action to its attention."<sup>75</sup> Thus, Amundsen argues, the NAC's decision was "based on suppression" of the district court's finding.<sup>76</sup>

To begin with, the district court order does not deal with the same issues involved in this proceeding. The district court's ruling was on a motion brought by the Commission to have Amundsen held in contempt for violating the injunction. The principal question in this proceeding, whether Amundsen violated NASD and FINRA rules by providing false information on thirty-six Forms U4, was not at issue in the district court action. In fact, the district court order does not mention either Form U4 or the pertinent NASD and FINRA rules.

Amundsen asserts in his reply brief that "[t]he only Court findings (in 2012) were that the injunction upon which all this controversy is about should be vacated."<sup>77</sup> This interpretation of the order is unfounded. To the contrary, the district court found that "in light of his consent decree, the defendant should never have begun the practice [of auditing financial statements of broker-dealers destined to be filed with the Commission] in the first place" and that Amundsen's "narrow reading" of the injunction as barring only audit reports for public companies was unreasonable.<sup>78</sup> The court advised Amundsen that he "would be well-advised to retain counsel" if he wanted to enter a motion to modify the scope of the injunction, but stated, "Whether or not such a motion would be

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<sup>75</sup> Amundsen's Opening Br. at 2.

<sup>76</sup> Amundsen's Reply Br. at 1 (unnumbered).

<sup>77</sup> *Id.* at 1. Amundsen does not identify the language in the order on which he relies.

<sup>78</sup> *SEC v. Amundsen*, No. C 83-00711 WHA, at 2-3 (N.D. Cal. Jan. 19, 2012) (order re motion for contempt). The court did not find Amundsen to be in contempt, but the absence of such a finding does not affect our disposition of this matter.



granted would depend on its own merits and this order does not intimate one way or the other."<sup>79</sup>

Thus, Amundsen's interpretation of the order as vacating the injunction, or suggesting that the injunction should be vacated, is incorrect.<sup>80</sup>

Even if the district court had vacated the injunction, that would not change the analysis under FINRA Rules 1122 and 2010 and their NASD counterparts. The Injunction Question asked Amundsen whether he had "ever" been enjoined in connection with any investment-related activity. The answer to that question was, and remains, "Yes." The entry of the injunction is a historic fact that would not be affected by a subsequent determination to vacate the injunction.<sup>81</sup>

<sup>79</sup> *Id.* at 3.

<sup>80</sup> Amundsen asserts, without further explanation or any evidentiary support, that "[t]he actual injunction was written by employees of the SEC (in 1983) who had never passed the bar exam, but represented to the Court that they were lawyers." Amundsen's Reply Br. at 1. Not only are these allegations unsupported, we also understand them as a collateral attack on the federal court proceedings. Such collateral attacks are impermissible in our administrative proceedings. *See, e.g., Neaton*, 2011 SEC LEXIS 3719, at \*43 (holding that findings of discipline board of state bar are not subject to collateral attack in FINRA review proceeding); *Phillip J. Milligan*, 2010 SEC LEXIS 1163, at \*13-15 (Mar. 26, 2010) (holding that district court findings in injunctive action and criminal proceeding are not subject to challenge in follow-on proceeding). Amundsen's assertions that "[t]he SEC lawyer in [the contempt proceeding in federal district court] lied when he said that [information used in the Commission's brief] was public," Amundsen's Opening Br. at 1, is equally unsupported.

In his petition for review, Amundsen states that Commission staff responded to an inquiry from the district court in the contempt action against Amundsen by saying that "the action had nothing to do with FINRA, and that Amundsen was able to do FINRA and FOCUS work." Petition for Review at 1 (unnumbered). Amundsen overly simplifies and misrepresents the staff's responses, which he attached to his reply brief in this proceeding. The staff stated that the injunction did not prevent Amundsen from working at a FINRA-registered broker-dealer, but that FINRA rules provided that the injunction must be disclosed to FINRA before the enjoined person could become registered, and appropriate supervisory rules must be put in place by the member firm and approved by FINRA. Letter from Christopher M. Bruckmann, Senior Counsel, SEC, Office of the Gen'l Counsel, to The Hon. William Alsup, U.S. District Judge, N.D. Cal. (Jan. 17, 2012), at 2. The staff also stated that because the injunction prohibited Amundsen "from appearing or practicing before the Commission in any way," it prohibited him from preparing FOCUS Reports (Financial and Operational Combined Uniform Single Reports), which it defined as "unaudited financial statements filed by broker-dealers with the SEC and/or self-regulatory organizations." *Id.* at 3. Amundsen points to nothing in the staff's responses that would support the argument he made before FINRA that the injunction was not in connection with investment-related activity. Moreover, Amundsen could not have relied on the staff's responses in completing the Forms U4 at issue, since all of those Forms U4 were completed before the staff's responses were submitted.

<sup>81</sup> *See Robert J. Sayegh*, Exchange Act Release No. 37953, 52 SEC 1110, 1996 SEC LEXIS 3177, at \*5 (Nov. 15, 1996) (holding that the pendency of a respondent's petition to vacate or overturn an injunction "would not alter the 'factual' existence of the injunction 'and its public interest implications'" (quoting *Charles Phillip Elliott*, Exchange Act Release No. 31202, 50 SEC 1273, 1992 SEC LEXIS 2334, at \*11 (Sept. 17, 1992)). In this connection, we note

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Moreover, Form U4 instructs applicants who answer "Yes" to the Injunction Question to provide details on a continuation page of the form. Thus, an applicant whose injunction was vacated would still be required to report the injunction, but would also have the opportunity to report facts relevant to its vacation.

Amundsen's contention that the NAC's decision was based on suppression of the district court's January 19 order is also unfounded. The NAC denied the Department of Enforcement's motion to exclude the district court order. Though it found that Amundsen "failed to seek leave to introduce additional evidence, and more importantly, failed to demonstrate why this proposed evidence is material to the proceeding," the NAC nonetheless "considered the substance of the documents and arguments, and . . . [found] that they are irrelevant to liability and sanctions in this matter."<sup>82</sup> Thus, Amundsen's allegation that the district court order was suppressed, or that the NAC failed to consider it, is baseless.<sup>83</sup>

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that the April 30, 2010 letter attached to Amundsen's opening brief, *see supra* note 64, asked FINRA to grant Amundsen relief from FINRA's eligibility requirements under FINRA Rule 9522(e)(1)(a). Rule 9522(e)(1)(A) allows FINRA to grant such relief to a person who is statutorily disqualified based on an injunction entered at least ten years before the proposed admission if certain conditions are met, including that the person in question be "not subject otherwise to disqualification." [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3987](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3987). To the extent Amundsen is arguing that FINRA should have granted him relief under Rule 9522(e)(1)(a), we note that, as explained above, he is subject to statutory disqualification for reasons other than the injunction. Moreover, even if FINRA had relieved him of the eligibility requirements in response to a request made in April 2010, that would not alter the fact that the answers he gave on Forms U4 completed between 2003 and January 2010 were false.

<sup>82</sup> *Amundsen*, 2012 FINRA Discip. 54, at \*24 n.16. FINRA Rule 9346 provides that additional evidence may be introduced in NAC proceedings only with prior approval, upon a showing that extraordinary circumstances exist.

<sup>83</sup> In his reply brief, Amundsen asserted that the NAC's decision "was based on the suppression of the fact that the SEC has in place a procedure for dealing with these disclosure issues." Amundsen's Reply Br. at 1. In support of this assertion, Amundsen attached what he characterized as "a form letter prepared by the SEC for dealing with such disclosure issues." *Id.* (referring to proposed exhibit 1). Rule of Practice 452, 17 C.F.R. § 201.452, permits a party to a Commission administrative proceeding to file a motion to adduce additional evidence, but requires that any such motion "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously." Amundsen did not file a motion to introduce the alleged "form letter" in his reply brief, and he does not explain why he could not have adduced that document previously. Moreover, neither

(continued...)

Finally, even if the NAC had not considered the district court order on which Amundsen relies, the failure to do so would not have affected the outcome of this proceeding. In our *de novo* review we have considered that order, and for the reasons discussed above, we conclude that it does not excuse his false answers to the Injunction Question, much less to the Revocation Question.<sup>84</sup>

## V.

Pursuant to Exchange Act § 19(e)(2), we sustain FINRA sanctions unless we find, giving due regard to the public interest and the protection of investors, that the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.<sup>85</sup> Here, we find no basis for reducing the bar imposed by FINRA. In the first place, the bar is consistent with FINRA's Sanction Guidelines.<sup>86</sup> When an individual files a false, misleading, or inaccurate Form U4, the Guidelines recommend a fine of between \$2,500 and \$50,000 and a suspension of from five to

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(...continued)

the record nor Amundsen's proposed Exhibit 1 shows that the Commission has any "procedure" for dealing with disclosure issues like Amundsen's, nor does the record show that Amundsen's attempt to establish this alleged fact was "suppressed." We therefore find both proposed Exhibit 1 and Amundsen's argument to this end irrelevant to the matters at issue in this proceeding, and we decline to admit proposed Exhibit 1. *See, e.g., Tucker*, 2012 SEC LEXIS 3496, at \*58-60 (declining to adduce proposed exhibits and citing additional authority).

<sup>84</sup> It is well established that *de novo* review by the Commission cures any harm that may have resulted from improper procedural decisions made at the hearing level or by the NAC. *See Tucker*, 2012 SEC LEXIS 3496, at \*52 & n.74 (citing additional authority); *see also Heath*, 2009 SEC LEXIS 14, at \*42 & n.65 (citing *McCarthy v. SEC*, 406 F.3d 179, 187 (2d Cir. 2005), for the proposition that "the 'due process afforded [the applicant] before the Commission cured any alleged defect in the proceedings before the [SRO]'").

<sup>85</sup> 15 U.S.C. § 78s(e)(2). Section 19(e)(2) permits us to affirm, reduce, or set aside a FINRA sanction, or to remand the matter to FINRA; it does not authorize us to increase the sanction. *Id.*; *see also Gregory W. Gray*, Exchange Act Release No. 60361, 2009 SEC LEXIS 2554, at \*39 n.41 (July 22, 2009) (noting that the Exchange Act does not authorize the Commission to increase a NYSE disciplinary sanction). Amundsen does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

<sup>86</sup> "FINRA promulgated the Sanction Guidelines to achieve greater consistency, uniformity, and fairness in its sanctions. Although the Guidelines do not control our consideration of the sanctions, they serve as a benchmark for our review under Exchange Act § 19(e)(2)." *Tucker*, 2012 SEC LEXIS 3496, at \*61 n.85 (citing *Craig*, 2008 SEC LEXIS 2844, at \*18 n.27).

thirty business days.<sup>87</sup> In egregious cases, however, such as when false, misleading, or inaccurate Form U4 filings have been made repeatedly or when a statutory disqualification event has not been disclosed, the Guidelines recommend that adjudicators consider a longer suspension of up to two years or a bar.<sup>88</sup> The Guidelines also invite consideration of the "[n]ature and significance of [the] information at issue," whether the violation "resulted in a statutorily disqualified individual becoming or remaining associated with a firm," and whether the misconduct "resulted in harm to a registered person, another member firm or any other person or entity."<sup>89</sup>

Amundsen's failures to disclose the injunction and the license revocation were egregious. Over six years, Amundsen was responsible for at least thirty-six false and misleading Forms U4.<sup>90</sup> The injunction and license revocation that he failed to disclose embody critical limitations on his practice as an accountant and his involvement in the securities industry. His false and misleading filings egregiously violated the standard of "candor and forthrightness" required of associated persons during the registration process.<sup>91</sup> Accurate and timely disclosure would have provided material information to the firms with which he sought employment and to potential customers.

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<sup>87</sup> FINRA Sanction Guidelines at 69 (2011), at <http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf>.

<sup>88</sup> *Id.* at 70.

<sup>89</sup> *Id.* at 69.

<sup>90</sup> The Sanction Guidelines set forth "Principal Considerations in Determining Sanctions" applicable to all violations, including whether the respondent "accepted responsibility for and acknowledged the misconduct . . . prior to detection," "demonstrated reasonable reliance on competent legal or accounting advice," "engaged in numerous acts and/or a pattern of misconduct," and/or "engaged in the misconduct over an extended period of time," as well as whether the misconduct "was the result of an intentional act, recklessness, or negligence," or "resulted in the potential for the respondent's monetary or other gain." *Id.* at 6-7. Here, we find that Amundsen repeatedly failed to accept responsibility for his actions, failed to demonstrate that he reasonably relied on advice from others, and engaged in a pattern of misconduct over a long period of time. Additionally, as discussed above, we find that the misconduct was the result of intentional acts, and that the misconduct resulted in potential monetary gain to Amundsen in that it made it possible for him to gain employment in the securities industry.

<sup>91</sup> *Mathis*, 2009 SEC LEXIS 4376, at \*16; *see also Craig*, 2008 SEC LEXIS 2844, at \*15 ("The effectiveness of the form depends on applicants' candid disclosures.").

Letting the firms know of his statutory disqualification was crucial to the regulatory scheme under which firms must assess whether they want to take on the additional burden of seeking FINRA's consent to let them continue in membership if they employ a statutorily disqualified individual. Amundsen's failure to provide this information to those firms may potentially have also put the firms themselves at risk of disciplinary action based on their employment of a statutorily disqualified individual.<sup>92</sup> Additionally, Amundsen's evasive and incredible testimony (which FINRA appropriately termed self-serving and implausible) reveals a disconcerting failure to acknowledge his own responsibility in this matter.<sup>93</sup>

We find no mitigating factors. As we have previously stated, failures to make truthful disclosures on Form U4 are not harmless: "[E]mployers, regulators, and investors [are] entitled to rely on the disclosures . . . submitted as part of the Form U4 registration process. . . . [F]alse and misleading disclosures undermin[e] efforts by each of these stakeholders in the securities industry to gather accurate information and to detect risks."<sup>94</sup> Although Amundsen argues that he has "never broken the law or defrauded anyone,"<sup>95</sup> he consented to the entry of an injunction based on allegations of antifraud violations. And even if he had no disciplinary history, we have repeatedly held that a lack of such history is not a mitigating factor.<sup>96</sup>

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<sup>92</sup> See *supra* note 4 (discussing statutory and regulatory provisions regarding association with statutorily disqualified individual).

<sup>93</sup> See *Craig*, 2008 SEC LEXIS 2844, at \*22 (noting that a "failure to take responsibility for . . . conduct makes recurrence more likely").

<sup>94</sup> *Tucker*, 2012 SEC LEXIS 3496, at \*65-66.


<sup>95</sup> Amundsen's Reply Br. at 1.

<sup>96</sup> E.g., *Craig*, 2008 SEC LEXIS 2844, at \*27 & n.45 (citing cases).

We find that the bar imposed by FINRA is an appropriate remedial response to Amundsen's misconduct. We find that this sanction is also appropriate to encourage other representatives to provide complete and accurate Form U4 disclosures,<sup>97</sup> and that it serves the public interest in "maintain[ing] a high level of business ethics in the securities industry" based on timely, accurate, and complete disclosure to investors.<sup>98</sup> Accordingly, we sustain this sanction because it is neither excessive nor oppressive, is remedial, and will protect investors and the public interest.<sup>99</sup>

An appropriate order will issue.<sup>100</sup>

By the Commission (Chair WHITE and Commissioners WALTER, PAREDES and GALLAGHER); Commissioner AGUILAR not participating.



*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

<sup>97</sup> See *Neaton*, 2011 SEC LEXIS 3719, at \*45 (affirming imposition of bar for willful failure to make required disclosures on Form U4 because, among other reasons, bar would encourage others in industry "to be forthright in their responses to questions on their Forms U4"); *Craig*, 2008 SEC LEXIS 2844, at \*28 (affirming imposition of bar for willful failure to make required disclosure on Form U4, among other reasons, to "impress upon others the importance of the accuracy of the information in Form U4").

<sup>98</sup> *Mathis*, 671 F.3d at 217; see also *Steadman v. SEC*, 603 F.2d 1126, 1142 (5th Cir. 1979) ("[T]he Commission also may consider the likely deterrent effect its sanctions will have on others in the industry."); *PAZ Secs., Inc. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (noting that although "general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry" (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005))).

<sup>99</sup> We also sustain FINRA's assessment of costs against Amundsen.

Amundsen asks that if we deny his petition for review, we give our "permission" for him "to take this matter back to the District Court in San Francisco, and also to the 9th Circuit Court for review." Amundsen's Reply Br. at 1. Amundsen also asserts that the injunction has "lost its usefulness and should be vacated." *Id.* at 2. Amundsen's rights to challenge the continued need for the injunction or otherwise to seek recourse in federal court do not depend on any permission from us. We therefore take no action in response to this request.

Amundsen also asks that if we grant his petition for review, or "agree with" him, we order that his FINRA licenses be restored, his legal bills be paid, and he receive "compensation for the illegal bar from working for the past three years." Amundsen's Reply Br. at 1. As set forth above, we do not grant Amundsen's petition, but even if we did, we do not have the statutory authority to grant the relief he seeks.

<sup>100</sup> We have considered all the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69406 / April 18, 2013

Admin. Proc. File No. 3-15056

In the Matter of the Application of

JOSEPH S. AMUNDSEN  
3537 Chain Dam Road  
Easton, PA 18045

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

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

ORDERED that the disciplinary action taken by FINRA against Joseph S. Amundsen is hereby sustained.

By the Commission.



*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

*Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3586 / April 18, 2013

INVESTMENT COMPANY ACT OF 1940  
Release No. 30446 / April 18, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15282

In the Matter of

UMESH TANDON

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(f) AND 203(k)  
OF THE INVESTMENT ADVISERS ACT OF  
1940 AND SECTION 9(b) OF THE  
INVESTMENT COMPANY ACT MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(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 Umesh Tandon ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

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### Summary

These proceedings arise out of materially false and misleading overstatements of Simran Capital Management ("Simran") assets under management made by Tandon and made by others at Tandon's direction. When responding to a 2008 request for proposal from the California Public Employers' Retirement System ("CalPERS"), Tandon ignored CalPERS's minimum selection qualifications and instead falsely certified that Simran managed more than \$200 million in assets as of year-end 2007. Simran actually managed only approximately \$80 million at that time. Induced by this deceit, and after eliminating other candidates for their failure to satisfy the minimum qualifications, CalPERS selected Simran as an adviser. Tandon touted, and instructed others to tout, CalPERS's selection when soliciting other clients, but without revealing that the selection had been fraudulently induced. In 2009 and 2010, Tandon fraudulently overstated, and instructed others to overstate, Simran's assets under management when soliciting at least fourteen other potential clients. Furthermore, Tandon filed, and instructed others to file, false Forms ADV with the Commission and otherwise misled the Commission staff.

### Respondent

1. Umesh Tandon ("Tandon"), age 37, was a resident of Chicago, Illinois but currently resides in Texas. He holds his Series 7, 24, and 63 licenses, but his Series 65 and 66 licenses have expired. Tandon has neither been associated with a registered broker-dealer nor been registered himself for the last two years. Tandon provided investment advisory services through Simran. He was the entity's president, Chief Compliance Officer ("CCO"), and sole owner.

### Related Parties

2. Simran Capital Management LLC, is a Delaware limited liability company, headquartered in Chicago, Illinois. It was registered with the Commission as an investment adviser from June 2007 until February 2012, when it withdrew its registration. Simran served as a sub-adviser to funds managed by other advisers and provided advisory services to its own private onshore fund (Simran Pre-Event Driven Activist Opportunity Fund LP) and a private offshore fund (Simran Pre-Event Driven Activist Opportunity Fund Ltd), both of which fed into a master fund. Simran has ceased operations, distributed assets to its investors, and is now effectively a defunct entity.

### Background

3. Tandon managed Simran as its president and sole owner, and served as Simran's CCO. Tandon marketed Simran as an experienced fixed income manager that applied a unique risk-averse strategy bearing a low correlation to equity and debt markets. Tandon and Simran responded to numerous requests for proposals issued by municipal and governmental entities, as well as by other managers.

### *Tandon Fraudulently Procured CalPERS as a Client*

4. In 2008, the California Public Employers' Retirement System issued a request for proposal to select investment managers. Among other things, CalPERS required that applicants, as of December 31, 2007, manage at least \$200 million for institutional clients. The request for proposal stated that failure to satisfy the minimum qualifications would result in rejection of the applicant.

5. In May 2008, Tandon, on behalf of Simran, falsely certified that Simran met CalPERS's minimum qualifications, including that Simran managed at least \$200 million for institutional clients as of December 31, 2007. Simran actually managed only approximately \$80 million as of year-end 2007. Indeed, Simran's Form ADV, filed with the Commission in February 2008, reported that Simran had \$102 million of assets under management – itself a falsely inflated number.

6. In October 2008, CalPERS's Investment Committee selected Simran as an adviser, incorrectly believing that Simran met the requisite minimum qualifications. Minutes from the committee's meeting indicate that proposals from three other entities were eliminated because they failed to meet the minimum qualifications. After funding its account, CalPERS paid advisory fees to Simran.

7. In September 2009, CalPERS provided Simran with \$50 million to manage. At that time, Simran again overstated its assets under management to CalPERS. A Simran employee claimed that Simran managed net assets of \$325 million, whereas Simran actually managed only approximately \$79 million at the time. Simran ultimately managed up to \$122 million for CalPERS (in May 2010). CalPERS initiated the termination of its relationship with Simran in April 2010.

8. Tandon acted intentionally when inflating, and instructing others to inflate, Simran's assets under management in their communications with CalPERS. In multiple subsequent emails, Tandon, and other Simran managers, admitted that Simran did not meet CalPERS's minimum qualifications, and that Tandon and Simran ignored the qualifications when applying. For example, in January 2010, Tandon wrote in an email to two Simran employees that he "would not pay too much attention to minimum asset requirements nor length of performance record" in requests for proposals from other prospective clients because "CalPERS had similar criteria but we applied anyway." And in June 2010, Tandon wrote in an email that Simran should submit a proposal to another potential client because "CalPERS had a lot more criteria which we did not fit."

### *Tandon Touted, and Instructed Others to Tout, CalPERS's Selection, and Falsely Inflated AUM to Other Potential Clients*

9. Although procured by fraud, Tandon touted, and instructed others to tout, Simran's selection as an adviser by CalPERS to the public, to other current clients, and to prospective clients, all of whom were unaware that the relationship with CalPERS was procured by fraud.

Moreover, from June 2009 through November 2010, and potentially longer, Simran and Tandon continued to falsely inflate Simran's assets under management to others.

10. In December 2009, Simran served as sub-adviser to an adviser to a registered investment company. At that time, Simran falsely told the adviser that Simran had assets under management of approximately \$250 million. Simran actually managed only approximately \$115 million at the time. Tandon and Simran acted intentionally when falsely inflating Simran's assets under management to the adviser.

11. Similarly, in communications made to at least fourteen prospective clients during 2009 and 2010, Simran and Tandon grossly overstated Simran's assets under management, in many instances by many multiples. Tandon acted intentionally when he personally made, or instructed others to make, misrepresentations about Simran's assets under management to each of these fourteen prospective clients.

*Tandon Filed, and Instructed Others to File, False Forms ADV with the Commission*

12. In at least four Forms ADV filed with the Commission, including at least one signed by Tandon, Simran falsely overstated its assets under management. First, in its Form ADV filed in February 2008, Simran claimed to manage \$102 million. Simran actually managed only approximately \$80 million at that time. Second, in its Form ADV filed in March 2009 (and signed by Tandon), Simran claimed to manage \$108 million. Simran actually managed only approximately \$30 million at that time. In its Schedule D to this Form ADV, Simran also falsely represented that the Simran Pre-Event Driven Activist Opportunity Fund LP and the Simran Pre-Event Driven Activist Opportunity Fund LTD had a current asset value totaling \$54 million, whereas the value actually was approximately \$4 million. Third, in its Form ADV filed in March 2010, Simran claimed to manage \$375 million. Simran actually managed only approximately \$115 million at that time. In its Schedule D to this Form ADV, Simran also falsely represented that the Simran Pre-Event Driven Activist Opportunity Fund LP and the Simran Pre-Event Driven Activist Opportunity Fund LTD had a current asset value totaling \$80 million, whereas the value actually was approximately \$7 million. Fourth, in its Form ADV filed in July 2010, Simran claimed to manage \$375 million. Simran actually managed only approximately \$25 million at that time.

13. In January 2011, the Commission staff began a routine examination of Simran. During the examination, Tandon provided inaccurate information to the Commission staff about Simran's AUM, statements made in its Forms ADV, and the reasons for CalPERS's departure as a Simran client.

14. In its Form ADV filed in February 2011, Simran reduced its reported assets under management to \$28,729,296. And in its Schedule D to this Form ADV, Simran reported that the Simran Pre-Event Driven Activist Opportunity Fund LP and the Simran Pre-Event Driven Activist Opportunity Fund LTD had current asset values totaling approximately \$6.5 million.

15. In February 2012, Simran withdrew its registration with the Commission as an investment adviser. Since then, Simran has sold all liquid positions, distributed the proceeds to its clients, and effectively ceased operations pending a final audit.

#### Violations

16. As a result of the conduct described above, Tandon willfully violated Advisers Act Section 207 by making untrue statements of a material fact in registration applications or reports filed with the Commission and willfully omitting to state in such applications or reports material facts which were required to be stated therein.

17. As a result of the conduct described above, Tandon willfully violated Advisers Act Sections 206(1) and 206(2), by making false or misleading statements to, or otherwise defrauding, clients or prospective clients.

#### IV.

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

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Tandon cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 207 of the Advisers Act.

B. Respondent Tandon is:

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

ii. 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.

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 \$20,018, prejudgment interest of \$1,680 and a civil money penalty of \$100,000. Respondent shall satisfy these obligations by disbursing the foregoing disgorgement, prejudgment interest, and civil monetary penalty as follows:

1. Respondent shall make a \$20,018 payment to and for the benefit of the CalPERS within ten days of the date of the Commission's order instituting proceedings and making findings in this matter. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent shall simultaneously transmit a copy of such payment and notification to Peter K. M. Chan, Assistant Regional Director, Chicago Regional Office, 175 W. Jackson Blvd., Suite 900, Chicago, IL 60604. Respondent shall cooperate with the staff of the Commission to obtain evidence of receipt of the payment by CalPERS. In the event that Respondent fails to complete the disbursement under the terms set forth in the Order, payment of the full disbursement amount (or the balance thereof) shall be due and payable immediately to the Commission, without further application. The Commission shall then disburse that payment to CalPERS. Further, Respondent agrees to be responsible for all tax compliance responsibilities associated with the disbursement of the \$20,018 to CalPERS and may retain professional services as necessary. The costs and expenses relating to Respondent's responsibility for tax compliance shall be borne solely by Respondent and shall not be paid out of the \$20,018 payment to CalPERS or the civil penalty paid pursuant to part two below.
2. Respondent shall pay the civil money penalty and prejudgment interest in the amount of \$101,680 to the Commission for transfer to the United States Treasury within ten days of the date of the Commission's order instituting proceedings and making findings in this matter. If payment is not made by the date payment is required by this Order, the entire outstanding balance plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:
  - (1) Respondent may 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 Tandon 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 Peter K.M. Chan, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois, 60604.

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3587 / April 18, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15283

In the Matter of

VECTOR WEALTH  
MANAGEMENT, LLC

Respondent.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(e) AND  
203(k) OF THE INVESTMENT ADVISERS  
ACT OF 1940, MAKING FINDINGS, AND  
IMPOSING REMEDIAL SANCTIONS AND A  
CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Vector Wealth Management, LLC ("Respondent").

II.

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

III.

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

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

### Summary

1. This matter involves custody rule violations and supervisory and compliance failures at Vector, a Minnesota investment adviser registered with the Commission since 1997. From October 2008 to May 2011, an administrative and clerical employee of Vector ("Employee"), forged checks to misappropriate \$33,147 of dividends owed to four advisory clients participating in two pooled investment vehicles (the "Pooled Vehicles") that were managed by Vector. Although Vector had custody of the Pooled Vehicles' assets, Vector did not arrange to have the quarterly account statements or audited annual financial statements for the Pooled Vehicles distributed to the clients who invested in them, and Vector was not subject to an annual surprise examination. Vector's policies and procedures also were not reasonably designed to prevent violation of the custody rule, and Vector failed to conduct an annual review of the adequacy and effectiveness of its compliance policies and procedures. Finally, throughout the relevant period, Vector failed reasonably to supervise Employee with a view to preventing and detecting Employee's violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 promulgated thereunder.

### Respondent

2. Vector is a Minnesota limited liability company headquartered in Minneapolis, Minnesota. Vector has been registered with the Commission as an investment adviser since 1997. As of July 12, 2011, Vector provided discretionary and non-discretionary investment management services to over 500 client accounts and managed approximately \$422 million in assets. Vector is owned and managed by three principals, Principal A, Principal B, and Principal C. Vector acted as an investment adviser to the Pooled Vehicles.

### Other Individual

3. Employee, age 33, resides in St. Paul, Minnesota. Until his termination in May 2011, Employee served as an administrative and clerical employee of Vector.

### Background

4. In 2005, a principal of Vector ("Principal A") identified an opportunity to invest in commercial real estate through a partnership that owned and operated a commercial office building located in Iowa. In January 2006, under the auspices of Vector, he formed Pooled Vehicle 1 to pool investor funds for the purpose of investing in the partnership. Thirteen investors, including Principal A, placed a total of \$700,000 in Pooled Vehicle 1. Eight of these investors were advisory clients of Vector. Each investor purchased membership interests in Pooled Vehicle 1, which in turn, purchased membership interests in the real estate partnership. Principal A acted as managing member of Pooled Vehicle 1. In that capacity, he invested Pooled Vehicle 1's funds in the commercial real estate partnership, retained and monitored tax, accounting, and legal professionals, handled distributions, and reported on the status of the investment. Neither Vector nor Principal A actively managed the real estate partnership into which Pooled Vehicle 1's funds were invested.



5. In August 2007, Principal A and another individual not affiliated with Vector formed another similar investment vehicle, Pooled Vehicle 2. Pooled Vehicle 2 invested in four single-asset limited partnerships that owned and operated commercial use buildings in Iowa and South Dakota. Twenty-one investors, including the managing members, participated in Pooled Vehicle 2, investing a total of \$1.9 million in October 2007. Eleven of these investors were advisory clients of Vector. As with Pooled Vehicle 1, each investor purchased membership interests in Pooled Vehicle 2, which in turn, purchased membership interests in the real estate partnerships. In his capacity as co-managing member of Pooled Vehicle 2, Principal A managed Pooled Vehicle 2 in a manner similar to Pooled Vehicle 1.

6. Since 2006 and 2007, respectively, the Pooled Vehicles earned annual dividends that were deposited by the underlying commercial real estate partnerships into two accounts held by a third-party custodian in the name of the Pooled Vehicles. Balances in the Pooled Vehicle accounts were swept into a money market fund on a daily basis. These funds remained in the third-party custodial accounts until a public accounting firm prepared tax forms for the real estate partnerships. Once the forms were prepared, the accounting firm provided Vector with the amount of dividend income due to each investor in the Pooled Vehicles based on the investors' percentage of ownership.

7. Vector then prepared dividend checks to be paid from the Pooled Vehicles' third-party custodial accounts and mailed those checks to investors. Principal A possessed signatory authority over the Pooled Vehicles' third-party custodial accounts but delegated to Employee the task of preparing checks for his signature. Employee was responsible for preparing the distribution checks, obtaining Principal A's signature on them, and mailing them to investors.

8. In October 2008, Employee began misappropriating from the Pooled Vehicles' third-party custodial accounts dividends owed to investors. On at least eleven occasions, Employee wrote checks to himself from the investors' distributions, causing the redemption of money market fund shares sufficient to cover the amount of the check, and took steps to conceal his conduct from others. From October 2008 until discovery of the scheme in May 2011, Employee misappropriated \$33,147 from four investors, all of whom were advisory clients of Vector. By his conduct, Employee willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

9. Before the discovery of Employee's misconduct, Vector failed to adopt or implement procedures that were reasonably designed to prevent violations of the custody rule. For example, Vector's policies and procedures were not reasonably designed to ensure that investors in the Pooled Vehicles were sent quarterly account statements pertaining to the Pooled Vehicle investments or audited financial statements on an annual basis. Vector also failed to conduct an annual compliance review of its advisory activities.

10. Vector discovered the Employee's scheme in May 2011 while attempting to reconcile an unrelated, potentially erroneous payment. Vector promptly terminated Employee, restricted his account and system access, and initiated an internal investigation.

11. Vector promptly reported Employee's misconduct to Commission staff members. In June 2011, Vector engaged an independent accounting firm to audit the Pooled Vehicles and prepare a formal accounting of the misappropriated funds. Following this audit, Vector notified the affected clients of the misappropriation and subsequently reimbursed them for the misappropriated amounts with interest, for a total of \$42,986. Employee, in turn, reimbursed Vector for the amounts that Vector repaid to the investors. Vector shared the results of its internal investigation and independent accounting with the staff and cooperated with the staff's investigation. Vector also relinquished custody of the Pooled Vehicles' assets, and retained and expanded the services of an outside compliance adviser.

### Violations

12. As a result of the conduct described above, Vector failed reasonably to supervise Employee, within the meaning of Section 203(e)(6), with a view to preventing and detecting Employee's violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

13. Vector also willfully<sup>2</sup> violated Section 206(4) of the Advisers Act, which prohibits fraudulent conduct by an investment adviser, through its violation of Rule 206(4)-2 promulgated thereunder. Section 206(4) prohibits investment advisers from engaging in "any act, practice, or course of business which is fraudulent, deceptive, or manipulative," as defined by the Commission by rule. Before the amendment of Rule 206(4)-2, effective March 12, 2010, Rule 206(4)-2 provided in pertinent part that it constituted a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) for any registered investment adviser to have custody of client funds or securities unless, among other things, the adviser had a reasonable basis for believing that a qualified custodian was sending quarterly account statements to each of the clients for which it maintained funds or securities, or to each beneficial owner of a pooled investment vehicle, identifying the amount of funds and of each security in the account at the end of the period and setting forth all transactions in the account during the period.<sup>3</sup> The pre-amendment rule also provided that, if the adviser sent the quarterly

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<sup>2</sup> A willful violation of the securities laws means merely " 'that the person charged with the duty knows what he is doing.' " *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor " 'also be aware that he is violating one of the Rules or Acts.' " *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

<sup>3</sup> The amended Rule 206(4)-2 is not materially different from the pre-amendment rule with respect to the custody violations at issue in this matter, except to the extent that the requirements generally were made more stringent. For example, under the amended rule, an adviser may no longer send its own account statements to clients in lieu of having a qualified custodian send quarterly statements to clients or to investors in a pooled vehicle (which the adviser could do under the pre-amendment rule if it was subject

account statements itself, an independent public accountant generally must verify all of the client funds and securities by actual examination at least once during each calendar year on a date chosen by the accountant without prior notice to the investment adviser (a "surprise examination").<sup>4</sup> During the relevant period, however, investors in the Pooled Vehicles never were sent quarterly account statements containing information about the Pooled Vehicle accounts, and Vector was not subject to an annual surprise examination.

14. Vector also willfully violated Section 206(4) of the Advisers Act through its violation of Rule 206(4)-7 promulgated thereunder. Rule 206(4)-7 under the Advisers Act requires registered investment advisers (1) to adopt and implement written policies and procedures reasonably designed to prevent violation by the adviser and supervised persons of the Advisers Act and rules adopted under the Act; (2) to review at least annually the adequacy of the policies and procedures and the effectiveness of their implementation; and (3) to designate a chief compliance officer, who is a supervised person, responsible for administering the policies and procedures. Vector's policies and procedures were not reasonably designed to prevent violations of the custody rule. For example, Vector had no policies and procedures reasonably designed to ensure that investors in the Pooled Vehicles were sent quarterly account statements pertaining to the Pooled Vehicle investments. Vector also failed to conduct an annual compliance review of its advisory activities.

#### Remedial Acts

15. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

#### Undertakings

16. Independent Compliance Consultant. With respect to the retention of an independent compliance consultant, Respondent has agreed to the following undertakings:

- a. Vector shall retain, within thirty (30) days of the entry of this Order, the services of an independent compliance consultant (the "Independent Consultant") that is not unacceptable to the Commission staff. The Independent Consultant's compensation and expenses shall be borne exclusively by Vector.

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to a surprise examination each year). Under the amended rule, an adviser generally must be subject to an annual surprise examination and have a reasonable basis for believing that the qualified custodian is sending quarterly statements.

<sup>4</sup> Both the pre- and post-amendment Rule 206(4)-2(b) provided similar exceptions from the surprise examination and quarterly account statement requirements for a pooled investment vehicle if certain criteria are met, including, among other things, an annual audit of the pool by an independent public accountant and delivery of audited financial statements to investors in the vehicle. These provisions, however, do not apply because the Pooled Vehicles were not audited.

- b. Vector shall require that the Independent Consultant conduct during the second quarter of 2013 and the second quarter of 2014 comprehensive reviews of Vector's supervisory, compliance, and other policies and procedures reasonably designed to detect and prevent federal securities law violations by Vector and its employees (the "Reviews"), including but not limited to violations of Sections 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 promulgated thereunder.
- c. Vector shall provide to the Commission staff, within thirty (30) days of retaining the Independent Consultant, a copy of an engagement letter detailing the Independent Consultant's responsibilities, which shall include the Reviews to be made by the Independent Consultant as described in this Order.
- d. Vector shall require that, within forty-five (45) days from the end of the applicable quarterly period, the Independent Consultant shall submit a written and dated report of its findings to Vector and to the Commission staff (the "Report"). Vector shall require that each Report include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to Vector's policies and procedures or disclosures to clients, and a procedure for implementing the recommended changes in or improvements to Vector's policies and procedures or disclosures.
- e. Vector shall adopt all recommendations contained in each Report within sixty (60) days of the applicable Report; provided, however, that within forty-five (45) days after the date of the applicable Report, Vector shall in writing advise the Independent Consultant and the Commission staff of any recommendations that Vector considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that Vector considers unduly burdensome, impractical, or inappropriate, Vector 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.
- f. As to any recommendation with respect to Vector's policies and procedures on which Vector and the Independent Consultant do not agree, Vector and the Independent Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the applicable Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by Vector and the Independent Consultant, Vector shall require that the Independent Consultant inform Vector and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Vector considers to be unduly burdensome,

impractical, or inappropriate. Vector shall abide by the determinations of the Independent Consultant and, within sixty (60) days after final agreement between Vector and the Independent Consultant or final determination by the Independent Consultant, whichever occurs first, Vector shall adopt and implement all of the recommendations that the Independent Consultant deems appropriate.

- g. Within ninety (90) days of Vector's adoption of all of the recommendations in a Report that the Independent Consultant deems appropriate, as determined pursuant to the procedures set forth herein, Vector shall certify in writing to the Independent Consultant and the Commission staff that Vector has adopted and implemented all of the Independent Consultant's recommendations in the applicable Report. 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 Kathryn Pyszka, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois, 60604, or such other address as the Commission staff may provide.
- h. Vector shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of their files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.
- i. To ensure the independence of the Independent Consultant, Vector:
  - (1) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission staff; and
  - (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.
- j. Vector shall require the Independent Consultant 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 Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Vector, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in the performance of the Independent Consultant'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 Vector, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

17. Recordkeeping. Vector 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 Vector's compliance with the undertakings set forth in this Order.

18. Deadlines. For good cause shown, the Commission staff may 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.

19. Certifications of Compliance by Respondents. Vector 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 Vector agrees to provide such evidence. The certification and supporting material shall be submitted to Kathryn Pyszka, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois, 60604, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

#### IV.

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

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

A. Respondent Vector shall cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 promulgated thereunder.

B. Respondent Vector is censured.

C. Respondent acknowledges that the Commission is not imposing a civil penalty based upon its cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and without prior notice to the

Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay a civil money penalty. Respondent may not, by way of defense to any resulting administrative proceeding: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

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

*Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69390 / April 18, 2013

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3588 / April 18, 2013

INVESTMENT COMPANY ACT OF 1940  
Release No. 30467 / April 18, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15284

In the Matter of  
  
CHARLES T. FEE  
  
Respondent.

**ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTION 21C OF THE  
SECURITIES EXCHANGE ACT OF 1934,  
SECTION 203(f) 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**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Charles T. Fee ("Fee" 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

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herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

### III.

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

#### Summary

1. From October 2008 to May 2011, Fee, an administrative and clerical employee of Vector Wealth Management, LLC ("Vector"), a Minnesota investment adviser registered with the Commission since 1997, forged checks to misappropriate \$33,147 of dividends owed to four advisory clients participating in two pooled investment vehicles (the "Pooled Vehicles") that were managed by Vector.

#### Respondent

2. Fee, age 33, resides in St. Paul, Minnesota. Until his termination in May 2011, Fee served as an administrative and clerical employee of Vector.

#### Other Entity

3. Vector is a Minnesota limited liability company headquartered in Minneapolis, Minnesota. Vector has been registered with the Commission as an investment adviser since 1997. As of July 12, 2011, Vector provided discretionary and non-discretionary investment management services to over 500 client accounts and managed approximately \$422 million in assets. Vector is owned and managed by three principals, Principal A, Principal B, and Principal C. Vector acted as an investment adviser to the Pooled Vehicles.

#### Background

4. In 2005, a principal of Vector ("Principal A") identified an opportunity to invest in commercial real estate through a partnership that owned and operated a commercial office building located in Iowa. In January 2006, under the auspices of Vector, he formed Pooled Vehicle 1 to pool investor funds for the purpose of investing in the partnership. Thirteen investors, including Principal A, placed a total of \$700,000 in Pooled Vehicle 1. Eight of these investors were advisory clients of Vector. Each investor purchased membership interests in Pooled Vehicle 1, which in turn, purchased membership interests in the real estate partnership. Principal

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

A acted as managing member of Pooled Vehicle 1. In that capacity, he invested Pooled Vehicle 1's funds in the commercial real estate partnership, retained and monitored tax, accounting, and legal professionals, handled distributions, and reported on the status of the investment. Neither Vector nor Principal A actively managed the real estate partnership into which Pooled Vehicle 1's funds were invested.

5. In August 2007, Principal A and another individual not affiliated with Vector formed another similar investment vehicle, Pooled Vehicle 2. Pooled Vehicle 2 invested in four single-asset limited partnerships that owned and operated commercial use buildings in Iowa and South Dakota. Twenty-one investors, including the managing members, participated in Pooled Vehicle 2, investing a total of \$1.9 million in October 2007. Eleven of these investors were advisory clients of Vector. As with Pooled Vehicle 1, each investor purchased membership interests in Pooled Vehicle 2, which in turn, purchased membership interests in the real estate partnerships. In his capacity as co-managing member of Pooled Vehicle 2, Principal A managed Pooled Vehicle 2 in a manner similar to Pooled Vehicle 1.

6. Since 2006 and 2007, respectively, the Pooled Vehicles earned annual dividends that were deposited by the underlying commercial real estate partnerships into two accounts held by a third-party custodian in the name of the Pooled Vehicles. Balances in the Pooled Vehicle accounts were swept into a money market fund on a daily basis. These funds remained in the third-party custodial accounts until a public accounting firm prepared tax forms for the real estate partnerships. Once the forms were prepared, the accounting firm provided Vector with the amount of dividend income due to each investor in the Pooled Vehicles based on the investors' percentage of ownership.

7. Vector then prepared dividend checks to be paid from the Pooled Vehicles' third-party custodial accounts and mailed those checks to investors. Principal A possessed signatory authority over the Pooled Vehicles' third-party custodial accounts but delegated to Fee the task of preparing checks for his signature. Fee was responsible for preparing the distribution checks, obtaining Principal A's signature on them, and mailing them to investors.

8. In October 2008, Fee began misappropriating from the Pooled Vehicles' third-party custodial accounts dividends owed to investors. On at least eleven occasions, Fee wrote checks to himself from the investors' distributions, causing the redemption of money market fund shares sufficient to cover the amount of the check, and took steps to conceal his conduct from others. From October 2008 until discovery of the scheme in May 2011, Fee misappropriated \$33,147 from four investors, all of whom were advisory clients of Vector.

9. Vector discovered the scheme in May 2011 while attempting to reconcile an unrelated, potentially erroneous payment. Vector promptly terminated Fee, restricted his account and system access, and initiated an internal investigation.

10. Vector notified the affected investors of the misappropriation and subsequently reimbursed them for the misappropriated amounts with interest, for a total of \$42,986. Fee, in turn, reimbursed Vector for the amounts that Vector repaid to the investors.

11. As a result of the conduct described above, Fee willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

#### IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act, Section 203(f) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Fee shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Fee 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 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.

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, within fourteen (14) days of the entry of this Order, pay a civil money penalty in the amount of \$10,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or

(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying Charles T. Fee 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 Kathryn A. Pyszka, Division of Enforcement, Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Watter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 19, 2013

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In the Matter of :

UC HUB GROUP, INC., :

ORDER OF SUSPENSION  
OF TRADING

File No. 500-1 :

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of UC Hub Group, Inc. ("UC Hub") because it has not filed a periodic report since it filed its Form 10-Q for the period ending April 30, 2010, filed on June 14, 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of UC Hub. Therefore, it is ordered, pursuant to Section 12(k) of the Exchange Act, that trading in the securities of UC Hub is suspended for the period from 9:30 a.m. EDT on April 19, 2013, through 11:59 p.m. EDT on May 2, 2013.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

April 19, 2013

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**In the Matter of**

**EWAN 1, INC. n/k/a ACCESSKEY IP, INC.**

**File No. 500-1**

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**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 Ewan 1, Inc. n/k/a AccessKey IP, Inc. (“AccessKey”) because it has not filed a periodic report since it filed its registration pursuant to the Securities Exchange Act of 1934 (“Exchange Act”) on August 21, 2002.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of AccessKey. Therefore, it is ordered, pursuant to Section 12(k) of the Exchange Act, that trading in the securities of AccessKey is suspended for the period from 9:30 a.m. EDT on April 19, 2013, through 11:59 p.m. EDT on May 2, 2013.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

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*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION  
April 19, 2013

In the Matter of

Biopharm Asia, Inc.,  
China Organic Agriculture, Inc. and  
Guilin Paper, 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 Biopharm Asia, Inc., China Organic Agriculture, Inc., and Guilin Paper, Inc. because Biopharm Asia, Inc. and China Organic Agriculture, Inc. have not filed any periodic reports for any reporting period subsequent to September 30, 2010, and Guilin Paper, Inc. has not filed any periodic reports for any reporting period subsequent to September 30, 2007.

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

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT, April 19, 2013, through 11:59 p.m. EDT, on May 2, 2013.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

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*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69410 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15289

In the Matter of  
  
Guilin Paper, Inc.,  
  
Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent Guilin Paper, Inc. (CIK No. 1337826) is a Nevada corporation located in Calgary, Alberta, Canada as reflected in its last periodic filing. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of April 5, 2013, Respondent's common stock (symbol "GUPR") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc., had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
2. Respondent's most recent periodic filing was a Form 10-Q for the period ended September 30, 2007, filed on November 16, 2007.
3. The Division of Corporation Finance sent a delinquency letter to Respondent on May 24, 2011.
4. Respondent failed to heed the delinquency letter sent to it by the Division of Corporation Finance or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letter.

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

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

### III.

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

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

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

### IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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



*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69409 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15288

In the Matter of  
  
China Organic Agriculture, Inc.,  
  
Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent China Organic Agriculture, Inc. (CIK No. 1337826) is a Florida corporation located in Jilin Province, China as reflected in its last periodic filing. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of April 5, 2013, Respondent's common stock (symbol "CNOA") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc., had twelve market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).
2. Respondent's most recent periodic filing was a Form 10-Q for the period ended September 30, 2010, filed on November 22, 2010.
3. The Division of Corporation Finance sent a delinquency letter to Respondent on November 21, 2011.
4. Respondent failed to heed the delinquency letter sent to it by the Division of Corporation Finance or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letter.

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

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

### III.

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

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

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

### IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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



*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69408 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15287

In the Matter of

Biopharm Asia, Inc.,

Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent Biopharm Asia, Inc. (CIK No. 1080908) is a Nevada corporation located in Jilin Province, China as reflected in its last periodic filing. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of April 5, 2013, Biopharm Asia's common stock (symbol "BFAR") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group Inc., had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. The most recent reporting period with respect to which the company has filed a periodic report is the quarter ended September 30, 2010, for which it filed a Form 10-Q on November 12, 2010.

3. The Division of Corporation Finance sent a delinquency letter to Respondent on June 14, 2011.

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4. Respondent failed to heed the delinquency letter sent to it by the Division of Corporation Finance or, through its failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letter.

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

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

### III.

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

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

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

### IV.

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

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

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f),



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

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69415 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15291

In the Matter of

EWAN 1, INC. n/k/a  
ACCESSKEY IP, INC.

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate and 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 Ewan 1, Inc. n/k/a AccessKey IP, Inc. ("Respondent" or "AccessKey").

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. AccessKey is a Nevada corporation with its principal place of business in Santa Ana, California. As of March 8, 2013, the Respondent's common stock (ticker symbol "AKYI") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc., had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. AccessKey's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. AccessKey and its previous corporate iterations have filed registration statements three times: once as Tollycraft Yacht Corp., once as Ewan 1, Inc., and once as AccessKey IP, Inc. The company filed Forms 15 deregistering its stock as both "Tollycraft" and "AccessKey." However, the company did not deregister its stock as "Ewan 1"

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and has not made any periodic reports under that iteration since filing its Exchange Act registration on August 21, 2002.

### **DELINQUENT FILINGS**

3. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

4. The Respondent filed its Exchange Act Registration on Form 10-SB on August 21, 2002. Since then, the Respondent has not filed any required periodic reports.

5. As a result of the conduct described above, the Respondent has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

### **III.**

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

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

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

### **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 ten (10) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice [17 C.F.R. § 201.220].

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

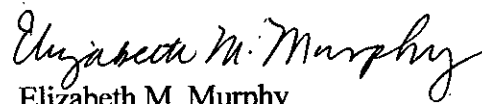
provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310].

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

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

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

By the Commission.

  
Elizabeth M. Murphy  
Secretary



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69414 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15290

In the Matter of

UC HUB GROUP, INC.

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate and 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 UC Hub Group, Inc. ("Respondent" or "UC Hub").

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. UC Hub is a Nevada corporation with its principal place of business in West Hollywood, California. Respondent has a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of March 8, 2013, the Respondent's common stock (ticker symbol "UCHB") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc., had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

DELINQUENT FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with

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the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

3. The Respondent filed its last Form 10-K for the year ended July 31, 2009 on November 16, 2009, and its last Form 10-Q for the quarter ended April 30, 2010 on June 14, 2010. Since then, the Respondent has not filed its required periodic reports.

4. The Respondent is delinquent on the following periodic filings.

<u>Form</u>	<u>Period Ended</u>	<u>Due on or about</u>
10-K	July 31, 2010	October 29, 2010
10-Q	October 31, 2010	December 15, 2010
10-Q	January 31, 2011	March 17, 2011
10-Q	April 30, 2011	June 14, 2011
10-K	July 31, 2011	October 29, 2012
10-Q	October 31, 2011	December 15, 2011
10-Q	January 31, 2012	March 16, 2012
10-Q	April 30, 2012	June 14, 2012
10-K	July 31, 2012	October 29, 2012
10-Q	October 30, 2012	December 15, 2012
10-Q	January 31, 2013	March 17, 2013

5. As a result of the conduct described above, the Respondent has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

### III.

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

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

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

### 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 ten (10) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice [17 C.F.R. § 201.220].

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

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

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

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

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69416 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15292

In the Matter of

THE ESTATE VAULT, INC.

Respondent.

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

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

RESPONDENT

1. Estate Vault is a Nevada corporation with its principal place of business in Las Vegas, Nevada. Respondent has a class of equity securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. As of March 8, 2013, the Respondent's common stock (ticker symbol "TEVI") was quoted on OTC Link (previously "Pink Sheets") operated by OTC Markets Group, Inc., had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

DELINQUENT FILINGS

2. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers with classes of securities registered pursuant to Section 12 of the Exchange Act to file with

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the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires issuers to file quarterly reports.

3. The Respondent filed its last Form 10-K for the year ended November 30, 2008 on November 16, 2009, and its last Form 10-Q for the quarter ended February 28, 2009 on December 24, 2009. Since then, the Respondent has not filed its required periodic reports.

4. The Respondent is delinquent on the following periodic filings:

<u>Form</u>	<u>Period Ended</u>	<u>Due on or about</u>
10-Q	May 31, 2009	July 15, 2009
10-Q	August 31, 2009	October 15, 2009
10-K	November 30, 2009	February 28, 2010
10-Q	February 28, 2010	April 14, 2010
10-Q	May 31, 2010	July 15, 2010
10-Q	August 31, 2010	October 15, 2010
10-K	November 30, 2010	February 28, 2011
10-Q	February 28, 2011	April 14, 2011
10-Q	May 31, 2011	July 15, 2011
10-Q	August 31, 2011	October 15, 2011
10-K	November 30, 2011	February 28, 2012
10-Q	February 29, 2012	April 14, 2012
10-Q	May 31, 2012	July 15, 2012
10-Q	August 31, 2012	October 15, 2012
10-K	November 30, 2012	February 28, 2013

5. As a result of the conduct described above, the Respondent has failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

### III.

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

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

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

### 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 ten (10) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice [17 C.F.R. § 201.220].

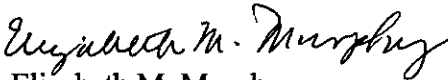
If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules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

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

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

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

By the Commission.

  
Elizabeth M. Murphy  
Secretary



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3590 / April 19, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15293

In the Matter of

FOXHALL CAPITAL  
MANAGEMENT, INC. AND  
PAUL G. DIETRICH,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE  
AND CEASE-AND-DESIST PROCEEDINGS,  
PURSUANT TO SECTIONS 203(e), 203(f)  
AND 203(k) OF THE INVESTMENT  
ADVISERS ACT OF 1940, MAKING  
FINDINGS, AND IMPOSING REMEDIAL  
SANCTIONS AND A CEASE-AND-DESIST  
ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), against Foxhall Capital Management, Inc. ("Foxhall") and Paul G. Dietrich ("Dietrich") (collectively referred to as "Respondents").

II.

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

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### III.

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

1. Between January 1, 2007 and September 3, 2009, the relevant time period at issue, Foxhall Capital Management, Inc. ("Foxhall"), a registered investment adviser, failed to adopt and implement written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules, as required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder. Foxhall also failed to keep complete and accurate records as required by Section 204 of the Advisers Act. The Commission's examination staff conducted an examination of Foxhall in 2009 and alerted it to deficiencies regarding its compliance program, including: Foxhall's failure to follow its stated policies and procedures in its compliance manual; Foxhall's failure to maintain adequate records of its trading; and Foxhall's failure to timely conduct the required 2007 annual compliance review. The Commission's examination staff referred the matter to enforcement staff for further investigation. Enforcement staff determined that Foxhall's deficiencies continued after the examination period. Specifically, Foxhall's trade management system did not interface properly with its primary broker-dealer and custodian's ("custodian's") trading platform which caused Foxhall to not always have the most up-to-date information about its client account balances. As a result, when trades were placed, certain clients did not have sufficient funds in their accounts to purchase their allocated shares within the larger block trade. When certain clients could not purchase their shares due to insufficient funds, Foxhall's practice was to reallocate these shares to other clients who were within the same investment model portfolio. However, it did so without regard as to whether the share price increased or decreased from the date of the original trade.

2. During the relevant time period, Foxhall did not maintain complete and accurate records concerning the process it followed when clients had insufficient funds to receive allocated shares and its decision to reallocate shares to other clients. In addition, Paul G. Dietrich ("Dietrich"), Foxhall's Chief Executive Officer ("CEO"), Co-Chief Investment Officer ("Co-CIO") as well as its then Chief Compliance Officer ("CCO"), and Foxhall failed to conduct a timely annual review of Foxhall's 2007 compliance policies and procedures.

### Respondents

3. **Foxhall**, headquartered in Middleburg, Virginia, was founded in 1986 and has been registered with the Commission as an investment adviser since 1987. When Paul G. Dietrich purchased Nye, Parnell and Emerson Capital Management, Inc. ("NPE") in 1999, he renamed the firm Foxhall. In its Form ADV, filed on July 20, 2012, Foxhall reported that it had approximately \$100 million in assets under management, approximately 1,600 client accounts and 10 employees. In 2009, the end of the time period at issue, Foxhall had approximately \$742 million in assets under management, over 7,000 client accounts and 15 employees.

4. **Paul G. Dietrich**, 63, a resident of Upperville, Virginia, is the majority stock owner of Eton Court Asset Management, Ltd., the former majority owner of Foxhall, and is the current CEO of Foxhall. During the time period at issue, Dietrich was the CEO and Co-CIO of Foxhall.

Dietrich also was the Chief Compliance Officer ("CCO") of Foxhall from January 2007 through March 2007 and then again from May 2007 through October 2008.

### Background

5. Effective October 5, 2004, Rule 206(4)-7, promulgated under Section 206(4) of the Advisers Act, requires that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and its rules; (2) review the adequacy of the written policies and procedures and the effectiveness of their implementation on at least an annual basis; and (3) designate a CCO.

6. Foxhall offered its clients active investment portfolio management using several model portfolios designed to meet particular investment goals. Foxhall's clients chose particular model portfolios based on their needs and risk tolerance and delegated to Foxhall the discretionary authority to manage their accounts. Foxhall reserved the discretion to aggregate client orders into block trades. Foxhall exercised this discretion by buying and selling securities for all clients assigned to a particular investment strategy by placing large block trades. Foxhall would allocate shares in the block trade among clients based upon the clients' chosen model portfolios and their account balances. Foxhall then ordered the custodian to execute the block trades on behalf of Foxhall's clients and then allocated the trades to specific client accounts pursuant to Foxhall's investment discretion and orders. Foxhall's stated investment strategy was focused on keeping clients in their selected investment portfolio model over the long term.

7. During the relevant time period, the number of Foxhall's client accounts grew from approximately 1,000 accounts to over 7,000 accounts. Foxhall's assets under management also increased from approximately \$300 million in assets under management to over \$742 million in assets under management.

8. The majority of Foxhall's client accounts were held at a custodian that executed most of Foxhall's block trades on behalf of its clients. Foxhall's existing trade management system was not compatible with the custodian's trading platform, however, and this began creating real-time trade reconciliation issues. In approximately July 2007, Dietrich, at the time, Foxhall's CEO, CCO and Co-CIO, was advised of this trade reconciliation issue. Foxhall switched to a new custodian in August 2008. In June 2009, Foxhall replaced its trading platform. By September 2009, Foxhall's trade reconciliation issues were effectively eliminated.

9. Because of these trade reconciliation issues, at times, Foxhall traders did not possess accurate real-time information from the custodian regarding clients' actual current account balances when Foxhall was making initial allocations to clients for block trades. Therefore, on occasion, Foxhall reallocated shares to its clients based on inaccurate client account balance information. During the relevant time period, due to this inaccurate information, some clients who were allocated to receive certain shares did not have sufficient funds in their accounts to purchase the allocated shares. Therefore, the block trades could not be allocated.

10. Foxhall typically learned of the existence of unallocated shares between three and five days after the original block trade was placed. When the custodian encountered insufficient funds in any client account that was part of the block trade, it would alert Foxhall and ask it for guidance as to how to allocate the remaining part of the block trade.

11. At the time, Foxhall followed an unwritten practice to reallocate shares to only those clients who fell within the same investment model portfolio and who possessed sufficient extra cash above a previously designated cash threshold. If these qualifications were met, Foxhall reallocated the unallocated shares to these client accounts. Foxhall also followed a policy where shares could be reallocated to new clients to bring them within their investment model portfolio. If, at the end of this process, shares were unable to be reallocated under these criteria, the unallocated shares were sold through Foxhall's account. During the relevant time period, as CEO, Co-CIO and CCO, Dietrich was generally aware of the trade reconciliation issues and was aware that traders were taking steps to address these issues, but was not aware of the details of the practice followed by the traders to handle the issues.

12. In most cases, Foxhall, with Dietrich as its CEO, Co-CIO and CCO, directed the custodian to place the unallocated shares from the block trade into other client accounts within the same investment model which had sufficient extra cash to purchase the shares being reallocated. Foxhall reallocated these unallocated shares to clients with cash at the execution price, without consideration of whether the price had gone up or down since the shares were purchased. Depending on the movement of the stock price, this practice resulted in some clients paying more (and some clients paying less) for the stock than they would have paid had Foxhall bought the shares on the open market at the time of the reallocation. Shares that Foxhall could not reallocate to clients were sold through its error account. Foxhall incurred a benefit when the shares had increased in value from the purchase price.

13. Foxhall's practice for reallocating shares was followed consistently and was memorialized into a formal, written policy on May 1, 2009. Foxhall, with Dietrich as its CEO, Co-CIO and CCO, did not categorize the reallocated shares as trade errors, but treated them as administrative errors. If the reallocated shares had been labeled as trade errors, Foxhall's compliance procedures required Foxhall to document the trade error and perform a profit and loss analysis for the trade. Foxhall's written policy also required it to make any client whole if any trade error resulted in a loss to the client. Foxhall's policy stated, in pertinent part: "In the event that any error occurs in the handling of any client transactions, due to Foxhall's actions, or inaction, or the actions of others, Foxhall's policy is to seek to identify and correct any errors without disadvantaging the client or benefiting Foxhall in any way . . . If the error is the responsibility of Foxhall, any client transaction will be corrected and Foxhall will be responsible for any client loss resulting from an inaccurate or erroneous number."

14. In over 400 instances during the relevant time period, Foxhall reallocated unallocated shares to clients other than those originally intended to receive the shares. These clients suffered approximately \$20,183 in losses as a direct result of those reallocations.

15. In addition, Foxhall and Dietrich failed to conduct a timely annual review of Foxhall's 2007 compliance policies and procedures.

16. During the relevant time period, Foxhall did not maintain complete and accurate records concerning its trading practices or the reallocations of unallocated shares from client accounts with insufficient funds. Neither Foxhall's trade allocation spreadsheet, nor its trading records contained complete records of these trade reallocations. No formal records of these trade reallocations were kept or maintained.

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

18. As a result of the conduct described above, Foxhall willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder which requires, among other things, that a registered investment adviser make and keep true, accurate and current records relating to its business including . a memorandum of each order given by the investment adviser for the purchase or sale of any security; of any instruction received by the investment adviser from the client concerning the purchase, sale, receipt or delivery of any particular security, and of any modification or cancellation of any such order or instruction.

19. As a result of the conduct described above, Dietrich, in his roles as CEO, CCO and Co-CIO, willfully<sup>2</sup> aided and abetted and caused Foxhall's violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2(a)(3) and 206(4)-7 thereunder.

#### **Foxhall's Remedial Efforts**

20. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Foxhall and cooperation afforded the Commission staff. Specifically, Foxhall changed its primary custodian in 2008 and upgraded its trading platform in 2009. Additionally, Foxhall and Dietrich hired a compliance consultant to perform the 2007 and 2008 annual compliance reviews and to evaluate and give guidance regarding Foxhall's compliance practices and procedures. Foxhall currently has a third party compliance consultant serving as its Chief Compliance Officer. Foxhall also hired an independent accountant to analyze the impact of Foxhall's reallocation process on its clients.

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<sup>1</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

<sup>2</sup> *Id.*

#### IV.

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

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

A. Respondents Foxhall and Dietrich cease and desist from committing or causing any violations and any future violations of Sections 204 and 206(4) of the Advisers Act and Rules 204-2(a)(3) and 206(4)-7 thereunder.

B. Respondents Foxhall and Dietrich are censured.

C. Respondent Foxhall shall, within thirty (30) days of the entry of this Order, pay disgorgement of \$20,183, plus prejudgment interest of \$2,247.87 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. 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;
- (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 Foxhall 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 Elaine C. Greenberg, Associate Regional Director, Securities and Exchange Commission, 701 Market Street, Suite 2000, Philadelphia, PA 19072.

D. Respondent Foxhall shall, within thirty (30) days of the entry of this Order, pay a civil penalty in the amount of \$100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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;



- (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 Foxhall 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 Elaine C. Greenberg, Associate Regional Director, Securities and Exchange Commission, 701 Market Street, Suite 2000, Philadelphia, PA 19072.

E. Respondent Dietrich shall pay a civil penalty of \$25,000 to the United States Treasury. Payment shall be made in the following installments: \$5,000 shall be paid within thirty (30) days of the entry of this Order; and the remaining \$20,000 shall be paid in installments over the following 10 months, in payments of \$2,000 per month, due by the 15<sup>th</sup> day of each consecutive month until paid in full. If any payment is not made by the date payment is required by this Order, the entire outstanding balance of the civil penalty, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately. 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;
- (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 Dietrich 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 Elaine C. Greenberg, Associate Regional Director, Securities and Exchange Commission, Philadelphia Regional Office, Suite 2000, Philadelphia, PA 19106.

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Jill M. Peterson  
Assistant Secretary

*Commissioner Aguilar  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69425 / April 22, 2013

INVESTMENT ADVISERS ACT OF 1940  
Release No. 3591 / April 22, 2013

INVESTMENT COMPANY ACT OF 1940  
Release No. 30474 / April 22, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15295

In the Matter of

HARBORLIGHT CAPITAL  
MANAGEMENT, LLC and  
DEAN G. TANELLA,

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,  
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 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Dean G. Tanella ("Tanella") and 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 HarborLight Capital Management, LLC ("HCM") and Tanella (collectively "Respondents").

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these

proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

### III.

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

#### Summary

HCM, an unregistered investment adviser, and its principal, Dean G. Tanella, breached their fiduciary duty to one of HCM's managed hedge fund-of-funds, the HarborLight Diversified Fund ("Diversified"), by directing Diversified to purchase a significant interest in the HarborLight FAB Fund 2, L.P. ("FAB 2"), an affiliated hedge fund-of-funds, for the purpose of satisfying significant pending redemption requests. Their conduct left Diversified and its limited partners invested in a distressed fund, which HCM then announced four months later that it was closing. FAB 2 investors have not received any distributions to date.

As of September 2008, HCM and Tanella managed approximately \$31 million invested in Diversified and the HarborLight FAB Fund, L.P. ("FAB"). Beginning in late September 2008, FAB had approximately \$2 million in assets segregated in a reserve due to impaired value and approximately \$3.8 million in remaining net assets. FAB faced a liquidity shortfall after several investors sought redemptions totaling more than fifty percent of the fund's net assets. FAB had no access to liquidity to satisfy the requests because the remaining \$3.8 million in net assets were invested in three portfolio funds that had suspended redemptions, commenced orderly liquidation, or denied FAB's request to redeem prior to the fund's formal redemption period. Tanella and HCM subsequently formed FAB 2 and transferred FAB's three portfolio funds that had not been segregated. Effective January 2009, all of FAB's pending redemption requests were paid through FAB 2.

In an effort to create liquidity in FAB 2 to satisfy pending redemption requests, Tanella directed Diversified to make two investments in FAB 2 totaling \$2.35 million, then immediately used the \$2.35 million to pay the outstanding redemption requests. As a result of the two investments, Diversified owned over 60% of the troubled FAB 2 fund.

During this same period, HCM and Tanella also raised \$550,000 from new FAB 2 investors while failing to adequately disclose the fund's risks. FAB 2's offering materials did not disclose the fund's mounting redemption requests and liquidity crisis, or that HCM would use new investor money to satisfy outstanding redemption requests rather than to purchase securities. HCM and Tanella also did not adequately disclose that FAB 2 was illiquid and in distress.

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

## Respondents

1. **HCM**, a Delaware limited liability company formed in 2003 and based in Tampa, Florida, is an unregistered private fund adviser. HCM was previously registered with the Commission as an investment adviser until it withdrew its registration in 2005, because its assets fell below the level requiring registration. HCM was also previously registered with the State of Florida until 2008. HCM is the general partner of HarborLight Management L.P., a Delaware limited partnership that serves as the general partner to several of HCM's funds. HCM is wholly owned by Tanella and his wife.

2. **Dean G. Tanella**, age 52, was HCM's President and chief executive officer throughout the relevant time and controlled all aspects of HCM. From 2006 to 2009, Tanella also was the executive vice president of capital markets for GunnAllen Financial, Inc. ("GunnAllen"), a now defunct broker-dealer formerly based in Tampa, Florida. Tanella is currently the president of HarborLight Capital Group, a Florida corporation formed in January 2010 that acts as a placement agent for unaffiliated private offerings. Tanella is also a registered representative with International Assets Advisory, a registered broker-dealer located in Orlando, Florida.

## Other Relevant Entities

3. **FAB**, a Delaware limited partnership formed in 2006, is a private fund-of-funds that invested in other funds that primarily held asset-backed securities. HCM was the fund's general partner and investment manager.

4. **FAB 2**, a Delaware limited partnership, is a private fund-of-funds formed after the assets of two of FAB's portfolio funds became potentially impaired. Tanella formed FAB 2 in October 2008 and transferred the unimpaired assets of FAB to FAB 2 effective January 2009. The impaired assets remained in FAB. HCM is FAB 2's general partner and investment manager.

5. **Diversified**, a Delaware limited partnership formed in 2003, is a private fund-of-funds that invested in a portfolio of approximately five to twenty private funds with diversified investment strategies. Diversified is organized in a master feeder structure and acts as the master fund for two feeder funds: Safe Harbor Canada, L.P. (a Delaware unregistered limited partnership with Canadian investors), and HarborLight Diversified Fund, Ltd. (a British Virgin Islands corporation and registered fund for U.S. non-taxable and foreign investors). Diversified also has individual U.S. investors. Diversified's general partner is HarborLight Management, L.P. and its investment manager is HCM.

## Background

6. HCM is the investment manager of Diversified and FAB, which are two funds-of-funds that together had approximately 150 investors and \$31 million in assets as of September 30, 2008. Each of the funds paid HCM fees for its management services.

7. Diversified was a multi-strategy fund-of-funds with approximately \$25 million in assets invested in as many as twenty underlying hedge funds as of 2008. Diversified's stated objective was to provide investors with "capital appreciation and absolute returns over the long term that will exceed those of broad U.S. equity market indices, with lower volatility and risk of loss than those indices."

8. FAB was a single strategy fund-of-funds with approximately \$6 million in assets as of 2008 invested in portfolio funds focused on asset-backed securities. FAB's stated investment objective was "to provide investors with capital appreciation and moderate absolute returns over the long term regardless of the overall direction of the equity markets." FAB further sought to provide investors a return of 7% to 10% net of all fees and was "targeted as a conservative return instrument with risk parameters similar to two times the 90-Day US Treasury [bill]," which is a proxy for risk-free returns. FAB's offering documents permitted withdrawals (subject to certain limitations) on the first day of each calendar quarter beginning four quarters after admission to the Fund and upon at least 60 days' prior written notice.

9. HCM issued to FAB's investors monthly statements prepared by its internal accountant based on monthly value estimates received from FAB's and Diversified's portfolio funds. HCM also provided investors with monthly updates and quarterly newsletters, which Tanella drafted and signed. The newsletters provided fund performance figures for the month and year to date, and compared the returns to the S&P 500 index. Tanella also included in the newsletters commentary on broad market conditions and generalized statements about each fund.

#### FAB's Holdings

10. In approximately September 2008, HCM received information that the assets of two of FAB's five portfolio funds may have become impaired. These two funds represented approximately 33% of FAB's assets. HCM established an "ABL Reserve" in FAB to segregate these at-risk portfolio funds. The ABL Reserve was illiquid and non-redeemable by FAB's investors.

11. FAB's three remaining and unimpaired portfolio funds consisted of Capstone Cayman Special Purpose Fund, L.P. ("Capstone") (valued at approximately \$1.7 million), Palm Beach Multi-Strategy, L.P. ("PBMS") (valued at approximately \$1.3 million), and Stillwater Asset Backed Fund II, L.P. ("Stillwater") (valued at approximately \$700,000).

12. In mid-October 2008, Tanella formed a new fund-of-funds, FAB 2, and transferred FAB's ownership interests in PBMS, Capstone, and Stillwater from FAB to FAB 2, effective January 1, 2009. Tanella invited existing FAB investors to consent to becoming limited partners of FAB 2. All FAB investors who did not already have pending redemption requests agreed to become limited partners of FAB 2.

#### Liquidity Issues

13. Starting in September 2008, FAB began receiving significant redemption requests from investors. On September 30, 2008, FAB's largest investor requested a full redemption of

approximately \$743,000. That same day, HCM requested full redemptions from each of FAB's unimpaired portfolio funds for the next available redemption date.

14. FAB continued to receive redemption requests through the remainder of 2008. For instance, in early October 2008, three FAB investors requested redemptions totaling an additional \$660,000. Then on December 29, 2008, two additional FAB investors requested redemptions totaling approximately \$519,000. By January 6, 2009, FAB had approximately \$2.1 million in outstanding redemption requests, which represented approximately 55% of FAB's unimpaired portfolio funds.

15. HCM was not able to access liquidity from any of FAB's portfolio funds to satisfy the redemption requests. On November 26, 2008, PBMS notified HCM that it had formally suspended all redemptions. In early December 2008, Stillwater informed HCM that it would not be able to satisfy HCM's request for early redemption.<sup>2</sup> On December 29, 2008, Capstone notified HCM that it was both suspending redemptions and commencing liquidation proceedings.

#### **Use of Diversified's Assets to Satisfy FAB Redemptions**

16. On January 12, 2009, Tanella and HCM caused Diversified to invest \$1,650,000 in FAB 2 and its legacy holdings transferred from FAB. Over the next two days, Tanella used Diversified's entire investment to pay pending redemption requests.

17. On April 7, 2009, Tanella directed Diversified to invest another \$700,000 into FAB 2. The following day, FAB 2 paid a pending redemption request of \$680,000.

18. At the time of each of Diversified's two investments, FAB 2 was illiquid and in distress. For instance, two of FAB's three portfolio funds of asset-backed securities (Capstone and PBMS) had suspended redemptions. Furthermore, HCM had not received any performance reports from PBMS since September 2008, and Tanella had concerns about PBMS's future performance.

19. Four months after Diversified's investments in FAB 2, Tanella announced the voluntary wind down of all HCM-managed funds. FAB 2's investors have not received any distribution payments to date.

#### **Inadequate Disclosures to FAB 2 Investors**

20. Prior to closing HCM's funds, Tanella and HCM also attempted to generate liquidity by soliciting new investors for FAB 2. Tanella and HCM prepared a Private Offering Memorandum ("POM") for FAB 2, dated October 30, 2008, stating that FAB 2 is "a conservative return instrument with risk parameters similar to two times the 90-Day US Treasury" with the objective of generating returns of 7% to 10% net of all fees. Tanella also prepared investor presentation materials that mirrored these claims, which HCM utilized to solicit new investors.

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<sup>2</sup> Stillwater's official redemption terms allowed redemptions on an annual basis based on the date of investment, which for FAB was not until February 2009. Stillwater never actually redeemed FAB's investment. In November 2009, Stillwater formally suspended redemptions and commenced liquidation of the fund.

21. The FAB 2 POM included pro forma results and claimed that the fund had “no operating history prior to January 2009 upon which investors may evaluate the potential performance of the fund and its portfolio managers.” In fact, FAB 2’s entire portfolio had been transferred from FAB and had measurable past performance results.

22. In November 2008, Tanella contacted a prospective investor and touted HCM’s funds, and FAB 2 in particular. Tanella provided this investor with a copy of FAB 2’s POM. This investor made two investments of \$150,000 each in FAB 2 – one in December 2008 and one in January 2009. Tanella did not inform this investor that his entire investment would be used to satisfy existing redemption requests rather than to purchase securities and that two of FAB 2’s portfolio funds had suspended redemptions or announced liquidation. This investor stated that he would not have invested if he had known this information.

23. HCM and Tanella also raised \$250,000 for FAB 2 from another new investor. Similarly, HCM used this investor’s money solely to satisfy outstanding redemption requests, not to make additional investments.

#### **Inadequate Disclosures to All FAB Investors**

24. Between November 2008 and July 2009, HCM sent monthly newsletters and quarterly commentaries prepared by Tanella that touted FAB’s performance in comparison to the major benchmarks and presented a generally positive outlook on the fund’s future performance. None of the newsletters disclosed the growing number of investor redemption requests (approximately 55% of FAB’s value as of December 2008) or the total lack of accessible liquidity from the portfolio funds needed to satisfy the requests.

25. FAB’s November 2008 monthly newsletter, which HCM distributed in December 2008, reported excellent lending opportunities in the asset backed lending space but did not disclose the problems with FAB’s specific investments in the asset backed lending space. In fact, by November 30, 2012, Tanella and HCM had concerns with the future performance of PBMS, FAB’s largest portfolio fund, which had suspended redemptions. Furthermore, at the time, FAB was facing \$1.4 million in redemption requests that it had no ability to satisfy.

26. FAB’s December 2008 monthly newsletter, which HCM distributed in January 2009, reported that “‘hedge fund scares’ recently fueled by the media have also caused large redemption requests from many ABL (asset-backed lending) funds.” Tanella and HCM, however, omitted that FAB itself was facing large redemption requests totaling 55% of its assets.

27. In August 2009, Tanella announced the voluntary wind down of all HCM-managed funds. FAB 2 investors have not received any distribution payments to date.



### Violations

28. Because of the conduct described above, HCM and Tanella willfully<sup>3</sup> violated Section 206(2) of the Advisers Act by engaging in transactions, practices or courses of business which operated as a fraud or deceit upon any client or prospective client, including managed accounts.

29. Because of the conduct described above, HCM and Tanella willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit fraudulent conduct by advisers to "pooled investment vehicles" and specifically prohibit misleading statements to investors or prospective investors in those pools. Scienter is not required to establish a violation of Section 206(4) and Rule 206(4)-8.

### Undertaking

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

### IV.

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

Accordingly, pursuant to Section 15(b) of the Exchange Act, Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

- A. Respondents cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder;
- B. Respondent HCM is censured;
- C. Respondent Tanella be, and hereby is, suspended from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent for a period of twelve months;
- D. Respondent Tanella be, and hereby is, prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or

<sup>3</sup> A willful violation of the securities laws means merely "that the person charged with the duty knows what he is doing." *Woinsover 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)).

principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of twelve months;

E. Respondent Tanella be, and hereby is, suspended from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock; or inducing or attempting to induce the purchase or sale of any penny stock for a period of twelve months; and

F. Respondents HCM and Tanella shall, jointly and severally, pay a total of \$64,072 in disgorgement, \$6,543 in prejudgment interest, and \$200,000 in civil money penalties to the Securities and Exchange Commission. Payment shall be made in the following installments: (1) \$20,000 shall be due and payable within 10 days of the entry of this Order; (2) an additional \$168,000 shall be due and payable within six months of the entry of this Order; and (3) the final \$82,615 shall be due and payable within one year of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application.

Payment must be made in one of the following ways:

- (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying HarborLight Capital Management, LLC, and Dean G. Tanella 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 Chad Alan Earnst, Assistant Regional Director, Asset Management Unit, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, FL 33131.

G. Respondent Tanella shall comply with the undertaking enumerated in Paragraph 30 above.

By the Commission.

*Elizabeth M. Murphy*  
Elizabeth M. Murphy  
Secretary

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-69433; File No. 4-661]

### Credit Ratings Roundtable

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Notice of roundtable discussion; request for comment.

**SUMMARY:** The Securities and Exchange Commission will host a one day roundtable to discuss various matters related to credit ratings. The roundtable will consist of three panels. The first panel will examine issues in connection with the possibility of developing a credit rating assignment system. The second panel will discuss the effectiveness of the Commission's current system under the Securities Exchange Act of 1934 for encouraging unsolicited ratings of asset-backed securities. The third panel will focus on other potential alternatives to the current issuer pay business model.

The roundtable discussion will be held in Room L-006 (the multi-purpose room) at the Securities and Exchange Commission's headquarters located at 100 F Street, NE, in Washington, DC 20549. The public is invited to observe the roundtable discussion. Seating will be available on a first-come, first-served basis. The roundtable discussion also will be available via webcast on the Commission's website at [www.sec.gov](http://www.sec.gov).

**DATES:** The roundtable discussion will take place on May 14, 2013. The Commission will accept comments regarding issues addressed at the roundtable until June 3, 2013.

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

Electronic Comments:

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

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- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number 4-661 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 4-661. 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/other.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Scott Davey at (212) 336-0075, Office of Credit Ratings, Securities and Exchange Commission, 3 World Financial Center, New York, NY 10281-1022.

By the Commission.



Elizabeth M. Murphy  
Secretary

Dated: April 23, 2013

*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69432 / April 23, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15298

In the Matter of

ANTHONY PIANELLI,

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 Anthony Pianelli ("Pianelli" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III. 3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Pianelli, age 58, resides in Middletown, New Jersey. From February 1983 through May 2004, Pianelli was a securities lending representative associated with Weiss, Peck & Greer, LLC ("Weiss Peck"), a broker-dealer registered with the Commission.

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2. On September 24, 2007, the Commission filed an amended complaint against Pianelli in the United States District Court for the Eastern District of New York alleging that he violated the antifraud provisions of the federal securities laws, *SEC v. Joseph Simone, et al.*, 07-cv-3928 (JG)(RML). The Commission's complaint alleges, among other things, that between 2000 and 2004, Pianelli knowingly engaged in a scheme to defraud Weiss Peck in connection with the lending and borrowing of securities.

3. On January 5, 2012, the court entered a judgment which, among other things, permanently enjoined Pianelli from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

#### IV.

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

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

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

*Commissioner Watter  
not participating*

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

**SECURITIES EXCHANGE ACT OF 1934  
Release No. 69430 / April 23, 2013**

**ADMINISTRATIVE PROCEEDING  
File No. 3-15296**

**In the Matter of**

**ALFRED VARRICCHIO,**

**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 Alfred Varricchio ("Varricchio" or "Respondent").

**II.**

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III. 3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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### III.

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

1. Varricchio, age 53, resides in Lynbrook, New York. From October 1979 to October 2006, he was a securities lending representative employed with A.G. Edwards & Sons Inc. ("A.G. Edwards"), a broker-dealer registered with the Commission.

2. On September 24, 2007, the Commission filed an amended complaint against Varricchio in the United States District Court for the Eastern District of New York alleging that he violated the antifraud provisions of the federal securities laws, *SEC v. Joseph Simone, et al.*, 07-cv-3928 (JG)(RML). The Commission's complaint alleges, among other things, that between 2003 and 2004, Varricchio knowingly engaged in a scheme to defraud A.G. Edwards in connection with the lending and borrowing of securities.

3. On May 22, 2012, the court entered a judgment which, among other things, permanently enjoined Varricchio from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### IV.

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

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

barred from association with any broker or 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

  
By: Jill M. Peterson  
Assistant Secretary

allowance recommendations and the key judgments underlying the recommendations. By the time CRM adopted Look Ahead for use in COAF in the first quarter of 2007, the tool had been used for several years by Capital One's credit card division, its largest business. CRM tested Look Ahead for use in COAF and concluded that the tool was superior to the then-current loss forecasting tool, and adopted Look Ahead as part of its loss forecasting methodology in arriving at a reasonable forecast.

15. The Look Ahead model utilizes at least five years of COAF historical loss data, which is needed to run the model. The tool analyzes actual loan losses and breaks them down into four constituent loss drivers: (a) maturation (losses due to the age of an account); (b) vintage (losses due to credit quality based on when a loan was booked); (c) seasonality (loss variance patterns due to the time of year); and (d) exogenous, a residual factor that identifies losses that Look Ahead is not able to attribute to any of the other three factors. The exogenous output of Look Ahead can include both internally driven and externally driven factors, including losses relating to macroeconomic and credit deterioration. An increase in the exogenous factor reflects an increase in losses across all loan vintages, regardless of the age of the accounts, including the broad spectrum of loans that do not share the same underwriting, pricing or collection strategy. In its loss forecasting policies and procedures, Capital One generally used the term "exogenous" to represent losses driven by factors outside the company, including macroeconomic trends.

16. CRM's loss forecasting policies during the relevant period stated that the exogenous factor, a "key element" in loss forecasting, was estimated based on "recent industry [exogenous] factor performance and the application of judgment." The policies further stated that the "general bias" was to estimate the exogenous factor at current observed levels, unless there was compelling data" justifying a deviation. Given that the external credit environment had a material impact on incurred losses during the second and third quarters of 2007, FAS 5 required that Capital One properly assess that environment in estimating its' incurred exogenous-driven losses.

17. The exogenous factor generated by Look Ahead was viewed by loss forecasters at COAF, during the relevant period, as the most important factor in making an allowance recommendation and was closely monitored by Capital One. Unlike the other factors in the tool, the exogenous is a direct multiplier on the entire loss forecast.

18. CRM, in fact, adopted the Look Ahead tool in COAF because of its ability to develop a more reliable exogenous output than the previous model generated. CRM noted in its Look Ahead validation documents that accurate and timely understanding of the exogenous factor was "critical in an uncertain economic environment." CRM concluded, after a period of extensive testing, that the "Look Ahead generated exogenous curve is more aligned with several pieces of external data," including competitor data, the credit card business' exogenous factor, and other economic factors, such as trends in the Gross Domestic Product growth rate, unemployment rate and used car price index.

#### Deteriorating Credit Environment Prior to the Second Quarter of 2007

19. COAF's auto financing business includes several lines of business focused on dealer-driven and direct financing platforms, both of which provide financing to subprime and prime consumers. Within subprime financing, the Dealer Subprime business constituted the largest area of profitability for COAF. COAF's dealer and direct subprime businesses were deemed high risk by Capital One because the customers were at the lower end of the credit quality spectrum.

20. Beginning no later than October 2006, Capital One started to face higher, unexplained loan charge-offs and delinquencies than it had forecast in virtually all of its consumer lines of business, including the credit card business, COAF, Global Financial Services and U.K. division. COAF continued to experience significant higher actual losses than forecast, referred to internally as adverse or negative variances, for the next four consecutive months. Moreover, COAF experienced negative variances across both dealer and direct lines of businesses and across both prime and subprime credit segments. Given the magnitude and broad scale of the losses, COAF was concerned that it was experiencing a credit turn, which was understood within the company to mean a phenomenon where there is a general worsening in the credit environment in a way that drives credit losses for consumer lending businesses.

21. For the month of January 2007, COAF's actual losses, or charge-offs, were 20% higher than forecast, creating a significant loss problem for the business. In a February 5, 2007 email, a top level COAF business official advised Schnall and other senior finance officials that "COAF credit results for January are quite concerning, continuing a trend that we've seen since October [2006]" and that the "underlying trends suggest that gap [the adverse variance] is widening over time." In a report entitled "COAF Credit Risk Performance Assessment" dated February 12, 2007, COAF identified that, for the period of October 2006 through January 2007, "losses exceeded forecasts by a sizable margin [averaging 10.4%] for the past 4 months, creating substantial risk to our earnings." Given the sustained negative variances, CRM and COAF business officials explored the possibility that COAF was experiencing a credit turn and discussed that such a scenario could cause future losses of up to \$100 million over the course of the year.

22. As early as the first quarter 2007, Schnall and other CRM officials learned that an adverse exogenous turn was causing higher delinquencies and significant credit deterioration in Capital One's credit card business. For example, CRM officials learned in March 2007 that an official from the credit card business had warned against assuming that the credit card business' unexplained adverse variances were temporary, describing such an assumption as "aggressive" and "underpredict[ing] losses." The credit card business official further stated that, given the subprime mortgage problems in the industry and increase in subprime credit card delinquencies, there was a 70% chance that an "exogenous shift" was occurring.

23. Given the negative loss variances in COAF, CRM increased COAF's allowance by \$70 million at the end of the first quarter. This allowance build was intended to account, primarily, for internally driven, non-exogenous causes for higher charge-offs, such as risk expansion measures that the business had taken in extending credit to riskier applicants and worsening performance of certain loan portfolios from acquisitions. There was a continued concern by a senior official in COAF, however, that a credit turn brought on by exogenous worsening had

likely caused the adverse variances, and this concern continued to play an important role in CRM's credit risk assessments for COAF. In the second and third quarters of 2007, CRM identified exogenous worsening as a significant risk to its COAF loss forecasts but, as set forth below, did not adequately incorporate such worsening into COAF's allowance reserves.

#### The Look Ahead Exogenous Uptick in the Second Quarter of 2007

24. In April, the first month in the second quarter, COAF again suffered an adverse forecast variance where its actual losses came in 11% higher than forecast. At the same time, the Look Ahead tool reflected a 5% uptick in the exogenous factor.

25. LaGassa discussed in a May 7, 2007 email with his loss forecast team that, given the large allowance build in the first quarter that was intended to cover losses associated with COAF's credit risk expansion, COAF should expect the gap between actual and forecasted losses to narrow, not worsen. CRM and COAF business officials also became concerned that the company was facing a credit turn, which would indicate a longer term loss problem for the business. LaGassa, for example, expressed concerns to his forecast team in the May 7, 2007 email that the April forecast miss was broad-based, impacting all loan vintages and all COAF business units. LaGassa further discussed that the pattern of losses were what he would expect to see in a credit turn.

26. By May, COAF's actual losses had increased to 23% above forecast, while the Look Ahead exogenous was now 14% higher and considered to be a significant uptick. The loss levels for certain COAF businesses were even worse, including, for example, the Direct Subprime business, which suffered 30% higher actual losses than forecast.

27. In response to the loss situation, LaGassa organized a "swat team" to diagnose the drivers of the losses. From June 2-11, 2007, LaGassa provided almost daily email updates to Capital One senior executives, including Schnall and senior COAF business officials, regarding the swat team's loss assessment. By June 11, LaGassa highlighted for these officials the following significant facts: (a) the Look Ahead tool had shown a 14% exogenous uptick; (b) the largest driver of the losses stemmed from "environmental worsening" from the exogenous increase; and (c) the worsening was broad-based, occurring across all vintages and lines of businesses, including subprime and the better credit quality loans in the prime business, signaling an "exogenous shift."

#### Capital One's Failure to Recognize Projected Exogenous Losses in COAF's Second Quarter Loan Loss Expense

28. By the close of the second quarter loss forecast in mid-June of 2007, CRM had assessed that COAF's allowance build would increase by approximately \$72 million by year-end if the current Look Ahead exogenous level was assumed to continue at that level for the 12-month period covered by the loss forecast. In assessing how to incorporate the exogenous impact into the forecast and allowance recommendation, LaGassa proposed the following three options to Schnall and others: (a) none of the exogenous worsening would be factored into the forecast, resulting in no exogenous impact to the allowance recommendation; (b) factoring in only one-

third of the exogenous level, resulting in a \$24 million allowance impact by year-end; or (c) factoring in the entire, current exogenous level, resulting in a \$72 million allowance impact by year-end.

29. LaGassa informed his loss forecasting team, in an early June email, that the Installment Loan division, which (unlike COAF) had a forward looking exogenous tool, expected a 10% increase in losses over the course of 2007 "due to macro-economic softening" which he believed was "another indicator that we [COAF] should be expecting some worsening [ . . . ]." CRM was also aware that the credit card business, Capital One's largest business, had already declared a credit turn based on the several months of unexplained worsening across all vintages and account ages.

30. As reflected in a June 15, 2007 email, a top-level COAF business executive informed Schnall and other senior Capital One business and finance executives that mid-month June loss numbers were unfavorable to forecast. Moreover, LaGassa informed a senior CRM official that based on the early June numbers, "our indications are that elevated unit loss levels are continuing to occur."

31. In a June 19, 2007 email to Schnall, a senior CRM official and COAF business and finance executive, LaGassa expressed that the exogenous worsening was not included in COAF's loan loss forecast, and that, based on mid-month results, he was "not optimistic that we are going to suddenly see a slowing in losses" and assessed that COAF would continue to face adverse variances.

32. CRM ultimately chose to assume that no part of the elevated exogenous level generated by Look Ahead would continue, resulting in the under-accrual of Capital One's loan loss reserve. This recommendation was made by LaGassa to the Chief Consumer Credit Officer and approved by Schnall. CRM's decision, which departed from the observed exogenous from Look Ahead, gave insufficient weight to the evidence of exogenous-driven incurred losses as of the second quarter balance sheet date. As a result, Capital One's second quarter loan loss expense for COAF did not appropriately incorporate information necessary to determine incurred losses under GAAP.

33. Had the full amount of the exogenous been incorporated by CRM, Capital One's consolidated second quarter loan loss expense would have been \$473 million, an increase of 18% over the \$401 million that was reported. Further, Capital One's consolidated net income would have been reduced from \$750 million to \$699 million, a 7% decrease. COAF's loan loss expense would have increased from \$182 million to \$254 million, nearly a 40% increase, and COAF would have reported a net loss of \$13 million rather than net income of \$38 million for the second quarter.

#### Capital One's Recognition of Only One-Third of Exogenous Losses in the Third Quarter

34. For the third quarter, COAF suffered approximately 15-20% in higher actual losses than forecast, while the Look Ahead exogenous factor remained at elevated levels for five straight months, including by 12.5% for most of the third quarter. By the third quarter, CRM had

assessed that COAF faced a potential allowance build by year-end of \$100 million, \$85 million of which resulted from incorporating the full exogenous levels generated from Look Ahead.

35. In August, Schnall and others were informed that Capital One's net asset charge-off from its company-wide loan portfolio was higher than forecast due, in large part, to loan charge-offs from exogenous worsening in COAF. Also by August 2007, Capital One took steps internally to protect its business interests against the exogenous impact. The Dealer Subprime business, COAF's largest area of profits, for example, took a series of steps to mitigate its risks from the exogenous worsening, including tightening credit standards and underwriting policies "to match the recently observed exogenous level," as reflected in emails from LaGassa to several Capital One senior executives, including Schnall. Further, as reflected in an August 30, 2007 email, Schnall wanted to build COAF's capital plan around "something somewhat worse than our expectations" given how close COAF was running to its capital targets.

36. In a September 10, 2007 email to a COAF finance official, LaGassa advised that "despite the huge [allowance] impact of just assuming exogenous stays flat, I don't assess such an assumption to be 'conservative' - in fact, I think it is a bit optimistic." CRM, nonetheless, recommended that only one-third of the current exogenous impact be incorporated for the allowance.

37. In both the September 10, 2007 email, as well as another email on September 11 to a senior CRM official and a senior COAF business executive that was forwarded to Schnall, LaGassa recommended incorporating only one-third of the current exogenous impact into the loan loss expense while recognizing and noting that the recommendation would create a high risk to the loss forecast.

38. As reflected in a September 28, 2007 document entitled "September Credit Outlook and Corporate Implications" that was sent to CRM officials as well as other top level finance and accounting executives, there was a "preponderance of evidence" across Capital One's consumer businesses of credit worsening arising from delinquency and overall exogenous worsening.

39. By the end of the third quarter loss forecast, COAF's business leaders identified as its "#1 Top Risk" the deterioration in credit quality in subprime markets "due to negative movement in the economy (mortgage market) and a general credit turn," as reflected in an August 29, 2007 presentation.

40. A senior CRM official who reported to Schnall, recommended to Schnall that COAF, consistent with the credit card business, recognize the current level of exogenous worsening— an \$85 million loan loss expense impact by year-end. Schnall, after discussions with that official, noted that he and the other official were in agreement to recognize "some, but not all, of the worsening in order to avoid oversteer," but that they should highlight the remainder to management and the finance and accounting teams as a "high" internal financial risk. Schnall should have taken steps to ensure that differing views and approaches to CRM's exogenous treatment were communicated to Capital One's allowance committee, which was responsible for ensuring that COAF's allowance complied with FAS 5.

41. CRM decided to incorporate one-third of the exogenous level, which translated into a \$28 million exogenous impact on the loss forecast and allowance. Because the decision gave insufficient weight to evidence of COAF's exogenous-driven losses, the third quarter COAF provision for loan losses did not appropriately incorporate information necessary to determine incurred losses under GAAP. The decision was also not adequately documented or communicated to the committee responsible for vetting allowance decisions.

42. CRM's exogenous treatment was questioned by COAF loss forecasters. These loss forecasters raised concerns within CRM regarding the decision to incorporate only one-third of the exogenous impact. The loss forecasters believed that incorporating anything less than the full exogenous level would result in an insufficient allowance. The loss forecasters, however, were not provided documentation or rationale supporting the exogenous decisions.

43. Had Capital One incorporated the full exogenous worsening in COAF, its consolidated third quarter provision for loan losses would have been \$647 million, an increase of 9% over the \$596 million that was actually reported. Further, consolidated net loss for the quarter would have been \$115 million, a 41% increase over the reported net loss of \$82 million. For COAF, the provision for loan losses would have been \$296 million, which is 21% higher than COAF's \$245 million reported loan loss expense for the quarter. COAF's \$4 million reported net loss would have been more than nine times greater than reported, or approximately a net loss of \$37 million.<sup>6</sup>

#### Capital One's Deficient Controls Over Loss-Forecasting in COAF's Prime Business

44. In the third quarter of 2007, CRM conducted a loss forecasting analysis to determine the loss impact attributable to COAF's Dealer Prime business, including losses arising from a failed "front-end pricing strategy" and a troubled portfolio known as "ONYX BAU" that COAF had acquired from another lender. This process involved, among other things, running the Look Ahead tool and engaging in discussions with COAF's Dealer Prime business team. CRM determined through this process that the loss impact arising from worsening portfolios in the Dealer Prime business represented the second largest contributor of COAF's total incurred losses (following exogenous-driven losses).

45. CRM's loan loss expense recommendation for the loss impact attributable to its worsening Dealer Prime portfolio, however, was at least \$10 million less than what its initial loss forecasting analysis yielded. Similar to the exogenous treatment, CRM did not adequately document why it did not fully incorporate its initial loss forecasting analysis for COAF's Dealer Prime business, which included the results of Look Ahead. CRM failed to maintain adequate documentation supporting its loan loss expense recommendation relating to COAF's worsening Dealer Prime loan portfolio. Further, the basis for CRM's allowance recommendation relating to COAF's Dealer Prime business, which was at least \$10 million less than its initial loss

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<sup>6</sup> Had Capital One appropriately incorporated exogenous-driven losses in the second quarter, the magnitude of the understatement of the Company's third quarter financial results would have been proportionally less.



forecasting analysis, was not communicated to Capital One's Allowance Advisory Committee, which is responsible for reviewing CRM's allowance recommendations.

#### Capital One's Internal Control Failures Over COAF's Allowance-setting Process

46. Capital One failed to incorporate sufficient amounts of COAF's exogenous-driven losses into the second and third quarter loss forecasts for COAF and, in turn, its loan loss expense, as a result of its deficient internal controls over the COAF allowance-setting process. Schnall and LaGassa failed to ensure that CRM followed Capital One's policies and procedures governing the exogenous treatment, documented the reasons and rationale for excluding the exogenous impact on COAF's loan loss expense, and addressed prior audit concerns. Schnall failed to ensure that CRM's allowance decisions and their rationale related to the COAF exogenous treatment were adequately communicated to Capital One's accounting group or the Allowance Advisory Committee, Capital One's committee responsible for vetting allowance decisions. Further, Capital One's accounting group failed to ensure that the COAF provision for loan losses for the second and third quarters of 2007 was properly supported, documented and determined in accordance with accounting requirements.

#### Capital One's Failure to Follow Policies and Procedures Regarding Exogenous Forecasting

47. Capital One's treatment of the exogenous factor in the second and third quarters of 2007 was inconsistent with its policies and procedures. CRM's COAF exogenous policy was to incorporate the current Look Ahead exogenous levels into COAF's loss forecast and, in turn, the provision for loan losses, unless there was "compelling data" justifying a departure from its policies.

48. CRM's COAF loss forecasting policies from October 2005 through August 2007 stated that the exogenous factor, a "key element" in loss forecasting, "is estimated based on recent industry [exogenous] factor performance and the application of judgment" but "[o]ur general bias is to project future industry factor at current observed levels unless there is compelling data to do otherwise."

#### Capital One's Failure to Adequately Address Prior Internal Audit Concerns Regarding COAF's Loss Forecasting

49. By the second quarter of 2007, Capital One was aware of several risks to COAF's allowance process from its exogenous forecasting that were identified by Internal Audit.

50. In 2005, an Internal Audit report that was sent to Schnall found that, despite the ability of the exogenous factor to drive significant swings in loss assessments, CRM did not have a reliable method to forecast it in COAF. In responding to the finding, CRM acknowledged that its current exogenous methodology was not "very scientific and also not reliable."

51. In 2006, another Internal Audit review found that CRM had "no guard rail process" in place governing when the COAF exogenous factor should be changed. CRM agreed with the audit finding and tasked COAF's then Director of Loss Forecasting with the responsibility of

developing a guard rail process for governing how the exogenous factor would be incorporated into the forecast.

52. In the first quarter of 2007, the COAF Director of Loss Forecasting proposed a policy, stating that “future exogenous will be straight-lined based on the last data point or average of the last 3 data points, if the data is [sic] too volatile.” The concept of “straight-lining” was a common term of art in the company, which meant that the last data point, or current exogenous level, in a model would be carried forward for purposes of loss forecasting and, in turn, setting the allowance. The “guard rails” policy further noted that if an exception to this rule was applied, the exogenous treatment would be documented.

53. The guard rails policy was sent to officials of COAF and to LaGassa, who were informed that the new policy “closed out” the audit concern over exogenous forecasting.

54. CRM, in setting the COAF loan loss expense, failed to follow the “guard rails” policy by not “straight-lining” the current exogenous—which would have incorporated the full worsening—or documenting the rationale for why it deviated from the policy.

55. By the third quarter of 2007, Capital One’s Internal Audit group identified in its audit planning materials that there was a “significant risk” that COAF gave “insufficient consideration of external factors (credit environment, economy, legislation, etc.)” in determining its allowance. This risk was identified by Internal Audit as “high” in terms of impacting allowance decisions.

56. In addition, during the course of performing its procedures, Internal Audit expressed concerns internally regarding CRM’s exogenous treatment for COAF in both the second and third quarters of 2007. Internal Audit sought support for COAF’s exogenous treatment from COAF’s loss forecasters. While the loss forecasters did not provide a complete explanation of why the full exogenous was not included in the allowance, based on the information that was provided, Internal Audit nonetheless signed off on the COAF allowance without raising any issues or findings for both the second and third quarters.

#### Capital One’s Failure to Adequately Document Support for COAF’s Allowance

57. The exogenous treatment was an important assumption made for purposes of the loss forecasts upon which the calculation of COAF’s loan loss expense was based. CRM was responsible for ensuring that such important assumptions were adequately documented in Capital One’s books and records. During the second and third quarters of 2007, despite requirements in policies and procedures, several internal directives, Commission expectations detailed in FR-28, and subsequently under SAB 102, regarding the need to document the rationale supporting assumptions used, CRM failed to ensure that the exogenous assumptions made for purposes of the COAF loss forecast and allowance recommendation were adequately documented.

58. In 2006, there were several memos that were sent to CRM forecasters and CRM officials, including Schnall, highlighting the need for CRM to formalize the exogenous documentation process. One such memo stated that the exogenous sign-off “is becoming increasingly important” because “changes in exogenous outlook drive a significant portion of the loss forecast

. . . . therefore documenting our exogenous assumptions becomes critical.” Another memo dated August 8, 2006, acknowledged that the need to have documentation and governance surrounding exogenous assumptions was critical because “[a]s we get closer to a potential credit turn, there is increasing scrutiny inside and outside of CRM on our economic assumptions.” The August memo further recognized that “the use of [exogenous] assumptions in our ALLL [allowance] calculation requires explicit documentation and sign-off to satisfy Sarbanes-Oxley certification requirements.”

59. In the third quarter of 2007, Schnall, a senior finance executive and other credit officials were sent a report from a CRM director level employee, highlighting the importance of documenting exogenous assumptions in light of the credit worsening experienced throughout the company. The report explicitly stated that “[w]e should be explicit about all assumptions in the outlook, particularly when they differ from current trends, consensus view or historical pattern.”

Failure to Adequately Communicate Key Assumptions and Judgments Regarding COAF’s Exogenous Treatment to the Allowance Advisory Committee

60. One of CRM’s key functions was to provide a recommendation concerning the provision for loan losses for each consumer lending business and the assumptions supporting them, on a quarterly basis, to the Allowance Advisory Committee (“allowance committee”), which functioned as an advisory committee to Capital One’s Chief Financial Officer for purposes of critically assessing CRM’s allowance recommendations. The allowance committee was comprised of top-level executives with accounting expertise, such as the Controller, Assistant Controller and Chief Accounting Officer of Capital One, who were responsible for ensuring that Capital One’s allowance was compliant with GAAP.

61. Schnall, as Capital One’s Chief Risk Officer, was a key member of the committee, along with another newly-appointed senior CRM official, and was ultimately responsible for ensuring that CRM’s key allowance-related judgments and assumptions were adequately communicated to the allowance committee.

62. During the second and third quarters of 2007, the allowance committee process was one of Capital One’s primary internal controls over the allowance-setting function and for ensuring GAAP compliance of CRM’s allowance-related decisions. As described by an Internal Audit report, the company’s allowance policies “assign approval authority for the [allowance] methodologies . . . to the Allowance Advisory Committee.” The committee’s oversight over the COAF allowance determination was particularly critical, given that Capital One’s accounting group did not otherwise analyze support for CRM’s allowance recommendations for COAF or have insight into COAF’s loss forecasting function.

63. Capital One’s accounting group relied on CRM and Schnall to provide information concerning the judgments underlying the allowance recommendations during allowance committee meetings. Schnall, however, did not take adequate steps to ensure that CRM’s exogenous treatment for COAF and supporting rationale in the second and third quarters of 2007 were adequately communicated to the allowance committee or documented in materials provided to the committee.

64. Schnall also failed to ensure that sufficient information was included in the written materials provided to the allowance committee. For example, in connection with an allowance committee meeting that took place on September 28, 2007, the presentation materials reflected that COAF's allowance impact from recognizing a "steady state" (current exogenous levels) was \$23 million, instead of the full \$85 million impact the Look Ahead exogenous factor reflected. The presentation materials also inaccurately reflected a \$23 million allowance impact from a "base risk increase" scenario, which analyzes exogenous worsening beyond current levels, even though the allowance impact from the Look Ahead exogenous factor should have reflected an amount higher than \$85 million.

#### Failure of Capital One's Accounting Group to Obtain Support for CRM's Exogenous Treatment

65. Capital One's allowance policy required that the Director of Loan Accounting "review the monthly [allowance] calculations and supporting documentation" for each of the business divisions, including COAF. With regard to the COAF allowance, however, this policy was not followed in the second and third quarters of 2007, and the role of Capital One's accounting group was limited to recording the journal entry to post the allowance and performing balance sheet reconciliations, as opposed to performing a detailed validation or verification of the allowance calculations.

66. Because Capital One failed to implement a system for Capital One's accounting group to monitor the COAF loss forecast, CRM loss forecasters were not required to—and did not—provide Accounting with support for judgments that were made in the forecast, including the exogenous assumptions.

#### Capital One's On-Top Adjustments to the COAF Loss Forecast

67. During the second and third quarters of 2007, Capital One did not employ its standard "grounds-up" loss forecasting practice for COAF and, instead, carried out the loss forecast through a series of on-top adjustments.

68. When CRM ran its loss forecasting tool in its entirety, it generated a "grounds-up" forecast that used the loss analysis results as the basis for a quarterly loss forecast. In the second and third quarters, however, LaGassa, with the knowledge of Schnall, the corporate accounting group and internal audit, did not run Look Ahead to generate a grounds-up forecast.

69. During these quarters, LaGassa was implementing a redesign of the loss forecasting process. Because his team was working on the redesign, LaGassa instructed the team to start with the previous quarter's forecast and then apply "on-top" adjustments to arrive at a new forecast. The on-top adjustments were made on the basis of CRM's subjective views on changes in trends from the prior quarter's forecast. During this period, CRM ran Look Ahead only for purposes of monitoring COAF's exogenous, while choosing not to produce a full loss forecast using Look Ahead loss data, such as maturation, vintage and seasonality. While the practice of making on-top adjustments is not *per se* improper, Capital One was required to ensure that proper controls surrounding the on-top adjustments were in place, given the adverse credit

deterioration experienced by COAF and the inherent risks stemming from making on-top adjustments. The company, however, failed to ensure that the on-top adjustments were properly supported and documented.

70. By the third quarter, CRM was aware of certain deficiencies and risks surrounding a forecast based on on-top adjustments, including at least one loss forecaster's concerns that a manually adjusted forecast would lead to a less accurate forecast and another concern by a senior CRM official who expressed frustration over "making an exogenous credit assumption for loss forecasting and provision build in Q3, in the absence of a full bottoms-up forecast." CRM, nonetheless, chose to carry out yet another on-top adjusted forecast in the third quarter using the understated second quarter's forecast as the foundation.

### VIOLATIONS

71. Section 13(a) of the Exchange Act and Rule 13a-13 thereunder require that every issuer of a security registered pursuant to Section 12 of the Exchange Act file with the Commission information, documents and annual and quarterly reports as the Commission may require, and, pursuant to Rule 12b-20 of the Exchange Act, mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading.

72. Section 13(b)(2)(A) of the Exchange Act and Rule 13b2-1 thereunder require reporting companies to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets, and prohibit any person from, directly or indirectly, falsifying or causing to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

73. Section 13(b)(2)(B) of the Exchange Act requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP.

74. As a result of the conduct described above, Capital One violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder because the provision for loan and lease losses, which excluded exogenous-driven losses for COAF, was materially understated, and income before taxes was materially overstated, and, thus, the Company filed inaccurate periodic reports with the Commission for the quarters ended June 30, 2007 and September 30, 2007.

75. As a result of the conduct described above, Capital One violated Section 13(b)(2)(A) of the Exchange Act because it did not keep books, records or accounts that accurately reflected its loan loss expense for COAF.

76. As a result of the conduct described above, Capital One violated Section 13(b)(2)(B) of the Exchange Act because it failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that its loan loss expense is recorded as necessary to permit preparation of financial statements in accordance with GAAP.

77. As a result of the conduct described above, Schnall and LaGassa caused Capital One's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13a-13 thereunder. As a result of that same conduct, Schnall and LaGassa violated Rule 13b2-1 under the Exchange Act in that they indirectly caused Capital One's violation of Section 13(b)(2)(A) of the Exchange Act.

#### IV.

78. In determining to accept Capital One's Offer, the Commission considered remedial acts undertaken by Capital One. Among other things, Capital One redesigned COAF CRM's loss forecasting process starting in the fourth quarter of 2007, established an allowance subcommittee, which meets quarterly to review the preliminary quarterly allowance calculations for the company's consumer businesses, appointed key personnel in the accounting group to review key assumptions underlying the allowance and implemented additional controls designed to prevent similar deficiencies going forward, including a formal process for documenting the exogenous treatment in allowance determinations.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Capital One cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder.

B. Pursuant to Section 21C of the Exchange Act, Schnall and LaGassa cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-13 and 13b2-1 thereunder.

C. Respondent Capital One shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$3,500,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;<sup>7</sup>
- (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

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<sup>7</sup> The minimum threshold for transmission of payment electronically is \$50,000.00 as of April 1, 2012. This threshold will be increased to \$1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

(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 Capital One Financial Corp. 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 Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

D. Respondent Schnall shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$85,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;<sup>8</sup>
- (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 Peter A. Schnall 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 Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

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<sup>8</sup> The minimum threshold for transmission of payment electronically is \$50,000.00 as of April 1, 2012. This threshold will be increased to \$1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.

E. Respondent LaGassa shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of \$50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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;<sup>9</sup>
- (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 David A. LaGassa 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 Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.

Elizabeth M. Murphy  
Secretary

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

<sup>9</sup> The minimum threshold for transmission of payment electronically is \$50,000.00 as of April 1, 2012. This threshold will be increased to \$1,000,000 by December 31, 2012. For amounts below the threshold, respondents must make payments pursuant to option (2) or (3) above.



*Commissioner Walter  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69431 / April 23, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15297

In the Matter of

CHARLES PETEREIN,

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 Charles Peterein ("Peterein" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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### III.

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

1. Peterein, age 63, resides in Evergreen Park, Illinois. From at least 1996 to April 2005, Peterein was employed as a stock loan trader at PAX Clearing Corporation ("PAX"), a registered broker-dealer, where he was responsible for negotiating, arranging and entering into stock loan transactions on behalf of the firm. From June 2005 to February 2009, Peterein worked as a stock loan trader at Sallerson-Troob, LLC, also a registered broker-dealer.

2. On September 24, 2008, the Commission filed a complaint against Peterein in the United States District Court for the Southern District of New York alleging that he violated the antifraud provisions of the federal securities laws, *SEC v. Melvyn Nathanson, et al.*, 08-cv-8205 (LBS). The Commission's complaint alleges that from at least 2003 through 2004, during the course of Peterein's employment with PAX, he knowingly engaged in a scheme to defraud broker-dealers in connection with the lending and borrowing of securities.

3. On March 5, 2013, the court entered a partial final judgment against Peterein which, among other things, permanently enjoined him from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

### IV.

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

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

barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

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

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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

*Commissioner Aguilar  
Commissioner Gallagher  
not participating*

UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69442 / April 24, 2013

ACCOUNTING AND AUDITING ENFORCEMENT  
Release No. 3456 / April 24, 2013

ADMINISTRATIVE PROCEEDING  
File No. 3-15299

In the Matter of

CAPITAL ONE FINANCIAL  
CORPORATION, PETER A.  
SCHNALL, AND DAVID A.  
LAGASSA,

Respondents.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Capital One Financial Corporation, Peter A. Schnall, and David A. LaGassa (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over themselves and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings and Imposing a Cease-and-Desist Orders and Civil Penalties ("Order"), as set forth below.

III.

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

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## SUMMARY

1. Capital One Financial Corporation (“Capital One”), a provider of consumer and commercial lending and diversified banking services, materially understated its provision for loan and lease losses (the “provision for loan losses” or “loan loss expense”) for the second and third quarters of 2007. The understatement was of the provision for loan losses for Capital One’s auto finance business, known as Capital One Auto Finance (“COAF”). As a result of the understatement, Capital One materially understated its provision for loan losses by as much as \$72 million for its second quarterly filing and as much as \$51 million in its third quarterly filing. Capital One also failed to maintain effective internal controls to ensure the appropriate and accurate recording and reporting of its loan loss expenses. Accordingly, Capital One violated the reporting, books and records and internal controls provisions of the Exchange Act, and Capital One’s Chief Risk Officer at the time, Peter A. Schnall (“Schnall”), and COAF’s Divisional Credit Officer at the time, David A. LaGassa (“LaGassa”) were each a cause of Capital One’s violations.
2. Starting no later than October 2006 and continuing through the third quarter of 2007, COAF, as well as nearly every other Capital One consumer lending business, experienced significantly higher charge-offs and delinquencies for its loans than it had forecasted. COAF, whose profitability was primarily derived from extending credit to subprime consumers, experienced these higher loss variances across all types of loans. By the second quarter of 2007, credit markets began to deteriorate, and COAF assessed from its internal loss forecasting tool that its escalating loss variances were attributable to an increase in a forecasting factor it called the “exogenous.” This factor measured the impact on credit losses from conditions external to the business, including macroeconomic conditions. A change in the exogenous factor generally had a significant impact on COAF’s loan loss expense, and it was closely monitored by the company through its loss forecasting tool.
3. Instead of incorporating the full exogenous levels generated by its loss forecasting tool into COAF’s loss forecast, Capital One failed to include any of COAF’s exogenous-driven losses for the second quarter provision for loan losses and only included one-third of such incurred losses in its third quarter provision for loan losses. The exogenous losses were an integral component of Capital One’s methodology for calculating its provision for loan losses. The decisions made concerning the treatment of elevated exogenous levels gave insufficient weight to the evidence available at the time. As a result, Capital One’s second and third quarter loan loss expense for COAF did not appropriately estimate probable incurred losses in accordance with accounting requirements. Accordingly, Capital One violated the periodic reporting provisions of the Exchange Act.
4. As a result of Capital One’s understatement, Capital One’s consolidated provision for loan and lease losses was understated by approximately 18% in the second quarter and 9% in the third quarter of 2007. COAF’s loan loss expense was understated by approximately 40% and 21%, respectively, for the second and third quarters of 2007.

5. Because Capital One failed to include certain incurred losses as of its balance sheet date and adequately document the rationale for its accounting treatment for such losses, it violated the books and records and internal control provisions of the federal securities laws. These failures also violated Capital One's own policies and procedures, which, among other things, required Capital One's accounting group to ensure that COAF's loan loss expense was properly supported and documented and required Capital One's credit risk management function to fully disclose the significant assumptions underlying its loan loss allowance determination to the management committee responsible for ensuring that Capital One's allowance comported with accounting guidelines.

### RESPONDENTS

6. **Capital One Financial Corp.** is a Delaware company, headquartered in McLean, Virginia, that provides commercial and consumer lending and diversified banking services. Capital One's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange (Ticker: COF). Capital One files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

7. **Peter A. Schnall**, age 49, was the Chief Risk Officer of Capital One, a position he held from June 2006 until January 31, 2013. Beginning in 2002, Schnall oversaw Capital One's Credit Risk Management group. As part of his responsibilities, Schnall supervised the Chief Consumer and Commercial Credit Officers. As their supervisor, Schnall was ultimately responsible for, among other things, Credit Risk Management's loan loss allowance recommendations that are provided to Capital One's Corporate Accounting Group, resulting from the quarterly loss forecasting process conducted by the Chief Consumer and Commercial Credit Officers' organizations for each of Capital One's consumer and commercial lending divisions. Schnall reported directly to the Chief Executive Officer of Capital One.

8. **David A. LaGassa**, age 44, is currently a Managing Vice President within Capital One's Financial Services division. From March 2007 through March 2010, including the time of the events described in this Order, LaGassa was the Divisional Credit Officer for COAF. As the Divisional Credit Officer, LaGassa was responsible for managing the COAF loss-forecasting function. LaGassa reported to the Chief Consumer Credit Officer, who, in turn, reported to Schnall.

### FACTS

#### Relevant Accounting Principles for Allowance for Loan and Lease Losses

9. The allowance for loan and lease losses ("allowance") represents a company's best estimate of incurred losses<sup>1</sup> inherent in its loan portfolio at any given financial reporting date.

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<sup>1</sup> The term "incurred losses" refers to an estimated loss that meets the following two conditions for accrual as set forth in paragraph 8 of Statement of Financial Accounting Standards ("FAS") No. 5 ("FAS 5"), Accounting for Contingencies: "(a) information available prior to the issuance of the financial statements indicates that it is probable

The provision for loan losses, in turn, is the periodic cost (*i.e.*, quarterly, annually, etc.) of maintaining an adequate allowance. An increase to the allowance, or an "allowance build," is recorded as an expense on the institution's income statement and decreases net income for that period. The Commission has issued extensive guidance to financial institutions to ensure that their accounting for loan losses is consistent with Generally Accepted Accounting Principles ("GAAP") and well documented.<sup>2</sup>

10. In accounting for COAF's loan loss expense, Capital One was required to satisfy the requirements of FAS 5, which, generally, provides that losses should be recorded if they are both probable and reasonably estimable.<sup>3</sup> Pursuant to FAS 5, an entity must capture the reasonable estimate of losses "in light of the current economic environment" that exists as of the balance sheet date.<sup>4</sup> Given that the allowance is subjective and represents one of the key elements in a bank's financial statements, it is critical to maintain rigorous internal controls over the allowance-setting process.<sup>5</sup>

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that an asset had been impaired or a liability had been incurred at the date of the financial statements [...]; and (b) the amount of the loss can be reasonably estimated." Further, FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss an Interpretation of FASB Statement No. 5, states in paragraph 3 (in part) "[w]hen condition (a) in paragraph 8 is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, condition (b) in paragraph 8 is met and an amount shall be accrued for the loss. When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued."

<sup>2</sup> Accounting for loan losses is governed by FAS 5, Accounting for Contingencies, and FAS No. 114, Accounting by Creditors for Impairment of a Loan. In December 1986, the SEC issued Financial Reporting Release No. 28, which added subsection (b) Procedural Discipline in Determining the Allowance and Provision for Loan Losses to be Reported, of Section 401.09, Accounting for Loan Losses by Registrants Engaged in Lending Activities, to the Codification of Financial Reporting Policies. In July 2001, the SEC staff issued Staff Accounting Bulletin No. 102 ("SAB 102"), Selected Loan Loss Allowance Methodology and Documentation Issues. In addition to Commission guidance, in July 2001, the banking regulators, after issuance of a proposed policy statement and consideration of comments, issued a "Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions."

<sup>3</sup> Because Capital One has deemed the loans within the COAF portfolio to be a homogeneous population with similar risk characteristics, the company accounts for the COAF provision for loan losses in accordance with FAS 5, rather than FAS 114.

<sup>4</sup> Paragraph 23 of FAS 5 states "[w]hether the amount of loss can be reasonably estimated (the condition in paragraph 8(b)) will normally depend on, among other things, the experience of the enterprise, information about the ability of individual debtors to pay, and appraisal of the receivables *in light of the current economic environment*." (Emphasis added). Interagency Policy Statement on the Allowance for Loan and Lease Losses ("Interagency Policy"), which operates as regulatory interpretive guidance on FAS 5, similarly states that management should consider the impact of "current qualitative or environmental factors" that exists as of the balance sheet date.

<sup>5</sup> Accounting for Loan Losses by Registrants Engaged in Lending Activities, 51 Fed. Reg. 237 (Dec. 10, 1986) (codified at 17 C.F.R. part 211) ("FR-28") expresses the Commission's views regarding certain matters affecting reported amounts of loan losses, including, among other things, the need for procedural discipline in determining amounts of loan losses to be reported. Specifically, expected in the books and records of a registrant such as Capital One include "documentation of a systematic methodology to be employed each period in determining the amount of loan losses to be reported, and rationale supporting each period's determination that the amounts reported were adequate." Further, "specific rationale upon which the amount actually reported in each individual period is based – *i.e.*, the bridge between the findings of the detailed review and the amount actually reported in each period – would be documented to help ensure the adequacy of the reported amount..." Several years after the publication of FR-28, the SEC Staff issued SAB 102 to provide a more detailed explanation of its expectations concerning the allowance-

## The Credit Risk Management Function

11. Capital One's consumer credit divisions, during the relevant period, primarily included U.S. Credit Card, COAF, Installment Loans and the so-called United Kingdom division. These businesses were divided in two distinct branches: Credit Risk Management ("CRM"), supervised by Schnall; and the branch that is responsible for, among other things, originating new loans, underwriting loans and marketing credit products ("the business side"), headed by the President of each of these businesses. CRM is responsible for preparing the quarterly loss forecast that is used to develop the allowance. Although the business side had no reporting duties to CRM or official loss forecasting responsibilities, CRM considered the business side an important stakeholder in the loss forecasting process and relied on it for providing views on credit risk during the relevant period.

12. Schnall had ultimate supervisory authority over the loss forecasting function for all consumer and commercial businesses at Capital One as well as CRM's allowance recommendations for these businesses. Schnall directly supervised the Chief Consumer Credit Officer for Capital One, who assumed the role in September of 2006. The Chief Consumer Credit Officer, in turn, directly supervises each Divisional Credit Officer ("DCO") assigned to a particular business division. The DCOs manage the teams that conduct the quarterly loss forecasting process for their respective business divisions, which is used to generate a recommendation to the Chief Consumer Credit Officer, who then reviewed that recommendation with Schnall. The recommendation is then sent to Capital One's senior finance and accounting officials for setting a provision for loan losses. During the relevant period, LaGassa was the DCO for COAF.

## Allowance Methodology for COAF and the "Exogenous Factor"

13. Capital One's policies and procedures require a systematic methodology to determine management's best estimate of its allowance. The methodology in place included the use of a loss forecasting tool known as "Look Ahead." The purpose of Look Ahead is to assist management in developing an accurate and reasonable quarterly loss forecast, which is used to make CRM's allowance recommendation.

14. In preparing its quarterly loss forecast for COAF during the relevant period, CRM considered, among other things, outputs from Look Ahead. CRM's loss forecast is, in turn, converted to an allowance recommendation for COAF. Capital One's internal controls over the loan loss expense component of its financial reporting, therefore, is directly impacted by Look Ahead. Pursuant to Capital One's policies and procedures, CRM was required to document its

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setting process, including the development, maintenance and documentation of a comprehensive, systematic and consistently applied process for determining the allowance. SAB 102 further details that a registrant should "maintain documentation to support its method of estimating loan losses" and "maintain copies of the economic and other reports that provided source data." SABs reflect the views of Commission staff regarding certain accounting-related practices and represent interpretations and policies used by Commission staff to administer the federal securities laws.



UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69439 / April 24, 2013

Admin. Proc. File No. 3-14935

In the Matter of  
  
A-POWER ENERGY GENERATION  
SYSTEMS, LTD.

ORDER SUMMARILY AFFIRMING IN PART AND IMPOSING REMEDIAL SANCTIONS

A-Power Energy Generation Systems, Ltd. is a British Virgin Islands corporation located in the People's Republic of China with stock registered with the Commission pursuant to § 12(b) of the Securities Exchange Act of 1934.<sup>1</sup> It appeals from the initial decision of an administrative law judge.<sup>2</sup> In that decision, the law judge revoked the registration of the company's securities based on her finding that A-Power had violated § 13(a) of the Exchange Act<sup>3</sup> and Rule 13a-1 promulgated thereunder,<sup>4</sup> in that it had failed to file its required annual report for fiscal year 2010 as charged in the Order Instituting Proceedings.<sup>5</sup> She also found that A-Power failed to file an annual report for fiscal year 2011 or report the resignation of Simon & Edward as its auditor on Form 6-K.<sup>6</sup>

A-Power filed a timely appeal of the initial decision, and the parties filed briefs in accordance with the schedule that was issued. We reviewed the hearing transcript and the record of action before the law judge *de novo*, as well as the briefs filed by the parties on appeal. We also take official notice that A-Power failed to make any of its required filings since the date of

<sup>1</sup> 15 U.S.C. § 78l(b).

<sup>2</sup> *A-Power Energy Generation Sys., Ltd.*, Initial Decision Release No. 470, 2012 SEC LEXIS 3419 (Nov. 2, 2012).

<sup>3</sup> Exchange Act § 13(a), 15 U.S.C. § 78m(a), requires issuers of securities registered pursuant to Exchange Act § 12 to file periodic reports in accordance with Commission rules.

<sup>4</sup> Rule 13a-1, 17 C.F.R. § 240.13a-1, requires registrants to file annual reports.

<sup>5</sup> *A-Power Energy Generation Sys., Ltd.*, Exchange Act Release No. 67338, 2012 SEC LEXIS 2090 (July 3, 2012).

<sup>6</sup> *Id.*

the initial decision,<sup>7</sup> including its annual reports for fiscal years 2010 and 2011 and notification via Form NT 20-F of its inability to file the 2011 annual report.<sup>8</sup>

## I. Summary Affirmance In Part

Based on our review, we have determined that the law judge's factual findings are correct (with the exception of her finding discussed below concerning Form 6-K). We have also determined that the law judge was correct in finding that "A-Power violated Exchange Act Section 13(a) and Exchange Act Rule 13a-1."<sup>9</sup> We find that these issues do not warrant consideration by the Commission of further oral or written argument. We further find that no prejudicial error was committed in the conduct of the proceeding and that the decision embodies no exercise of discretion or decision of law or policy that is important and that the Commission should review.<sup>10</sup> Accordingly, on our own initiative, we summarily affirm and adopt these findings of the law judge.<sup>11</sup>

## II. Sanctions

As to sanctions, however, while we arrive at the same outcome as the law judge, we must separately analyze the factors set forth in *Gateway Int'l Holdings, Inc.*<sup>12</sup> because the law judge based her sanctions determination, in part, on a finding that A-Power "failed to report the resignation of its auditor on Form 6-K, in violation of 17 C.F.R. § 240.13a-16."<sup>13</sup> While A-Power was in the practice of reporting information on Form 6-K (until it stopped filing forms with the Commission altogether), it is not clear that it was required to do so. A foreign private issuer is required to make reports on Form 6-K to furnish whatever information it (i) makes or is required to make public pursuant to the law of the jurisdiction of its domicile or in which it is incorporated or organized, (ii) files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, or (iii) distributes or is

<sup>7</sup> Our Rules of Practice permit us to take official notice of information (or the lack thereof) in the Commission's EDGAR database. See 17 C.F.R. § 201.323.

<sup>8</sup> 17 C.F.R. §§ 240.12b-25, 249.322 (requiring issuers to provide notification of their inability to file Form 20-F, or other periodic report, along with supporting reasons, by filing a Form NT 20-F "no later than one business day after the due date" for such report). A-Power did, however, file a Form NT 20-F with respect to its 2010 annual report.

<sup>9</sup> *A-Power Energy Generation Sys., Ltd.*, 2012 SEC LEXIS 3419, at \*6.

<sup>10</sup> See 17 C.F.R. § 201.411(e)(2).

<sup>11</sup> See *id.* (permitting the Commission, on its own initiative, to summarily affirm an initial decision); *Andover Holdings, Inc.*, Exchange Act Release No. 68966, 2013 SEC LEXIS 548, at \*3 (Feb. 21, 2013); *Eric S. Butler*, Exchange Act Release No. 65204, 2011 SEC LEXIS 3002, at \*1 n.2 (Aug. 26, 2011).

<sup>12</sup> Exchange Act Release No. 53907, 2006 SEC LEXIS 1288, at \*19-20 (May 31, 2006).

<sup>13</sup> *A-Power Energy Generation Sys., Ltd.*, 2012 SEC LEXIS 3419, at \*8. This violation was not charged in the OIP.

required to distribute to its security holders.<sup>14</sup> The record, however, does not establish that information concerning the resignation of Simon & Edward was required to be reported by A-Power on Form 6-K.

Our determination of the appropriate sanction under Exchange Act § 12(j)<sup>15</sup> "turns on the effect on the investing public, including both current and prospective investors, of the issuer's violations, on the one hand, and the Section 12(j) sanctions, on the other hand."<sup>16</sup> We consider a non-exclusive list of factors in making this determination, including (i) the seriousness of the issuer's violations, (ii) the isolated or recurrent nature of the violations, (iii) the degree of culpability involved, (iv) the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and (v) the credibility of its assurances, if any, against further violations.<sup>17</sup>

Based on our consideration of these *Gateway* factors, we find that the protection of investors requires revoking the registration of A-Power's stock. The company's violations are serious, recurrent, and demonstrate a high degree of culpability.<sup>18</sup> Indeed, A-Power's failure to file two annual reports deprived both existing and prospective shareholders of current and reliable information about the company's operations and financial condition. As we stated in *Gateway*:

Failure to file periodic reports violates a central provision of the Exchange Act. The purpose of the periodic filing requirements is to supply investors with current and accurate financial information about an issuer so that they may make sound decisions. Those requirements are the primary tools which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities.<sup>19</sup>

A-Power also failed to file Form NT 20-F in connection with its delinquent 2011 annual report, further demonstrating its disregard for our reporting requirements.

We have held that a respondent's repeated failure to file its periodic reports on time is "so serious" a violation of the Exchange Act that only a "strongly compelling showing" regarding the

<sup>14</sup> See 17 C.F.R. §§ 240.13a-16; <http://www.sec.gov/about/forms/form6-k.pdf>.

<sup>15</sup> Section 12(j) authorizes the Commission to suspend or revoke an issuer's registration for violation of Exchange Act filing requirements if it is "necessary or appropriate for the protection of investors." 15 U.S.C. § 781(j).

<sup>16</sup> *Gateway Int'l Holdings, Inc.*, 2006 SEC LEXIS 1288, at \*19.

<sup>17</sup> See *id.* at \*19-20.

<sup>18</sup> See *Am. Stellar Energy, Inc.*, Exchange Act Release No. 64897, 2011 SEC LEXIS 2455, at \*15-16 (July 18, 2011) (finding issuer's failure to file two annual reports and eight quarterly reports to be serious and recurrent violations); *Impax Labs., Inc.*, Exchange Act Release No. 57864, 2008 SEC LEXIS 1197, at \*27 (May 23, 2008) ("[T]he failure to provide accurate, complete, and timely financial information is serious."); *America's Sports Voice, Inc.*, Exchange Act Release No. 55511, 2007 SEC LEXIS 1241, at \*11 (Mar. 22, 2007) (finding that a "long history of ignoring . . . reporting obligations" evidences a "high degree of culpability").

<sup>19</sup> 2006 SEC LEXIS 1288, at \*26 (internal quotation omitted).

other *Gateway* factors would justify a sanction less than revocation.<sup>20</sup> No such showing has been made here. To the contrary, revocation is supported further by A-Power's failure to demonstrate any effort to remedy its past violations or to offer any credible assurances against future violations.

Indeed, A-Power does not state when it expects to file its long overdue 2010 annual report, although it requests an extension of time for that filing.<sup>21</sup> A-Power further claims that it needs six additional months after filing its 2010 annual report to complete and file its delinquent 2011 annual report. But A-Power has provided no information on the steps that it has taken or plans to take to remedy its past violations and ensure future compliance. And it has not indicated whether it has hired an auditor to replace Simon & Edward, which resigned over a year ago. Therefore, it is unreasonable to expect that A-Power can become current in its reporting obligations in the foreseeable future.

A-Power argues that revocation will harm its shareholders. We previously have recognized that "in any deregistration current shareholders could be harmed by a diminution in the liquidity and value of their stock by virtue of the deregistration,"<sup>22</sup> but also have held that "any harm that may result to existing shareholders cannot be the determining factor in our analysis."<sup>23</sup> In evaluating what is necessary or appropriate to protect investors, "regard must be had not only for existing stockholders of the issuer, but also for potential investors."<sup>24</sup> Indeed, we have emphasized the significant interests of prospective investors who can be substantially hindered in their ability to evaluate an issuer in the absence of current filings.<sup>25</sup> In any event, both existing and prospective shareholders are harmed by the continuing lack of current and reliable financial information for the company.

A-Power also argues that matters outside of the OIP, such as A-Power's failure to file its 2011 annual report, cannot "be regard[ed] as the main evidence[]" in imposing sanctions and "should be applied cautiously."<sup>26</sup> This argument is without merit. A-Power's later filing history—

<sup>20</sup> *Nature's Sunshine Prods., Inc.*, Exchange Act Release No. 59268, 2009 SEC LEXIS 81, at \*30 (Jan. 21, 2009); *Impax Labs., Inc.*, 2008 SEC LEXIS 1197, at \*27.

<sup>21</sup> A-Power's brief to the law judge requested a one-year extension of the time to file its 2010 annual report. Its briefs to the Commission simply request an extension of time.

<sup>22</sup> *Eagletech Commc'ns, Inc.*, Exchange Act Release No. 54095, 2006 SEC LEXIS 1534, at \*13 (July 5, 2006).

<sup>23</sup> *Gateway Int'l Holdings*, 2006 SEC LEXIS 1288, at \*31.

<sup>24</sup> *Id.* (citation omitted).

<sup>25</sup> *See id.* (stating that, in the context of NASD listing decisions, the Commission has emphasized the interests of future investors rather than the interests of existing shareholders, and noting that "similar policy considerations are applicable in a Section 12(j) proceeding").

<sup>26</sup> Company's Br. in Support of Pet. for Review at 6 (internal quotations and ellipsis omitted). The company did not cite any authority in support of this argument.

of which the Commission may take official notice—is a relevant factor in determining whether revocation is necessary or appropriate for the protection of investors.<sup>27</sup>

Finally, A-Power argues that suspension rather than revocation is an appropriate sanction. However, given its serious and recurrent failure to file its periodic reports and its failure to remedy its past violations or offer credible assurances against future violations, we find that revocation is necessary and appropriate for the protection of investors.

### III. Conclusion

Accordingly, it is ORDERED that the law judge's findings of fact are summarily affirmed, with the exception of her finding of fact with respect to Form 6-K;

it is further ORDERED that the law judge's finding that A-Power Energy Generation Systems, Ltd. violated Exchange Act § 13(a) and Rule 13a-1 promulgated thereunder, is summarily affirmed; and

it is further ORDERED that the registration of all classes of the registered securities of A-Power Energy Generation Systems, Ltd. under § 12(b) of the Securities Exchange Act of 1934, be revoked pursuant to Exchange Act § 12(j).

By the Commission.

Elizabeth M. Murphy  
Secretary

  
By: Lynn M. Powalski  
Deputy Secretary

<sup>27</sup> See, e.g., *Gateway Int'l Holdings, Inc.*, 2006 SEC LEXIS 1288, at \*24 n.30; *e-Smart Tech., Inc.*, Exchange Act Release No. 50514, 2004 SEC LEXIS 2361, at \*10 (Oct. 12, 2004).

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69451; File No. SR-NSCC-2013-802)

April 25, 2013

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of Filing of Advance Notice, as Modified by Amendment No. 1, to Institute Supplemental Liquidity Deposits to Its Clearing Fund Designed to Increase Liquidity Resources to Meet Its Liquidity Needs

Pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> thereunder, notice is hereby given that on March 21, 2013, the National Securities Clearing Corporation (“NSCC”) filed with the Securities and Exchange Commission (“Commission”) an advance notice described in Items I, II and III below, which Items have been prepared primarily by NSCC. On April 19, 2013, NSCC filed with the Commission Amendment No. 1 to the advance notice.<sup>3</sup> The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Advance Notice

To enhance its ability to meet its liquidity requirements, NSCC is proposing to amend its Rules & Procedures (“Rules”) to provide for a supplemental liquidity funding obligation, as described below.

II. Clearing Agency’s Statement of the Purpose of, and Statutory Basis for, the Advance Notice

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<sup>1</sup> 12 U.S.C. 5465(e)(1). Defined terms that are not defined in this notice are defined in Exhibit 5 of the advance notice filing, available at <http://www.sec.gov/rules/sro/nsccl.shtml> under File No. SR-NSCC-2013-802, Additional Materials.

<sup>2</sup> 17 CFR 240.19b-4(n)(i).

<sup>3</sup> Amendment No. 1 revised NSCC’s original advance notice filing to include as Exhibit 2 a written comment received by NSCC relating to the advance notice proposal, as described in Item II(B) below.

In its filing with the Commission, NSCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. NSCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>4</sup>

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

Proposal Overview

According to NSCC, as a central counterparty ("CCP"), NSCC occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions, thereby reducing the risk faced by its Members and contributing to global financial stability. Further, pursuant to the Clearing Supervision Act, NSCC has been designated a systemically important financial market utility ("SFMU") by the Financial Stability Oversight Council, obliging NSCC to meet certain risk management regulatory standards related to, among other things, maintaining adequate financial resources to meet its obligations to its Members in the event of the default of the Member or family of affiliated Members ("Affiliated Family") that would generate the largest aggregate payment obligation to NSCC in stressed conditions. In this regard and to enhance its ability to meet its liquidity requirements, NSCC is proposing to amend its Rules to provide for a supplemental liquidity funding obligation.

A substantial proportion of the liquidity needed by NSCC is attributable to the exposure presented by those unaffiliated Members and Affiliated Families that regularly incur the largest

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<sup>4</sup> The Commission has modified the text of the summaries prepared by NSCC.

gross settlement debits over a settlement cycle during trading activity on business days other than periods coinciding with quarterly triple options expiration dates (“Regular Activity Periods”), as well as during times of increased trading activity that arise around quarterly triple options expiration dates (“Options Expiration Activity Periods”).

With the goal of ensuring that NSCC has sufficient liquidity to meet its obligations during Regular Activity Periods, as well as during Options Expiration Activity Periods, it is appropriate that those unaffiliated Members and Affiliated Families provide additional liquidity to NSCC. Under proposed Rule 4(A), this will take the form of supplemental liquidity deposits to the Clearing Fund (i) in an amount based on the largest liquidity need NSCC would have in the event of the default of an unaffiliated Member or Affiliated Family during a Regular Activity Period (“Regular Activity Supplemental Deposit”), and (ii) an additional amount to cover the largest liquidity need NSCC would have in the event of the default of an unaffiliated Member or Affiliated Family during an Options Expiration Activity Period (“Special Activity Supplemental Deposit”) (collectively with Regular Activity Supplemental Deposit, “Supplemental Deposit”).

The obligation of an unaffiliated Member or the Members of an Affiliated Family to make a Regular Activity Supplemental Deposit (“Regular Activity Liquidity Obligation”) or a Special Activity Supplemental Deposit (“Special Activity Liquidity Obligation”) would be imposed on the thirty (30) unaffiliated Members and/or Affiliated Families who generate the largest aggregate liquidity needs over a settlement cycle that would apply in the event of a closeout (i.e., over a period from date of default through the following three (3) settlement days), based upon a lookback period. The Regular Activity Liquidity Obligation of an unaffiliated Member or the Members of an Affiliated Family to make a Regular Activity Supplemental



Deposit will be reduced by any liquidity such Members or their affiliates may provide in the form of commitments under NSCC's committed liquidity facility ("Credit Facility").

The calculations for both the Regular Activity Liquidity Obligation and the Special Activity Liquidity Obligation are designed so that NSCC has adequate liquidity resources to enable it to settle transactions, notwithstanding the default of an unaffiliated Member and/or Affiliated Family during Regular Activity Periods, as well as during Options Expiration Activity Periods. The Liquidity Obligations imposed on Affiliated Families would be allocated among the Family Members in proportion to the liquidity risk (or peak exposure) they present to NSCC.

#### Regulatory Background

As both a CCP and a designated SFMU, NSCC adheres to strict risk management processes that are regularly reviewed against applicable regulatory and industry standards. This includes the securities laws and rulemaking promulgated by the Commission, such as Rule 17Ad-22(b)(3), which requires registered clearing agencies that perform CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant (defined in Rule 17Ad-22(a)(3) to include a participant family) to which it has the largest exposure.

NSCC is also mindful of the standards set forth in the Principles for Financial Market Infrastructures ("PFMI") of the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions. Key Consideration 4 of PFMI Principle 7, addressing liquidity risk, provides that a CCP should maintain sufficient liquidity resources to meet its payment obligations under a wide range of

stress scenarios including the default of the participant and its affiliates that would generate the largest aggregate payment obligation to the CCP.

NSCC believes the proposed rule change should assist NSCC in securing adequate liquidity resources to meet its settlement obligations during both Regular Activity Periods and Options Expiration Activity Periods, notwithstanding the default of one of its unaffiliated Members and/or Affiliated Families that pose the largest aggregate liquidity need over the four day settlement cycle.

*Supplemental Liquidity Providers*

Every business day NSCC measures the liquidity obligations of its unaffiliated Members and Affiliated Families by taking the sum of their purchase obligations on that day in securities that are eligible for processing in NSCC's Continuous Net Settlement ("CNS") system and for the following three (3) settlement days (which equates to the period from the date of default through the remaining settlement cycle). NSCC then takes into account certain adjustments, assumptions and offsets, and assumes the occurrence of certain stressed conditions.

The stressed market conditions NSCC assumes in this calculation include, but are not limited to, (i) the simultaneous default, without prior warning, of all Members of the Affiliated Family with the largest aggregate four (4) day settlement obligations; (ii) that on the day of such default, the Members of such Affiliated Family are trading at peak historical trading levels and no market participants curtail their activity with any Members of the Family; and (iii) leading up to or after the default, there is no increased volatility in the market that would result in a significant increase in Clearing Fund requirements, mark-to-market collections, or other risk-based premiums that would have the result of increasing NSCC's liquidity resources. NSCC believes that these conditions simulate the impact of significant credit risk and market risk

stresses on NSCC's liquidity need across both Regular Activity Periods and Options Expiration Activity Periods.

NSCC then identifies the largest Member liquidity need on each day and determines if the available liquidity resources, consisting of the aggregate Required Deposits, any Supplemental Deposits, and any Prefund Deposits in the Clearing Fund on the day the liquidity need was observed, are adequate to cover that liquidity need, or if there is a calculated liquidity shortfall under the assumed stressed market conditions described above.

The Regular Activity Supplemental Deposits will be calculated to address those daily liquidity shortfalls that fall on any business day included in a Regular Activity Period ("Regular Activity Supplemental Liquidity Need"), and the Special Activity Supplemental Deposits will be calculated to address those additional daily liquidity shortfalls that fall on any business day included in an Options Expiration Activity Period ("Special Activity Supplemental Liquidity Need").

*Regular Activity Supplemental Deposits*

Under this proposal, every six (6) months, NSCC will determine (i) its largest Regular Activity Supplemental Liquidity Need ("Regular Activity Peak Liquidity Need") over the preceding twelve (12) month period and (ii) those unaffiliated Members and Affiliated Families that presented the largest aggregate liquidity exposures to NSCC over the preceding six-month period. NSCC will then rank the aggregate liquidity exposures presented by the unaffiliated Members and/or Affiliated Families ("Regular Activity Peak Liquidity Exposures") during the lookback period to determine which thirty (30) such unaffiliated Members and Affiliated Families presented the largest respective Regular Activity Peak Liquidity Exposures within the lookback period. NSCC's Regular Activity Peak Liquidity Need will then be allocated to these

thirty (30) unaffiliated Members and Affiliated Families (“Regular Activity Liquidity Providers”), in proportion to the Regular Activity Peak Liquidity Exposures they presented to NSCC during the lookback period.

The first of these semi-annual calculations of the Regular Activity Liquidity Obligations will be made to coincide with NSCC’s annual renewal of the Credit Facility each year (“Regular Activity First Tranche Liquidity Obligations”) and the second calculation each year will be made six (6) months thereafter (“Regular Activity Second Tranche Liquidity Obligations”).

*Special Activity Supplemental Deposits*

Special Activity Supplemental Deposits are deposits made in addition to Regular Activity Supplemental Deposits, designed to cover the additional liquidity exposure that occurs over an Options Expiration Activity Period. Each calendar quarter, on a day that is no later than the fifth business day preceding any Options Expiration Activity Period, NSCC will also determine (i) its largest Special Activity Supplemental Liquidity Need (“Special Activity Peak Liquidity Need”) over the preceding twenty-four (24) months (i.e., the eight prior Options Expiration Activity Periods, or a longer lookback period as determined by NSCC) and (ii) those unaffiliated Members and Affiliated Families that presented the largest aggregate Special Activity liquidity exposures to NSCC over the same period. NSCC will then rank the aggregate Special Activity liquidity exposures presented by such unaffiliated Members and/or Affiliated Families (referred to as their respective “Special Activity Peak Liquidity Exposures”) during the lookback period to determine which thirty (30) such unaffiliated Members and Affiliated Families presented the largest respective Special Activity Peak Liquidity Exposures within the lookback period. NSCC’s Special Activity Supplemental Peak Need will then be allocated to these thirty (30)

Members and Affiliated Families (“Special Activity Liquidity Providers”), in proportion to the Special Activity Peak Liquidity Exposures they presented to NSCC during the lookback period.

*Interim Adjustments and Calls*

With the goal of ensuring that NSCC’s liquidity resources remain adequate between the specified calculation dates, if either current liquidity needs increase significantly over those liquidity needs used for the regular calculations (or Special Activity Calculations), or the amount of liquidity resources is significantly reduced, the proposal permits NSCC to make interim recalibrations and liquidity calls: if between the semi-annual calculations of the Regular Activity Liquidity Obligations, the aggregate amount of Regular Activity Supplemental Deposits decreases by an amount that exceeds a threshold as determined by NSCC (whether as a result of the retirement of Members, a cease to act, or otherwise), then NSCC will recalculate its Regular Activity Peak Liquidity Need and allocate it among the unaffiliated Members and Affiliated Families that then comprise the applicable thirty (30) largest Regular Activity Liquidity Providers, in the same manner such calculations and allocations would be made at each semi-annual calculation of Regular Activity Liquidity Obligations.<sup>5</sup>

Conversely, if on any business day between regular semi-annual calculation dates NSCC observes an increase in its Regular Activity Liquidity Needs that exceeds a predetermined threshold amount, or between the dates on which it calculates Special Activity Liquidity Obligations it observes an increase in its Special Activity Liquidity Needs that exceeds a predetermined threshold amount, NSCC shall be entitled to call for an additional deposit from the Member whose increase in activity levels caused (or was the primary cause of) such increased

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<sup>5</sup> NSCC plans to use an interim date calculation as the first calculation under the proposed rule, should it become effective on a date after the effective date of the 2013 renewal of its Credit Facility.

liquidity need ("Liquidity Call"). Liquidity Call amounts will be treated as a part of that Member's Regular Activity Supplemental Deposit or Special Activity Supplemental Deposit, as applicable.

Operation of the Funding Obligation

Each Regular Activity Liquidity Provider will be obligated to contribute to the Clearing Fund, no later than five (5) business days following the effective date of the renewal of the Credit Facility, the amount of its Regular Activity Liquidity Obligation, reduced (i) dollar for dollar by amounts committed to the Credit Facility by that Regular Activity Liquidity Provider or its affiliates, and (ii) ratably (among all Regular Activity Liquidity Providers) by amounts committed to the Credit Facility by the lenders party thereto which are not Members or their affiliates.

If the amount of the Regular Activity Second Tranche Liquidity Obligation of an unaffiliated Member or Affiliated Family exceeds its Regular Activity First Tranche Liquidity Obligation (including because the unaffiliated Member or Affiliated Family had no Regular Activity First Tranche Liquidity Obligation), such Regular Activity Liquidity Provider will be obligated to contribute its calculated amount within three (3) business days following the final notice of such amount. If the Regular Activity Second Tranche Liquidity Obligation of an unaffiliated Member or Affiliated Family is less than its Regular Activity First Tranche Liquidity Obligation, then it shall be entitled to a refund of the amount of the difference, provided, that nothing shall reduce or in any way affect any commitment or other obligation of any Member or its affiliate under the Credit Facility.

Promptly after calculation of the Special Activity Liquidity Obligations, NSCC will inform Special Activity Liquidity Providers of their Special Activity Liquidity Obligations, and

those Special Activity Liquidity Providers must make their Special Activity Supplemental Deposits to the Clearing Fund in cash no later than the close of business on the second business day preceding the applicable Options Expiration Activity Period (i.e., generally the Wednesday before the options expiration date).

However, if a Special Activity Liquidity Provider anticipates that its Special Activity Peak Liquidity Exposure at any time during an Options Expiration Activity Period will be greater than the amount calculated by NSCC, it may, no later than the first business day of that Options Expiration Activity Period, make an additional cash deposit to the Clearing Fund that is in excess of its Required Deposit and is designated as a "Special Activity Prefund Deposit." Members may also, at their discretion, deposit to the Clearing Fund amounts in excess of their Required Deposit that are designated "Regular Activity Prefund Deposits." Because Prefund Deposits are included in calculating available liquidity resources, they thus reduce NSCC's Supplemental Liquidity Needs, as well as the depositing Member's Regular Activity (or Special Activity) Peak Liquidity Exposure.

As noted above under "Interim Adjustments and Calls," to the extent that NSCC observes a peak shortfall that breaches predetermined thresholds at any time throughout the year, the amount of the shortfall will be allocated solely to the Member responsible for the activity that caused the shortfall. The liquidity called as a result of that shortfall will be held until the next applicable reset period. This is intended to incentivize Members to make Prefund Deposits to avoid Liquidity Calls, since Prefund Deposits are refunded after the period of activity for which they were made, while Liquidity Calls are retained until the next regular calculation of the applicable supplemental deposit.

*Treatment and Use of the Supplemental Deposits*

All Regular Activity Supplemental Deposits (other than Regular Activity Prefund Deposits), as adjusted semi-annually, shall remain on deposit in the Clearing Fund, and may not be withdrawn by the applicable Member until five (5) business days after the next following maturity date of the Credit Facility (generally, for a period of 364 days). Regular Activity Prefund Deposits shall remain on deposit in the Clearing Fund and may not be withdrawn by the applicable Member until seven (7) days after they are deposited. All Special Activity Supplemental Deposits (including Special Activity Prefund Deposits) may be refunded to the Special Activity Liquidity Providers seven (7) business days after the end of the applicable Options Expiration Activity Period.

Any amounts deposited in response to a Liquidity Call for an additional Regular Activity Supplemental Deposit must remain in the Clearing Fund until the next semi-annual calculations of the Regular Activity Liquidity Obligations, and any amounts deposited in response to a Liquidity Call for an additional Special Activity Supplemental Deposit must remain in the Clearing Fund until two (2) business days preceding the next Options Expiration Activity Period.

A Member's Supplemental Deposit will be made in addition to its Required Deposit to the Clearing Fund, and any other deposit of any such Member to the Clearing Fund.

A Member's Supplemental Deposit will be considered part of that Member's actual deposit to the Clearing Fund, and, as such, may be used to satisfy obligations of that Member to NSCC, in the same manner as provided in Section 3 of Rule 4. Therefore, if the Member who contributed the Supplemental Deposit defaults, NSCC will be permitted to use its entire actual deposit, which will include the amount of its Supplemental Deposit, to satisfy any loss resulting from closing out that Member's open positions.



A Member's Supplemental Deposit will not, however, constitute part of its Required Deposit under NSCC's Rule 4, and, as such, will not be used, pursuant to Section 4 of Rule 4, to satisfy the obligations of any other Member of NSCC that has defaulted in the performance of its obligations to NSCC. A Member's Supplemental Deposit, therefore, will not be used in calculating any pro rata charge (i.e., loss assessment) due from that Member in the event of the default of another Member under Rule 4. Supplemental Deposits will also not be subject to the provisions of Section 6 of Rule 4 when a Member ceases to be a participant.

Pending any permitted use described in NSCC's Rules, the aggregate of all Supplemental Deposits on deposit at NSCC may be invested by NSCC as permitted pursuant to the investment policy adopted by NSCC and as in effect from time to time, and in the same manner the Clearing Fund is invested pursuant to such investment policy. Any interest earned on investment of a Supplemental Deposit, as a part of a Member's actual deposit, will be payable at the rate that NSCC earns on the investment of such funds, credited monthly and paid on demand.

#### Implementation Timeframe

Pending Commission approval, Members will be advised of the implementation date of this proposal through issuance of an NSCC Important Notice. Members will be provided not less than ten (10) days' notice of the first date on which Supplemental Deposits will be payable.

#### Proposed Rule Changes

NSCC proposes to amend its Rules to create a new Rule 4A to reflect the changes as described above. For both the Regular Activity Supplemental Deposits and the Special Activity Supplemental Deposits, the new Rule 4A will provide: (i) a general description of the relevant Supplemental Deposit, (ii) a provision describing the calculation and operation of the funding obligation, and (iii) a description of the treatment and permitted uses of the Supplemental

Deposit by NSCC. NSCC believes that this proposed rule change contributes to NSCC's goal of assuring that NSCC has adequate liquidity resources to meet its settlement obligations during both Regular Activity Periods and Options Expiration Activity Periods, notwithstanding the default of its unaffiliated Members and/or Affiliated Families that pose the largest aggregate liquidity exposure over the relevant settlement cycle. As such, NSCC believes that the proposal is consistent with Rule 17Ad-22(b)(3), as well as with Principle 7 of the PMFI.

(B) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

On March 19, 2013, National Financial Services, LLC submitted written comments relating to the proposed rule change. NSCC will respond to this comment and all future comments received at a later date, as appropriate.

(C) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

NSCC is proposing to amend its Rules in order to provide for supplemental liquidity deposits to NSCC's Clearing Fund designed to ensure that NSCC has adequate liquidity resources to meet its liquidity needs. The proposed change is described in detail above.

Anticipated Effect on and Management of Risk

As described above, NSCC believes that the proposed change to add a Supplemental Deposit, which NSCC believes is calculated so that NSCC has adequate liquidity resources to enable it to settle transactions during Regular Activity Periods and Options Expiration Activity Periods when NSCC's liquidity need may increase, notwithstanding the default of the unaffiliated Member or Affiliated Family that would generate the largest aggregate liquidity need for NSCC over a four day settlement cycle in stressed market conditions, will enhance NSCC's

ability to meet certain risk management standards, such as Rule 17Ad-22(b)(3) and Principle 7 of the PMFI, described above.

By calculating unaffiliated Member's or Affiliated Family's Supplemental Deposit funding obligation in proportion to the liquidity needs that such entities present to NSCC, NSCC believes that the proposed rule change will ensure that NSCC's Members fairly and equitably contribute to NSCC's liquidity resources for settlement, and also contribute to the goal of financial stability in the event of Member default.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The clearing agency may implement the proposed change pursuant to Section 806(e)(1)(G) of the Clearing Supervision Act<sup>6</sup> if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission received the advance notice or (ii) the date the Commission receives any further information it requested for consideration of the notice. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date of receipt of the advance notice, or the date the Commission receives any further information it requested, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions

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<sup>6</sup> 12 U.S.C. 5465(e)(1)(G).

imposed by the Commission. The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.<sup>7</sup>

#### IV. Solicitation of Comments

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

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-NSCC-2013-802 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.

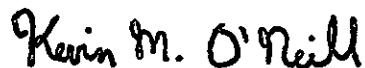
All submissions should refer to File No. SR-NSCC-2013-802. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your

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<sup>7</sup> NSCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. Pursuant to Section 19(b)(2) of the Exchange Act, within 45 days of the date of publication of the proposed rule change in the Federal Register or within such longer period up to 90 days if the Commission designates or the self-regulatory organization consents the Commission will either: (i) by order approve or disapprove the proposed rule change or (ii) institute proceedings to determine whether the proposed rule change should be disapproved. 17 U.S.C. 78s(b)(2)(A). See Release No. 34-69313 (Apr. 4, 2013), 78 FR 21487 (Apr. 10, 2013).

comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings also will be available for inspection and copying at the principal office of NSCC and on NSCC's website at [http://dtcc.com/downloads/legal/rule\\_filings/2013/nsc/SR-NSCC-2013-802.pdf](http://dtcc.com/downloads/legal/rule_filings/2013/nsc/SR-NSCC-2013-802.pdf). All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. SR-NSCC-2013-802 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



Additionally, SinoHub failed to respond to comments from the Commission's Division of Corporation Finance concerning the company's Form 10-K for the year ended December 31, 2011.

3. SinoHub's Form 10-Q for the quarter ended June 30, 2012 was due on August 14, 2012. On August 14, 2012, SinoHub filed a Form 12b-25 announcing that it was unable to timely file its Form 10-Q for the quarter ended June 30, 2012 "without unreasonable effort or expense. The Company expects to file the report within the extension period." To date, SinoHub has not filed a Form 10-Q for the period ended June 30, 2012.

4. SinoHub's Form 10-Q for the quarter ended September 30, 2012 was due on November 14, 2012. To date, SinoHub has not filed this Form 10-Q.

5. SinoHub's Form 10-K for the year ended December 31, 2012 was due on April 1, 2013. To date, SinoHub has not filed this Form 10-K.

6. On September 14, 2012, the Division of Corporation Finance issued comments to SinoHub concerning the company's Form 10-K for the year ended December 31, 2011 and the Form 8-K dated September 6, 2012. On December 14, 2012, the Division of Corporation Finance notified SinoHub that the comments from the September 14, 2012 letter remained outstanding and unresolved, and that, since the company failed to provide a substantive response, it was terminating its review.

7. Section 13(a) of the Exchange Act and the rules promulgated thereunder require issuers of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission current and accurate information in periodic reports. Specifically, Rule 13a-1 requires issuers to file annual reports (Form 10-K) and Rule 13a-13 requires issuers to file quarterly reports (Form 10-Q).

8. As a result of its failure to make the required periodic filings described above, Respondent failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

### III.

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

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

B. Whether it is necessary or appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of, each

class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act.

IV.

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

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

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

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

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

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

By the Commission.

Elizabeth M. Murphy  
Secretary

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



SECURITIES AND EXCHANGE COMMISSION  
[Release No. 34-69449/April 25, 2013]

**Order Making Fiscal Year 2013 Annual Adjustments to Transaction Fee Rates**

**I. Background**

Section 31 of the Securities Exchange Act of 1934 (“Exchange Act”) requires each national securities exchange and national securities association to pay transaction fees to the Commission.<sup>1</sup> Specifically, Section 31(b) requires each national securities exchange to pay to the Commission fees based on the aggregate dollar amount of sales of certain securities (“covered sales”) transacted on the exchange.<sup>2</sup> Section 31(c) requires each national securities association to pay to the Commission fees based on the aggregate dollar amount of covered sales transacted by or through any member of the association other than on an exchange.<sup>3</sup>

Section 31 of the Exchange Act requires the Commission to annually adjust the fee rates applicable under Sections 31(b) and (c) to a uniform adjusted rate.<sup>4</sup> Specifically, the Commission must adjust the fee rates to a uniform adjusted rate that is reasonably likely to produce aggregate fee collections (including assessments on security futures transactions) equal to the regular appropriation to the Commission for the applicable fiscal year.<sup>5</sup>

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<sup>1</sup> 15 U.S.C. 78ee.

<sup>2</sup> 15 U.S.C. 78ee(b).

<sup>3</sup> 15 U.S.C. 78ee(c).

<sup>4</sup> In some circumstances, the SEC also must make a mid-year adjustment to the fee rates applicable under Sections 31(b) and (c).

<sup>5</sup> 15 U.S.C. § 78ee(j)(1) (the Commission must adjust the rates under Sections 31(b) and (c) to a “uniform adjusted rate that, when applied to the baseline estimate of the aggregate dollar amount of sales for such fiscal year, is reasonably likely to produce aggregate fee collections under [Section 31] (including assessments collected under [Section 31(d)]) that are equal to the regular appropriation to the Commission by Congress for such fiscal year.”).

The Commission is required to publish notice of the new fee rates under Section 31 not later than 30 days after the date on which an Act making a regular appropriation for the applicable fiscal year is enacted.<sup>6</sup> On March 26, 2013, the President signed a continuing resolution that funds the SEC at FY 2012 levels through the remainder of FY 2013. Consistent with past practice [and guidance from OMB], the SEC is treating this continuing resolution, which lasts through the remainder of the fiscal year, as a regular appropriation for FY 2013 for purposes of Section 31 of the Exchange Act.

## **II. Fiscal Year 2013 Annual Adjustment to the Fee Rate**

The new fee rate is determined by (1) subtracting the sum of fees estimated to be collected prior to the effective date of the new fee rate<sup>7</sup> and estimated assessments on securities futures transactions to be collected under Section 31(d) of the Exchange Act for all of fiscal year 2013<sup>8</sup> from an amount equal to the regular appropriation to the Commission for fiscal year 2013, and (2) dividing the difference by the estimated aggregate dollar amount of sales for the remainder of the fiscal year following the effective date of the new fee rate.

The regular appropriation to the Commission for fiscal year 2013 is \$1,321,000,000. The Commission estimates that it will collect \$895,226,704 in fees for the period prior to the

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<sup>6</sup> 15 U.S.C. § 78ee(g).

<sup>7</sup> The sum of fees to be collected prior to the effective date of the new fee rate is determined by applying the current fee rate to the dollar amount of covered sales prior to the effective date of the new fee rate. The exchanges and FINRA have provided data on the dollar amount of covered sales through February 28, 2013. To calculate the dollar amount of covered sales from that date to the effective date of the new fee rate, the Division is using the same methodology it developed in consultation with the CBO and OMB to estimate the dollar amount of covered sales in prior fiscal years. An explanation of the methodology appears in Appendix A.

<sup>8</sup> The Division is using the same methodology it has used previously to estimate assessments on securities future transactions to be collected in fiscal year 2013. An explanation of the methodology appears in Appendix A.

effective date of the new fee rate and \$37,356 in assessments on round turn transactions in securities futures products during all of fiscal year 2013.<sup>9</sup> Using a methodology for estimating the aggregate dollar amount of sales for the remainder of fiscal year 2013 (developed after consultation with the Congressional Budget Office and the Office of Management and Budget), the Commission estimates that the aggregate dollar amount of covered sales for the remainder of fiscal year 2013 to be \$24,458,583,925,062.

As described above, the uniform adjusted rate is computed by dividing the residual fees to be collected of \$425,735,940 by the estimate of the aggregate dollar amount of covered sales for the remainder of fiscal year 2013 of \$24,458,583,925,062. This results in a uniform adjusted rate for fiscal year 2013 of \$17.40 per million.<sup>10</sup>

### **III. Effective Date of the Uniform Adjusted Rate**

Under Section 31(j)(4)(A) of the Exchange Act, the fiscal year 2013 annual adjustments to the fee rates applicable under Sections 31(b) and (c) of the Exchange Act shall take effect on the later of October 1, 2012, or 60 days after the date on which a regular appropriation to the Commission for fiscal year 2012 is enacted.<sup>11</sup> The regular appropriation to the Commission for fiscal year 2013 was enacted on March 26, 2013, and accordingly, the new fee rates applicable under Sections 31(b) and (c) of the Exchange Act will take effect on May 25, 2013.<sup>12</sup>

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<sup>9</sup> The estimate of fees to be collected prior to the effective date of the new fee rate is determined by applying the current fee rate to the dollar amount of covered sales prior to the effective date of the new fee rate.

<sup>10</sup> Appendix A shows the purely arithmetical process of calculating the fiscal year 2013 annual adjustment. The appendix also includes the data used by the Commission in making this adjustment.

<sup>11</sup> 15 U.S.C. § 78cc(j)(4)(A).

<sup>12</sup> As noted above, consistent with past practice [and guidance from OMB], the SEC is treating the continuing resolution enacted on March 26, 2013 as a regular appropriation for FY 2013.

**IV. Conclusion**

Accordingly, pursuant to Section 31 of the Exchange Act,

IT IS HEREBY ORDERED that the fee rates applicable under Sections 31(b) and (c) of the Exchange Act shall be \$17.40 per \$1,000,000 effective on May 25, 2013.

By the Commission.



Elizabeth M. Murphy  
Secretary

## APPENDIX A

This appendix provides the formula for determining the annual adjustment to the fee rates applicable under Sections 31(b) and (c) of the Exchange Act for fiscal year 2013. Section 31 of the Exchange Act requires the fee rates to be adjusted so that it is reasonably likely that the Commission will collect aggregate fees equal to its regular appropriation for fiscal year 2013.

To make the adjustment, the Commission must project the aggregate dollar amount of covered sales of securities on the securities exchanges and certain over-the-counter markets over the course of the year. The fee rate equals the ratio of the Commission's regular appropriation for fiscal year 2013 (less the sum of fees to be collected during fiscal year 2013 prior to the effective date of the new fee rate and aggregate assessments on security futures transactions during fiscal year 2013) to the projected aggregate dollar amount of covered sales for fiscal year 2013 (less the aggregate dollar amount of covered sales prior to the effective date of the new fee rate).

For 2013, the Commission has estimated the aggregate dollar amount of covered sales by projecting forward the trend established in the previous decade. More specifically, the dollar amount of covered sales was forecasted for months subsequent to February 2013, the last month for which the Commission has data on the dollar volume of covered sales.<sup>13</sup>

The following sections describe this process in detail.

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<sup>13</sup> To determine the availability of data, the Commission compares the date of the appropriation with the date the transaction data are due from the exchanges (10 business days after the end of the month). If the business day following the date of the appropriation is equal to or subsequent to the date the data are due from the exchanges, the Commission uses these data. The appropriation was signed on March 26, 2013. The first business day after this date was March 27, 2013. Data for February were due from the exchanges on March 14. So the Commission used February 2013 and earlier data to forecast volume for March 2013 and later months.

**A. Baseline estimate of the aggregate dollar amount of covered sales for fiscal year 2013.**

First, calculate the average daily dollar amount of covered sales (ADS) for each month in the sample (February 2003 – February 2013). The monthly aggregate dollar amount of covered sales (exchange plus certain over-the-counter markets) is presented in column C of Table A.

Next, calculate the change in the natural logarithm of ADS from month to month. The average monthly percentage growth of ADS over the entire sample is 0.0102 and the standard deviation is 0.122. Assuming the monthly percentage change in ADS follows a random walk, calculating the expected monthly percentage growth rate for the full sample is straightforward. The expected monthly percentage growth rate of ADS is 1.78 %.

Now, use the expected monthly percentage growth rate to forecast total dollar volume. For example, one can use the ADS for February 2013 (\$252,666,501,426) to forecast ADS for March 2013 (\$257,167,513,594 = \$252,666,501,426 x 1.0178).<sup>14</sup> Multiply by the number of trading days in March 2013 (20) to obtain a forecast of the total dollar volume for the month (\$5,143,350,271,889). Repeat the method to generate forecasts for subsequent months.

The forecasts for total dollar volume of covered sales are in column G of Table A. The following is a more formal (mathematical) description of the procedure:

1. Divide each month's total dollar volume (column C) by the number of trading days in that month (column B) to obtain the average daily dollar volume (ADS, column D).
2. For each month  $t$ , calculate the change in ADS from the previous month as  $\Delta_t = \log(\text{ADS}_t / \text{ADS}_{t-1})$ , where  $\log(x)$  denotes the natural logarithm of  $x$ .
3. Calculate the mean and standard deviation of the series  $\{\Delta_1, \Delta_2, \dots, \Delta_{120}\}$ . These are given by  $\mu = 0.0102$  and  $\sigma = 0.122$ , respectively.

<sup>14</sup> The value 1.0178 has been rounded. All computations are done with the unrounded value.

4. Assume that the natural logarithm of ADS follows a random walk, so that  $\Delta_s$  and  $\Delta_t$  are statistically independent for any two months  $s$  and  $t$ .
5. Under the assumption that  $\Delta_t$  is normally distributed, the expected value of  $ADS_t / ADS_{t-1}$  is given by  $\exp(\mu + \sigma^2/2)$ , or on average  $ADS_t = 1.0178 \times ADS_{t-1}$ .
6. For March 2013, this gives a forecast ADS of  $1.0178 \times \$252,666,501,426 = \$257,167,513,594$ . Multiply this figure by the 20 trading days in March 2013 to obtain a total dollar volume forecast of  $\$5,143,350,271,889$ .
7. For April 2013, multiply the March 2013 ADS forecast by 1.0178 to obtain a forecast ADS of  $\$261,748,706,992$ . Multiply this figure by the 22 trading days in April 2013 to obtain a total dollar volume forecast of  $\$5,758,471,553,822$ .
8. Repeat this procedure for subsequent months.

**B. Using the forecasts from A to calculate the new fee rate.**

1. Use Table A to estimate fees collected for the period 10/1/12 through 5/24/13. The projected aggregate dollar amount of covered sales for this period is  $\$39,965,477,866,718$ . Actual and projected fee collections at the current fee rate of 0.0000224 are  $\$895,226,704$ .
2. Estimate the amount of assessments on securities futures products collected during 10/1/12 and 9/30/13 to be  $\$37,356$  by projecting a 1.78% monthly increase from a base of  $\$3,038$  in February 2013.

3. Subtract the amounts \$895,226,704 and \$37,356 from the target offsetting collection amount set by Congress of \$1,321,000,000 leaving \$425,735,940 to be collected on dollar volume for the period 5/25/13 through 9/30/13.
4. Use Table A to estimate dollar volume for the period 5/25/13 through 9/30/13. The estimate is \$24,458,583,925,062. Finally, compute the fee rate required to produce the additional \$425,735,940 in revenue. This rate is \$425,735,940 divided by \$24,458,583,925,062 or 0.0000174064.
5. Round the result to the seventh decimal point, yielding a rate of .0000174 (or \$17.40 per million).



**Table A. Estimation of baseline of the aggregate dollar amount of sales.**

**Fee rate calculation.**

a. Baseline estimate of the aggregate dollar amount of sales, 10/1/12 to 4/30/13 (\$Millions)	35,170,071
b. Baseline estimate of the aggregate dollar amount of sales, 5/1/13 to 5/24/13 (\$Millions)	4,795,407
c. Baseline estimate of the aggregate dollar amount of sales, 5/25/13 to 5/31/13 (\$Millions)	1,065,646
d. Baseline estimate of the aggregate dollar amount of sales, 6/1/13 to 9/30/13 (\$Millions)	23,392,938
e. Estimated collections in assessments on securities futures products in FY 2013 (\$Millions)	0.037
f. Implied fee rate $((\$1,321,000,000 - \$22.40*(a+b) - e) / (c+d)$	\$17.40

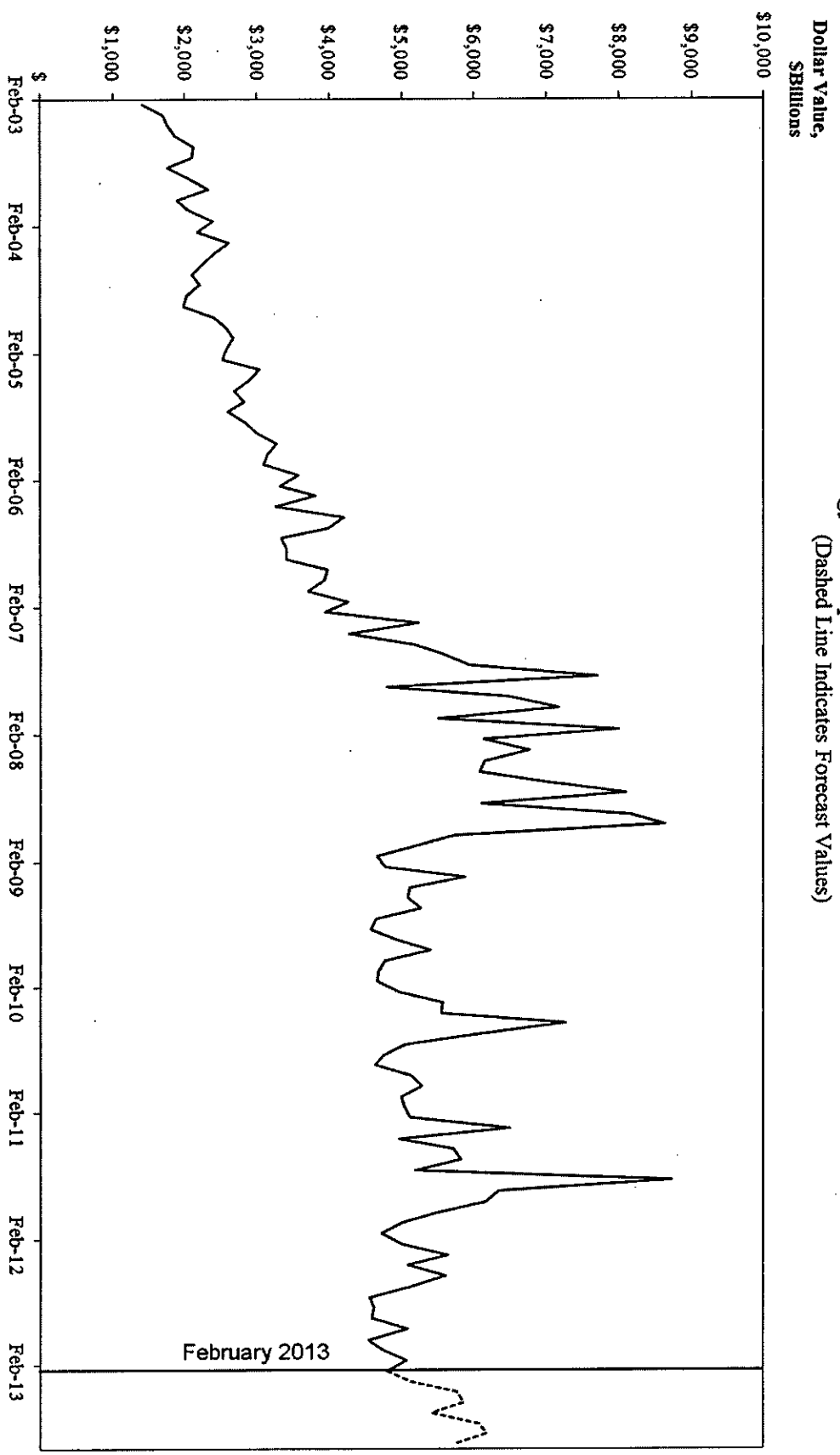
**Data**

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Dollar Amount of Sales	(D) Average Daily Dollar Amount of Sales (ADS)	(E) Change in LN of ADS	(F) Forecast ADS	(G) Forecast Aggregate Dollar Amount of Sales
Feb-03	19	1,411,722,405,357	74,301,179,229	-		
Mar-03	21	1,699,581,267,718	80,932,441,320	0.085		
Apr-03	21	1,759,751,025,279	83,797,667,870	0.035		
May-03	21	1,871,390,985,678	89,113,856,461	0.062		
Jun-03	21	2,122,225,077,345	101,058,337,016	0.126		
Jul-03	22	2,100,812,973,956	95,491,498,816	-0.057		
Aug-03	21	1,766,527,686,223	84,120,366,011	-0.127		
Sep-03	21	2,063,584,421,939	98,265,924,854	0.155		
Oct-03	23	2,331,850,083,022	101,384,786,218	0.031		
Nov-03	19	1,903,726,129,859	100,196,112,098	-0.012		
Dec-03	22	2,066,530,151,383	93,933,188,699	-0.065		
Jan-04	20	2,390,942,905,678	119,547,145,284	0.241		
Feb-04	19	2,177,765,594,701	114,619,241,826	-0.042		
Mar-04	23	2,613,808,754,550	113,643,858,893	-0.009		
Apr-04	21	2,418,663,760,191	115,174,464,771	0.013		
May-04	20	2,259,243,404,459	112,962,170,223	-0.019		
Jun-04	21	2,112,826,072,876	100,610,765,375	-0.116		
Jul-04	21	2,209,808,376,565	105,228,970,313	0.045		
Aug-04	22	2,033,343,354,640	92,424,697,938	-0.130		
Sep-04	21	1,993,803,487,749	94,943,023,226	0.027		
Oct-04	21	2,414,599,088,108	114,980,908,958	0.191		
Nov-04	21	2,577,513,374,160	122,738,732,103	0.065		
Dec-04	22	2,673,532,981,863	121,524,226,448	-0.010		
Jan-05	20	2,581,847,200,448	129,092,360,022	0.060		
Feb-05	19	2,532,202,408,589	133,273,810,978	0.032		
Mar-05	22	3,030,474,897,226	137,748,858,965	0.033		
Apr-05	21	2,906,386,944,434	138,399,378,306	0.005		
May-05	21	2,697,414,503,460	128,448,309,689	-0.075		
Jun-05	22	2,825,962,273,624	128,452,830,619	0.000		
Jul-05	20	2,604,021,263,875	130,201,063,194	0.014		
Aug-05	23	2,846,115,585,965	123,744,155,912	-0.051		
Sep-05	21	3,009,640,645,370	143,316,221,208	0.147		
Oct-05	21	3,279,847,331,057	156,183,206,241	0.086		
Nov-05	21	3,163,453,821,548	150,640,658,169	-0.036		
Dec-05	21	3,090,212,715,561	147,152,986,455	-0.023		
Jan-06	20	3,573,372,724,766	178,668,636,238	0.194		
Feb-06	19	3,314,259,849,456	174,434,728,919	-0.024		
Mar-06	23	3,807,974,821,564	165,564,122,677	-0.052		

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Dollar Amount of Sales	(D) Average Daily Dollar Amount of Sales (ADS)	(E) Change in LN of ADS	(F) Forecast ADS	(G) Forecast Aggregate Dollar Amount of Sales
Apr-06	19	3,257,478,138,851	171,446,217,834	0.035		
May-06	22	4,206,447,844,451	191,202,174,748	0.109		
Jun-06	22	3,995,113,357,316	181,596,061,696	-0.052		
Jul-06	20	3,339,658,009,357	166,982,900,468	-0.084		
Aug-06	23	3,410,187,280,845	148,269,012,211	-0.119		
Sep-06	20	3,407,409,863,673	170,370,493,184	0.139		
Oct-06	22	3,980,070,216,912	180,912,282,587	0.060		
Nov-06	21	3,933,474,986,969	187,308,332,713	0.035		
Dec-06	20	3,715,146,848,695	185,757,342,435	-0.008		
Jan-07	20	4,263,986,570,973	213,199,328,549	0.138		
Feb-07	19	3,946,799,860,532	207,726,308,449	-0.026		
Mar-07	22	5,245,051,744,090	238,411,442,913	0.138		
Apr-07	20	4,274,665,072,437	213,733,253,622	-0.109		
May-07	22	5,172,568,357,522	235,116,743,524	0.095		
Jun-07	21	5,586,337,010,802	266,016,048,133	0.123		
Jul-07	21	5,938,330,480,139	282,777,641,911	0.061		
Aug-07	23	7,713,644,229,032	335,375,836,045	0.171		
Sep-07	19	4,805,676,596,099	252,930,347,163	-0.282		
Oct-07	23	6,499,651,716,225	282,593,552,879	0.111		
Nov-07	21	7,176,290,763,989	341,728,131,619	0.190		
Dec-07	20	5,512,903,594,564	275,645,179,728	-0.215		
Jan-08	21	7,997,242,071,529	380,821,051,025	0.323		
Feb-08	20	6,139,080,448,887	306,954,022,444	-0.216		
Mar-08	20	6,767,852,332,381	338,392,616,619	0.098		
Apr-08	22	6,150,017,772,735	279,546,262,397	-0.191		
May-08	21	6,080,169,766,807	289,531,893,657	0.035		
Jun-08	21	6,962,199,302,412	331,533,300,115	0.135		
Jul-08	22	8,104,256,787,805	368,375,308,537	0.105		
Aug-08	21	6,106,057,711,009	290,764,652,905	-0.237		
Sep-08	21	8,156,991,919,103	388,428,186,624	0.290		
Oct-08	23	8,644,538,213,244	375,849,487,532	-0.033		
Nov-08	19	5,727,998,341,833	301,473,596,939	-0.221		
Dec-08	22	5,176,041,317,640	235,274,605,347	-0.248		
Jan-09	20	4,670,249,433,806	233,512,471,690	-0.008		
Feb-09	19	4,771,470,184,048	251,130,009,687	0.073		
Mar-09	22	5,885,594,284,780	267,527,012,945	0.063		
Apr-09	21	5,123,665,205,517	243,984,057,406	-0.092		
May-09	20	5,086,717,129,965	254,335,856,498	0.042		
Jun-09	22	5,271,742,782,609	239,624,671,937	-0.060		
Jul-09	22	4,659,599,245,583	211,799,965,708	-0.123		
Aug-09	21	4,582,102,295,783	218,195,347,418	0.030		
Sep-09	21	4,929,155,364,888	234,721,684,042	0.073		
Oct-09	22	5,410,025,301,030	245,910,240,956	0.047		
Nov-09	20	4,770,928,103,032	238,546,405,152	-0.030		
Dec-09	22	4,688,555,303,171	213,116,150,144	-0.113		
Jan-10	19	4,661,793,708,648	245,357,563,613	0.141		
Feb-10	19	4,969,848,578,023	261,570,977,791	0.064		
Mar-10	23	5,563,529,823,621	241,892,601,027	-0.078		
Apr-10	21	5,546,445,874,917	264,116,470,234	0.088		
May-10	20	7,260,430,376,294	363,021,518,815	0.318		
Jun-10	22	6,124,776,349,285	278,398,924,968	-0.265		

(A) Month	(B) # of Trading Days in Month	(C) Aggregate Dollar Amount of Sales	(D) Average Daily Dollar Amount of Sales (ADS)	(E) Change in LN of ADS	(F) Forecast ADS	(G) Forecast Aggregate Dollar Amount of Sales
Jul-10	21	5,058,242,097,334	240,868,671,302	-0.145		
Aug-10	22	4,765,828,263,463	216,628,557,430	-0.106		
Sep-10	21	4,640,722,344,586	220,986,778,314	0.020		
Oct-10	21	5,138,411,712,272	244,686,272,013	0.102		
Nov-10	21	5,279,700,881,901	251,414,327,710	0.027		
Dec-10	22	4,998,574,681,208	227,207,940,055	-0.101		
Jan-11	20	5,043,391,121,345	252,169,556,067	0.104		
Feb-11	19	5,114,631,590,581	269,191,136,346	0.065		
Mar-11	23	6,499,355,385,307	282,580,668,926	0.049		
Apr-11	20	4,975,954,868,765	248,797,743,438	-0.127		
May-11	21	5,717,905,621,053	272,281,220,050	0.090		
Jun-11	22	5,820,079,494,414	264,549,067,928	-0.029		
Jul-11	20	5,189,681,899,635	259,484,094,982	-0.019		
Aug-11	23	8,720,566,877,109	379,155,081,613	0.379		
Sep-11	21	6,343,578,147,811	302,075,149,896	-0.227		
Oct-11	21	6,163,272,963,688	293,489,188,747	-0.029		
Nov-11	21	5,493,906,473,584	261,614,593,980	-0.115		
Dec-11	21	5,017,867,255,600	238,946,059,790	-0.091		
Jan-12	20	4,726,522,206,487	236,326,110,324	-0.011		
Feb-12	20	5,011,862,514,132	250,593,125,707	0.059		
Mar-12	22	5,638,847,967,025	256,311,271,228	0.023		
Apr-12	20	5,084,239,396,560	254,211,969,828	-0.008		
May-12	22	5,611,638,053,374	255,074,456,972	0.003		
Jun-12	21	5,129,437,103,879	244,258,909,709	-0.043		
Jul-12	21	4,567,519,314,374	217,500,919,732	-0.116		
Aug-12	23	4,621,597,884,730	200,939,038,467	-0.079		
Sep-12	19	4,598,499,962,682	242,026,313,825	0.186		
Oct-12	21	5,095,175,588,310	242,627,408,967	0.002		
Nov-12	21	4,547,882,974,292	216,565,855,919	-0.114		
Dec-12	20	4,744,922,754,360	237,246,137,718	0.091		
Jan-13	21	5,079,604,017,496	241,885,905,595	0.019		
Feb-13	19	4,800,663,527,089	252,666,501,426	0.044		
Mar-13	20				257,167,513,594	5,143,350,271,889
Apr-13	22				261,748,706,992	5,758,471,553,822
May-13	22				266,411,509,970	5,861,053,219,340
Jun-13	20				271,157,376,325	5,423,147,526,509
Jul-13	22				275,987,785,753	6,071,731,286,563
Aug-13	22				280,904,244,306	6,179,893,374,738
Sep-13	20				285,908,284,869	5,718,165,697,372

**Figure A.**  
 Aggregate Dollar Amount of Sales Subject to Exchange Act Sections 31(b) and 31(c)<sup>1</sup>  
 Methodology Developed in Consultation With OMB and CBO  
 (Dashed Line Indicates Forecast Values)



<sup>1</sup>Forecasted line is not smooth because the number of trading days varies by month.

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933  
Release No. 9400 / April 30, 2013

SECURITIES EXCHANGE ACT OF 1934  
Release No. 69478 / April 30, 2013

INVESTMENT COMPANY ACT OF 1940  
Release No. 30498 / April 30, 2013

Admin. Proc. File No. 3-14848  
Admin. Proc. File No. 3-14853

In the Matter of

OPTIONSXPRESS, INC.,  
THOMAS E. STERN, and  
JONATHAN I. FELDMAN

In the Matter of

OX TRADING, LLC,  
OPTIONSXPRESS, INC., and  
THOMAS E. STERN

**ORDER GRANTING EXTENSIONS**

**I.**

The Chief Administrative Law Judge, Brenda P. Murray, has moved, pursuant to Commission Rule of Practice 360(a)(3),<sup>1</sup> for extensions of time to issue the initial decisions in these proceedings. For the reasons set forth below, we have determined to grant the law judge's motion.

<sup>1</sup> 17 C.F.R. § 201.360(a)(3).

### The April 16, 2012 optionsXpress OIP

On April 16, 2012, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings against optionsXpress, Inc., a registered broker-dealer; Thomas E. Stern, chief financial officer of optionsXpress; and Jonathan I. Feldman, an optionsXpress customer.<sup>2</sup> The OIP alleges that between October 2008 and March 2010, six optionsXpress customers, including Feldman, employed illegal options trading strategies with no legitimate economic purpose and resulting in "continuous failure-to-deliver position[s] in . . . securities for extended periods of time," improperly "extracting a profit at the expense of the true purchasers of the shares."<sup>3</sup> It further alleges that Feldman knowingly engaged in this trading strategy from at least June 2009 to March 2010 without intending to deliver shares by the relevant settlement dates. The OIP alleges that optionsXpress willfully violated the securities delivery requirements in Rules 204 and 204T of Regulation SHO<sup>4</sup> and that Stern caused and willfully aided and abetted these violations. The OIP further alleges that Feldman willfully violated Securities Act § 17(a)<sup>5</sup> and Exchange Act § 10(b)<sup>6</sup> and Rules 10b-5 and 10b-21,<sup>7</sup> and that Stern and optionsXpress caused and aided and abetted Feldman's violations.

### The April 19, 2012 OX Trading OIP

On April 19, 2012, we issued another Order Instituting Administrative and Cease-and-Desist Proceedings against OX Trading, LLC, an optionsXpress affiliate; optionsXpress; and Stern, chief financial officer of optionsXpress and chief financial officer, secretary, director, and chief compliance officer of OX Trading.<sup>8</sup> The OX Trading OIP alleges that OX Trading was formed in August 2007 to "provide price improvement on orders from optionsXpress customers and to profit from those trades."<sup>9</sup> It charges that, from 2009 to 2010, OX Trading willfully violated § 15(a) of the Exchange Act,<sup>10</sup> which makes it unlawful for any unregistered dealer to induce or attempt to induce any purchase or sale of a security, and willfully violated Exchange Act § 15(b)(8),<sup>11</sup> which makes it illegal to effect securities transactions unless such broker-dealer is a member of a registered national securities association or effects transactions solely on a

<sup>2</sup> *optionsXpress, Inc.*, Exchange Act Release No. 66815, 2012 SEC LEXIS 1222 (Apr. 16, 2012).

<sup>3</sup> *Id.* at \*8 & 13-14.

<sup>4</sup> 17 C.F.R. §§ 242.204 and 242.204T.

<sup>5</sup> 15 U.S.C. § 77q(a).

<sup>6</sup> *Id.* § 78j(b).

<sup>7</sup> 17 C.F.R. §§ 240.10b-5 and 240.10b-21.

<sup>8</sup> *OX Trading, LLC*, Exchange Act Release No. 66831, 2012 SEC LEXIS 1251 (Apr. 19, 2012).

<sup>9</sup> *Id.* at \*3.

<sup>10</sup> 15 U.S.C. § 78o(a).

<sup>11</sup> *Id.*, § 78o(b)(8).

national exchange of which it is a member. The OIP also alleges that Sterns and optionsXpress caused and willfully aided and abetted OX Trading's violations of §§ 15(a) and 15(b)(8).

## II.

Each OIP directs the presiding law judge to issue an initial decision no later than 300 days from the date of service of the OIP. On January 16, 2013, Chief Administrative Law Judge Brenda P. Murray filed a motion stating that the initial decisions are due on February 19, 2013 and requesting extensions pursuant to Commission Rule of Practice 360(a)(3).<sup>12</sup>

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.<sup>13</sup> 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."<sup>14</sup>

In the motion, Chief Judge Murray states that the "size, complexity, and interrelationship of the two proceedings" renders it impossible to complete the initial decisions by February 19, 2013 and seeks a six-month extension for each decision.<sup>15</sup> She notes that the optionsXpress hearing spanned seventeen days and that the final brief for that proceeding is due on February 1, 2013. Moreover, the same counsel are representing optionsXpress, Stern, and the Division of Enforcement in both proceedings, and the OX Trading proceeding has been stayed because "the parties agreed that it would be impossible to conduct both proceedings simultaneously."<sup>16</sup> Under

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<sup>12</sup> 17 C.F.R. § 201.360(a)(3).

<sup>13</sup> See *Adopting Release*, Securities Act Release No. 8240, 2003 SEC LEXIS 1404, at \*2-3 (June 11, 2003).

<sup>14</sup> 17 C.F.R. § 201.360(a)(3).

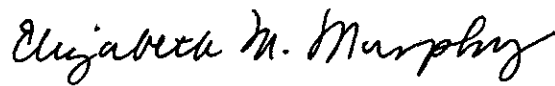
<sup>15</sup> Motion to the Commission for Extension, Administrative Proceedings Rulings Release No. 739 (Jan. 16, 2013) at 1-2.

<sup>16</sup> *Id.*

the circumstances, it appears appropriate in the public interest to grant the Chief Administrative Law Judge's request and to extend the initial decision deadlines.

Accordingly, IT IS ORDERED that the deadlines for filing the initial decisions in these matters are extended to August 19, 2013.

By the Commission.



Elizabeth M. Murphy  
Secretary